Issues related to Security Interest under Bankruptcy and Reorganization Procedures

by

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Abstract

This thesis examines issues related to security interest, especially the security that holds after acquired property as well as present property, which are caused by discharge under bankruptcy procedure. This thesis also examines security interest valuation issue under proposal under Bankruptcy and Insolvency Act. Both issues are related to the nature of security interest, which is, in my opinion, to hold the value of collateral at the time of realization. This thesis especially focuses on the security under after acquired clause, which holds interests in after acquired property as well as present property. In my view, the security on after acquired property has proprietary interest. It leads to the conclusion on the issue whether the security can attach to a property acquired after discharge.
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Chapter 1
Introduction

Under s. 178 (2) of the Bankruptcy and Insolvency Act (the “BIA”)\(^1\), an order of discharge releases a bankrupt from all claims provable in bankruptcy other than those specified in s. 178 (1). However, release of the debt supporting the security interest does not nullify a security interest. Professor Buckwold explains this point that:

The security interest is saved by the principle that a trustee in bankruptcy is entitled to distribute only the “property of the bankrupt”, which comprises all non-exempt real and personal property owned by the bankrupt at the date of bankruptcy, as well as property acquired by her between commencement of the bankruptcy and the date of discharge. To the extent that the bankrupt’s property is subject to a security interest, the secured creditor is entitled to take it and apply its value in satisfaction of the debt she is owed. The property charged with the security interest is thus not viewed as property of the bankrupt and is accordingly exempt from distribution by the trustee. The secured creditor is entitled to realize against the property to the extent of her interest during the course of the bankruptcy and even after the bankrupt’s discharge, notwithstanding the fact that the debt that originally sustained creation of the interest cannot be enforced against the bankrupt personally.\(^2\)

Thanks to the principle, a secured creditor is basically unaffected by its debtor’s bankruptcy by exercising seizure of the property under the security agreement entered between the secured creditor and the debtor.

An important practical and conceptual issue has arisen in the case law where the secured creditor holds a security interest in the debtor’s after acquired property as well as in present property. Will the after acquired property clause attach to property interests acquired after the time of discharge? In *Holy Rosary Parish (Thorold) Credit Union Ltd. v. Bye*\(^3\), Judson J held that:

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1 RSO 1985, c. B-3, as mended 1992, c. 27; 1997, c. 12.


There is no doubt that the borrowing by Bye from the credit union did create a debt provable in bankruptcy. The credit union did not prove in bankruptcy. The debt has now gone by operation of law. The assignment was given as a means of collection of the debt. The statutory release of the debtor under the Bankruptcy Act renders the assignment ineffective as means of collection.

Similarly, the Ontario Court of Appeal in *Pelyea v. Canada Packers Employees Credit Union Ltd.*\(^4\) said that the debt secured by an assignment of the debtor’s interest in an employee profit sharing plan was “extinguished” by s. 178 (2) of BIA, though the security which was in existence at the date of bankruptcy was not extinguished.\(^5\)

There are two issues raised in two cases after *Bye*: those are *Seaboard Acceptance Corporation Ltd. v. Moen*\(^6\) and *Andrew v. FarmStart.*\(^7\) And courts’ decisions in those cases were apparently contradict with *Bye*.

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5 Buckwold, supra, footnote 2, at p. 440.


Chapter 2
Security Interest in Future Property Acquired after Discharge

1 Seaboard – The secured creditor’s security interest after the debtor’s discharge

1.1 Introduction

In Seaboard, a lessee retained a leased vehicle and paid the lease payments during the period she was in bankruptcy and shortly thereafter. She then defaulted and the lessor brought action against her for the full amount payable under the lease contract. This was more than the unpaid lease payments; it was an amount that, in effect, was equivalent to the purchase price of the vehicle and an applicable credit charge. The British Columbia Court of Appeal rejected the argument of the lessee that she had been released from her obligation to pay amounts owing under the contract when she obtained her discharge in bankruptcy. The Court concluded that the contract “continued” after the discharge. The fact that there may have been a claim provable in bankruptcy did not affect the “continuing effect” of the contract into the post-discharge period.\(^8\)

The court concluded that:

The contract continued throughout the bankruptcy and continued after the discharge from bankruptcy; it was never terminated in accordance with its provisions for termination, and the fact that there might have been a claim provable in bankruptcy, or that a claim provable in bankruptcy might have been made, does not affect the fact that the contract itself continued and continued to regulate the relationship of the parties after the discharge from bankruptcy.

1.2 Analysis

This conclusion rested on the fact that the bankrupt had maintained payments and retained possession of the car throughout her bankruptcy and thereafter, constituting what the court called endorsement of the contract following discharge. Lambert J.A. specifically indicated that there

had not been a novation of the contract, merely a “continuation” of it.\(^9\)

Professor Buckwold contends the conclusion. She says that:

If the claim provable in bankruptcy emanated from the lessee’s promise of payment under the contract, the straightforward application of s. 178 (2) should have led inexorably to the conclusion that the bankrupt lessee was, after her discharge, no longer obliged to satisfy that claim. Similarly, the fact that the contract between the parties may have continued to exist after the lessee’s discharge was irrelevant to the enforceability of any right of payment that the lessor had under it. The court’s belief that the payment obligation was sustained by continuation of the contract over looks both the clear intention of the statute and the Supreme Court of Canada’s unequivocal view of its operation, as expressed in \textit{Bye}.”\(^{10}\) “The emasculation of the mandatory wording of s. 178 (2) through an undeveloped theory of “continuation” of the contract would, in such circumstances, be quite unacceptable.\(^{11}\)

If the debt under a contract is a claim provable under the BIA, it is inevitably released by s. 178 (2) of BIA. Although the contract itself does not extinguish by s. 178 (2) of BIA and continue in existence as mentioned by the court, the secured creditor cannot claim the debt that was released. Allowing the continuation approach adopted by the court is equivalent to reviving the debt released. It is in effect a novation. However, it is common understanding that “novation requires a conscious decision on the part of the debtor to pay a debt that she would otherwise not be obliged to satisfy in return for the creditor’s agreement to waive a present right of seizure.”\(^{12}\)

In \textit{Seaboard}, the debtor clearly had not promised to pay the full amount of the debt outstanding. “Her continuation of payments was simply a strategic device to avert repossession of the car.”\(^{13}\) Therefore it cannot be a novation. The continuation approach in \textit{Seaboard} is insupportable.

\(^9\) Buckwold, supra, footnote 2, at p. 443.
\(^{10}\) Buckwold, supra, footnote 2, at pp. 444-45
\(^{11}\) Buckwold, supra, footnote 2, at p. 449
\(^{12}\) Buckwold, supra, footnote 2, at pp. 443-44.
\(^{13}\) Buckwold, supra, footnote 2, at p. 444.
A possible explanation supporting the decision by the court in *Seaboard* is that Seaboard’s claim was not a claim provable in bankruptcy, therefore, the claim was not released by debtor’s discharge. This explanation was adopted by the trial judge in *Seaboard*. However, the decision of the Supreme Court of Canada in *Keneric Tractor Sales Ltd. v. Langille*\(^{14}\) clearly leads to the conclusion that Seaboard’s claim to enforce the personal promise to pay was a claim provable in bankruptcy within the meaning of the BIA. Professor Buckwold explains this issue that:

In *Keneric*, the court held that the ordinary principles of contract law apply to a claim arising from breach of a lease, whether it be a lease of land or of chattels. A lessor’s contractual right as against the lessee is the right to enforce performance of the obligations undertaken by the lessee. That right arises at the time the contract is made. The primary device for enforcement of contractual rights is, of course, a claim for damages for breach of a contractual obligation, or obligations, by the other party. A lessor’s claim for damages against a lessee in breach is quantifiable through the application of the general contract principle that the claimant is entitled to the sum that would put her in the position she would have been in had the lessee’s obligations under the lease been performed. If the lease in *Seaboard* were a true lease, Seaboard’s “claim” against Ms Moen at the date of her bankruptcy would be the right to enforce her personal obligation to pay the sums promised. After the initiation of bankruptcy proceedings, that right could be enforced by filing a proof of claim for the amount that would be recoverable in an action for breach of contract. The quantum of damages would depend upon the losses actually caused by the breach, qualified by the obligation to mitigate. That sum might or might not equal the payments remaining unpaid under the lease. In *Keneric*, the Supreme Court rejected the view that was adopted by the trial judge in *Seaboard*, namely, that a lessor’s monetary claim against a defaulting lessee is limited to unpaid installments of rent due from time to time. Since no installments of rent remained unpaid at the time of Ms Moen’s bankruptcy, the judge reasoned, incorrectly, that Seaboard did not have a claim provable in bankruptcy.\(^{15}\)


\(^{15}\) Buckwold, supra, footnote 2, at p, 444.
Another alternative explanation was proposed by Professor Ziegel, which is that Ms Moen’s conduct estopped her from invoking her discharge rights against Seaboard’s claim.16 I agree with Professor Ziegel. Lambert J. in *Seaboard* pointed out that:

The defendant took possession of the vehicle in April 1982 when the contract was signed. On 7th December 1983 the defendant made a voluntary assignment into bankruptcy. She did not inform the trustee in bankruptcy of the lease contract with Seaboard or the terms by which she had possession of the automobile… and absolute order of discharge was made on 22nd May 1984. The defendant made the required payments until 14th September 1984, that is, from before the bankruptcy right through the bankruptcy, past the time of her discharge, and several payments after the discharge had been granted. But, in September 1984, default occurred and in the end the vehicle was returned to Seaboard in November 1984. At that time Seaboard calculated the amount owing under the contract in accordance with the terms of the contract just as if no bankruptcy had occurred and Seaboard made a demand for the balance owing.

