A central issue in the law of security over movable property is the recognition of, and the regulatory implications of recognizing, a secured transaction. Systems of law derived from Article 9 of the United States Uniform Commercial Code take as their point of departure what at first sight is a unitary conception of such a transaction, which is described in terms of the "intention" underlying it, or its "substance". In the view of the authors, such a conception cannot be sustained except as a way of asking the question of whether a transaction is appropriately viewed as a secured one for the purposes of the legal issue at hand. Indeed, the problems encountered in attempting to apply a purely functional analysis to title-based transactions such as conditional sale, bailment, and trust—and to legal issues arising outside of, if closely connected to, the ones which Article 9 systems address—show that concepts which focus on the distinction between what is owned and what is owed may be unavoidable in the law.

The heuristic nature of functional analysis enables one to see that other systems of law without such a unitary conception of "security" as that identified with Article 9 may reach appropriate legal results at least as efficiently and fairly as Article 9 systems, and may do so with less risk of eliminating the non-security aspects of the transaction.

La reconnaissance d'une transaction garantie et les conséquences réglementaires d'une telle reconnaissance posent un problème central en droit des sûretés mobilières. Les systèmes de droit dérivés de l'Article 9 du Uniform Commercial Code américain ont, comme point de départ, une notion de transaction qui paraît être, à première vue, unitaire. Celle-ci se décrit selon «l'intention» qui la fonde ou selon sa «substance». D'après les auteurs, une telle notion ne peut être soutenue que pour se demander si une transaction est adéquatement perçue comme garantie dans le contexte d'un problème juridique donné. En effet, les difficultés rencontrées en tentant d'appliquer une analyse purement fonctionnelle aux transactions d'attribution ou de réserve du droit de propriété, mais aussi aux problèmes juridiques survenant indépendamment des problèmes ressortant des systèmes de l'Article 9, montrent que les concepts qui se concentrent sur la distinction entre ce qui constitue une propriété et ce qui constitue une dette pourrait être inéluctable en droit.

Le but d'illustrer la pertinence de l'analyse fonctionnelle est de montrer que d'autres systèmes de droit qui n'adoptent pas une conception unitaire de «sûreté», telle qu'identifiée dans l'Article 9, peuvent toutefois atteindre des résultats juridiques de façon aussi efficace et juste que les systèmes de l'Article 9, tout en diminuant le risque de diluer les autres aspects de la transaction.
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Conclusion
Introduction: Substance, Function, and Form in Secured Transactions Law

Article 9 on secured transactions is widely regarded as the most innovative and successful of the Articles that make up the United States Uniform Commercial Code ("U.C.C.").¹ Nearing the half century mark of its promulgation,² it is still seen by its sponsors as "fundamentally and conceptually sound,"³ a view reportedly shared by practising commercial lawyers.⁴

Article 9 has been adopted by all fifty states of the United States,⁵ and its influence has been equally remarkable in common law Canada where various incarnations of the Personal Property Security Act ("PPSA") adapted from the Article 9 model are in operation in all but one of the common law jurisdictions.⁶ Further afield, countries

¹ See e.g. C. Felsenfeld, “But the Proposed Uniform (?) Commercial Code was Adopted” (1993) 26 Loy. L.A. L. Rev. 597 who states that Article 9 is a "legislative triumph" (ibid. at 598), a "beautiful exercise" which created a "logical and flowing treatment" of security interests (ibid. at 605-606).

² Grant Gilmore, one of the principal architects of U.C.C. Article 9, regards 1950 as the U.C.C.'s intellectual birth date. See G. Gilmore, Security Interests in Personal Property, vol. 1 (Boston: Little, Brown, 1965) at 288-89 [hereinafter Security Interests]. Although the 1962 Official Text was the first version of the U.C.C. which was enacted nationally, earlier versions had been enacted by several states, including Pennsylvania, in 1953. An amended version of Article 9 was promulgated as the 1972 Official Text.

