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THE STATUS OF UNPERFECTED SECURITY INTERESTS IN INSOLVENCY PROCEEDINGS

By

Anthony Duggan*

1. Introduction

All the Personal Property Security Acts clearly state that an unperfected security interest is ineffective against the debtor’s trustee in bankruptcy.1 However, they are less clear about the status of an unperfected security interest in CCAA2 proceedings, BIA3 commercial and consumer proposal proceedings and receiverships. In Ontario, the governing provision is OPPSA, s.20(1)(b), which provides as follows:

Except as provided in subsection (3), until perfected, a security interest,

. . .

(b) in collateral is not effective against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a trustee in bankruptcy.

This replaces an earlier provision, which referred to a person “who represents the creditors of the debtor as assignee for the benefit of creditors, trustee in bankruptcy or receiver”4.

In the Saskatchewan Personal Property Security Act (“SPPSA”),5 the governing provision is s.20(2), which provides as follows:

A security interest in collateral is not effective against:

(a) a trustee in bankruptcy if the security interest is unperfected at the date of bankruptcy; or

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* The Hon. Frank H. Iacobucci Chair, Faculty of Law, University of Toronto. I am grateful for helpful comments from Deborah Grieve, Stephanie Ben-Ishai and Jacob Ziegel. All errors are mine.
1 See e.g., Personal Property Security Act RSO 1990, c.P-10 (“OPPSA”), s.20(1)(b) and the corresponding provision in other provinces and territories.
2 Companies’ Creditors Arrangement Act, RSC 1985, c.C-36.
4 Personal Property Security Act, RSO 1970, c.344, s.22(1)(a)(iii).
5 Personal Property Security Act, SS 1993, c.P-6.2.
(b) a liquidator appointed pursuant to the Winding-Up [and Restructuring] Act (Canada) if the security interest is unperfected on the day that the winding-up order is made.

The other provincial and territorial PPSAs contain a provision similar to the SPPSA version. There is no reference in the SPPSA version to a person who represents the creditors of the debtor. In Ontario, the statute invites the argument that a CCAA monitor, a BIA proposal trustee or a receiver, as the case may, is a person who represents the creditors of a debtor. By contrast, in the other provinces and territories, the question turns solely on the courts’ willingness to read the reference to a trustee in bankruptcy expansively.

The corresponding provision in Revised Article 9 provides that a security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected. “Lien creditor” means: (1) a creditor that has acquired a lien on the property involved by attachment, levy or the like; (2) an assignee for the benefit of creditors from the time of assignment; (3) a trustee in bankruptcy from the date of the filing of the petition; and (4) a receiver in equity from the time of appointment. The reference to a “trustee in bankruptcy” needs to be read in conjunction with s.1107(a) of the Bankruptcy Code which provides that, as a general rule, a debtor in possession in Chapter 11 proceedings has the same rights and powers and is to perform the same functions and duties as a Chapter 11 trustee. It follows that an unperfected security interest is subordinate not only to a trustee in Chapter 7 bankruptcy proceedings, but also to a Chapter 11 trustee and debtor in possession. The strong arm clause in s.544(a) of the Bankruptcy Code leads to the same result. The strong arm clause among other things gives the trustee the rights and powers of a hypothetical lien creditor or unsatisfied execution creditor as of the commencement of the case. Article 9 subordinates an unperfected security interest to the rights of a lien creditor and the strong arm clause puts

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6 SPPSA, s.20(1)(d) provides that a security interest in collateral is subordinate to “the interest of a representative of creditors, but only for the purpose of enforcing the rights of [an execution creditor]” (emphasis added). The effect of this provision is “to give only a derivative status to a representative of creditors. The representative can assert only the priority status of actual creditors of the debtor”: Ronald CC Cuming, Catherine Walsh and Roderick J. Wood, Personal Property Security Law (Irwin Law Inc., Toronto, 2005), p.441, n.53.


8 Ibid., s.9-102 (52).

9 Bankruptcy Code, USC, Title 11, s.1107(a).
the trustee in the same position. The strong arm clause applies to cases under all chapters.10

The Article 9 reference to a “receiver in equity” is obsolete because receiverships have long been “out of fashion” in the United States.11 Nevertheless, the provision was clearly intended to cover at least court-appointed receivers.12 Receiverships have recently fallen out of favour in Canada, too, in the wake of the Supreme Court’s decision in Commercial Credit Corporation-Canada v. TCT Logistics Inc.13 However, the following discussion proceeds on the assumption that this disaffection will be short-lived and that there will be further case law developments or statutory reforms to allay the concerns TCT Logistics has given rise to. Part 2, below discusses the case law dealing with unperfected security interests in (a) CCAA proceedings, (b) BIA proposal proceedings and (c) receiverships. Part 3 looks at the policy issues and the need for reform. Part 4 concludes.

2. The cases

(a) CCAA proceedings

In PSINet Ltd (Re),14 P held a general security interest in the debtor’s assets. It registered a financing statement in 1996, but the registration expired on February 19, 2001. The debtor filed for CCAA protection on May 31, 2001 and P applied to the court for an order lifting the stay so that it could reperfec its security interest. One of the issues was whether OPPSA, s.20(1)(b) applied on the basis that a CCAA monitor is a “person who represents the creditors of the debtor”. If s.20(1)(b) applied then, since P was unperfected at the date of the monitor’s appointment, it would have been relegated to unsecured creditor status in the CCAA proceedings; reperfection of its security interest

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12 The definition of “lien creditor” was borrowed from the Uniform Trust Receipts Act (see Gilmore, op.cit s.16.6) and it was reproduced without change in Revised Article 9.
would not have changed this outcome because reperfection is not retroactive. However, Farley J. held that a monitor is not a person who represents the creditors of the debtor and so s.20(1)(b) did not apply. On this basis, he granted P’s application, subject to an order for the costs of all parties affected by P’s registration lapse.

In TRG Services Inc. (Re), C. Campbell J. reached the same conclusion subject to the qualification that the position may vary from case to case depending on the terms of the Initial Order. In the present case, the Initial Order gave the monitor power over the claims resolution process, but the court held that this was not sufficient to make the monitor a person who represents the creditors. The monitor was insufficiently like a trustee in bankruptcy because the order did not grant it “any legal entitlement to or over the assets of the debtor”. This statement suggests that the words “person who represents the creditors of the debtor” in s.20(1)(b) are to be read *ejusdem generis* with the references to a trustee in bankruptcy and an assignee for the benefit of creditors and there is further support for this approach in 1231640 Ontario Inc. (Re), which is discussed in Part 2(c), below. In PSINet, P’s unperfected status was the result of inadvertence. By contrast, in TRG, the secured party’s (“Cisco’s”) failure to register a financing statement was a conscious one. It was argued that the cases were distinguishable on this basis, but C.Campbell J rejected the submission. However, following Farley J.’s lead in PSINet, he made the order lifting the stay conditional on the payment of costs incurred by the debtor and the other creditors due to Cisco’s failure to perfect its security interest.

