



# Imperfections

PERSONAL PROPERTY SECURITY LAW COMMITTEE/COMITÉ SUR LES SÛRETÉS MOBILIÈRES  
BUSINESS LAW SECTION/SECTION DU DROIT DES AFFAIRES

Volume 28, No. 1  
September/Septembre  
2008

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## A. Unreported Cases

### 1. PMSI Perfected Post Bankruptcy

*Re Frederick Earl Wright (28 July 2008), Estate No. 31-1025063 (Ont. Sp. Ct.), Deputy Registrar Diamond*

Dec. 13/07: Wright purchased a 2007 Dodge vehicle under a conditional sale agreement financed by Chrysler Financial.

Dec. 20/07, 5:38 p.m.: Wright made a voluntary assignment into bankruptcy.

Dec. 20/07, 7:50 p.m.: Chrysler Financial registered its security under the PPSA.

Jan. 7/08: Chrysler Financial filed its proof of claim as a secured creditor.

Jan. 20/08: The trustee disallowed this claim.

Held: Chrysler Financial was a secured PPSA creditor. Ontario's PPSA section 20(3) provides that a PMSI perfected by registration before or within 10 days of the debtor obtaining possession of the collateral is effective against a trustee in bankruptcy.

Section 20(1) provides that, "Except as provided in subsection (3), until perfected..." Together subsections 20(1) and (3) create an exception for PMSIs to take priority ahead of a bankruptcy trustee.



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## B. Reported Cases

### 1. Licence of IP is Not Property

*Royal Bank of Canada v. Body Blue Inc.* (2008), 42 C.B.R. (5th) 125 (Ont. S.C.J., Commercial List), Morawetz J.

Jan. 1/05: Old Body Blue entered into a licence agreement granting Herbal Care Systems an exclusive licence to manufacture and sell certain technology (the “IP”).

April 28/06: A receiver was appointed over the assets of Old Body Blue.

May 19/06: The receiver sold the assets of Old Body Blue, including the IP, to Body Blue 2006. A vesting order was granted under the *Companies’ Creditors Arrangement Act* for this sale. Herbal Care did not take any steps to appeal or vary the vesting order during the appeal period. It later obtained an order for damages in its favour from the courts in Arizona on the basis that the vesting order could not sell assets free and clear of all claims.

April 2008: Body Blue 2006 moved for an order that it owns the IP and that the contract and licence rights of Herbal Care was ended by the vesting order.

Held: Body Blue 2006 is the owner of the IP because:

- a) Herbal Care provided no evidence it had any property in the IP. As held by Farley, J. in *Re T. Eaton Co.* [1999] O.J. No. 4216, a licence is mere permission to do something which would otherwise be unlawful to do;
- b) Herbal Care took no step to amend or appeal the vesting order. For two years, parties have acted and conducted their affairs on the basis of the vesting order, and this should not be disrupted, which would be contrary to the CCAA’s objective for efficient restructurings; and
- c) any remedies Herbal Care has are contractual in nature with rights against Old Body Blue.

### 2. No Right to RSLA Sale after Payment into Court

*CIT Financial Ltd. v. Ewart and International Tire and Equipment Ltd.*, (2008), 12 P.P.S.A.C. (3d) 249 (Ont. S.C.J.)

Held: CIT as lessor of the subject transport truck was awarded damages where the bailiff hired by the unpaid repairer, International, sold the truck at auction, after CIT had paid the disputed repair claim amount into court pursuant to section 24 of the *Repair and Storage Liens Act*.

### 3. CRA’s Right to Proceeds of Bankrupt’s RRSP

*Attorney General of Canada on behalf of the MNR v. Keith G. Collins Ltd.* (2008) 41 C.B.R. (5<sup>th</sup>) 287 (Man. Q.B.)

Ms. McGregor made an assignment into bankruptcy. CRA was a creditor by four assessments under s.160 of the *Income Tax Act*, one of which was certified by the Federal Court of Canada for some \$148,000. CRA registered this certificate under both the PPSA and with the Land Titles Office.

CRA filed in her bankruptcy as a secured creditor and claimed the proceeds from the liquidation of the bankrupt's RRSP by her trustee.

Held: CRA was a secured creditor for these RRSP proceeds by section 223 of the *Income Tax Act*, and upon registration, CRA acquired a security interest in all of her property, which interest was broad enough to include these proceeds.

#### 4. OMVIC Registrar and Lessees and Security Deposit Claims

*HOJ National Leasing Group (Trustee of)* (2008), 293 D.L.R. (4<sup>th</sup>) 455 (Ont. C.A.)

On Sept. 27, 2004, two HOJ leasing companies assigned themselves into bankruptcy. They had some 4,000 leased vehicles, financed by way of a securitization trust. Lessees had paid HOJ security deposits at the start of these leases. At the date of the bankruptcy, the lessees had no claims for repayment of the deposits as the leases were not matured or in default.

In 2004, the trustee assigned the portfolios of leases to third parties to continue HOJ's role as administrator and receivables collector for the securitization trusts by a vesting order, free and clear of all claims, including the claims of the lessees for unpaid security deposits.