At the time of finalising this text, there were proposals to revise parts of Article 9 pending before the American Law Institute. This article does not take these revisions into account since none of them is seen to affect the points made herein.


⁴ See e.g. H. Ruda, “Article 9 Works—How Come?” (1994) 28 Loy. L.A. L. Rev. 309 at 309: “More than thirty years of personal experience with the application of Article 9 to commercial transactions leads me to concur in [the view that Article 9 is fundamentally sound].”

⁵ The civil law state of Louisiana was the last state to enact Article 9: 3 U.L.A. § 1-201 (1992).

⁶ In order of implementation, the nine provinces (and one territory) are: Ontario (R.S.O. 1990, c. P-10); Manitoba (R.S.M. 1987, c. P-35, to be replaced by S.M. 1993, c. 14, which is not yet in force); Saskatchewan (S.S. 1993, c. P-6.2); Yukon Territory (R.S.Y. 1986, c. 130); Alberta (S.A. 1988, c. P-4.05); British Columbia (R.S.B.C. 1996, c. 359); New Brunswick (S.N.B. 1993, c. P-7.1); Nova Scotia (S.N.S. 1995-96, c. 13); Prince Edward Island (S.P.E.I. 1997, c. 33); and Newfoundland (S.N. 1998, c. P-7.1, which was not in force as of 12 February 1999). Law reform officials in Newfoundland have delayed the implementation of PPSA reform until after they implement radical improvements to the province’s general judgment and debt enforcement laws, a reform sequence that some would regard as more logical and fair: see E. Warren, “Further Reconsideration” (1994) 80 Va. L. Rev. 2303 at 2308:
as varied as New Zealand, Gaza, and the West Bank have signalled their commitment to follow the United States and Canadian examples. Moreover, the Article 9 model is proving to be influential in the drafting of international conventions on security on movables.

In our analysis of Article 9, ... we seem to take as the starting point the creditor's right to collect under Article 9, without asking much about whether the dismal collection prospects under state collection law create such a gap between the abilities of secured and unsecured creditors to collect that other undesirable consequences arise.


Article 9's appeal is not, however, universal. Within Canada, after sustained debate, the civil law province of Quebec ultimately declined to adopt the Article 9 model in its new Civil Code. Furthermore, while English and Australian law reformers have expressed varying degrees of support for the Article 9 model, their recommendations have not been taken up by the legislators. Even in the United States, the basic jurisprudential and economic premises underpinning Article 9 remain the subject of ongoing scholarly debate.
This article examines some of the reasons for the uneven reception afforded to Article 9 and the Canadian PPSAs by focusing on the distinctive feature of the reform model: the adoption of a unitary concept of security which replaced the complexity of security forms and devices that prevailed under the prior law. This unitary approach is derived from the drafters' perception that all security interests perform an identical function and should be subject to an identical legal framework. Consequently, a security interest is defined in purely functional terms as an interest in personal property which secures payment or performance of an obligation.

Article 9's unitary concept of security is typically described as reflecting a "substance over form" philosophy. Certainly, this is part of the concept. While the drafters sought to codify Equity's time-honoured willingness to look behind the form of a debtor-creditor property transfer in order to decide its true character, their goal was scholars have begun to question the efficiency of awarding full priority to secured creditors upon insolvency. See "Priority of Secured Claims", supra note 8; and "Reply to Critics", supra note 8.


The distinctive feature of Article 9 is that it abolishes the pre-Code distinctions between the multiplicity of common law, equitable and statutory security devices and replaces them with the generic concept of a "security agreement" creating a "security interest". This radical solution [was] derived from the drafters' profound insight that all security interests serve the same function—to secure payment or performance of an obligation—and that there was no justification for the retention of the old divisions [footnotes omitted].

12 U.C.C. § 1-201(37) defines "security interest" as "an interest in personal property ... which secures payment or performance of an obligation." For the equivalent PPSA definition, see e.g. New Brunswick PPSA, supra note 6, s. 1: "security interest' means an interest in personal property that secures payment or performance of an obligation."