PSINet and TRG were both Ontario cases. There are no cases in the other provinces directly in point. However, Brookside Capital Partners Inc. v. RSM Richter (“Brookside”), an Alberta Court of Queen’s Bench decision, is relevant. In that case, the debtor filed for CCAA protection on March 11, 2005 and on August 10, 2005 the court appointed the monitor as the receiver-manager of the debtor’s assets so as to facilitate their sale to a third party. Brookside held an unperfected security interest and

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15 (2006) 26 CBR (5th) 203 (Ont. SCJ)
16 Ibid. para.[57].
17 2007 ONCA 810 (OCA).
18 Ibid., para.[53].
19 (2006) 25 CBR (5th) 273 (Alta QB)
one of the issues was whether the receiver qualified as a “trustee in bankruptcy” for the purposes of the Alberta PPSA (“APPSA”), s.20(a)(i). Lo Vecchio J. answered the question in the negative, holding that:

“the words trustee and receiver are not judicially interchangeable, the Bankruptcy and Insolvency Act and the Judicature Act are different statutes from different levels of government with largely different purposes and the Receiver did not lead any evidence to suggest that the Legislature intended anyone other than a trustee in bankruptcy to have priority”.

It seems clear that, a fortiori, a monitor who has not been appointed receiver-manager would not qualify as a trustee in bankruptcy for the purposes of the section. Likewise, if the other provincial courts accept the rulings in PSINet and TRG that a monitor is not a person who represents the creditors of the debtor for the purposes of OPPSA, s.20(1)(b), a fortiori, a monitor cannot be equated with a trustee in bankruptcy. Hupfer (Re) lends further support to this conclusion. In that case, Master Funduk held that a licensed trustee acting as a BIA consumer proposal administrator is not a trustee in bankruptcy within the meaning of APPSA, s.20(a)(i). The functions of a proposal administrator are at least roughly comparable to those of a CCAA monitor (subject to any special provisions in the CCAA Initial Order) and so, if a proposal administrator is not a trustee in bankruptcy, then neither, presumably, is a CCAA monitor.

In PSINet and the other cases discussed above, the court takes it as given that the validity of the security interest depends on perfection. For example, in PSINet, P’s collateral included assets located outside Ontario and P never registered a financing statement in the other jurisdictions. Farley J. held that this meant P could not claim a security interest in the non-Ontario collateral: “[P] was unsecured as to any assets outside Ontario vis-à-vis other creditors.” Farley J.’s decision to lift the stay so that P could register a financing statement rests on the same assumption because, if perfection were not a

20 “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”: Personal Property Security Act RSA 2000, c.P-7, s.20(a)(i).
22 In TRG, the court cited Brookside with approval, clearly implying that the two cases were equivalent: (2006) 26 CBR (5th) 203 at paras [49]-[52].
23 2003 ABQB 267.
24 Ibid. at para.[6].
requirement for the validity of a security interest in CCAA proceedings, there would have been no need for P’s application. Counsel for the debtor made this point during argument in \textit{TRG},\footnote{26 (2006) 26 CBR (5th) 203 at para.[45].} but, unfortunately, C.Campbell J. overlooked it in his reasons for decision.

As it happens, the validity of a security interest depends on attachment, not perfection. While it is true that perfection may affect the status of a security interest \textit{vis-à-vis} competing claims to the same collateral,\footnote{27 See, \textit{e.g.}, OPPSA, s.20.} failure to perfect does not deprive the secured party of its security interest. So, for example, an unperfected security interest is ineffective against the debtor’s trustee in bankruptcy. However, that is only because OPPSA, s.20(1)(b) and its inter-provincial counterparts say so. But for these provisions, the holder of an unperfected security interest would retain priority over unsecured creditors in the debtor’s bankruptcy.\footnote{28 \textit{Re Giffen} [1998] 1 SCR 91. See Anthony Duggan and Jacob Ziegel, “Justice Iacobucci and the Canadian Law of Deemed Trusts and Chattel Security” (2007) 57 \textit{University of Toronto Law Journal} 227 at pp 229-237.} Accordingly, given the court’s conclusion in \textit{PSINet} that OPPSA, s.20(1)(b) was inapplicable, it became unnecessary for it decide whether the stay should be lifted so that P could perfect its security interest; since OPPSA, s.20(1)(b) did not apply, P’s status as a secured creditor in the CCAA proceedings did not depend on perfection and so there was no need for a lifting of the stay. Assume that in \textit{PSINet}, there had been another security interest in competition with P’s and that prior to the expiration of P’s registration, P’s security interest had priority. In those circumstances, P might want to reperfect following the commencement of the CCAA proceedings so as to preserve its priority over the other security interest.\footnote{29 OPPSA, s.30(6).}

However, this was not the situation in \textit{PSINet}: while there were several security interests in competition with P, it seems they were all purchase money security interests with priority over P’s security interest whether it was perfected or not.\footnote{30 (2002) 30 CBR (4th) 226 at paras 3 and 11.} Likewise, in \textit{TRG} and \textit{Brookside} it seems that the secured party had no need for a lifting of the stay once it had been determined that the relevant PPSA provisions (OPPSA, s.20(1)(b) and APPSA, s.20(a)(i), respectively) did not apply.
In summary: (1) the cases establish that a CCAA monitor is neither a person who represents the creditors of the debtor for the purposes of OPPSA, s.20(1)(b) or a trustee in bankruptcy within the meaning of OPPSA, s.20(1)(b) and the corresponding provision in the other jurisdictions; (2) therefore, an unperfected security interest is not ineffective in CCAA proceedings; (3) contrary to what the cases assume, the holder of an unperfected security interest need not register a financing statement to maintain its priority over unsecured creditors in CCAA proceedings; (4) this means that, unless there are other priority contests in play, there should be no occasion for a court application; and (5) without an application, the court will have no opportunity for the exercise of its discretion either to deny the secured party secured creditor status or to require the secured party to compensate the debtor and other creditors for any losses resulting from the secured party’s failure to publicize its security interest.31

(b) BIA proposals

It was held in Re Mercantile Steel Products Ltd,32 that a BIA commercial proposal trustee is neither a trustee in bankruptcy nor a person who represents the creditors of the debtor. The case was decided under the former OPPSA, but the provision in question was not materially different from what is now OPPSA, s.20(1)(b). Anderson J. noted that “the trustee represents the creditors only to the extent necessary to ensure performance of the proposal, and not in any more general sense”.33 BIA, s.66(1) (then s.46(1)) provides that all the provisions of the Act, in so far as they are applicable, apply, with such modifications as the circumstances require, to BIA proposals. However, Anderson J. held that this provision did not justify assimilating a proposal trustee with a trustee in bankruptcy in the present context because:34

“the purpose sought by a proposal is continuation of the business carried on by the debtor. While the proposal must present benefits for creditors it is fundamentally a mechanism for the advantage of the

31 Cf PSINet (2002) 30 CBR (4th) 226 at para;14 per Farley J.: “while I understand the frustration of the other creditors, I do not think that [P] has put itself into a position whereby it should be prevented from re-registering. However, that is a discretionary decision and it appears to me that it would be just and reasonable to impose certain conditions as a pre-requisite to that permission”.
32 (1978) 28 OR (2d) 237 (OSC). The judgment opens grumpily by saying: “[t]his is another in the apparently endless series of cases arising under the [OPPSA] “: at p.238 per Anderson J.
33 Ibid. at p.239 per Anderson J.
34 Ibid. at p.240.
debtor making it. That being the case, it would be anomalous if the debtor could improve its position through objections put forward by the trustee concerning security, of a nature such that they could not have been successfully asserted by the debtor directly. If the proposal succeeds, the ordinary creditors will receive what they contracted to accept and there is no reason why it should be augmented by an amount realized at the expense of a secured creditor. If [the] proposal does not succeed, bankruptcy will ensue and the trustee in bankruptcy can assert all the rights created by the Act”.