Professor Ziegel reasons that under the circumstances pointed out by Lambert J:

a debtor is statutorily obliged to disclose her assets and liabilities in the statement of affairs required to be filed at the time of the assignment in bankruptcy.17 Likewise, the trustee is obliged to notify all the bankrupt’s creditors of the assignment together with a list of creditors and proof of claim and notice of the first meeting of creditors where a meeting is required.18 Therefore, whether Ms Moen failed to disclose the lease to the trustee or whether she persuaded the trustee not to include Seaboard in the list of creditors, she was guilty of a breach of her statutory obligations.19

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17 BIA, s. 49(2).

18 BIA, s. 102(2).

19 In *Halliday v. Kmedy* (1997), 108 O.A.C. 204, 50 C.B.R. (3d) 281 (Div. Ct.), the court held that a debtor and creditor could not contract out of a statutory obligation to list the creditor in the list of creditors and that such an agreement might amount to fraud.
That breach seriously prejudiced Seaboard by depriving the corporation of the remedies available to it under the lease on the happening of the bankruptcy. Seaboard could also plausibly argue that had it known the true position it would have insisted on Ms Moen reaffirming the contract as a condition of allowing her to remain in possession of the vehicle.  

It is issue whether an estoppel can interfere with rights established by statute.

In *Kenora (Town) Hydro Electric Commission v. Vacationland Dairy Co-operative Ltd.*, the court held that an estoppel cannot supersede an obligation to perform a clear statutory duty that imposes a positive duty precluding the estoppel. It follows from the conclusion that an estoppel cannot supersede the operation of a statutory provision that directly precludes the enforcement of a debt. The application of the principle showed in *Kenora* requires considering the overall scheme of the statute in question, and its apparent objectives to decide if the statute clearly preclude an estoppel. The statute should be viewed as precluding operation of an estoppel only if that result would appear to be necessary to achieve a primary statutory goal or policy. The statutory objective of the bankruptcy discharge is of fundamental importance. It is by its terms directed to “all claims provable in bankruptcy.” Only those liabilities specifically provided for are not released by discharge. They include s. 178 (1) (f) of BIA that provides that the liability for the dividend that a creditor would have been entitled to receive on any provable claim not disclosed to the trustee, unless the creditor had notice or knowledge of the bankruptcy and failed to take reasonable action to prove his claim. In my view, s. 178 (1) (f) of BIA is a statutory form of an estoppel and it purports to allow a claim based on an estoppel

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20 Ziegel, supra, footnote 16, at pp. 145-46.
23 Buckwold, supra, footnote 2, at p. 446, footnote 34.
24 Buckwold, supra, footnote 22, at p. 129.
25 Buckwold, supra, footnote 22, at p. 130.
26 BIA, s. 178 (2).
only to the extent of s. 178 (1) (f) of BIA. Professor Buckwold effectively explains the point
that:

If a secured creditor has been prevented by the bankrupt’s non-disclosure from proving a claim for
the then unsecured portion of the debt, he or she is therefore entitled to recover (only) the amount
of the dividend he or she would have received had the debt been disclosed. In contrast, an
estoppels arising from the non-disclosure would appear to enable the secured creditor to recover the
entire debt. Since that result directly contradicts the explicit scheme of the BIA, it surely cannot be
justified.27

Thus, s. 178 of BIA “generally” precludes unsecured creditors and secured creditors that have a
deficit between the value of the collateral and the amount of the debt secured by the collateral
from claiming any debt other than the debt recoverable under s. 178 (1) (f) of BIA.

However, in the case, like Seaboard where the debtor’s bankrupt remains in possession of
collateral and continues payment after his or her discharge, we have to consider the special
circumstances. That is the fact that the secured creditor was deprived of the chance of
negotiating reaffirmation or novation of the contract. Professor Ziegel explained this point that:

The reasoning would run as follows. Had Ms Moen met her statutory obligations and made the
disclosure, Seaboard would have been entitled under the standard form leasing agreement to
terminate the agreement, and repossess and dispose of the vehicle in accordance with the applicable
statutory provisions. Ms Moen could have averted this result by offering to reaffirm the leasing
contract or to enter into an entirely new contract assuming reaffirmation is permitted under the BIA
even before a debtor has received her discharge. Another way to explain this result is to reason that
Ms Moen failed to disclose the lease to the trustee because she wanted to continue with it and that,
having benefited from her non-disclosure well beyond the date of her discharge, she is estopped

27 Buckwold, ssupra, footnote 22, at p. 130.
from denying the reasonable inferences drawn from her conduct regardless of what her actual motives may have been.

1.3 Conclusion

In my view, the reason that s. 178 (1) (f) of BIA limits the amount to be recovered by the provision to the amount equivalent to the dividend that otherwise would be delivered to the creditor if there is disclosure, is that there is no reason to allow the creditor recover the debt owing to him or her more than the amount that could be delivered in bankruptcy. Therefore, s. 178 (1) (f) of BIA does not preclude an estoppel to compensate the secured creditor the loss of opportunity of reaffirmation or novation of contract because such loss is different from the loss that s. 178 (1) (f) of BIA contemplates. Even though fresh start is a fundamental principle of discharge, the bankrupt who did not disclose its bankruptcy to its secured creditor in order to remain in possession of collateral does not deserve the benefit of fresh start. In this case, the necessity to give relief to the secured creditor is greater than the necessity to give fresh start to the debtor.

As a result, in my opinion, although the reasoning is not supportable, the decision by the British Columbia Court of Appeal in Seaboard itself is supportable and is not contradict with Bye.

2 FarmStart – The secured creditor’s security interest against the debtor’s equity accruing after discharge

2.1 Background

Professor Ziegel explains the overview of FarmStart as follows:\(^*\): In FarmStart, a parcel of land owned by the bankrupt was subject to three mortgages, the first two of which secured debts cumulatively greater than the value of the land. FarmStart, the governmental lending agency holding the third mortgage on the land, accordingly filed in the bankruptcy as a preferred creditor,

\[^*\] Buckwold, supra, footnote 2, at pp. 459-60.
on the basis that the value of its security was nil. A small dividend was paid on its claim and the bankrupt was discharged. The debts secured by the first and second mortgages were thereafter paid and the mortgages discharged from the debtor’s title, substantially increasing the mortgagor’s equity in the property. When the mortgagor subsequently sold the land, FarmStart asserted a claim to the proceeds on the cases of its mortgage, which was still registered. Both the majority and dissenting judgments focused primarily on the question of whether FarmStart had, by its conduct, surrendered its security to the trustee, thereby precluding subsequent reliance on its proprietary rights. However, having established that the security had not been surrendered, the majority went on to hold that FarmStart was entitled to assert its claim as mortgagee on the ground that, “A secured creditor may realize upon his security after discharge of the bankrupt. The court relied on *Pelyea v. Canada Packers Employees Credit Union Ltd.*\(^{29}\) as authority. The Ontario Court of Appeal in *Pelyea* said that the security which was in existence at the date of bankruptcy was not extinguished by s. 178 (2) of BIA after discharge.

In fact, the parcel of land subject to the secured claim remained the same throughout the bankruptcy and discharge. However, the debtor’s equity in the land had increased in value after his discharge, and it was that newly acquired equity that the third mortgagee sought to attach. The question here is whether the decision by the Supreme Court of Canada in *Bye* should be extended to the case where the debtor gets equity in the collateral that have existed since before discharge. If so, the secured creditor is prohibited to realize upon his security after discharge of the bankrupt, on the contrary to the decision in *FarmStart*. My opinion is contrary to the decision in *FarmStart*.

### 2.2 Plausibility of the decision in *Bye*

To reach the conclusion about the question, we have to consider the plausibility of the decision in *Bye*. My opinion is against the decision in *Bye*. In *Bye*, the Judson J said that:

> There is no doubt that the borrowing by Bye from the credit union did create a debt provable in bankruptcy. The credit union did not prove in bankruptcy. The debt has now gone by operation of

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Professor Ziegel casts a question on the decision in *Bye*, saying that the court’s decision is in direct conflict with the English Court of Appeal in *In re Lind*. In 1905, L gave N a mortgage in an expectancy in L’s mother’s estate. In 1908, he gave a second mortgage in the expectancy to A, subject to the first mortgage. In August 1908, L was adjudged bankrupt and in 1910 he obtained his discharge. Neither N nor A proved in L’s bankruptcy. In 1911 L gave an assignment of the expectancy to the I Syndicate. In 1914, L’s mother died and L’s share of the estate fell into his possession. Two principal issues were argued before the Court of Appeal. The first was whether N and A had acquired an effective security interest in the expectancy. The second was whether the security interests had survived L’s discharge from bankruptcy. A court answered both questions affirmatively. So far as the second question was concerned, Swinfen Eady LJ wrote that:

It was urged by the appellants that having regard to the wide language of s. 37 of the Bankruptcy Act, 1883, with regard to debts and liabilities provable in bankruptcy, all liability of the assignor of every kind, under the mortgages of 1905 and 1908, was provable; and that as the debts created by the mortgage deeds were extinguished by the bankruptcy, the contract relating to the future property, which was merely ancillary to and for the purpose of securing the debt, was also discharged. The answer is that the mortgagees under the deeds of 1905 and 1908 elected to rely upon their security, and not to prove, and therefore as mortgagees they stand outside the bankruptcy; and, moreover, that any contract contained in those deeds far vesting the future property in the mortgagees was ancillary not to the debt, but to the mortgage by which the debt was secured, in like manner as the covenant not to revoke a will which had appointed a sum of money to a mortgagee was so held in *Robinson v. Ommanney* both by Kay J and the Court of Appeal.

30 [1915] 2 Ch. 345 (C.A.).

31 Ziegel, supra, footnote 16, at p. 151.

32 Ziegel, supra, footnote 16, at pp. 151-52.
What the court stated in *In re Lind* is that secured parties are not affected by the debtor’s discharge if they do not prove in respect of the debts. In other words, the security has an independent existence and is not affected by the discharge, as a result, the secured party should be entitled to continue to claim the collateral.