13 See e.g. New Brunswick PPSA, ibid., s. 3(1): "This Act applies to every transaction that in substance creates a security interest, without regard to its form" [emphasis added]. Similarly, U.C.C. § 9-102(1)(a) makes it clear that Article 9 applies "to any transaction (regardless of its form) which is intended to create a security interest in personal property" [emphasis added]. To make clear the applicability of Article 9 to the wide variety of pre-Code security devices, U.C.C. § 9-102(2) provides that Article 9 applies to all "security interests created by contract" and lists the different forms that secured transactions took under prior law. For an equivalent PPSA provision, see e.g. New Brunswick PPSA, ibid., s. 3(1)(b).

14 Operating on the basis of the equitable maxim "once a mortgage, always a mortgage," courts in the common law tradition were willing, from a very early stage, to receive parole evidence showing that a debtor's conveyance of property to its creditor was subject to a transfer back on satisfaction of the underlying loan obligation. In this situation, the transaction would be characterized as a mortgage, not a sale, notwithstanding the parties' use of the words "absolute transfer". See e.g. Wilson v. Ward, [1930] S.C.R. 212, 2 D.L.R. 433. For recent applications of this principle in the PPSA context, see Gulraj v. Miller (1994), 95 B.C.L.R. (2d) 353, 8 P.P.S.A.C. (2d) 96 (S.C.); and Pool v. Heaps, [1996] B.C.W.L.D. 647 (S.C.), online: QL (BCJ).
also far more ambitious. They sought nothing less than to detach the legal entailments of security from conventional property analysis."

Prior law placed what the drafters generically called "security" along a highly-calibrated property rights continuum. In the Canadian common law version of this continuum, there was (i) the unpaid seller's reservation of ownership pending payment of the price, which was not really security; (ii) the classic chattel mortgage under which the debtor conveyed title to specific goods as security; (iii) the fixed equitable mortgage or charge on after-acquired assets; and (iv) the floating charge over shifting assets (inventory and accounts) under which the debtor retained the power to manage and dispose of the collateral in the ordinary course of business. Roughly speaking, the further along the continuum a security interest was placed, the weaker its proprietary character for the purposes of determining the creditor's enforcement rights upon the debtor's default as well as the potency of the security interest against third party claimants."

For Karl Llewellyn, the legal realist who acted as Chief Reporter for the U.C.C. project, this use of property "pigeonholes" to establish a priori answers to substantive legal questions was too abstract, too static, and too absolutist to serve as a basis for resolving commercial disputes. Llewellyn's antipathy to conceptual property rights analysis had its greatest impact on the drafting of U.C.C. Article 2 dealing with the sale of goods. However, it also had a significant influence on the drafters of Article 9 in their conceptualization of "security". Not only the form of the transaction but also the location of title to the collateral—and by implication its proprietary quality—were rejected as indicia of security. Functionalism, which respects the parties' bargain and

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16 A clear example of the broader reach of title-neutral, functionalist analysis relative to classic "substance over form" thinking is the inclusion of title reservation security devices—e.g. conditional sales and financing leases—within Article 9 and the PPSAs. Substance over form implies a dissonance between the legal form selected by the parties and the real underlying nature of the transaction. In the case of conditional sales and the like, no such dissonance exists. The unpaid seller is simply doing what any prudent owner of property would do: refusing to transfer ownership until the property is paid for. This point is considered in greater detail in Part I.B., below.

17 Parts I and II, below, address the enforcement and priority entailments of the traditional property law approach to the classification of security interests in some detail.


19 K. Llewellyn, "Through Title to Contract and a Bit Beyond" (1938) 15 N.Y.U. L. Rev. 159 at 165-69.

20 Tabac, supra note 18 at 409; and D.P. Board, "The Scope of Article 9 Is Only One Quarter as Great as Is Commonly Supposed" (1993) 47 U. Miami L. Rev. 951.