This statement is a *non sequitur*: the question is whether, as a matter of law, BIA, s.66(1) assimilates a proposal trustee with a trustee in bankruptcy for all or any purposes, not whether it makes sense to assimilate them as a matter of policy. Furthermore, the policy consideration Anderson J. identifies is open to question, for reasons to be discussed in Part 3(c), below. However, Anderson J.’s conclusion regarding BIA, s.66(1) might still be supported on the ground that the purpose of the provision is simply to incorporate other BIA provisions into the proposals regime by reference and so it cannot be relied on to assimilate a proposal administrator with a trustee in bankruptcy at large.

*Mercantile Steel Products* was a BIA commercial proposal case. However, the reasoning is equally applicable to consumer proposal administrators. As mentioned earlier, it was held in *Hupfer* that a consumer proposal administrator is not a trustee in bankruptcy for the purposes of APPSA, s.20(a)(i).35

(c) Receivers

There is nothing in either the text or the history of SPPSA, s.20(2) to suggest that it was intended to apply to receivers. The provision applies only to trustees and, as Lo Vecchio J. observed in *Brookside*, “the words trustee and receiver are not judicially interchangeable”.36 The position is the same in the other provinces except Ontario which involves a more complex analysis. OPPSA, s.20(1)(b) replaces an earlier provision which did refer specifically to receivers.37 The change originated in a recommendation of the Catzman Committee.38 The Catzman Committee Report does not explain why the reference to receivers was dropped, but according to Catzman himself, the term “receiver” is a generic one, covering both privately-appointed and court-appointed

35 See text at n.23, above.

36 See text at n.21, above.

37 See text at n.4, above.

receivers, and it is only a court-appointed receiver that can be said to represent the interests of creditors.\textsuperscript{39} This statement provides a clue to the committee’s thinking: the purpose, apparently, was to make it clear that the section did not apply to a privately appointed receiver but that it did apply to a court-appointed receiver as a person who represents the creditors.\textsuperscript{40} However, in \textit{1231640 Ontario Inc(Re)},\textsuperscript{41} a majority of the Court of Appeal (Feldman and La Forme JJA, Weiler JA dissenting), concluded otherwise.

The facts of the case were that the Royal Bank of Canada, acting as agent for a group of lenders, applied to the court for the appointment of an interim receiver, Pricewaterhouse Coopers Inc. (“PWC”), over the debtor’s assets pursuant to BIA, s.47(1). The appointment order authorized the receiver to carry on the debtor’s business and to sell certain assets and it stayed all proceedings against the debtor. Acting pursuant to the appointment order, the receiver sold the assets and the following day, November 15, 2001, it arranged to change the debtor’s name from “The State Group Limited” to “1231640 Ontario Inc.”, as required by the terms of the sale agreement. On January 31, 2002, the receiver put the debtor into bankruptcy and PWC was appointed trustee. Some time later, the trustee received a substantial income tax refund payable to the debtor.

The bank and another creditor, St Paul, both held perfected security interests in all the debtor’s assets but the bank had priority because it was the first to register. However, neither party registered a financing change statement within 30 days after learning of the debtor’s name change, as required by OPPSA, s.48(3). It was conceded that they must have become aware of the name change by December 6, 2001 at the latest. On this basis, both security interests were unperfected by the date of the debtor’s bankruptcy. The main item in dispute was the tax refund; St Paul argued that both security interests were ineffective by virtue of OPPSA, s.20(1)(b) and so the funds should be distributed ratably between itself and the bank. The bank relied on OPPSA, s.20(2)(b) which provides that:

\textsuperscript{39} F.M. Catzman \textit{et al.}, \textit{Personal Property Security Law in Ontario} (Carswell, Toronto, 1976), at p.114.
\textsuperscript{40} \textit{1231640 Ontario Inc. (Re)} 2007 ONCA 810 at para.[41] per Weiler J.A.
\textsuperscript{41} \textit{Ibid.}
“the rights of a person … under clause (1)(b) in respect of the collateral are to be determined as of the date from which the person’s representative status takes effect”.

The bank’s argument ran as follows: (1) PWC’s representative status took effect when it was appointed interim receiver; (2) an interim receiver is a person who represents the creditors of the debtor within the meaning of s.20(1)(b); and (3) by virtue of s.20(2)(b), since the bank’s security interest was perfected at the date of the receivership order, it remained effective in the debtor’s bankruptcy even though it had become unperfected in the meantime.42

Ground J. at first instance rejected the argument, ruling that an interim receiver is not a person who represents the creditors of the debtor and that, therefore, OPPSA, s.20(1)(b) was not engaged until the date of the debtor’s bankruptcy, by which time the agent’s security interest was unperfected.43 The Court of Appeal upheld this ruling. Feldman J.A., for the majority, gave the provision an *ejusdem generis* construction and held that the words “a person who represents the creditors” only catch representatives who are like assignees or trustees. A receiver is different from an assignee or trustee in bankruptcy in two key respects:

“[u]nlike a trustee in bankruptcy and an assignee for the benefit of creditors, a receiver does not obtain the debtor’s rights in respect of the collateral and is therefore not in a priority contest with any creditor on behalf of unsecured creditors. Also, in a receivership, the debtor maintains its rights in the collateral. Second, unlike in a bankruptcy, creditors’ rights are not frozen on a receivership by statute. Those rights may be stayed by the court order appointing the receiver, but … the stay can be and often is lifted in order to allow a creditor to register to maintain its perfected status”.

42 St Paul could have made the same argument, but it was against its interests to do so. The reason is that, if the argument had succeeded, both parties would have had enforceable security interests but the bank would have had priority. St Paul was better off arguing that both security interests were ineffective because that way it would end up with a *pro rata* share of the disputed funds.

43 1231640 Ontario Inc. (Re) O.J. No. 2850 (Ont. SCJ).

