Security Interests in Goods Held for Lease: The Double Perfection Requirement

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Version  Post-print/accepted manuscript

Citation  Anthony Duggan, "Security interests in goods held for lease: the double perfection requirement" (2011) 51 Canadian Business Law Journal 85.


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Security Interests in Goods Held for Lease: The Double Perfection Requirement*

1. Introduction

Section 20(b) of the British Columbia Personal Property Security Act¹ (“PPSA”) provides that a security interest in collateral is not effective against a trustee in bankruptcy if the security interest is unperfected at the date of the bankruptcy. There is a similar provision in all the other provincial and territorial PPSAs. The PPSA, again in common with the other provincial and territorial laws, applies to a lease of goods for a term of more than one year,² in effect deeming the transaction to be a security agreement for the purposes of the Act; consistently with this scheme, PPSA, s.1(1) defines “security interest” to include the interest of a lessor under a lease for a term of more than one year.

In Re Giffen,³ the Supreme Court of Canada considered the application of PPSA, s.20(b) to a lease for a term of more than one year, holding that the failure of the lessor to perfect its deemed security interest made the security interest ineffective against the lessee’s trustee in bankruptcy with the consequence that the lessor could not assert its reversionary title to the goods against the trustee. In Perimeter Transportation Ltd (Re),⁴ a recent decision of the British Columbia Court of Appeal, the question was how PPSA, s.20(b) applies in a case where the unperfected lessor has assigned its interest in the goods to a third party.

2. Case summary

The essential facts of the case can be stated quite simply. In April, 2008, Century McMynn Leasing Partnership (“Century”) leased three buses (the “Perimeter lease

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¹ Thanks to David Denomme for generous and helpful comments on an earlier draft.
⁴ 2010 BCCA 509.
buses”) to Perimeter Transportation Ltd (“Perimeter”). The lease was subject to the PPSA because it was for a term of more than one year, but Century did not register a financing statement. In May, 2008, Century entered into an Equipment Loan and Security Agreement with GE Canada Equipment Financing G.P. (“GE”) as security for a loan, in which Century gave GE a security interest in a set of ten buses, including the Perimeter lease buses.

The ten buses were all either leased, or held for lease, by Century in the course of its business. In other words, the buses were part of Century’s inventory and GE’s security interest was a floating one; the agreement expressly contemplated that Century would lease the buses in the ordinary course of its business and that, at various stages during the life of the agreement, the buses might be in and out of lease. While a bus was out of lease, GE’s security interest would attach to the bus itself but, when it was under lease, GE’s security interest would attach instead to the rentals coupled with Century’s reversionary interest in the bus and also, of course, whatever rights Century held with respect to the other buses in the set. GE registered a financing statement as against Century in which it described the buses by serial number.

In November, 2008, Perimeter went into bankruptcy. Perimeter’s trustee in bankruptcy released the Perimeter lease buses to Century on the basis of legal advice that GE’s security interest prevailed over the trustee. The trustee, after further investigation, arrived at the opinion that GE’s security interest was not valid after all, and it brought an application for directions pursuant to s.34(1) of the Bankruptcy and Insolvency Act.

The trustee advanced two main arguments. The first was based on PPSA, s.30(2), which provides that, as a general rule, a buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free of any perfected or unperfected security interest in the goods given by the seller or lessor. According to the trustee, the transaction between Century and Perimeter was a lease of goods in the

5 In the agreement, Century gave GE a security interest in the buses and “all the proceeds therefrom, including from leasing or rental of the buses”: ibid. at para.[4].
ordinary course of Century’s business, therefore s.30(2) applied and the effect of the provision was to extinguish GE’s security interest. Call this the “lessee in ordinary course argument”. The second argument ran as follows: GE’s security interest was limited to Century’s own interest in the buses at the date of the security agreement; Century held only a reversionary interest, having already leased the three buses to Perimeter; and, since, on the authority of Re Giffen, Century’s reversionary interest was ineffective against Perimeter’s trustee in bankruptcy by virtue of PPSA, s.20(b), GE’s security interest was likewise ineffective. Call this the “nemo dat argument.”

The chambers judge, at first instance, was faced with two conflicting earlier decisions, Car-Ant Investments Ltd v. Peat Marwick Thorne Inc. and David Morris Fine Cars Ltd v. North Sky Trading Co. (Trustee of). Both cases involved facts similar to those in Perimeter, and in both cases the trustee relied on the lessee in ordinary course argument and the nemo dat argument. In Car-Ant, GMAC was the third party financial institution and the dispute was over a number of tanker trailers. The court rejected the lessee in ordinary course argument on the ground that the lease of the trailers was not in the ordinary course of the lessor’s business because the lessor was in the finance business, not the trailer business. The court also rejected the nemo dat argument, apparently on the ground that GMAC’s security interest in the trailers was perfected and so the Saskatchewan equivalent of PPSA, s.20(b) did not apply. The result was that GMAC prevailed. In North Sky, the Bank of Montreal was the third party financial institution and the dispute was over a car. The court accepted the lessee in ordinary course argument, distinguishing Car-Ant on the facts, and it also accepted the nemo dat argument. The result was that the trustee prevailed.