21 All the Canadian PPSAs expressly reject the location of title as a determinant of security: see e.g. New Brunswick PPSA, supra note 6, s. 3(1)(a): "This Act applies to every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral" [emphasis added]. See also the Official Comment to U.C.C. § 9-101: "This Ar-
is sensitive, not to metaphysical property constructs, but to the interests of third parties, was henceforth to be the only reliable guide to modern secured financing law.

For the most part, the courts have taken to heart the drafters’ strictures against relying on property analysis and title theory to resolve Article 9 and PPSA issues and disputes. Attempts to alter priority outcomes by resorting to prior law characterizations of security have routinely been rejected. Instead, the courts have focused, as functionalism directs them to do, on whether the transaction presents elements that fall within the regulatory objectives of the Article 9 and PPSA model. This approach leads to the discouragement of sham transfers and the curing of ostensible ownership and "false wealth" problems, the promotion of certainty and predictability in the resolution of priority disputes, and the protection of the interest of the debtor and any subordinate third parties in the collateral at the point of enforcement.

Functional analysis has not, however, produced clarity. On the contrary, there is a surprising level of confusion on the very question that a functionalist definition of "security" was designed to answer, i.e., what is the essence of a security interest? Many current thinkers tend to treat ownership and security as fungible and interchangeable concepts. In our view, this results because of three major problems attributable to Article 9 and PPSA functionalism.
The first problem is the analysts’ evident temptation to see the presence of elements that fall within the regulatory objectives of Article 9 and the PPSAs as being sufficient for the transaction to be characterized as secured in nature. So, for instance, if a non-possessory interest in property creates the risk of “ostensible ownership” problems, there is a tendency to characterize it as a security interest so as to bring it within the Article 9 and PPSA filing regime. This tends to occur even if the transaction is otherwise factually remote from the world of secured credit. While the publicity problem is solved, the solution obscures consideration of whether differences between ownership and security might require a different response to the common “ostensible ownership” problem created by a separation of property rights and possession. Moreover, the further the characterization of security departs from the ordinary understanding of the concept, the more potential there is for unfair surprise to parties who, quite legitimately, did not anticipate the application of secured lending law to their transaction.

Second, this brand of functionalism has resulted in the conscious incorporation of certain true ownership interests within the Article 9 and PPSA regulatory framework, albeit for limited purposes. That these interests are deemed to be security interests demonstrates that the drafters, despite their antipathy to title analysis, saw ownership and security as distinct concepts. Nonetheless, the use of a drafting technique—deeming something to be that which it is not, itself a celebration of form over substance—has contributed to the blurring of that distinction.

Third, the embrace of functionalism of Article 9 and the PPSAs is more than a little ambivalent. Its abandonment of property concepts is not as absolute as an isolated reading of the definition of “security” might lead us to suppose. Doctrinally, the priority afforded to secured creditors over other claimants continues to be conceptualized and justified in property terms: a security interest is an interest in personal property. Consequently, it remains necessary to include charging language in a security agreement for it to qualify as such. What functionalism has done, however, is blur the traditional distinctions between the relative property rights attaching to differ-

24 Although Article 9 and the PPSAs adopt practically identical language to define “security interest”, they differ in their approach to non-security institutions. Notably, Article 9 and the Ontario PPSA extend their reach beyond “true” security interests only to the assignment of accounts or chattel paper by outright sale, whereas the newer and reformed Canadian PPSAs add non-security commercial consignments and non-security leases for a term of more than one year to their list of “deemed” security interests: see e.g. New Brunswick PPSA, supra note 6, s. 3(2)(a)-(c). The New Brunswick PPSA also includes a “sale of goods without a change of possession of the goods sold” definition (ibid., s. 1) if the sale takes place outside of the ordinary course of business. This is essentially a continuation of the policy found in the old Bills of Sale Act, R.S.N.B. 1986, c. B-3. See New Brunswick PPSA, ibid., s. 3(2)(d).