44 2007 ONCA 810 at para.[57]. Weiler J.A. dissenting, held that a court-appointed receiver owes fiduciary obligations to all the creditors and this means the receiver is their representative: *ibid.* at paras [45]-[51]. On this view, OPPSA, s.20(1)(b) would apply to all receivers, including a privately-appointed receiver. However, the history and context of the provision suggest that it was not intended to apply to privately appointed receivers: see text at nn 39 and 40 above and text at n. 79, below. Moreover, a duty to take another party’s interests into account is not the same as a duty to act on their behalf. For example, a secured creditor cannot disregard the interests of the debtor or other interested parties when exercising a power of sale: see, *e.g.*, OPPSA, s.63(2). However, this rule does not make the secured creditor a representative of
OPPSA, s.30(6) was a significant factor in the court’s decision. Section 30(6) provides as follows:

“Where a security interest that is perfected by registration becomes unperfected and is again perfected by registration, the security interest shall be deemed to have been continuously perfected from the time of first perfection except that if a person acquired rights in all or part of the collateral during the period when the security interest was unperfected, the registration shall not be effective as against the person who acquired the rights during such period.”

Assume Creditor A applies to the court for appointment of a receiver. Creditor B holds a security interest which was previously perfected by registration but is unperfected at the date of the receivership order. If, as the bank argued in the 1231640 Ontario case, s.20(1)(b) applies to receiverships, Creditor B’s security interest would be ineffective against the receiver. However, Creditor B could avoid this outcome by reperfeting its security interest at any time; then, by virtue of s.30(6), Creditor B’s security interest will be deemed to have been continuously perfected, thereby negating the operation of s.20(1)(b). The receiver could not rely on the exception in s.30(6), because a receiver does not acquire rights in the collateral. The case is different in bankruptcy because, unlike a receiver, a trustee in bankruptcy does acquire rights in the collateral. This means that if Creditor B were to reperfet its security interest after the debtor had gone into bankruptcy, the security interest would still be ineffective against the trustee. In short, OPPSA, s.30(6), as it is presently drafted, undermines the argument that s.20(1)(b) applies in receiverships. Incidentally, the same point might be made in further support of the conclusion that s.20(1)(b) does not apply in BIA proposal or CCAA proceedings.

45 Subject to an application to the court for a lifting of the stay in the receivership order to allow registration of the new financing statement.
46 The reference in s.30(6) is to proprietary rights and any rights the receiver has in the collateral are of an administrative nature only: 1231640 Ontario Inc. (re) 2007 ONCA 810 at para.[32] per Feldman J.A.
47 See Jacob S. Ziegel and David L. Denomme, The Ontario Personal Property Security Act: Commentary and Analysis (2nd ed., Butterworths, Toronto, 2000), s.30.5.3.
48 In any event, Creditor B would need to apply to the court for a lifting of the stay so that it could register the new financing statement. In contrast to receiverships, the bankruptcy stay is a statutory one and the court may deny the application.
49 Only in Ontario, though because the corresponding provision to OPPSA, s.30(6) in the other provinces is differently worded: see n.91, below.
3. Policy considerations

(a) Introduction

As currently drafted, the PPSAs do not affect the status of an unperfected security interest relative to unsecured creditors’ claims. However, they do make an unperfected security interest subordinate to, or ineffective against: (1) a perfected security interest in the same collateral; (2) an execution creditor who has proceeded to the point of seizure; (3) the debtor’s trustee in bankruptcy; and (4) a transferee of the collateral for value.\(^{50}\) With the exception of item (3), the common thread running through these cases is the importance of protecting the competing claimant’s reliance interest and preserving the integrity of the registration system: “public disclosure of the security interest is required to prevent innocent third parties from granting credit to the debtor or otherwise acquiring an interest in the collateral”.\(^{51}\) Failure to perfect makes a security interest effectively undiscoverable and parties such as prospective competing secured creditors, execution creditors and transferees might be prejudiced if their claims were subordinate to a prior security interest they were unaware of at the time they committed themselves to the transaction.\(^{52}\) By contrast, non-perfection typically does not prejudice an unsecured creditor because in advance of execution proceedings an unsecured creditor has no claim on the collateral.

Item (3), above (the debtor’s trustee in bankruptcy) appears to be the odd one out. The trustee in bankruptcy is not in the position of an innocent third party: she does not rely on the register for any of her dealings with the debtor and so she is not prejudiced by a secured party’s failure to perfect its security interest. Why then should an unperfected security interest be ineffective against the trustee? Re Giffen\(^{53}\) provides the answer, as

\(^{50}\) E.g., OPPSA, s.20(1).
\(^{51}\) Re Giffen [1998] 1 SCR 91 at para.38 per Iacobucci J.
\(^{52}\) Note that an unperfected security interest is ineffective against a perfected security interest in the same collateral even if the unperfected security interest was earlier in time and the holder of the perfected security interest knew about it at the time of its dealing with the debtor. This feature of the rule is inconsistent with the explanation in the text. However, it can be explained on the basis that: (1) a knowledge limitation would reduce the incentive to perfect by diluting the consequences of non-perfection; and (2) a knowledge limitation would increase litigation costs and lower the predictability of litigation outcomes: The Robert Simpson Company Ltd v. Shadlock and Duggan (1981) 31 OR (2d) 612; In the Matter of Bruce A. Smith 326 F.Supp.1311 (US DC Minn., 1971).
As noted above, the PPSAs provide that an unperfected security interest is subordinate to execution creditors. An execution creditor may be prejudiced by an unperfected security interest and the PPSAs provide a remedy by giving the execution creditor priority over the unperfected security interest. If the debtor becomes bankrupt while the execution process is still in train, the execution creditor loses this priority by virtue of the stay provisions in BIA, ss 69.3, 70 and 73(2) and (3). In effect, “the judgment enforcement rights of unsecured creditors are merged in the bankruptcy proceedings”. Making the security interest ineffective against the trustee is a kind of quid pro quo. It compensates execution creditors for the loss of their priority by giving a corresponding priority to the trustee in the trustee’s capacity as the creditors’ representative.