The lessees had the potential for \$1.2 million of claims against the fund maintained by the Registrar under the *Motor Vehicle Dealers Act*. The Registrar and the lessees moved to vary the vesting order and the motion was dismissed in its entirety.

The Court of Appeal dismissed the Registrar's appeal on the basis that:

- a) the motions judge was correct in concluding that the Registrar and lessees had no proprietary or economic rights affected by the vesting order and no standing to vary it;
- b) the Registrar had a statutory liability to honour claims under the MVDA and was attempting to pass this liability to the portfolio assignees by a variation of the vesting order; and
- c) the Registrar's motion was heard two years after the vesting order, which order in the interim had been acted upon by the assignees and lessees.

#### 5. 427 v. Unperfected Security Interest

*Radius Credit Union v. Royal Bank* (2008), 39 C.B.R. (5<sup>th</sup>) 273 (Sask. Q.B.)

The Credit Union lent funds to the debtor farmer, obtained his GSA, but failed to register it under the PPSA.

The debtor took subsequent loans from the Bank and granted the Bank section 427 *Bank Act* security. The debtor did not tell the Bank about the prior Credit Union loans.

Held: the Bank's subsequent section 427 security had priority over the prior unperfected GSA.

## 6. Unread Subordination Agreement

*1662254 Ontario Inc. v. Coby's Cookies Inc.* (2008), 40 C.B.R. (5<sup>th</sup>) 134 (Ont. S.C.J.)

Held: prior secured creditor's alleged failure to read the clearly worded priority and subordination agreement, prior to executing it, was no excuse.

## 7. Limitation Period on Guarantee

*2015673 Ontario Inc. v. Chorny* (2008), 90 O.R. (3d) 207 (Ont. S.C.J.)

Mr. Chorny guaranteed three separate term loans, each of which matured and became payable between Sept. and Oct. 2005. For various reasons, including the need to revive the corporate existence of the lender, the limitation periods on the collection of the debts under the promissory notes expired two years later in Sept. and Oct. 2007.

In Dec. 2007, the guarantor applied to have the action dismissed by reason of the limitation period having expired.

The motion to dismiss was granted.

The Court of Appeal referred to the Supreme Court of Canada's decision in *Communities Economic Development Fund v. Canadian Pickles Corp.*, [1991] 3 S.C.R. 388, at paragraphs 49 and 50, which held that a guarantee's existence is coterminous with the underlying debt, such that if the principal debt is void or unenforceable, then the guarantee is likewise void or unenforceable.

Applying the principal of co-existence, the Court held that the limitation period on the guarantee commenced to run when the debt was due and owing and not when demand was made on the guarantor.

**Editorial note:** The British Columbia Court of Appeal came to the same conclusion in *Business Development Bank of Canada v. Papke*, [2005] B.C.J. No. 1091. Clients need to understand that remedies against the guarantor need to be brought within the same two year limitation period from the time the underlying debt becomes due. In some cases, the extent of the lender's shortfall after enforcing its remedies against the collateral may not be known for various reasons, including priority disputes and resolution of the three super priority rights of the Crown for payroll source deductions, and the new wage claims and pension arrears legislation.

## 8. Co-op's Lien on Member's Equity

*Prince Albert Co-operative Assoc. Ltd. v. Nagy (Trustee of)* (2008), 43 C.B.R. (5<sup>th</sup>) 117 (Sask. Q.B.)

Held: the Co-op was a secured creditor against the bankrupt member's equity account by reason of:

- a) s. 45 of the *Co-operatives Act, 1996* created a statutory lien to the extent of the member's shares; and
- b) s. 2 of the BIA defines "secured creditor" to include lien holders.

## 9. Conflicts of Law over Aircraft Collateral

*Air Combat Training Inc. v. Canada (Minister of Public Works and Government Services)* (2008), 12 P.P.S.A.C. (3<sup>rd</sup>) 70 (Ont. S.C.J.)

A entered into an agreement to purchase six aircraft from the Canadian government, with funds from J in Florida, secured by the subject aircraft, and a subsequent loan secured to M in California. J registered its security with the United States Federal Aviation Authority. M registered its subsequent security under the Ontario PPSA. The aircraft were being stored in Ontario.

Held: section 8(1) of the PPSA conflict of law rules provides that the substantive matters involved in the enforcement of rights of the secured party against the collateral are governed by the proper law of the contract. The Court held that Ontario law applied to any dispute as to the procedural or substantive issues arising from M's enforcement against these aircraft.

### Upcoming Program

8th Annual Franchise Law Conference:  
Putting Principles into Practice  
November 25, 2008

**Imperfections** is published by the Personal Property Security Law Committee of the Business Law Section of the Ontario Bar Association.

*The PPSL Committee canvasses recent personal property security law decisions and developments and summarizes those aspects of them which may be of interest to readers of this newsletter. When available at the time of writing, a citation to a reporting service is given. When not available, the court of decision is indicated so that readers may obtain the judgment referred to for their consideration. Readers are cautioned against relying on the abstracts of decisions which are edited and in outline form only. Editorial content should not be taken as the legal opinion of the PPSL Committee or the Editor.*

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