25 “Security interest” is universally defined in Article 9 and the PPSAs as a proprietary interest. See e.g. New Brunswick PPSA, ibid., s. 1: “‘security interest’ means an interest in personal property” [emphasis added].

ent types of security interests. In conventional property rights analysis, the “all-assets” financier who holds a security interest in the debtor’s entire estate is now on the same conceptual plane as the unpaid seller who reserves ownership in a specific asset as security. Both are presumptively subject to the residual “first-to-register” rule of priority which underlies Article 9 and the PPSAs, and both suffer the same disastrous priority repercussions in the event of a failure to register. Article 9 and the PPSAs recognize the need to qualify the functionalist baseline. The most prominent example regarding this qualification is the “super-priority” afforded to later purchase money financiers against a first-in-time all-assets secured party. The relative priority status of different types of security is, however, no longer built into the formal classification of the security interest or its proprietary character. The result of this unitary approach to security is a psychological climate favouring the first-in-time all-assets secured creditor against later creditors, both secured and unsecured. This, in turn, imposes a heavy onus on those who argue for any alteration in the distribution of an insolvent debtor’s estate.

Part I of this article considers the continued relevance of formal property analysis in the characterization of security interests in Article 9 and PPSA regimes and the extent to which this has been recognized, thus far, in the jurisprudence and commentary. As we shall see, recognition of the formal limits on functionalism is important in order to understand a number of problems including the scope of the Article 9 and PPSA regimes, the limits on extending a secured lending regulatory regime to non-security transactions, and the intersection between conventional property transfer analysis and functionalism both within and outside the Article 9 and PPSA framework.

Part II addresses the implications of the compression of all security interests into a unitary property concept—the third of the three problems with functionalism outlined above—upon the insolvency distribution policy. In our view, the perception that any erosion in the primacy of secured credit in favour of the debtor’s general creditors is presumptively suspect would be less prevalent if it were recognized at the outset that different security interests may be entitled to a different level of protection in a conventional property rights analysis. While this may seem to be a reversion to the antiquated mode of thinking about security on personalty, the substantive rules derived from the formalism of commercial practice in many ways reflected a more nuanced functionalism than the functionalism of even the “realist” drafters of Article 9.

Recognition of the limits of Article 9 and PPSA functionalism is itself made easier by going outside the Article 9 and PPSA world altogether. The United Kingdom has, for instance, managed to get along without Article 9 and, in fact, has actively re-

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7 See e.g. T.H. Jackson & E.A. Peters, “Quest for Uncertainty: A Proposal for Flexible Resolution of the Inherent Conflicts between Article 2 and Article 9 of the Uniform Commercial Code” (1978) 87 Yale L.J. 907 at 913, observing that under Article 9, the legal incidents of security interests vary according to factual and functional distinctions—the type of collateral, its physical location, the purpose of the loan—rather than the form of the agreement or the location of title.
sisted its adoption. Quebec—notwithstanding its location within the world of North American commerce—has also resisted the call to adopt the functionalist concept of security that lies at the heart of the Article 9 and PPSA model during the recent reconceptualization of its law of secured transactions. These two inquiries are canvassed in Parts III and IV, respectively. There we review in some detail the law of those jurisdictions to throw into relief our analysis of functionalism. Our aim is to demonstrate that the present analysis is better understood by reference to—while also permitting the better understanding of—the reform (or the absence thereof) in those two jurisdictions.

We conclude that our lengthy internal and comparative analysis of secured transactions law shows that functionalism is in fact not the answer, not even part of the answer, to the reform of the law of secured transactions. Functionalism is, at best, the question.