Professor Ziegel posed another question about the court’s decision in *Bye*. He said that the decision in *Bye* had no logical halfway house because if the debt and the security interest are interdependent as said in *Bye*, the collateral must be released together with the debt, but it is common understanding that the security interest itself does not extinguish after discharge. With respect to the first question (discrepancy between *In re Lind* and *Bye*), which is right decision depends on the view on the nature of security interest. The PPSA adopts the concept of attachment under which a security interest attaches when the debtor has rights in the collateral and value is given. It follows that the secured creditor cannot acquire any security interest in after-acquired property until the debtor acquires the right in the property. As a conclusion, the secured creditor cannot claim against the property that the debtor acquired after its discharge because there is no debt to be secured because of the discharge. I will discuss in detail in separate section later.

### 2.3 Whether the decision in *Bye* should be extended to the case of post discharge accretion of debtor’s equity in collateral

Whether the decision in *Bye* is doctrinally wrong or not, it is binding case until the court revisit it. When the decision in *Bye* is accepted as a binding case, there is another issue. That is, whether the decision in *Bye* should be extended to the case of post discharge accretion of debtor’s equity in collateral, such as the case of *FarmStart*. One argues that since the charge held by a mortgagee under a Torrens system of land law is wholly accessory to the right to be paid the debt secured, it cannot attach to property of any kind acquired by the debtor once the debt has become unenforceable. Professor Buckwold insists that:

33 Ziegel, supra, footnote 16, at p. 156.

34 Buckwold, supra, footnote 2, at p. 460.
As at the date of discharge, the debt owed FarmStart was fully unsecured. Since the proprietary interest represented by a mortgage is simply a right to payment attaching to the collateral, FarmStart in fact had no such interest at that time. There were no units of value available in the “pool” to be applied to payment of its claim. Though FarmStart had registered a claim against the debtor’s title, there was no property to which a third mortgagee could attach. The declaration of FarmStart’s claim through registration of a document could not create an interest in non-existent property.\textsuperscript{35}

I agree with Professor Buckwold’s idea only to the extent that since the charge held by a mortgagee under the Torrens system is accessory to the right to be paid the debt secured, it cannot attach to property of any kind acquired by the debtor once the debt has become unenforceable. I, however, disagree with the idea that FarmStart in fact had no mortgage at the time of discharge. Her idea is based on the newly conceptualized notion of security interest that the proprietary interest represented by a mortgage should be lost when there is no economic value in the collateral available to satisfy the debt secured by the mortgage. Professor Ziegel criticized as follows that:

Taken to its logical conclusion it would lead to dramatic results. It would mean, for example, that a security interest may never come into existence if the collateral has no economic value at the time of its purported creation or attachment. Similarly, a security interest that was supported by economic value may drop out of sight because of a dramatic decline in value. Logically, it should also lead to the conclusion that a debtor should have the right to redeem the security at its current market value or, if the security interest is no longer supported by economic value, to seek a court declaration that the security interest has ceased to exist.\textsuperscript{36}

\begin{footnotes}
\item[$35$] Buckwold, supra, footnote 2, at p. 461.
\item[$36$] Ziegel, supra, footnote 16, at p. 150.
\end{footnotes}
Professor Ziegel goes on that:

Take this example. A piece of industrial property in which a bank holds a security interest is deeply polluted. Six surveyors have filed affidavits saying the bank’s security interest is worthless and, in their view, will never acquire a positive value. The debtor seeks a discharge of the bank’s financing statement on the ground that the bank no longer holds a real security interest. In my opinion, the court would be bound to reject the application even if it fully accepts the reliability of the surveyors’ affidavits.\(^\text{37}\)

In my view, the new conceptualization of security interest cannot be supported by the PPSAs. Since the conceptualization of security interest suggests that persons can be qualified as secured creditors or as holders of security interests only if the property designated as collateral has sufficient economic value to support their claim. If the economic value of the collateral vanished, like Professor Ziegel’s hypothesis above, or the collateral is fully encumbered by prior interests by another secured coreditor, the creditor could not be a “secured creditor” or would not hold “security interest” in the collateral. To overcome the difficulties, Professor Buckwold draws distinction between the “substantive rights” associated with a security interest and the “procedural rights” ascribed to secured creditors under the legislation. She says that:

The conceptual view of a security interest advanced in this article does not preclude the conferral of procedural rights on persons who claim to hold a security interest. A creditor who registers a financing statement under the PPSA is presumptively treated as a secured creditor under the Act, for purposes of determining her rights in the collateral or challenging the rights of another, regardless of whether the collateral has sufficient value to support her alleged interest. She is entitled to the notices prescribed in the Act and may otherwise avail herself of its procedural provisions. The substantive issue of whether she is in fact secured and is as such entitled to participate in the value of the collateral may hinge on questions of valuation and priority that

depend upon the application of provisions of the Act itself. A person claiming to hold a security interest must therefore be allowed the benefit of those provisions as a “secured creditor” until such time as it is determined that she is substantively unsecured in whole or in part.\(^{38}\)

However, the OPPSA does not have any provision that entitles a court to expunge an otherwise valid and perfected security interest on the ground that it has lost all economic value, even if there is a proper hearing and all other due process requirements have been met. So far as the right to redeem is concerned, the provincial PPSAs only entitle the debtor to exercise the right by tendering fulfillment of all obligations secured by the collateral together with the secured party’s expenses.\(^{39}\) Professor Buckwold rebuts that:

I agree that there is nothing to prevent a debtor from applying to the court for an order discharging a registration where the collateral has insufficient value to satisfy any part of the debt claimed. However, such a request should be refused if there is any prospect of future appreciation in the value of the collateral or an increase in the debtor’s equity that might accrue to the benefit of the secured creditor.\(^{40}\)

I agree that the request for discharging registration should be refused if there is any prospect of future appreciation in the value of the collateral or an increase in the debtor’s equity that might accrue to the benefit of the secured creditor. My agreement with Professor Buckwold is not because I agree with her new conceptualization of security interest but because, in my opinion, a security holds the possible future appreciation.

As I discuss in separate section later, under personal property security legislations, a security interest is dependent on a debt that is secured by the security. Since a security is accessory to a

\(^{38}\) Buckwold, supra, footnote 2, at p. 463, footnote 86.

\(^{39}\) Ziegeo, supra, footnote 16, at p. 150.

\(^{40}\) Buckwold, supra, footnote 22, at pp. 139-40.
debt, the purpose of a security is to hold the economic value of the collateral otherwise the debtor would have if there were not security on the collateral. And the secured creditor has a right to determine the timing of realization of security. The secured creditor is not forced to realize its security. Once the secured creditor realized its security, he can receive the amount of value of the collateral at the time of the realization, instead of the amount of value at the time of entering the security agreement or attachment. This means that a security holds a value of the collateral “at the time of realization”. Therefore, the security creditor holds future appreciation as a right inherent to security. For example, a secured creditor had a security interest in a vehicle owned by a debtor, which was worth ten thousand dollars. A rough vandalized the vehicle and its value declined to three thousand dollars. The debtor fixed the vehicle and it recovered its value up to eight thousand dollars. Is the secured creditor entitled to receive only three thousand dollars from the collateral? No. He is entitled to receive more than three thousand dollars, namely eight thousand dollars because the value of the vehicle recovered by the time of realization. Consequently, any security interest survives until its realization whatever the current price is and whatever prior security attaches to the same collateral because the possibility of future appreciation or discharge of prior security exists anytime.

2.4 Conclusion

Having concluded that a security holds the value of the collateral “at the time of realization”, not at present, my conclusion in FarmStart differentiates from Professor Buckwold’s conclusion. If FarmStart had not surrendered its security to the trustee as the majority in FarmStart concluded, FarmStart had the security interest that held the value of the parcel of land “at the time of realization.” Although the value of the security interest was nothing due to the prior security interests at the time of discharge, the security interest held the right to receive future appreciation and accretion in equity. Such proprietary interest survives discharge. Consequently, FarmStart was entitled to claim the proceeds of the parcel of land, which arises after discharge.

This conclusion is permissible even under the fresh start policy. Fresh start is not free. The bankrupt is supposed to relinquish all its property existing before discharge except for exempt property as a compensation to be exempt from outstanding debt. As long as the property exists before discharge and it is not exempt property, it is not against fresh start policy that the bankrupt is forced to relinquish the property. In FarmStart, the parcel of land belonged to the debtor
before discharge and was not exempt property. It was a compensation for the debtor to relinquish the land in order to get fresh start.

This conclusion is also consistent with PPSA. As Professor Buckwold admits, the request for an order discharging a registration where the collateral has insufficient value to satisfy any part of the debt claimed should be refused.\(^{41}\) It is because a security holds the value at the time of realization, instead of the value at the time other than realization. There is no reason to discharge the security interest that has proprietary interest to acquire future appreciation and accretion in equity.

\(^{41}\) Buckwold, supra, footnote 22, at p.140.
Chapter 3
The Nature of Security Interest under Personal Property Security Legislation

1 Introduction

Under common law, “property” is understood in two related but significantly different senses; the collateral itself and title of collateral. A Security interest in personal property defined by the PPSAs is “an interest in personal property that secures payment or performance of an obligation.” A PPSA security interest is a right to payment of a debt, enforceable against the collateral. This simply means that in the event of a default in payment, the secured creditor can appropriate the collateral to satisfaction of the secured debt in the manner prescribed by the statute. Because the right to satisfaction of the secured debt relates directly to identified property, a security interest is properly characterized as proprietary. However, security interests are not rights of ownership. They simply symbolize an entitlement to the property for purposes of payment of a debt. Because the hypothec represents nothing more than security for a debt, it is dependent on the debt’s continued existence. Understood in these terms, it is not necessary to mediate a secured creditor’s claim to collateral through the common law concept of title. One need only understand that a security interest gives the creditor rights in and to the collateral itself, which rights derive solely from the right to repayment of the secured debt.