In summary, the purpose of the rule is “to permit the unsecured creditors to maintain, through the person of the trustee, the same status vis-à-vis secured creditors which they enjoyed prior to the bankruptcy of the debtor”. Recall that the corresponding Article 9 provision makes a security interest subordinate to the rights of a person that becomes a lien creditor before the security interest is perfected; “lien creditor” is defined to include a creditor who has acquired a lien on the collateral by attachment, levy, or the like, and also

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54 The following draws on Duggan and Ziegel, op.cit. n.28, at pp 231-233.
55 See, e.g., OPPSA, s.20(1)(a)(ii): “until perfected, a security interest in collateral is subordinate to the interest of … a person who causes the collateral to be seized through execution, attachment, garnishment, charging order, equitable execution or other legal process”.
58 [1998] 1 SCR 91 at para. 42. Contrast Tabb’s somewhat different version, expressed in the context of United States law: “What is the justification for the rule embodied in s.544(a)(1) [of the Bankruptcy Code], which effectively gives the debtor’s general unsecured creditors the benefit of the rights of a lien creditor, when none of those creditors in fact has actually become a lien creditor by the time of the bankruptcy filing? Remember that the trustee’s power of avoidance under s.544(a)(1) does not depend on the existence of any actual lien creditors. If bankruptcy had not intervened, there would have been a priority race under Article 9 (U.C.C. s.9-301(1)(b)) between the holder of the unperfected security interest and all of the unsecured creditors that had not yet obtained a judicial lien. The winner would be the first party to take the required action: if the unperfected secured creditor perfected before any unsecured creditor obtained a judicial lien, the secured creditor would win; but if an unsecured creditor became a lien creditor before the secured party perfected, the lien creditor would win. The bankruptcy filing interrupts that race, before a ‘winner’ is determined; after filing, the secured party cannot perfect and unsecured creditors cannot obtain judicial liens … Section 544(a)(1) in effect declares that the unresolved race is a “tie”: the collateral goes back into the bankruptcy estate, where it will be shared equally by all unsecured creditors and by the formerly secured creditor”: op.cit. n.10 at p.339.
a trustee in bankruptcy.\textsuperscript{59} This drafting makes explicit the connection between execution creditors’ rights and the rights of a trustee in bankruptcy and so it reinforces \textit{Re Giffen}, as does the wording of the strong arm clause in s.544(a) of the Bankruptcy Code.\textsuperscript{60}

In \textit{Re Giffen}, the court put the case for the rule in fairness terms: when the debtor becomes bankrupt, the execution creditor loses the priority it previously had over unperfected security interests, but this is offset by giving priority to the trustee instead. However, the justification can also be expressed in economic terms. The thinking goes like this. Bankruptcy creates a common pool problem, which bankruptcy law addresses by substituting a mandatory system of collective debt collection for the individual first-come, first-served debt collection system that operates outside bankruptcy.\textsuperscript{61} Creditors’ relative entitlements should be the same inside bankruptcy as they are outside bankruptcy, because otherwise there will be incentives for individual creditors to use the bankruptcy laws opportunistically. If Creditor A improves it position relative to Creditor B in the debtor’s bankruptcy, A may want to put the debtor into bankruptcy regardless of whether the debtor’s financial situation is reversible.

In short, changing creditors’ relative entitlements in bankruptcy conflicts with the collectivization goal of the bankruptcy laws because it encourages self-interested behaviour by individual creditors, whereas the bankruptcy laws aim to subordinate individual self-interest to the interests of the creditors collectively. Assume Creditor A holds an unperfected security interest in collateral. Creditor B starts execution proceedings against the collateral. Without a rule favouring the trustee in bankruptcy, A would have an incentive to put the debtor into bankruptcy with the aim of regaining priority over B. There would be at least two potentially adverse consequences: first, the other creditors may suffer if the debtor’s bankruptcy is premature; and secondly, unsecured creditors at large may suffer due to the increased risk of taking execution

\textsuperscript{59} See text at nn 7 and 8, above.
\textsuperscript{60} United States Bankruptcy Code, U.S.C., Title, 11, s.544(a), discussed in text at n.9 and n.58, above.
\textsuperscript{61} Thomas H. Jackson, \textit{The Logic and Limits of Bankruptcy Law} (Cambridge, MA, Harvard University Press, 1986), Chapters 1 and 2.
proceedings. These effects would presumably be reflected in higher credit costs and reduced availability of credit.  

(b) CCAA proceedings

In both *PSINet* and *TRG*, it was held that a CCAA monitor is not a person who represents the creditors for the purposes of OPPSA, s.20(1)(b). This conclusion seems right as a matter of statutory interpretation, but it remains to consider whether the outcome is right as a matter of policy. As explained in Part 3(a), above, the reason for making an unperfected security interest ineffective in bankruptcy is to prevent the secured party from using the bankruptcy laws to regain priority over execution creditors. This consideration does not apply in CCAA proceedings because, while BIA, ss 70 and 73 terminate execution creditors’ rights, there are no equivalent provisions in the CCAA. A CCAA Initial Order will typically stay execution proceedings, but the execution creditor may apply for a lifting of the stay in order to complete the process. It follows that the commencement of CCAA proceedings does not necessarily restore the unperfected secured creditor’s priority and it makes no difference to this conclusion whether the CCAA proceedings are in the nature of liquidation proceedings or not.

However, this is not the end of the story because there are other policy considerations in play. In particular, unperfected security interests have the potential to disrupt CCAA plan arrangements. If a security interest is unperfected, plan stakeholders may have no way of finding out about it before they commit themselves to the plan. In some cases, even the debtor itself may be unaware of the security interest; for example, the security interest may depend on provisions in the loan agreement which had escaped the debtor’s

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62 This should not be taken to mean that it is unlawful or improper for creditors to use the bankruptcy laws as a way of improving their priority position. Rather, the point is that the law should not create such opportunities in the first place. See, e.g., *Bank of Montreal v. Scott Road Enterprises Ltd* (1989) 57 DLR (4th) 623 (BCCA).

There is a loophole in the law as it presently stands. BIA, s.2.1 provides in part that bankruptcy commences at the date of the granting of the bankruptcy order. The previous rule was that the bankruptcy was deemed to have commenced on the date of the application. The change gives the unperfected secured creditor a window of opportunity to perfect between the date of the application and the date of the order. This is a concern, but it is probably less serious than the loophole identified in Part 3(b), below.
attention or which the debtor did not realize might be construed as giving rise to a security interest. This suggestion is not a fanciful one. A creditor may be anxious to improve its position in CCAA proceedings and the law, as it presently stands, gives the creditor an incentive to go looking in its loan contract for any provision that might at least arguably support a secured claim. In such cases, the debtor may know nothing about the claim until the creditor asks the court for a ruling. This is one reason why the recognition of unperfected security interests in CCAA proceedings is a bad idea: it increases costs by promoting litigation of the kind just described.

Furthermore, there is a risk that the parties may invest time and money in negotiating a plan on the assumption that there are no relevant security interests, only to discover late in the process that the assumption was incorrect. This is precisely what happened in both *PSINet* and *TRG*. In *Brookside*, Lo Vecchio J. recognized the problem, but he seemed to think that it only mattered in CCAA restructurings and, in the case of CCAA liquidation proceedings, there is no danger of prejudice to stakeholders from unperfected security interests. However, *TRG* gives the lie to this suggestion. There the debtor and the other creditors formulated a liquidation plan on the basis that secured claims would be dealt with outside the plan. The viability of the plan depended on the debtor’s assessment of its capacity to service the secured claims and these calculations were upset by Cisco’s late arrival on the scene. The court acknowledged this concern and also that its decision

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64 This makes the argument from an *ex post* perspective. The *ex ante* version of the argument is that the inability to rely on PPS registry searches might make it difficult at the outset for parties to assess the appropriateness of CCAA proceedings, as opposed to BIA proceedings, a receivership or some other course of action. Again, this point was made by counsel for the debtor in *TRG*, but to no effect: (2006) 26 CBR (5th) 203 at para. [36].