I. Form over Function in the Characterization of Security Interests

It is intrinsic to the creation of security under the Canadian [PPSAs] that the beneficial title in property subject to a security interest is, or remains, in the debtor and that once the secured obligation has been discharged the debtor becomes the unencumbered owner of the collateral.28

This proposition is from a leading text on the Ontario PPSA. Its thrust—that the hallmark of a PPSA security interest is the location of beneficial title to the collateral in the debtor—is unremarkable when applied to our conventional understanding of security.29 Yet, for the same reason, it is redolent of the older conceptual models of analysis that Article 9 and the PPSAs, with their expressed indifference to the location of title, would apparently have us renounce. After all, pursuant to a functionalist model, the essence of a security interest is not determined by the formal legal framework out of which it arises, but in what it seeks to accomplish. So, a transaction cast

28 Ziegel & Denomme, supra note 6 at 63. In their view, this proposition explains why a Quistclose trust does not qualify as a security interest under the PPSAs. That form of trust, and that issue, are examined in Part I.F., below.

29 See e.g. R.M. Goode, Legal Problems of Credit and Security (London: Sweet & Maxwell, 1982) at 2: "There are only three types of consensual security known to English law: the pledge, the mortgage and the charge." Under each of these, beneficial title to the collateral originates with the debtor, or more accurately, does not originate with the secured party. This latter qualification is necessary because it is of course possible for owners to put up their assets as security for another's debt, a possibility recognized in the definition of "debtor" in the PPSAs. See e.g. Ontario PPSA, supra note 6, s. 1(1): ""debtor' means a person who owes payment or other performance of an obligation secured, whether or not the person owns or has rights in the collateral."
in some other form—sale, trust, lease, consignment, etc.—may nonetheless constitute a security interest if it functions to secure payment or performance of an obligation.\textsuperscript{30}

We question the explanatory power of a purely functionalist definition of security. Rather than distinguishing a secured transaction from other forms of property transfer, functionalism eliminates any meaningful distinction between them. Consider the recent decision of the British Columbia Court of Appeal in \textit{FWC. The Land Co. (Receiver of) v. Bohun}.\textsuperscript{31} Under an agreement between a real estate seller and the licensed agent with whom she was associated, the proceeds of sales negotiated by the seller were to be processed by the agent subject to an express trust in favour of the seller for her commissions. Upon the agent’s insolvency, the receiver appointed by the agent’s secured creditor argued that the trust arrangement was in substance a security interest and, as such, was ineffective against the receiver for want of registration under the British Columbia \textit{PPSA}. The Court of Appeal referred the issue back to the trial court for determination, observing that the trust created by the agreement “\textit{[a]rguably ... was intended to secure payment of [the seller’s] commissions}”\textsuperscript{32} so as to qualify as a security interest under the \textit{PPSA’s} functional definition.\textsuperscript{33}

There is no doubt that the trust arrangement between the agent and the seller was designed to secure the seller’s commissions against both the agent and the claims of the agent’s creditors. Nonetheless, if an agreement of this type is perceived to create security, then so does any trust-agency agreement, and indeed any real claim against assets in another’s possession or control. Clearly, the courts should not have to accept whatever label the parties put on their transaction; however, they should not feel free, absent a sufficient legislative directive, to disregard the legal entailments associated with a transactional form appropriate to the achievement of the parties’ business objectives. We are not dealing here, after all, with a “colourable” use of the trust vehicle to shore up a secured creditor’s claim to the proceeds of collateral.\textsuperscript{34}

\textsuperscript{30} On the unitary, functionalist concept of security at the heart of Article 9 and the \textit{PPSAs}, see the text accompanying notes 12-21, above.

\textsuperscript{31} (1997), 29 B.C.L.R. (3d) 179, 30 B.L.R. (2d) 149 (C.A.) [hereinafter \textit{FWC. Land} cited to B.C.L.R.].

\textsuperscript{32} \textit{Ibid}. at 191.