2 Analysis

The rights of a mortgagee of land under the law governing a Torrens land registration system are equivalent in this sense to those conferred upon the holder of a security interest by the PPSA. A Torrens system of land law governs real property rights in many of the provinces, as well as in

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42 Buckwold, supra, footnote 2, at p. 454.
43 Buckwold, supra, footnote 2, at p. 454.
44 Buckwold, supra, footnote 2, at p. 455.
the territories. In Torrens jurisdictions, a mortgagor retains title to the mortgaged land, subject to a charge in favor of the mortgagee arising from the contract of mortgage. Like the PPSA security interest, this charge can be understood as the embodiment of the cluster of rights ascribed to the mortgagee by the pertinent statute. Since the charge entitles the mortgagee to satisfy the mortgage debt through the proceeds of sale of the subject property or through acquisition of the mortgagor’s title via foreclosure, it comprises a proprietary right or interest in the land. However, the proprietary interest held by a real property mortgagee does not represent a transfer of ownership from debtor to creditor.46

Both the personal property security interest and the charge created by a mortgage of land must therefore be conceived relative to the amount of debt secured. The secured creditor has a claim against the subject property only to the extent of the debt outstanding, for her fundamental right is simply a right to payment of the amount of the debt through the proceeds of sale of that property.47

The common law principles governing the rights of mortgagees in non-Torrens jurisdictions proceed on a different conceptual footing. At common law, a mortgagee obtains title to the land subject to the mortgage in accordance with the terms of the mortgage contract. The proprietary rights represented by “title” to property are envisaged as relating to the land as an undivided entity, embracing whatever value may inhere in it at a given point. Although title (unlike security) is not conceptually dependent on a right to payment, the judicial invention of the mortgagor’s equity of redemption has qualified the character of a mortgagee’s title in a very significant way. It is said to constitute the mortgagor owner of the property, subject to the legal rights of the mortgagee. In Petranik v. Dale48, Dickson J. stated that the law as summarized by

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45 The Torrens system is the only method of registration in Saskatchewan, Iverta, British Columbia, the Northwest Territories and the Yukon. The legislation in all of those jurisdictions is entitled the Land Titles Act; see e.g. R.S.S. 1978, c. L-5. The Torrens system co-exists with the old deed registration system in Manitoba, Ontario and New Brunswick: see Real Property Act, R.S.M. 1988, c. R30 (as amended), Land Titles Act, S.N.B. 1981, c. L-1.1 (as amended) and the Land Titles Act, R.S.O. 1990, c. L.5.

46 Buckwold, supra, footnote 2, at pp. 455-56.

47 Buckwold, supra, footnote 2, at p. 456.

Kekewitch J. in *Tarn v. Turner*, who described the equity of redemption as an equitable estate amounting to “a fee simple subject to a charge.” ⁴⁹

The legal rights of the mortgagee are therefore necessarily qualified by the amount of debt secured by the mortgage. The mortgagee is entitled to exercise her rights of realization through foreclosure or sale for the sole purpose of satisfying her monetary claim. A common law mortgage thus operates in the same way as does a Torrens system mortgage. ⁵⁰

The legal rights associated with all forms of security survive the debtor’s bankruptcy, subject to the operation of s. 178 (2) of BIA. Though the debt supporting a security interest is released by that provision at the date of the bankrupt’s discharge, the secured creditor’s proprietary rights in and to collateral in existence at that point are unimpaired. ⁵¹

One argues that the principles described above dictate that release of the debt precludes attachment of the security interest to property acquired by the debtor thereafter. ⁵² The debt is released by discharge under s. 178 (2) of BIA. The effect of s. 178 (2) of BIA is interpreted as “extinguished” or “unenforceable.” ⁵³ Whatever the effect of s. 178 (2) of BIA is, it cannot support the creation of an interest in property acquired after the date of discharge, for if the debt is unenforceable, the secured creditor has no right to take collateral to enforce its payment. *Bye* is the leading case that the secured creditor who was assigned future accounts as a security cannot acquire security interest in accounts acquired after debtor’s discharge. Judson J in *Bye* said that:

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⁵⁰ Buckwold, supra, footnote 2, at pp. 455-57.

⁵¹ Buckwold, supra, footnote 2, at p. 457.

⁵² Buckwold, supra, footnote 2, at p. 457.

⁵³ Many courts in connection with the operation of s. 178(2) suggest that pre-bankruptcy debt is extinguished by the bankrupt’s discharge. On the other hand, Professor Buckwold supports that the debt is not extinguished but becomes unenforceable. See, Buckwold, supra, footnote 2, at pp. 457-58.
There is no doubt that the borrowing by Bye from the credit union did create a debt provable in bankruptcy. The credit union did not prove in bankruptcy. The debt has now gone by operation of law. The assignment was given as a means of collection of the debt. The statutory release of the debtor under the Bankruptcy Act renders the assignment ineffective as a means of collection.

The Supreme Court’s decision in *Bye* settled the matter as a binding case law. However, doctrinally, there is room for discussion in the reasoning adopted in *Bye*. Professor Ziegel calls the decision “heresy”.\(^{54}\) His argument relies on *In re Lind*. In *In re Lind*, Bankes L.J. wrote that:

> It appears to me to be manifest from these statements of the law that equity regarded an assignment for value of future acquired property as containing an enforceable security as against the property assigned quite independent of the personal obligation of the assignor arising out of his imported covenant to assign. It is true that the security was not enforceable until the property came into existence, but nevertheless the security was there, the assignor was the bare trustee of the assignee to receive and hold the property for him when it came into existence. Warrington J. in the Court below put his view into these words: “In the present case I am of opinion that the mortgagees were at the time of the bankruptcy entitled not merely to the benefit of a personal obligation on the part of the mortgagor resulting in a claim for damages, but to a prospective interest in the distributive share in question taking effect automatically on the death of Florence Lind.”\(^{55}\)

It is true that under PPSAs a security interest does not attach until the debtor has rights in the collateral.\(^{56}\) However, a future security interest attaches automatically when the debtor acquires an interest in the property without the need for a confirming act by either party. In other words, the secured creditor has proprietary interest (although not ownership) in future property. This supports Warrington J’s comment in *In re Lind* that “the mortgagees were at the time of the

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54 Ziegel, supra, footnote 16, at p. 150.
55 Ziegel, supra, footnote 39, at p. 147.
56 Ontario Personal Property Security Act, s. 11(2).
bankruptcy entitled not merely to the benefit of a personal obligation on the part of mortgagor resulting in a claim for damages, but to a prospective interest in the distributive share in question taking effect automatically on the death of Florence Lind”. Proprietary interest survives debtor’s discharge. Consequently, it can be said that the secured creditor’s proprietary interest in future property arises at the time of security agreement (although security interest in the meaning defined in PPSAs does not arise), it survives debtor’s discharge, and security interest attaches when the collateral comes into existence.

Professor Buckwold insists that the decision in In re Lind was wrong because “On the view of the Court of Appeal in In re Lind, the secured creditor acquires a security interest at the date of the agreement, even though at that time the debtor had no property to which that interest could attach. Moreover, this pre-bankruptcy interest in non-existent livestock would survive the debtor’s discharge from bankruptcy, thus entitling the creditor to seize the cattle acquired post-discharge, even though the debt secured by that interest had since been rendered unenforceable by the BIA.”57 I agree with her to the extent that it is wrong that the secured creditor acquired a security interest at the date of the agreement, even though at that time the debtor had no property to which that interest could attach. PPSAs clearly require the debtor to have a right in the collateral to establish attachment,58 and it is common understanding that if the security interest has failed to attach due to non compliance with the requirement, the secured party has no enforceable rights, qua secured party, even against the debtor.59 Therefore, the Bankes L.J.’s comment that “nevertheless the security was there” cannot be supportable under PPSAs. However, Warrington J.’s comment that “mortgagees were at the time of the bankruptcy entitled …to a prospective interest in the distributive share in question taking effect automatically on the death of Florence Lind” is not inconsistency with PPSAs because he recognized a proprietary interest, instead of a security interest in the meaning defined in PPSAs, which is the interest to acquire future property as collateral without further action on debtor’s side when it comes into existence. Further, in my view, the secured creditor is not required to have enforceable debt after

57 Buckwold, supra, footnote 22, at p. 133.
58 See, s. 11(2) of Ontario Personal Property Security Act.
debtor’s discharge in order to realize the collateral, given that the collateral acquired before debtor’s discharge can be realized after discharge even though the secured creditor has only unenforceable debt or even has no debt because of extinguishment by the discharge. There is no reason to prohibit realization of collateral only which was acquired after discharge even though it is allowed to realize the collateral which was acquired before the date of discharge.