67 He said: “This is not a case of one or more creditors relying upon the fact the Personal Property Security Registry certificate did not disclose a security interest of Brookside and incurring the cost of enforcing their interests based upon that reliance” and “[there was] no reason to believe Brookside’s amended registration would have any effect on the reorganization of Kodiak. Indeed, the evidence is to the contrary; when Brookside amended its registration on August 10, 2005, Kodiak had already filed materials a day earlier indicating that attempts to reorganize were at an end and that they were opting to liquidate the company. *In fact, the amended registration did not affect Kodiak’s reorganization in any way*”: (2006) 25 CBR (5th) 273 at paras [37] and [43] (emphasis added).
to uphold Cisco’s claim would either “necessitate a reformulation of the Plan” or trigger the debtor’s assignment into bankruptcy.\(^{68}\)

The court in TRG also acknowledged the costs to the debtor and the other creditors as a result of Cisco’s late arrival on the scene. As indicated earlier, its solution, following the precedent set in PSINet, was to make the order lifting the stay conditional on Cisco’s bearing the “reasonable expenses and costs” associated with its conduct.\(^{69}\) One problem with this response is that, as discussed in Part 2(a), above, it incorrectly assumes the need for a stay application to facilitate perfection of a security interest in CCAA proceedings. Another problem is that it underestimates the challenge of capturing all the losses resulting from the secured party’s failure to perfect. The losses include not only court costs, but also the time and money wasted on negotiating the original plan. These amounts may be hard to calculate with any degree of accuracy and, in any event, the calculation exercise may itself be costly, time-consuming and productive of still more litigation.\(^{70}\) Moreover, in cases where the secured party’s conduct forces the debtor to abandon a reorganization attempt in favour of liquidation, in principle the costs award should include, in addition to the court and transactions costs incurred by the immediate parties to the plan, the full social costs associated with the debtor’s failure discounted by the chance that the reorganization may have failed anyway.\(^{71}\) On the other hand, the courts may be unwilling to go this far and, in any event, identifying all the social costs is likely to prove difficult, as is determining the appropriate discount factor.

In summary, there is a strong policy argument, resting on the potential prejudice to the debtor and other creditors, for making an unperfected security interest ineffective in CCAA proceedings. The avoidance of prejudice to third parties is the theme running through OPPSA, s.20(1) and the corresponding provisions in the other jurisdictions; in this respect, CCAA plan stakeholders are no less deserving of protection than the holders

\(^{68}\) (2006) 26 CBR (5th) 203 at paras [72] and[75].
\(^{69}\) Ibid., paras [72] and [74].
\(^{71}\) The case for making the secured party bear the full social costs of the failed reorganization attempt rests on both fairness and efficiency grounds. From a fairness perspective, it is unacceptable to compensate some stakeholder losses, but not others. From an efficiency perspective, the secured party should bear the full social cost of its actions so that it will undertake a proper cost-benefit analysis before proceeding.
of competing perfected security interests, execution creditors and transferees of the collateral for value. United States law concedes this point and Canadian law should, too. In fact, it is probably fair to say that the current state of the law is no more than a product of history: the PPSAs were drafted before the emergence of the rescue culture and the CCAA’s ascendency.\(^{72}\)

There is a further consideration. OPPSA, s.20(1)(b) provides that an unperfected security interest is ineffective against the debtor’s trustee in bankruptcy. The rule should be the same for CCAA proceedings because different rules may skew the choice between straight bankruptcy and CCAA proceedings. More particularly, as counsel for the debtor argued in TRG, the recognition of unperfected security interests in CCAA proceedings would create a bias in favour of straight bankruptcy proceedings over CCAA reorganizations: “creditors [and perhaps debtors, too] would indeed be tempted to move immediately for bankruptcy, to remove the possibility of unperfected ‘secured creditors’ coming out of the woodwork at a later stage of the proceedings and claiming first rights on the debtor’s assets”.\(^{73}\) In other words, the recognition of unperfected security interests in CCAA proceedings potentially undermines the current policy of rescuing insolvent firms where possible, and treating liquidation as a last resort. In Ivaco Inc. (Re),\(^{74}\) the Ontario Court of Appeal observed that:

“[the] CCAA and BIA create a complementary and interrelated scheme for dealing with the property of insolvent companies, a scheme that occupies the field and ousts the application of provincial legislation. Were it otherwise, creditors might be tempted to forego efforts to restructure a debtor company and instead put the company immediately into bankruptcy. That would not be a desirable result”.\(^{75}\)

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\(^{72}\) For example, while the Catzman Committee in Ontario recommended various amendments to what is now OPPSA, s.20(1)(b), it made no mention of the CCAA and gave no indication that the issue had occurred to it: Catzman Committee Report, \textit{op.cit.}, n.38, above.

\(^{73}\) (2006) 26 CBR (5th) 203 at para.[64].

\(^{74}\) (2005) 275 DLR (4th) 132.

\(^{75}\) \textit{Ibid.} para.[64] \textit{per} Laskin J.A.
In *TRG*, C. Campbell J. disregarded this statement on the ground that the immediate issue in *Ivaco* was different from the one he had to decide.\(^7\) That may have been true, but the policy consideration the statement identifies was common to both cases.

In *TRG*, C.Campbell J. said that, “while the CCAA is a statute that permits a wide latitude for the exercise of discretion, I do not think that the discretion should be exercised to defeat the legal rights of a creditor in the position of Cisco”\(^7\) and that “unsecured creditors should not in my view, through the mechanism of the CCAA, displace the security of another creditor simply because that security is unperfected”.\(^7\)

Likewise, in *Brookside*, Lo Vecchio J. said that, “this is not a case of a creditor trying to gain an advantage but rather simply (sic) a creditor trying to hold on to an advantage it had already negotiated”.\(^7\) These statements of sympathy for the secured creditor overlook the policy considerations identified above. They also disregard the policy behind the PPSAs as currently drafted because precisely the same statements could be made about the fate of an unperfected security interest in straight bankruptcy proceedings. The answer in the bankruptcy context is two-fold: (1) the secured party is the author of its own misfortune because it failed to perfect its security interest; and (2) in any event, the interests of the other creditors take precedence, as does the need to maintain the integrity of the registration system. The same considerations apply in the CCAA context.

(c) BIA proposals

The cases discussed in Part 2 (b), above suggest that a proposal trustee is not a trustee in bankruptcy within the meaning of the PPSAs or a person who represents the creditors within the meaning of OPPSA, s.20(1)(b). These decisions are probably right as a matter of statutory construction and they are consistent with the case law relating to CCAA proceedings and receiverships.