In Perimeter, the chambers judge held that PPSA, s.30(2) applied because Century was in the business of leasing buses and the result was that Perimeter took the Perimeter lease.

7 Perimeter Transportation Ltd (Re) 2009 BCSC 1458.
8 (1990) 84 Sask.R.249 (Sask.Q.B.)

10 (1990) 84 Sask.R.249 at para.[19]. This ruling seems to overlook the point that GMAC’s security interest was perfected as against the lessor, not the lessee: see further, text at note 22, infra.
buses free of GE’s security interest. However, she rejected the trustee’s argument that because Perimeter took the buses free of GE’s security interest, the trustee also prevailed over GE in Perimeter’s bankruptcy. Instead, she reached the opposite conclusion on the following basis:

“at the time it entered into the security agreement with [GE], Century held title to the [Perimeter lease buses]. It was entitled to grant a security interest in the [buses] to another. The validity of [GE’s] perfected security interest should not be dependent on the fact that [Century] did not have a perfected security interest at the time it granted [GE] an interest in the [buses]”.

However, this passage addresses the *nemo dat* argument, not the lessee in ordinary course argument and, in relation to the lessee in ordinary course argument, the judgment fails to explain why Perimeter’s trustee did not step into Perimeter’s shoes so as to “take free” of GE’s security interest pursuant to PPSA, s.30(2). Furthermore, the proposition that “Century held title to the [Perimeter lease buses and] was entitled to grant a security interest in the [buses] to another” glosses over the point that, at the time of its transaction with GE, Century held only a reversionary interest in the buses, while the following two sentences appear to confuse perfection with validity; for both these reasons the quoted passage does not properly come to grips with the *nemo dat* argument either. In any event, the end result was that GE prevailed and the chambers judge justified this outcome by appealing to the “reasonable expectations of secured creditors” and considerations of “business efficacy”.

The Court of Appeal affirmed the chambers judge’s decision, but on different grounds. It agreed with her that PPSA, s.30(2) applied, but went on to point out that this did not mean Perimeter acquired ownership of the Perimeter lease buses. All s.30(2) meant was that GE could not assert its security interest against Perimeter so long as the lease remained on foot. “The security interest is not cut off; it remains effective with

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11 2009 BCSC 1458 at para.67.
14 The judgment was delivered by Newbury J., with Ryan and Groberman JJ. concurring.
respect to the reversionary interest of the debtor-lessee”\(^{15}\). In the present case, the trustee’s action in returning the buses to Century amounted to a disclaimer of the lease and, since the lease was terminated at that point, GE was free to stake its reversionary claim. This disposed of the lessee in ordinary course argument and the court apparently assumed it was sufficient also to dispose of the case. However, the court’s conclusion in GE’s favour failed to take account of the *nemo dat* argument.

### 3. Analysis

The Court of Appeal’s response to the lessee in ordinary course argument is correct, as far as it goes, but it overlooks the more fundamental point that PPSA, s.30(2) was inapplicable in the first place. The reason is that the provision only applies if the security interest in question pre-dates the sale or lease and, in *Perimeter*, the lease came first. It is true that the provision is not expressly limited to prior security interests, but the limitation is implicit, having regard to the policy underlying the section. In *Cuming*, Walsh and Wood’s words:

> “The policy underlying the section is that persons who buy goods in the ordinary course of business should not be required to take measures to protect themselves against the risk that the goods they buy are subject to *prior* perfected or unperfected security interests given by sellers with whom they deal. A secured party who takes a security interest in goods of a debtor who is in the business of selling goods of that kind can expect that its security interest will be defeated by transactions with customers of the debtor”\(^{16}\).

The court quotes this passage with approval early in its judgment\(^{17}\), but the judgment as a whole fails to pick up on the significance of the word “prior”. The timing consideration seems to be an obvious point in GE’s favour but, strangely, it appears to have been overlooked, as it was also in *Car-Ant* and *North Sky*.

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\(^{16}\) *Ibid.* at pp 286-287 (emphasis added).