3 Conclusion

In my opinion, because a secured creditor who entered a security agreement regarding future property has a proprietary interest in future property and the proprietary interest survives through discharge, the secured creditor can claim its security interest in the property acquired by the debtor after discharge.
Chapter 4
The Efficacy of After-Acquired Property Clauses in Bankruptcy

1 Introduction

In *Holy Rosary Parish (Thorold) Credit Union Ltd. v. Robitaille (Trustee of)*, the Supreme Court held that a security assignment covering the debtor’s present and future wages made prior to bankruptcy was effective to capture wages earned by the assignor while a bankrupt. The assignment was effective in equity to transfer property in the wages to the assignee as soon as they were earned. Consequently, the assignment was not affected by s. 67 (1) (c) of BIA. Later, the decision in *Holy Rosary* was reversed by amendments to the BIA. S. 68.1(1) of BIA provides that an after-acquired property clause is ineffective against property acquired after the commencement of bankruptcy proceedings in respect of wage assignment. S. 68.1(2) of BIA provides that an assignment of amounts payable as a result of services rendered by an individual is also of no effect in respect of amounts earned or generated after the bankruptcy. On the other hand, s. 71 of BIA provides that on a bankruptcy order being made or an assignment being filed with an official receiver, a bankrupt ceases to have any capacity to dispose of or otherwise deal with their property, which shall, “subject to…the rights of secured creditors”. However, these words have not been interpreted as giving to secured creditors rights to enlarge the scope of the collateral covered by their security interests after the debtor’s property vests in the trustee. Consequently, once a receiving order or assignment has been made, a mortgagee cannot invoke the equitable principle of consolidation of mortgages or the right of tacking advances if the effect is to reduce the value of the bankruptcy estate. An assignment of future receivables made before bankruptcy does not affect receivables generated from the post-bankruptcy sale by

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61 Cuming, supra, footnote 8, at p.430.
64 Cuming, supra, footnote 8, at pp. 432-33.
the trustee of the tangible assets of the estate.65 Thus, once property is vested in the trustee pursuant to s. 71 after bankruptcy, the property or its proceeds cannot be collateral under the security agreement entered prior to bankruptcy merely because that property falls within the collateral description contained in an after-acquired property clause in the security agreement.66 On the other hand, if the debtor acquires rights in after acquired property prior to it vesting in the trustee, the security interest attaches pursuant to the PPSA and the trustee acquires the property subject to the rights of secured creditors as long as the after acquired property falls within the scope of the security agreement.67

2 Cases

In the decided cases, the courts have concluded that it is not necessary for the account debtor’s obligation to be due or payable at the point of bankruptcy for the secured party to take precedence over the trustee. It is sufficient if the contract or other event upon which the account debtor’s obligation to pay has been completed or occurs prior to bankruptcy.68 For example, In re Dominion Used Store Fixtures Ltd.69, it has been held that a secured party has priority over a trustee to the proceeds of an insurance settlement reached between the trustee and the bankrupt’s insurer after bankruptcy, where the contract of insurance had been concluded and the loss or damage giving rise to the indemnity obligation of the insurer occurred prior to bankruptcy. Similarly, in Kent Steel Products Ltd. v. Arlington Management Consultants Ltd.,70 it was held that the secured party was entitled as against the trustee to the proceeds of a right of compensation for land of the bankrupt which had been expropriated prior to bankruptcy. The court noted that if the land had been expropriated after bankruptcy, the trustee would have been entitled to the proceeds as the land would have vested in the trustee as of the date of bankruptcy.

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66 Cuming, supra, footnote 8, at p. 433.
67 Cuming, supra, footnote 8, at p. 433.
68 Cuming, supra, footnote 8, at p. 433.
The courts have also given priority to a secured creditor over accounts generated by the trustee’s post-bankruptcy completion of an agreement of sale covering the debtor’s tangible assets that had been entered into by the debtor before bankruptcy.\(^ {71}\) Similarly, a secured party with a security interest in the debtor’s future accounts was held to be entitled, in precedence to the trustee, to the proceeds of the account generated by an auction sale of the debtor’s tangible assets that took place after bankruptcy where the debtor had entered into the auction agreement before making the assignment in bankruptcy.\(^ {72}\)

PPSAs require the debtor to have a right in the collateral to transfer rights in the collateral to a secured party.\(^ {73}\) The results in these cases can be justified on the basis that the debtor had acquired rights in the property interest that is subject to the security interest – the right to receive payment – sufficient to support attachment of the security interest under the PPSA before the innovation of bankruptcy (let me call this approach as “PPSA approach”, which is different from the approach adopted in Holy Rosary, “trustee approach”.\(^ {74}\))\(^ {75}\) The secured party may claim the proceeds of rights to payment in existence at the point of bankruptcy even where collected by the trustee.\(^ {76}\)

However, there are difficult cases to explain consistent with the PPSA approach. Those are cases in which preference has been given to the secured party over the trustee where the pre-bankruptcy account remains executory in nature, with the account debtor’s continuing


\(^ {73}\) See s. 11(2) of Ontario Personal Property Security Act.

\(^ {74}\) The Supreme Court in Holy Rosary held that a security assignment covering the debtor’s present and future wages made prior to bankruptcy was effective to capture wages earned by the assignor while a bankrupt. The assignment was effective in equity to transfer property in the wages to the assignee as soon as they were earned. The decision is based on the equitable doctrine that when the debtor, who has given an assignment or mortgage of property he does not own, acquires the property after becoming a bankrupt, the assignment or mortgage is effective against the trustee in bankruptcy since the bankrupt receives the property as trustee for the assignee or mortgagee. See, also In re Lind.


\(^ {76}\) Agricultural Credit Corp. of Saskatchewan v. Featherstone (Trustee of ), [1996] 8 W.W.R. 281 (Sask. Q.B.).
obligations to pay being dependent on continued counter performance by the debtor. For example, relying on the *Holy Rosary* decision, it has been held that rental payments falling due after bankruptcy under a pre-bankruptcy lease of the bankrupt’s personal property accrue to the secured party in preference to the trustee.\(^{77}\) Also difficulties are cases giving precedence to the secured party even where the event triggering the account debtor’s obligation to pay does not take place until after bankruptcy, for example, a right to payment of insurance indemnities for loss or damage to the debtor’s assets that occurs only after bankruptcy proceedings gave been initiated.\(^{78}\) In those cases, it is difficult to say that the debtor had acquired sufficient rights in the account prior to bankruptcy to support attachment of the security interest because it has been held that where a right to satisfaction of certain preconditions by the debtor, a security interest in the payments does not attach until those preconditions are satisfied.\(^{79}\)

### 3 Conclusion

As I discussed in previous section, it should be deemed (although it has been denied by the Supreme Court in *Bye*) that the secured creditor has a proprietary interest in future property, although it is not security interest in the meaning defined by PPSAs. The secured creditor acquires security interest in the collateral when it comes into existence before or after bankruptcy. Together with clear wording of s. 71 of BIA which provides that on a bankruptcy order being made or an assignment being filed with an official receiver, a bankrupt ceases to have any capacity to dispose of or otherwise deal with their property, which shall, “subject to…the rights of secured creditors”, this explanation has no difficulty unlike PPSA approach has. However, an assignment of future receivables made before bankruptcy obviously should not affect receivables generated from the post-bankruptcy sale under a purchase and sale agreement which was entered after bankruptcy by the trustee of the tangible assets of the estate. This is a conflict between secured creditor’s proprietary interest and trustee’s proprietary interest in the collateral. A reasonable criteria to decide which parties should be distributed the collateral should be established. Although I will confine this thesis just to raise awareness of this issue, I think that

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\(^{78}\) *In Re Dckie Estate* (1925), 5 C.B.R. 864 (N.S.S.C.).

\(^{79}\) *Western Surety Co. v. National Bank of Canada*, supra, footnote 77.
one possible criterion is which party has greater interest in the collateral. For example, even in
the case that the pre-bankruptcy account remains executory in nature, if a lease agreement from
which the rent generates is reasonably expected to continue through the bankruptcy procedure,
the a secured creditor has greater interest in the collateral than a trustee because the secured
creditor reasonably expects to get security interest on the rent through the bankruptcy procedure.
On the other hand, in the case that a trustee sold a personal property under a purchase and sale
agreement which was entered after commencement of bankruptcy procedure, and then account
receivable occurred, which is the objective of security, the trustee has greater interest in the
account receivable than the secured creditor because the account receivable is proceed of the
personal property that was assigned to the trustee due to commencement of bankruptcy.
Chapter 5
The Valuation of Collateral in Reorganization Process

1 Introduction

Same as liquidation process in bankruptcy, the interest of secured creditors conflict with the interest of unsecured creditors in reorganization process, which is a proposal under BIA. In the reorganization process, secured creditors want to maximize the payment they receive on their claims before payment is made to any other party. On the other hand, unsecured creditors generally prefer that the secured creditors be bound by the proposal, and want the secured creditors receive less payment in priority over the unsecured creditors. To resolve this conflict, the valuation of collateral which is a subject to the security in respect of the secured claim is important because how much the secured creditors receive payment and how much their secured claim could be deemed as “secured claim” in a proposal depend on the value of collateral. However, as far as I know, how should the valuation be done has not been discussed in the Canadian academic world so much. And this valuation issue is partly related to the discussion of the nature of security that I discussed above. Therefore, it is worth to examine this valuation issue in this thesis.

2 How the questions arise in a proposal process

2.1 Redemption

S. 50 (1.6) of BIA provides that (subject to section 50.1) as regards included secured creditors, any creditor may respond to the proposal as made to the creditors generally, by filing with the trustee a proof of claim in the manner provided for in sections 124 to 134 of BIA (in the case of secured creditors). S. 128 (3) of BIA says that the trustee may redeem a security on payment to the secured creditor of the debt or the value of the security as assessed, in the proof of security, by the secured creditor.
2.2 How much voting rights a secured creditor has in terms of ‘secured claim’ and ‘unsecured claim’ under s. 50.1(2) and (3) of BIA.

In the case that a proposal made to a secured creditor in respect of a particular secured claim includes a proposed assessed value of the security in respect of the claim, the secured creditor may file with the trustee a proof of secured claim, and may vote as a secured creditor on all questions relating to the proposal in respect of an amount equal to the lesser of (a) the amount of the claim, and (b) the proposed assessed value of the security (s. 50.1 (2) of BIA). Where the proposed assessed value is less than the amount of the secured creditor’s claim, the secured creditor may file with the trustee a proof of claim and may vote as an unsecured creditor on all questions relating to the proposal in respect of an amount equal to the difference between the amount of the claim and the proposed assessed value (s. 50.1 (3) of BIA). Thus, once a portion of claim is classified as ‘unsecured claim’, secured creditor’s negotiation power in proposal process is weakened into as mere unsecured creditor.

2.3 Whether a junior mortgagee is the holder of a secured claim.

As I mentioned above, s. 50.1 (2) of BIA gives voting rights as a holder of a secured claim only to the extent of the value of the security. Therefore, a junior mortgagee’s voting right depends on the valuation of the collateral as well as the amount of senior mortgagee’s claim.