\textsuperscript{33} See \textit{infra} note 36 and accompanying text. On the reference back to the trial level, Hutchison J. did not find it necessary to determine the issue. He reasoned that even if the trust agreement between the parties with respect to the seller’s commissions created a security interest as alleged, it was excepted from the scope of application of the British Columbia \textit{PPSA}, \textit{supra} note 6, s. 4(d) which excludes “an interest in present or future wages, salary, pay, commission or any other compensation for labour or personal services.” While the other Canadian \textit{PPSAs} likewise exclude wage assignments, there are significant variations among provinces in the scope and even the policy basis for the exclusion which is derived from U.C.C. § 9-104(d): see \textit{An Introduction}, \textit{supra} note 6 at 46.

\textsuperscript{34} Compare \textit{Hounsone Estates v. John Deere Ltd.} (1991), 3 O.R. (3d) 89, 4 C.B.R. (3d) 32 (Gen. Div.) [hereinafter \textit{Hounsone} cited to O.R.] where the holder of an unperfected assignment of an insolvent debtor’s receivables argued—unsuccessfully—that because the assignment nominated the debtor a trustee of the proceeds from the collection of the receivables, the proceeds constituted trust
Analysts readily acknowledge that Article 9’s open-ended definition of “security” cannot be taken at face value.” Thus, there is a tendency to focus not so much on the function of the transaction but on whether its substance or the parties’ intention engages the “secured transactions” label. These same analysts, however, are reluctant to develop a more refined qualification on functionalism’s inherent overreach.” While this reluctance is presumably occasioned by the concern of being led back into the world of arcane property doctrine, the failure to achieve certainty in something as fundamental as the very nature of security is curiously at odds with Article 9’s preference for certainty over discretion, for rules over standards.

property belonging to the assignee, thus were outside the bankrupt debtor’s estate. Therefore, it was argued that they could not be reached by the debtor’s trustee in bankruptcy notwithstanding the assignee’s failure to file under the PPSA. In rejecting that argument, Rosenberg J. employed the kind of formal beneficial title analysis captured by the proposition quoted in the text accompanying note 28, above:

From my analysis of the cases it appears that where the funds are never the property of the assignor [debtor], then the trust arrangement does not require a registration ... under the Personal Property Security Act. However, in cases where the receivable or property is that of the assignor [debtor] at the time of making the assignment, then the assignment must be registered by filing a financial statement under the Personal Property Security Act. In this case the receivable did belong to the ... [debtors] at the time that they made the assignment and accordingly it had to be registered under the Personal Property Security Act (Hounsome, ibid. at 97).

35 See e.g. J.J. White & R.S. Summers, Uniform Commercial Code, 4th ed. (St. Paul, Mn.: West, 1995) vol. 4 at 5:

But the definition of security interest in [U.C.C.] section 1-201(37) cannot be taken at face value. Section 1-201(37) defines “security interest” to mean any “interest in personal property or fixtures which secures payment or performance of an obligation,” a definition broad enough to include any distinctive claim to assets of a debtor that a creditor might assert on default [emphasis in original].

See also Security Interests, supra note 2 at 336-37: “Article 9, for all its comprehensiveness, is a statute drafted to regulate certain well-known and institutionalized financing transactions.”

36 That the function of a transaction and its substantive character are not quite the same thing seems to have been recognized by the Court in F.W.C. Land, supra note 31 at 191. In deciding to refer the characterization issue back to the trial level, the Court’s exact words were:

[S]. 2(1) of the P.P.S.A. states that it applies not only to every transaction that “in substance creates a security interest”, but also “to a ... trust, and a transfer of chattel paper where they secure payment or performance of an obligation.” Arguably, the trust created by ... the agreement ... was intended to secure payment of [the seller’s] commissions.

37 See e.g. Board, supra note 20 at 960:

An aversion to explicit conceptualization (not to mention systematization) has marked commercial-law scholarship for fifty years. It is unclear whether this aversion has saved Article 9 from the vices of “conceptualism,” but it has certainly discouraged efforts to analyse, classify, and compare transfer transactions and the rules that determine their consequences [footnotes omitted].
In our view, the above-mentioned proposition provides a test for distinguishing security interests from other forms of property transfer. The test rightfully ensures that the emphasis is placed on the way in which the parties have allocated the residual economic interest in the putative collateral. In other words, emphasis is placed on the location of beneficial title upon discharge of the "secured" obligation.