\(^{17}\) 2010 BCCA 509 at para.[11].
As mentioned above, the other flaw in the Court of Appeal’s judgment is its failure to address the *nemo dat* argument: the conclusion that PPSA, s.30(2) does not defeat GE’s security interest does not dispose of the argument that GE’s security interest was ineffective against Perimeter’s trustee by virtue of s.20(b) in combination with the *nemo dat* rule. The starting point in this connection is to note that, in most contexts, the PPSA replaces the *nemo dat* rule and other common law priority rules with specific statutory provisions, so making resort to these pre-PPSA rules both unnecessary and inappropriate. The *Perimeter* scenario is no exception. The governing provision is PPSA, s.23(2), which provides that a transferee of a security interest has the same priority with respect to perfection of the security interest as the transferor had at the time of the transfer. PPSA, s.23(2) was not mentioned in the *Perimeter* case and the equivalent Saskatchewan and Alberta provisions also appear to have been overlooked in both *Car-Ant* and *North Sky*.

In *Perimeter*, GE’s security interest was in the buses as inventory.\(^{18}\) Since the agreement contemplated that the buses might be leased, presently or in the future, it was equivalent to an agreement for a security interest in whatever interest Century might have in the buses during the term of any such lease (Century’s reversionary interest) together with the rental proceeds. Century’s reversionary interest was a security interest for the purposes of the Act.\(^{19}\) GE was a transferee of Century’s security interest under the Equipment Loan and Security Agreement and PPSA, s.23(2) applies on this basis.\(^{20}\) If Century had perfected its security interest in the buses by registering a financing statement as against Perimeter then, applying s.23(2), GE would have succeeded to Century’s perfected status and so it would have prevailed over Perimeter’s trustee in

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\(^{18}\) See Part 2, supra.

\(^{19}\) See text at n.2, supra.

\(^{20}\) A possible counter-argument is that “transfer” does not include a security agreement. But in other parts of the statute, “transfer” covers both security and non-security agreements and there is no reason for reading it more narrowly in s.23(2): see, e.g., PPSA, ss.4, 20(c). See also *Personal Property Security Act* R.S.O. 1990, c.P-10 (“OPPSA”), s.2(b): “this Act applies to . . . a transfer of an account or chattel paper even though the transfer may not secure payment or performance of an obligation”. This wording clearly implies that “transfer” covers both security and non-security agreements. A variation on the same argument might be that “transfer” does apply to chattel mortgages, but not charges or hypothecs. One response is that, in the *Perimeter* case, GE’s agreement with Century was a chattel mortgage. A more general response is that it would be contrary to the PPSA’s substance over form philosophy to read “transfer” as covering some types of security interest but not others.
bankruptcy. As this illustration shows, the purpose of s.23(2) is to avoid the need for a second registration following the assignment of a security interest.

Of course, the actual facts in Perimeter were different because Century did not get round to registering a financing statement until after Perimeter had gone into bankruptcy. However, s.23(2) should still apply except now the effect is that GE succeeds to Century’s unperfected status.\textsuperscript{21} It is true that GE registered its own financing statement, but that was to perfect its security interest in the buses from Century, not Century’s security interest from Perimeter. If it had wanted to perfect Century’s security interest against Perimeter, GE would have had to register a financing statement against Perimeter’s name.\textsuperscript{22} In summary, the collateral for GE’s security interest from Century was Century’s own unperfected security interest in the buses and since Century’s security interest was unperfected, it should have been ineffective against Perimeter’s trustee in bankruptcy. What, then, is the effect of GE’s own registration? The answer is that GE’s registration protected it against the risk of future dealings by Century in the same collateral (Century’s reversionary interest in the buses). However, those were not the facts of the case and GE’s registration had no bearing on its dispute with Perimeter’s trustee, just as it would have had no bearing on a dispute between GE and a party with a competing claim to the buses granted by Perimeter.

GE’s collateral included Century’s reversionary interest in the Perimeter lease buses, along with the rental proceeds. The reversionary interest would have allowed GE to repossess the buses if Perimeter defaulted on the rentals, while the proceeds claim

\textsuperscript{21} This argument may be easier to see in the context of the corresponding provision in the Ontario PPSA, which is worded somewhat differently: “an assignee of a security interest succeeds in so far as its perfection is concerned to the position of the assignor at the time of the assignment”: OPPSA, s.21(2). The words, “succeeding in so far as its perfection is concerned” clearly cover the case where the assignor is unperfected, as well as the case where the assignor is perfected. There is no reason to suppose that the drafters of the non-Ontario PPSAs intended a different meaning.