3 What value is measured – U.S. case

3.1 Introduction

In United States, this issue has been disputed as: what value is at issue: (1) the value of the collateral to the creditor, which will generally be the amount of money that the creditor would obtain by reselling it, (2) the value of the collateral to the debtor, which will generally be the
amount that the debtor would have to pay to replace it, or (3) some intermediate value. 80 Eugene R. Wedoff, the then United States Bankruptcy Judge, says that:

The difference between resale and replacement value may be significant. To take one common example, the cram down of an auto loan in Chapter 13, the amount of the creditor’s “allowed secured claim” can vary between the wholesale price at which the creditor could presumably resell the debtor’s vehicle, and the retail price at which the debtor could purchase a replacement. In In re Carlan, 157 B.R. 324, 325 (Bankr. S.D. Tex. 1993), the court considered evidence of an automobile with a wholesale value of $6,050 and a retail value of $7,675, a difference of $1,625. This difference is almost 27% of the wholesale value, and 21% of the retail value. 81

In Associates Commercial Corp. v. Rash, 117 S. Ct. 1897 (1997), the Supreme Court of United States announced that the replacement cost to the debtor, rather than the resale price of the creditor should be the touchstone for valuation of collateral. 82

3.2 The arguments presented to the Supreme Court in Rash.

Wedoff categorizes the arguments presented to the Supreme Court in Rash into four general categories: (a) Interpretation of Statutory Language 83, (b) Legislative history of the Bankruptcy Code 84, (c) Economic policy, and (d) the relevance of state law. As (a), (b) and (d) is out of the

81 Wedoff, supra, at p. 8.
82 Wedoff, supra, at p. 8.
83 Interpretation of s.506(a) of the Bankruptcy Code, which provides: An allowed claim of a creditor secured by a lien on property in which the estate has an interest...is a secured claim to the extent that the value of such creditor’s interest...is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor’s interest.
84 See Wedoff, supra, pp. 10 -11 for details.
purpose of this thesis in which Canadian BIA and PPSAs are discussed, I will examine only (c) above.

Advocates of both the resale and replacement approaches to value have acknowledged that replacement cost to the debtor produces a higher value for a secured claim than resale proceeds to the creditor. The economic policy debate between the two positions focuses on how this “bonus” over the resale value should be distributed.\(^\text{85}\) The opponents of replacement value says that reorganization involves risks of nonpayment and declining collateral value, so that some premium over resale value is appropriate, particularly since it is the debtor’s retention of the collateral that allows the reorganization to go forward. Moreover, a valuation based on the creditor’s resale proceeds (the wholesale price) would allow the debtor to sell the property later, at full replacement cost (retail price).\(^\text{86}\) The opponents of resale (wholesale) value says that resale value (wholesale price) reflects the true worth of the collateral, while replacement cost is equivalent to that true worth plus the services of “inventory storage, reconditioning, marketing, and warranties of quality” that a retailer would add. Furthermore, debtors would not likely be able to resell collateral at full replacement cost (retail price) unless they also incurred the costs associated with retail sales.\(^\text{87}\)

3.3 The Rash decision

Wedoff explains on the Supreme Court’s decision in *Rash* as follows that\(^\text{88}\):

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\(^{85}\) Wedoff, supra, at p. 11.

\(^{86}\) Wedoff, supra, pp. 11 – 12.

\(^{87}\) Wedoff, supra, at p.12.

\(^{88}\) Wedoff, supra, at p.13.
At first glance, the Supreme Court’s decision in *Rash* appears to be solidly supportive of the replacement approach in valuation. However, footnote 6 of the Court’s opinion interjects considerations that suggest valuation based on resale of collateral, and hence the opinion contains significant ambiguity.

The Court addresses economic concerns briefly, subscribing to the proposition that reorganization presents creditors with risks to their collateral that must be offset by valuation at higher than resale level: If a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use. Adjustments in the interest rate do not fully offset these risks. 89

In the end, the Court ruled its holding as follows: “Under s. 506 (a), the value of property retained because the debtor has exercised the …’cram down’ option is the cost the debtor would incur to obtain a like asset for the same ‘proposed…use.’” This appears to be a clear adoption of the replacement approach to value. However, footnote 6 to the holding created an ambiguity. Wedoff explains this issue as follows 90:

As noted in the description of the positions taken by the courts of appeal on the valuation question, it had been generally understood that replacement value implied the price that a debtor would have to pay to obtain an actual replacement for the collateral in question. Thus, with automobiles, replacement cost was understood to imply the price charged by retailers of used cars in the debtor’s area, since this would likely provide the only source for a replacement readily available to the debtor. The Fifth Circuit in its original panel decision in Rash, issued express holdings to the effect that the replacement value of a vehicle is its retail price. On the other hand, proponents of resale valuation argued that although retail might be the only basis on which a debtor could replace a particular item of collateral, retail value should not be used because it includes items of value not inherent in the collateral itself. Thus, the Fifth Circuit’s en banc opinion in Rash pointed to items such as “inventory storage, reconditioning, marketing, and warranties of quality,” that it believed were improperly added to resale value when replacement (retail) cost was employed. These

89 Wedoff, supra, at p. 14.
arguments, one might have thought, would have been rejected by the Supreme Court in its choice of replacement valuation. Not so. In a footnote to the holding quoted above, the Court made the following statement:

Whether replacement value is the equivalent of retail value, wholesale value, or some other value will depend on the type of debtor and the nature of the property. We note, however, that replacement value, in this context, should not include certain items. For example, where the proper measure of the replacement value of a vehicle is its retail value, an adjustment to that value may be necessary: A creditor should not receive portions of the retail price, if any, that reflect the value of items the debtor does not receive when he retains his vehicle, items such as warranties, inventory storage, and reconditioning.

Thus, the Court appears to modify the usual position of the replacement value proponents: what is being measured is not the actual price that a debtor would have to pay in an available market, but rather the value of the collateral itself, shorn of extra elements of value added by a retailer. The Court does not indicate how these items might be measured in a typical valuation situation.

In my view, the Supreme Court declared three important things: First, given the fact that the Court said: “Whether replacement value is the equivalent of retail value, wholesale value, or some other value will depend on the type of debtor and the nature of the property,” the Court considered that ‘replacement value’ is not necessarily based on retail value, but also based on wholesale value or some other value as the case may be. In other words, if a debtor is in a position to be able to buy the collateral at wholesale price, the collateral should be valued based on wholesale price. For instance, the debtor is a used-car dealer and it can buy a car for its use (company car) at wholesale price, the car should be valued based on wholesale price. Second, given that the Court subtract some cost, such as warranties, inventory storage, and reconditioning, that reflect the value of items the debtor does not receive when he retains his vehicle, items, the Court considered that the collateral should be valued assuming that the collateral is ‘retained’ by a debtor. The Court attached importance to the fact that the collateral continues to be used by a debtor in reorganization process. Third, given the fact that the Court named the theory adopted by it ‘replacement value’, rather than, for example, ‘disposal value’, the Court put greater
importance on the price which is available to a debtor to ‘buy’ the collateral, rather than the price which is available to a debtor to ‘sell’ the collateral. As a result, a company car owned by a debtor who is a used-car dealer is to be valued based on wholesale price even though the debtor can sell it at retail price.

4  How the value should be measured under Canadian BIA

4.1  Introduction

S. 50.1 (2) of BIA provides that:

Proposed assessed value

(2) Where a proposal made to a secured creditor in respect of a claim includes a proposed assessed value of the security in respect of the claim, the secured creditor may file with the trustee a proof of secured claim in the prescribed form, and may vote as a secured creditor on all questions relating to the proposal in respect of an amount equal to the lesser of

(a) the amount of the claim, and

(b) the proposed assessed value of the security.

The issue is how the wording of “value of the security” should be interpreted. As far as I know, there are no Canadian case decisions with respect to interpretation of s. 50.1 (2) of BIA, other than Workgroup Design Inc. (Re)91.

4.2  Workgroup

The facts in the case of Workgroup are as follows: On December 13, 2006 the proponent, WorkGroup Design Inc. (“WGD”) filed a Notice of Intention to Make a Proposal. This was

91 (2008) ONCA 214 (CanLII), <http://canlii.can/t/1w9g6> retrieved.
followed by a Proposal that was made to the creditors of WGD. Royal Bank of Canada (“RBC”) filed a proof of claim as a secured creditor of WGD and voted against the proposal. The proposal trustee (“Trustee”) rejected RBC’s claim as a secured creditor. While it is admitted that RBC advanced funds to WGD and holds a general security agreement (“GSA”), the Trustee argues that, the Canada Revenue Agency (“CRA”) has a claim in priority to that of RBC by operation of section 227 (4) of the Income Tax Act and a resulting trust pursuant to section 67 of BIA. The Trustee goes on to argue that if WGD was liquidated there would be insufficient assets to satisfy CRA’s claim, and as a result there are no assets over which RBC holds any security, and therefore should be treated as an unsecured creditor. CRA’s claim is for employee withholdings that WGD failed to remit. RBC argues that a liquidation valuation is not relevant as this is a proposal designed to allow WGD to restructure and continue as a going concern. RBC argues they are a secured creditor by operation of their GSA and should be treated in the proposal as a secured creditor. In terms of the valuation issue, Superior court of justice Ontario concluded:

…RBC raised the Issue of the proposal trustee’s valuation. I do not think it was unreasonable for the proposal trustee to have reached its determination on the basis of its liquidation analysis. There is no evidence before the Court that the value of the debtor, if it were sold on a going concern basis, would exceed the value of its parts, which I understood to be the approach in the proposal trustee’s liquidation analysis. RBC had an opportunity to provide evidence on the appeal to support its contention that either the valuation approach or the conclusion of the valuation was inappropriate. It failed to do so with the result that the only evidence before the Court is that of the proposal trustee. In the absence of evidence of bad faith on the part of the proposal trustee, I see no basis for invalidating the determination of the proposal trustee on the basis of the valuation used to conclude that there was no possible value in the security held by RBC.