\(^7\) (2006) 26 CBR (5th) 203 at paras [60]-[66].
\(^7\) *Ibid.* para.[59].
\(^7\) *Ibid.* para.[71].
\(^7\) (2006) 25 CBR (5th) 273 at para.[36].
The policy considerations in relation to BIA commercial proposal proceedings are more or less the same as for CCAA proceedings:80 (1) giving effect to an unperfected security interest in proposal proceedings may disrupt the proposal and prejudice parties who have supported the proposal on the assumption that there is no relevant security interest in play; and (2) the risk of being trumped by an unpublicized security interest may cause creditors to opt for bankruptcy instead, even though there is a reasonable chance that the proposal will succeed and, if so, the returns to creditors would be higher than in a bankruptcy. Moreover, if an unperfected security interest is ineffective in CCAA proceedings but not in relation to a BIA proposal, a party may be tempted to opt for CCAA protection even though, having regard to the debtor’s circumstances and the interests of the creditors at large, a BIA proposal would be more efficient in terms of time, cost or both.

In Re Mercantile Steel Products Ltd, Anderson J. suggested that, as a matter of policy, an unperfected security interest should be effective in BIA proposal proceedings because “it would be anomalous if the debtor could improve its position through objections put forward by the trustee concerning security, of a nature such that they could not have been asserted by the debtor directly”.81 However, the case was decided twenty years before Re Giffen and Anderson J’s statement is inconsistent with the reasoning in that case. It also overlooks the policy considerations outlined above.

(d) Receivers

As discussed in Part 2 (c), above, 1231640 Ontario Inc. is authority for the proposition that OPPSA, s.20(1)(b) does not apply in a receivership and it makes no difference whether the receiver is privately or court appointed. The position is the same in the other provinces. It makes sense to exclude privately appointed receivers because a privately appointed receiver typically stands in the shoes of the secured party who made the appointment and so the same PPSA priority rules apply as outside receivership. For example, if the appointing secured party is unperfected, then its security interest will be

80 Consumer proposal proceedings are different because only the debtor can make a consumer proposal and, as a general rule, a consumer proposal does not bind secured creditors.
81 See text at n.34, above.
subordinate to a perfected security interest in the same collateral by virtue of OPPSA, s.20(1)(a)(i) and the corresponding provision in the other jurisdictions, while it will retain priority over unsecured creditors other than execution creditors; these rules apply to the exclusion of s.20(1)(b). If the appointing secured party is perfected, then its security interest will have priority over an unperfected security interest in the same collateral; again, OPPSA, s.20(1)(a)(i) is the governing provision and so s.20(1)(b) is not engaged. In Ontario and Manitoba, repossession perfects a security interest in all collateral except intangibles.\footnote{OPPSA, s.22(1); Personal Property Security Act, CCSM, c.P35, s.24(1). Elsewhere, repossession is not sufficient to perfect a security interest: see, e.g., SPPSA, s.24.} It follows that a previously unperfected security interest may become perfected when the receiver takes possession, assuming the receiver can be taken to have acted on the secured party’s behalf.\footnote{But see Sperry Inc. v. Canadian Imperial Bank of Commerce (1985) 4 PPSAC 314 (OCA) (receiver deemed to be agent of debtor, not secured party, by virtue of deemed agency clause in security agreement).}

More or less the same considerations apply in the case of a receiver appointed by the court to enforce the security interest of an individual creditor.\footnote{As was the case in 1231640 Ontario Inc. (Re): see Part 2(c), above. Ground J. at first instance, gave this as an additional reason for saying that OPPSA, s.20(1)(b) did not apply: a receiver appointed to act on behalf of a particular creditor or group cannot be described as “[representing] the creditors of the debtor”: O.J. No.2850, para.28. Cf Weiler J.A., on appeal, pointing out that a court-appointed receiver owes fiduciary obligations to all the creditors: 2007 ONCA 810 at paras [45]-[51]. However, A may be under a duty to avoid harming B’s interests without necessarily being B’s representative: see n.44, above. Besides, Weiler J.A.’s argument seems to overlook OPPSA, s.60, which to some extent assimilates privately appointed and court-appointed receivers: see Ziegel and Denomme, op.cit. n.47, above at s.60.2.} However, the exclusion of receivers appointed by the court to act for the creditors at large is a different matter. Receivership is increasingly a substitute for bankruptcy and CCAA proceedings and \textit{vice versa}. The choice between these competing alternatives should be made in the interests of the creditors at large. Time, cost and the like should be the main factors in the choice, rather than the advantage one creditor may gain over another by exercising the choice in a particular way. If OPPSA s.20(1)(b) and its inter-provincial counterparts apply in bankruptcy and CCAA proceedings but not receiverships, creditors may opt for bankruptcy or CCAA proceedings ahead of receivership even though, on the basis of time, cost or the like, receivership would be the better alternative. The reason is that, if OPPSA, s.20(1)(b) does not apply, then an unperfected security interest may obtain priority in the receivership even though the appointing party and the other creditors had
no means of discovering the security interest at the time of the receivership application and might have chosen a different course if they had known the truth. To avoid the risk, creditors may shy away from receivership even in cases where, as it happens, there are no outstanding security interests.

In addition to these considerations, there is a concern that, if unperfected security interests are effective in receiverships, this may increase litigation costs by encouraging parties to make unmeritorious claims to a security interest in the hope of improving their position in the receivership proceedings. As indicated in Part 3(b), above, this is already an issue in the CCAA context and it is potentially no less of a problem in receiverships. In summary, the reasons why an unperfected security interest should be ineffective against a court-appointed receiver are that: (1) an unperfected security interest may prejudice creditors who have committed to the receivership in ignorance of the security interest; (2) if an unperfected security interest is effective in a receivership but not in other insolvency proceedings, this may skew creditors’ choices between the competing alternatives; and (3) the recognition of unperfected security interests in receiverships may promote unnecessary litigation.

In *1231640 Ontario Inc.*, the bank argued at trial that “the policy reason for requiring a secured creditor to maintain the perfection of its security interest disappears on a receivership in that the debtor is deprived of possession of its property and is not in a position to grant further security interests”. 85 Ground J. rejected this submission on the basis that it was factually incorrect. However, as the foregoing discussion shows, the real policy concern is not so much that the debtor might grant further security interests following the receiver’s appointment but, rather, that having different priority rules for insolvency proceedings that are functionally interchangeable encourages parties to behave opportunistically by manipulating the system in their own interests.

Ground J. went on to say that, even if policy considerations support making an unperfected security interest ineffective in a receivership, in the absence of any legislative gap, the court is powerless to act; a bankruptcy court cannot use its inherent

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85 [2006] OJ No.2850, at para.[49].
jurisdiction to override legislation.\footnote{86} On the other hand, there may be a solution of sorts under the law as it presently stands. On application by the receiver (or the CCAA monitor or BIA proposal trustee, as the case may be), the court might lift the stay to allow a creditor acting on behalf of all the unsecured creditors to take execution proceedings against the debtor to the point of seizure. This would trigger OPPSA, s.20(1)(a)(ii) or the like provision elsewhere (an unperfected security interest is subordinate to an execution creditor) and the upshot would be to make the security interest ineffective in the insolvency proceedings against the unsecured creditors at large.\footnote{87} The problem is that the courts might not be willing to play along and, besides, the strategy would be both costly and time-consuming. Statutory intervention is preferable because it avoids the need to involve the court and the sheriff.