\textsuperscript{22} It is true that GE’s financing statement included the serial numbers of the disputed buses and a person who conducted a register search against the serial numbers would discover both GE’s and Century’s interests. However, the PPSAs make no provision for registration against serial-number alone because the aim is to cater for both debtor name searches and serial-number searches. This means that the secured party must register against the debtor’s name even if the financing statement also includes the serial number. Would GE have had the status to register a financing statement against Perimeter’s name? Since the consequence of GE’s transaction with Century is that GE steps into Century’s shoes \textit{vis-a-vis} Perimeter, the answer in principle should be yes, and the principle is implicit in PPSA, s.23(2).
entitled GE to the collections. These are similar to the rights acquired by an assignee of chattel paper and, in principle, the outcome of GE’s dispute with Perimeter’s trustee should be the same as if Century had assigned the chattel paper represented by the Perimeter lease agreement to GE.23 Again, in that case, PPSA, s.23(2) would be the governing provision. As a result, GE would succeed to Century’s unperfected status in relation to the Perimeter lease buses and its claim would be ineffective against Perimeter’s trustee in bankruptcy. Conversely, if Century had registered a financing statement, GE would succeed to Century’s perfected status under s.23(2) and so its claim would prevail against the trustee. On the other hand, while s.23(2) would avoid the need for GE to register a new financing statement against Perimeter with respect to the buses, GE would still need to register a financing statement against Century with respect to the chattel paper. Otherwise, it would be at risk if Century were to assign the chattel paper a second time to someone else. The need for double perfection in the chattel paper context is well enough understood,24 and it should come as no surprise that the double perfection requirement also applies in functionally equivalent transactional settings like the one in the Perimeter case.

The implication of this analysis is that if A takes a security interest from B in a security interest B has from C, A should: (1) perfect its own security interest as against B; and (2) make sure that B has perfected the security interest it holds from C or, alternatively, register its own financing statement as against C. Step (1) alone is insufficient for two connected reasons. First, A’s collateral is B’s security interest from C and so the status of B’s claim against third parties dealing with C correspondingly determines the status of A’s claim. Secondly, the registration of a financing statement to perfect A’s security interest against B will not perfect B’s security interest against C because a valid registration depends on correctly stating the debtor’s name and the debtor is C, not B.25

23 To be clear, the argument is not that the Equipment Loan and Security Agreement was actually an assignment of chattel paper. The argument is simply that the transaction had a chattel paper-like component and so the emergence of the double perfection issue should have come as no surprise.


25 See PPSA, s.43(7).
In the *Perimeter* case, the chambers judge suggested that requiring GE to take both precautions would be contrary to” the reasonable expectations of secured creditors” and “inconsistent with business efficacy”.26 She does not develop the point, but the concern relates specifically to the type of transaction in issue, namely, an equipment loan and security agreement where the security interest is a floating one over the debtor’s inventory held for lease. With transactions like this, the precautions suggested above do not give A (GE) sufficient protection: even if A does make sure that B (Century) is perfected as against C (Perimeter), this will not help A if, for example, C returns the bus and B re-leases it to D. In that event, A would have to make sure that B was perfected as against D. Likewise, if B were to lease a substitute bus from the set to C, A would have to ensure that B was perfected as against C in relation to the substitute bus. In summary, the application of the double perfection requirement to this type of financing puts A in the position of having to constantly monitor B’s dealings with the buses and B’s perfected status in relation to each new dealing.

The court’s decision in the *Perimeter* case facilitates this type of financing because it eliminates the double perfection requirement which, in turn, substantially reduces A’s monitoring costs. The problem is that, as the above analysis suggests, while the outcome of the *Perimeter* case might be a commercially desirable one, the court’s reasoning does not withstand analysis. Turning to the integrity of the registration system, it might reasonably be asked why two registrations should be necessary. Given that GE had included the buses’ serial numbers in its own financing statement, a proper register search against the serial numbers would have revealed both GE’s and Century’s interests. The stumbling block lies in PPSA, s.43 (7), which provides that “a seriously misleading defect, irregularity, omission or error” in the debtor’s name, as it appears in the financing statement, invalidates the registration. This provision precludes registration by serial number alone, on the basis that a searcher should always have the option of searching the register against the debtor’s name, even if a serial-number search is also an option. It is hard to see a solution to the problem the *Perimeter* case identifies without some modification of s.43 (7). Any such amendment may increase register search costs,

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26 See text at n.13, *supra.*
because it would add to the reasons making it unsafe for a searcher interested in serial-numbered goods to rely on a debtor’s name search alone. However, it is probable that many such searchers already undertake both kinds of search, so the additional costs may not be all that high. On the other hand, the benefits, in terms of facilitating this type of financing, could be substantial.

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27 For example, to adapt the facts of the *Perimeter* case, a searcher interested in knowing about outstanding security interests in Perimeter’s buses would have to search against the serial numbers of the buses: a search against Perimeter’s name would not return Century’s security interest because GE’s financing statement names Century as the debtor, not Perimeter.