RBC appealed, and Court of Appeal for Ontario allowed the appeal and it concluded that RBC was to be treated as a secured creditor not by the reason that RBC’s security should be valued based on going concern sales basis, but by the reason that Trustee failed to comply with s. 50.1 (1) and its disallowance of RBC’s claim as a secured claim is invalid, therefore RBC should be treated a secured creditor with its full amount of secured claim.
The Superior court concluded the valuation issue because of lack of evidence that would be submitted by RBC, and did not examine what valuation principle should be applied to the valuation of the security of GSA under s. 50.1(2). Thus, the valuation issue still remains vague under Canadian case law.

4.3 Comparison with U.S. case

Rash was a ‘cram down’ case. On the other hand, Canadian BIA does not have cram down provisions. Rather, no part of nor whole secured claim is lapsed by a proposal without consent to the proposal by a majority in number and two thirds in value of the secured creditors’ voting on the resolution to accept the proposal (s. 62 (2) of BIA). Even so, the valuation of collateral is still important issue for secured creditors because, in the case that a proposal made to a secured creditor in respect of a particular secured claim includes a proposed assessed value of the security in respect of the claim, the secured creditor may vote as a secured creditor in respect of only an amount equal to the lesser of (a) the amount of the claim, and (b) the proposed assessed value of the security (s. 50.1 (2) of BIA). For instance, a junior mortgagee may be classified as an unsecured creditor if the mortgage is valued at lower price and there is no distribution to be allocated to the junior mortgagee. Moreover, once a portion of claim is classified as ‘unsecured claim’ pursuant to s. 50.1 (2) and (3) of BIA, the portion would be under the control of the proposal that is proposed to unsecured creditors and the secured creditor can only exercise its voting right as one of unsecured creditor (s. 50.1 (3) of BIA). And the amount of ‘unsecured claim’ is often reduced drastically by a proposal. Also, as for ‘secured claim’, it is bound and

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92 Cram down provisions under the Bankruptcy Code of United States are explained in 20 Harv. J. L. & Pub. Pol’y 937 1996-1997, at p. 937, as follows: cram down provisions allow individual debtors who meet the requirements of the Bankruptcy Code to be held liable only for secured debts. Under the cram down provisions, a debt is secured if the creditor is entitled to take from the debtor specified property of value equal to or greater than the debt if the debtor fails to pay the debt. The specified property is called “collateral.” A loan with no collateral is an unsecured debt. A debt may also be partly secured and partly unsecured. For example, a loan of $20,000 secured by collateral (such as an automobile) worth only $8,000 would be secured for $8,000 and unsecured for $12,000 (the amount of the loan in excess of $8,000). Section 506(a) governs the valuation of creditors’ secured and unsecured claims. In essence, s.506(a) defines debts as secured to the extent that they do not exceed the value of the underlying collateral. Thus, the valuation of that collateral is a key step in determining the amount of debt that will be discharged and what amount the debtor still must pay.

93 In this context, unlike in the context of cram down provisions of U.S. Bankruptcy Code, ‘secured claim” means a claim that is secured partly or wholly by a collateral. As for the meaning of secured claim in the context of cram down provisions of U.S. Bankruptcy Code, see footnote 94 above for details.
restricted by a proposal and the secured creditor can exercise its right of secured claim and security that secures the secured claim only subject to the proposal.

Thus, the economic policy that was discussed in *Rash* should be also considered in the proposal process under Canadian BIA. In my view, the Supreme Court of U.S.’s decision in terms of the economic policy:

> If a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use. Therefore, the valuation should not be based on only wholesale price.

is reasonable.

However, from my point of view, the “replacement cost” approach cannot be sustained under Canadian BIA. S. 506 (a) of the Bankruptcy Code of U.S., which governs the valuation, provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest…is a secured claim to the extent that the value of such creditor’s interest…is less than the amount of such allowed claim. *Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property*, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor’s interest.

The wording: *“Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property”* partly led the Supreme Court in *Rash* to the decision that named its approach as “replacement cost” approach, even though it modified the original idea of replacement value approach.
On the other hand, s. 50.1 (2) of Canadian BIA does not indicates any basis for the valuation of the collateral. Rather, the provision clearly says that value of “security” is to be assessed. Considering the wording, it is difficult to interpret that replacement cost can be a basis for the valuation of the security because a security exists in favor of the secured creditor therefore a value of the security should be valued based on the price that could be distributed to secured creditor as payment of debt that is secured by the security.

“Security interest” in personal property defined by the PPSAs is “an interest in personal property that secures payment or performance of an obligation”. A PPSA security interest is a right to payment of a debt, enforceable against the collateral. Therefore, as a natural result, the assessment under s. 50.1 (2) of BIA is to reflect the collateral value for payment to the secured creditor. Replacement cost is not relevant to the collateral value for payment to the secured creditor, but disposal value is. As I said, a security holds a value of the collateral at the time of realization. Namely, the security creditor holds future appreciation as a right inherent to security. It follows that, in reorganization, a security interest holds the proceeds arising from a disposition at retail value by the debtor in future. As long as a disposition at retail value is possible, the secured creditor’s right to receive the proceeds should not be deprived. As a result, unlike the consequence of replacement cost approach, a company car owned by a debtor who is a used car dealer is to be valued based on retail price, instead of wholesale price, because it is possible that the debtor sells it at retail price in future.

4.4 Going concern valuation approach

Going concern value is generally defined that the value of a business in operation, taking into account the goodwill and the value of the income, in addition to hard assets, such as real estate and equipment. In Workgroup, RBC advanced funds to WGD and holds GSA (general security agreement), however, CRA has a claim in priority to that of RBC. RBC argued that its security should be valued on the basis of going concern sales.

Going concern value is basically calculated based on future income. RBC’s GSA holds security interest in present and future assets of WGD, including proceeds of the future assets. RBC’s argues that a liquidation valuation is not relevant as this is a proposal designed to allow WGD to
restructure and continue as a going concern. And also, my understanding is that, RBC insists that it should be treated as a secured creditor because it has GSA that holds security interest in future assets.

In *Sevenway Capital Corp. v. Albertal Treasury Branches*, 2000, the Court of Queen’s Bench of Alberta examined whether preferred shares should be valued on a going concern valuation basis or on a liquidation valuation basis in a case of corporate restructuring. The facts of the case are as follows: Alberta Treasury Branches ("ATB") became a shareholder in 1994, when Seven Way Capital Corporation ("SevenWay") was in financial difficulties. ATB agreed to exchange $2,000,000 of outstanding debt for 20,000 Preferred Shares. ATB submits that the alternative would have been for ATB to cause the bankruptcy or receivership of SevenWay. The Preferred Shares have a stated capital of $2,000,000 – a value of $100 each. Pursuant to a Plan of Arrangement involving SevenWay and Glacier Ventures International Corp. ("Glacier", a British Columbia corporation), both companies would continue into the federal jurisdiction and subsequently amalgamate. In addition, SevenWay would raise up to $3,000,000 by way of a private placement. The amalgamated company would continue to pursue a merger or acquisition. On September 9, 1999, SevenWay passed a resolution to continue out of the Province of Alberta and into the federal jurisdiction (the “Continuance”). ATB was entitled to dissent from the Continuance, and did so in accordance with the legislation. The Continuance became effective on September 16, 1999 and, pursuant to s. 184 (3) of the Alberta Business Corporations Act (ABCA). SevenWay had monthly revenue of $36,000. It had monthly expenses of $45,200. These expenses were expected to continue until Glacier took over the administration in September or October 1999, at which time SevenWay’s operating expenses would be substantially reduced. Despite the excess of expenses over income, ATB conceded that there was no reason to think that a liquidation of SevenWay was imminent.

The major difference between the two parties is whether to approach the valuation on a going concern basis (favoured by SevenWay) or a liquidation basis (favoured by ATB). Both parties agree that SevenWay was not in any imminent danger of actual liquidation, nor did it intend to liquidate. Despite that, ATB strongly argues that the liquidation basis is the appropriate valuation method for a company with no current operations or business. ATB cites from *The
Valuation & Pricing of Privately-Held Business Interests\(^{94}\) the definition of “going concern” as “A business enterprise that is both conducting operations at a given date, and has every reasonable expectation of doing so for the foreseeable future after that date.” “Going concern value” is defined as “The present value of all future benefits expected to accrue from ownership, where a business operation is expected to continue to operate either for a finite period, or indefinitely into the future.” ATB stated that SevenWay was not a “going concern” because it was not conducting operations. ATB states that SevenWay’s solvency is irrelevant to the “going concern” test. SevenWay says that the going concern approach was appropriate because SevenWay had no intention to liquidate, and ATB could not cause SevenWay to be liquidated. SevenWay had a viable business plan.

The court pointed out that ATB, a preferred shareholder, never had any expectation of sharing in SevenWay’s success, apart from dividends, which were not mandatory nor cumulative. And the court rejected ATB’s argument that valuing on a liquidation basis is not necessarily related to the intention or likelihood of an actual liquidation. The court went on that while SevenWay had not had a specific business with a readily assessable future income stream, it had a definite business plan. There was no evidence before me that SevenWay sold its assets with the intent of liquidating and distributing the remaining assets to the shareholders. In the end, the court concluded that a going concern valuation approach should be the basis to evaluate the preferred shares, saying that “ATB knew SevenWay was not liquidating. ATB knew SevenWay was planning an amalgamation that would more than double its cash to carry out that business plan.” Because ATB had submitted that if the going concern approach were utilized, the value of the Preferred Shares is nominal, the court found that the Preferred Shares have a nominal value of $5 each, for a total award of $100,000.

Thus, the court in *Sevenway* put importance on the facts that SevenWay had a viable business plan and liquidation was unlikely, and ATB knew it and did not have any expectation to receive dividends arising from liquidation. In other words, the court considered that the criteria for

\(^{94}\) Canadian Institute of Chartered Accountants, 1990.
deciding a valuation approach for restructuring company are actual possibility of liquidation or restructuring, and whether the preferred shareholder knew the possibility of liquidation or restructuring and whether it had any expectation to receive dividends arising from liquidation. In Workgroup, RSB was not preferred shareholder but creditor. However, preferred shareholder can receive only fixed dividends and it is not cumulative, and does not have voting right. Those features are similar to features of creditor. Next, I will examine whether we can apply the criteria posed by the court in Sevenway to Workgroup case and other similar cases.