\subsection*{(e) Reform proposals}

For the foregoing reasons, the current PPSA rule that an unperfected security interest is ineffective against the debtor’s trustee in bankruptcy should be amended so that it applies also in CCAA proceedings, BIA commercial proposal proceedings and receiverships where the receiver is appointed by the court to administer the debtor’s assets in the interests of the creditors at large. This amendment would bring the Canadian PPSAs more closely into line with Article 9 in the United States. The following is a suggested draft:

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“An unperfected security interest in collateral is not effective:\footnote{88} 
(a) against a trustee in bankruptcy or a proposal trustee appointed pursuant to Part III of the Bankruptcy and Insolvency Act (Canada);

(b) against a liquidator appointed pursuant to the Winding-Up and Restructuring Act (Canada) [“WURA”] if the security interest is unperfected on the day that the winding-up order is made;\footnote{89}
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\footnote{86}{\textit{Ibid.}}\footnote{87}{I am grateful to Jacob Ziegel for this point.}\footnote{88}{\textit{Cf OPPSA, s.20(1)(b) which currently provides that “until perfected, a security interest…in collateral is not effective against … a trustee in bankruptcy”. The purpose of the change is to make the meaning clearer.}}\footnote{89}{Paragraph (b) derives from the SPPSA model; there is currently no corresponding provision in the OPPSA and, on the present state of the case law, it is an open question whether s.20(1)(b) would apply to a WURA liquidator for the reason that the liquidator is either a trustee in bankruptcy or a person who represents the creditors; on the basis of the \textit{ejusdem generis} construction of the provision in \textit{TRG} and 1231640 Ontario Inc., there are reasons for thinking that the liquidator might not fall within either description.}
(c) in proceedings taken under the Companies’ Creditors Arrangement Act (Canada);

(d) against a receiver appointed by the court to administer the debtor’s assets in the interests of the creditors generally; or

(e) against an assignee for the benefit of creditors.”

In Ontario, this reform would require a consequential amendment to PPSA, s.30(6) making it clear that reperfection of a security interest that was unperfected at the commencement of any of the proceedings in question does not make the security interest effective in the proceedings.

In the United States, the corresponding Article 9 provision is complemented by the strong arm clause in s.544(a) of the Bankruptcy Code. Why the need for both state and federal provisions? One reason is that the issue lies at the interface of secured transactions law and bankruptcy law and so both bodies of law have a claim on it. The Article 9 provision avoids the need for reference to bankruptcy law to determine the question in a secured transactions context, while the Bankruptcy Code provision reduces the need for reference to secured transactions law in the bankruptcy context. A related consideration is that federal law guarantees national uniformity, whereas uniformity may be harder to achieve or, at least, maintain at the state level. This is presumably the reason for having a federal

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90 Assignments for the benefit of creditors appear to be obsolete and so para. (e) might not be necessary.
91 See text at nn 45-48, above. The corresponding provision in the other provinces is differently worded and would require no change. For example, SPPSA, s.35(7) provides as follows: “Where:

(a) registration of a security interest:
   (i) lapses as a result of a failure to renew the registration; or
   (ii) is discharged without authorization or in error; and

(b) the secured party registers the security interest not later than 30 days after the lapse or discharge;
   the lapse or discharge does not affect the priority status of the security interest in relation to a competing perfected security interest that, immediately prior to the lapse or discharge, had a subordinate priority position, except to the extent that the competing security interest secures advances made or contracted for after the lapse or discharge and prior to the re-registration.”

Note that the provision only applies in the two cases specified in paras (a)(i) and (ii), there is a 30 day time limit on reperfection and there is no reference to competing claims which arise during the period of non-perfection.

92 See n.10, above.
93 Reduces but not avoids, because the strong arm clause gives the trustee the rights and powers of a hypothetical lien creditor at the commencement of the case. As to the rights and powers of a lien creditor relative to an unperfected security interest on the eve of bankruptcy, Article 9 governs.
bankruptcy law in the first place and, if so, the federal law should address all key aspects of the subject.

The case for reform at the federal level in Canada rests on similar considerations. Furthermore, there is the risk that some or all the provinces may reject the PPSA amendments proposed above. For all these reasons, the BIA, CCAA and WURA should all be amended to incorporate a provision along the lines of the United States strong arm clause and this should be done regardless of whether the provinces decide to take action as well.

4. Conclusion

As presently drafted, the PPSAs state that an unperfected security interest is ineffective against a trustee in bankruptcy and also, in Ontario, a person who represents the creditors. The cases establish that this rule does not apply in CCAA proceedings, BIA proposal proceedings or receiverships. These conclusions may be correct as a matter of statutory interpretation, but they are questionable in policy terms. As a matter of policy, the rule should apply in CCAA proceedings because: (1) the late assertion of a previously unpublicized security interest may inflict losses on the debtor and the other creditors and in some cases it may derail the debtor’s reorganization efforts; (2) to avoid this risk, the debtor or the other creditors may opt for bankruptcy even though there is a reasonable chance of a successful reorganization leading to a higher return for the creditors and benefits to other stakeholders; and (3) the recognition of unperfected security interests in CCAA proceedings may promote unnecessary litigation. More or less the same considerations apply in relation to BIA commercial proposals and court-appointed receivers, with the added dimension that making an unperfected security interest ineffective in CCAA proceedings but not in BIA commercial proposals or receiverships may skew parties’ choices between the types of proceedings.

In summary, as Re Giffen establishes, creditor priorities should be the same inside and outside bankruptcy to prevent parties from using the bankruptcy laws to trigger a priority flip. By the same token, creditor priorities should be the same for all types of insolvency
proceedings to prevent parties from choosing between the alternatives on the basis of individual self-interest rather than the interest of the creditors collectively. This should not be taken to mean that it is unlawful or improper for creditors to use the bankruptcy and insolvency laws as a means of improving their priority position. The point is simply that law-makers should try to avoid creating such opportunities in the first place.

In the cases decided to date, the courts have struggled to come to grips with the relevant policy considerations. There is a tendency for courts to sympathize with the holder of the unperfected security interest and this blinds them to the competing interests of other parties.94 However, even if this were not the case, the PPSAs as currently worded leave insufficient room for the courts to implement the right policy.95 A statutory solution is required.

94 See text at nn 77-79, above. Cf PSINet (2002) 30 CBR (4th) 226 at para. 7, where Farley J. suggests that the PPSA reperfection provisions may need “some looking at by the Legislature” (to prevent the holder of an unperfected security interest from taking CCAA plan stakeholders by surprise with a late re-registration). This is a misdiagnosis of the problem, for the reasons discussed in Part 2(a) above, but at least it recognizes that there is a problem.
95 Subject to text at n.87, above.