Can the going concern valuation approach be a basis for the assessment of security under GSA, under s.50.1 (2)? This question could be an issue in a case like: There is a debtor who run unique industry and owes debts to two secured creditors. One secured creditor has a security under GSA. Most of collateral are industrial machines owned by the debtor, which were specially designed for debtor’s unique industry. Another secured creditor also has a security under GSA but it is subordinate to another secured creditor’s GSA. Then, the debtor made a proposal to all creditors, including the two secured creditors. The liquidation value of the machines are low but the value based on going concern valuation approach is high because the debtor still has large market share in the unique industry and earns good profit by using the machines. 1st priority secured creditor is not willing to consent the proposal. 2nd priority secured creditor is willing to consent the proposal. If the debtor assesses security of those secured claim based on the going concern valuation approach, whole or part of claim owed to 2nd priority secured creditor might be classified as ‘secured claim’ under s. 50.1 (2) of BIA because usually a going concern value is greater than liquidation value when the debtor intends to restructure. Conversely, If the debtor assesses security of those secured claim based on the liquidation valuation approach, whole or part of claim owed to 2nd priority secured creditor might be classified as ‘unsecured claim’ under s. 50.1 (3) of BIA.

According to the court in Sevenway, the criteria to decide the valuation approach to evaluate the value of the security under proposal procedure would be: actual possibility of liquidation or restructuring, and whether the secured creditor knows the possibility of liquidation or restructuring and whether it had any expectation to receive distribution arising from liquidation. Under proposal procedure, the debtor intends to restructure it and makes possible business plan. The secured creditor should know the possibility of restructuring as long as it thinks the proposal is reasonable and viable in terms of its business plan. And, under the circumstances, the secured
creditor cannot expect to receive any distribution arising from debtor’s liquidation. Thus, it is possible to fulfill the criteria posed by the court in *Sevenway*.

Nonetheless, in my view, any security cannot be evaluated by using going concern valuation approach. That my conclusion is because of interpretation of s. 50.1 (2) and (3) of BIA: The function of s. 50.1 (2) and (3) of BIA is to bifurcate a claim which is partly secured by collateral into ‘secured claim’ and ‘unsecured claim.’ There must be clear difference in nature between ‘secured claim’ and ‘unsecured claim’ under s. 50.1 (2) and (3) of BIA after the bifurcation. If a claim is bifurcated by using the going concern valuation approach, ‘secured claim’ means a claim that is likely repaid by debtor’s future income if all such future income would be used to pay the claim, and ‘unsecured claim’ means a claim that is not likely repaid by debtor’s future income. However, the fact is that the debtor’s future income is not distributed exclusively to the secured creditor because no secured creditor has a right to exclusively receive debtor’s all future income unless it is proceeds of collateral that is subject to GSA. And even if the secured creditor foreclose all properties that are subject to GSA, the secured creditor cannot earn as same profit as the debtor could earn, because the secured creditor does not have any reputation and knowledge in a business same as the debtor. In the end, the potion of ‘secured claim’ in excess of the value that is based on liquidation valuation approach is in same position as unsecured claim in terms of receiving repayment from debtor’s future income. Thus, there is no difference in nature between the potion of ‘secured claim’ in excess of the value that is based on the liquidation valuation approach and ‘unsecured claim.’ On the other hand, if a claim is bifurcated by the value that is based on the liquidation valuation approach, ‘secured claim’ means a claim that is likely satisfied by exercising security or proceeds arising from future disposition of the collateral by the debtor, and ‘unsecured claim’ means a claim that is not likely satisfied by exercising security or proceeds arising from future disposition of the collateral by the debtor. As I said, a security holds a value of the collateral at the time of realization. Namely, the security creditor holds future appreciation as a right inherent to security. However, it does not mean that the security, even GSA, holds debtor’s going concern value. The difference between ‘secured claim’ and ‘unsecured claim’ under s. 50.1 (2) of BIA should also be classified in accordance with the nature of security. In conclusion, the going concern valuation approach cannot be a basis for the assessment of value of the security under s. 50.1 (2) of BIA.
While I concluded that the general principle to assess the value of the security under s. 50.1 (2) of BIA is to be the liquidation valuation approach, I think that in some cases, a security interest could hold debtor’s going concern value. To illustrate it, suppose that a secured creditor and a hotel management company entered into GSA and the secured creditor has security interest in all present and future properties that are and will be owned and operated by the hotel management company, and the parties agreed in the GSA that in the case of foreclosure, the debtor shall operate the hotel in favor of the secured creditor. And this agreement is effective through the reorganization. The hotel management company has good reputation and excellent hotel managing skill, and the hotels run by the hotel management company earn good profit. Under the circumstances, the secured creditor can legally expect to earn good profit from the hotel under the operation by the debtor, using debtor’s reputable name and operation knowledge after foreclosure, until the secured creditor’s claim is repaid in full. Thus, the security essentially holds not only liquidation value but also going concern value (future income arising from the hotel operated by the debtor).

4.5 Conclusion

As I discussed above, under Canadian BIA, the assessment of the value of a security should primarily be based on disposal value, instead of replacement cost, because of the wording of s. 50.1 (2) of BIA and the nature of security interest. The disposal value could be retail value and wholesale value as case may be. It depends on at which value the debtor or the secured creditor likely dispose the collateral. However, generally, the going concern valuation approach cannot be a basis for the assessment of the value of the security because the going concern value reflects future income of a debtor but does not reflects the value of security interest, even GSA, because a secured creditor cannot exclusively receive the future income nor earn same future income even if it forecloses the collateral. However, the value of the security can be assessed based on the going concern valuation approach in the case that the secured creditor has any agreement with the debtor, under which in effect the secured creditor can receive all future income of the debtor until the secured claim is paid in full.
Chapter 6  
Conclusion  

Under the personal property security legislation, debt and security is interdependent. A security interest occurs only when the debtor acquire a right in the collateral. Therefore, the secured creditor cannot hold any security interest in after acquired-property until it comes into existence.

However, a secured creditor is entitled to a proprietary interest to acquire security interest in after-acquired property when it comes into existence without any action. This idea is supported by the axiomatic that a future security interest attaches automatically when the debtor acquires an interest in the property without the need for a confirming act by either party. Therefore, the decision in *Bye*, which is that a security on after-acquired property becomes ineffective after discharge of debt that is secured by the security, is doctrinally wrong.

Accretion of equity in collateral after discharge cannot be regarded same as new property acquired after discharge because security holds the value of the collateral at the time of the realization. Therefore, the decision in *FarmStart* is supportable, although the reasoning is not supportable.

Claiming an estoppel is allowed only to the extent of s. 178 (1) (f) of BIA. However, under special circumstances where the secured creditor was deprived of the chance to negotiate reaffirming or novation, claiming an estoppel should be allowed. Therefore, the decision in *Seaboard* is supportable, although the reasoning is not supportable.

With PPSA approach, there are difficulties to explain cases regarding the efficacy of after-acquired property clause in bankruptcy. On the other hand, given that a secured creditor has a proprietary interest in future property, the secured creditor acquires security interest in the collateral when it comes into existence before or after bankruptcy. We need criterion to decide which party, a secured creditor or a trustee, should be distributed the collateral in the case where a conflict between secured creditor’s proprietary interest and trustee’s proprietary interest in the collateral exists.

Under Canadian BIA, the general principle for the assessment of the value of the security is not decided by courts yet. In my opinion, the assessment of the value of the security should
primarily be based on disposal value, instead of replacement cost, because of the wording of s. 50.1 (2) of BIA, which is different from s. 506 (a) of U.S. Bankruptcy Code, and the nature of security interest, which is that a security interest holds a value of the collateral at the time of realization. The disposal value could be retail value and wholesale value as case may be. It depends on at which value the debtor or secured creditor likely dispose the collateral. Generally, the going concern valuation approach cannot be a basis for the assessment of the value of the security under s. 50.1 (2) of BIA because the going concern value reflects future income of a debtor but does not reflects the value of security interest, even GSA, because a secured creditor cannot exclusively receive the future income nor earn same future income even if it forecloses the collateral. However, the value of the security can be assessed based on the going concern valuation approach in the case that the secured creditor has any agreement with the debtor, under which in effect the secured creditor can receive all future income of the debtor until the secured claim is paid in full.

In this thesis, I examined the nature of security interest and concluded that the nature of security interest is to hold the (liquidation) value of collateral at the time of realization. Also, I examined the right of a secured creditor who has agreed with a debtor after acquired clause, and concluded that the secured creditor has proprietary interest in after acquired (future) property although it does not amount to the meaning of the security interest under PPSAs, and the proprietary interest survives debtor’s discharge and it does not need existing or enforceable debt at the time of attachment. These two conclusions led me to support the decision, although not reasoning, of the court in FarmStart. I applied my view on the nature of the security interest to interpret s. 50.1 (2) of BIA, which mentions the assessment of value of the security. Thus, I tried to examine issues regarding collateral or security interest by considering the nature of the security. Through this work, I found that under PPSA the nature of the security can be interpreted as same as the one under civil law, which governs my county, Japan. This fact represents that the discrepancy between common law and civil law is in reality not so large within property law. Nonetheless, I could not wholly understand the relationship between the concept of security interest under common law and the concept of security interest under PPSA legislation. It will be my future subject for me to study. Also, I left the issue of the conflict between secured creditor’s proprietary interest in future property (for example, account receivable) and trustee’s proprietary interest in it (for example, account receivable that is a proceed arising from sale of personal
property that was vest assigned to the trustee due to commencement of bankruptcy). I could not wholly examine the reasonable criteria to decide which parties should be distributed the collateral should be established. I want to examine this issue if the opportunity arises.