In the following section, consideration is given to the utility of the above-cited proposition, the significance of its qualification of functionalism, and the extent to which it has or has not been applied in PPSA analysis and caselaw.

A. Sale and Security: Accounts and Chattel Paper Financing

Accounts and chattel paper may be purchased outright or transferred conditionally as collateral security for a loan. From a functionalist point of view, there is little to distinguish the two forms of transfer. The assignee-buyer is as much a financier as the assignee-lender in that they both represent a source of immediate working capital for the assignor's business. Furthermore, should the assignor become insolvent, the assignee's real interest in the collateral functions to give it priority over other creditors whether the assignment is by way of sale or security. Article 9 and the PPSAs apply to both forms of transfer. This is typically offered as evidence of the drafters' functional approach to the concept of security. The authors of a leading text on the U.C.C. characterize "factors" as "lenders in sheep's clothing" and, therefore, it is only "just" that they should be regulated as such.

In our view, the functional identity of sale and security assignments is an inaccurate, even misleading, explanation of why both should be included within the Article 9 and PPSA model. After all, the drafters themselves did not see the interest of a buyer-assignee as being automatically included within their functional definition of "security". They found it necessary to expressly extend that definition, thereby con-
ceding it to be an "artificial" enlargement of the notion of security in the interests of drafting convenience. Moreover, a sale was included within the definition of a "security interest" only so as to bring into play the perfection and priority rules—not the enforcement rules—applicable to this regime.

The Article 9 and PPSA enforcement regime is constructed around the premise that the debtor retains the residual beneficial title to the collateral: the secured party's real remedies against the collateral are contingent upon the debtor's default and are then limited to the value needed to satisfy the secured obligation. Thus, implicit in the exclusion of sale assignments from the security enforcement regime is the idea that sale and security remain distinct transactions even in a functionalist world, and that the source of this distinction lies in the location of beneficial title in the collateral.

This distinction is sometimes obscured by the particular characterization difficulties that attend assignments of accounts and chattel paper. This is attributable, in part, to formal considerations such as the tendency of lawyers to draft both transactions in the common language of sale. Moreover, the characterization difficulties are com-

more apparent that the drafters did not regard sales of accounts and chattel paper as included within a functional definition of "security". See e.g. New Brunswick PPSA, supra note 6, s. 3(2): "[T]his Act applies ... (c) to a transfer of an account or chattel paper ... that [does] not secure payment or performance of an obligation" [emphasis added]; and s. 1: "security interest' means ... (b) the interest of ... (ii) a transferee under a transfer of an account or a transfer of chattel paper ... that does not secure payment or performance of an obligation; ... 'debtor' means ... (d) a transferor of an account or chattel paper" [emphasis added].

42 See Security Interests, supra note 2 at 334.

43 Thus, unless the security takes the form of a pledge, the secured party's right to take possession of the collateral is contingent upon the debtor's default. In either case, while the goods are in the secured party's possession, the secured party is subject to a non-disclaimable duty of reasonable care and its right to exploit the value of the collateral is subject to significant constraints. If the secured party fails to protect the debtor's interest in the collateral, it may be liable to the debtor. Perhaps most significantly, the secured party must account to the debtor for any surplus and is entitled to claim any deficiency following liquidation of the value of the collateral. See generally Part 5 of U.C.C. Article 9, and the Canadian PPSAs.


45 See e.g. the form of security assignment in issue in Alberta (Treasury Branches), ibid. See also T.E. Plank, "Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle" (1994) 26 Conn. L. Rev. 397 at 408-09 [hereinafter "Sacred Cows"]: Perhaps to obtain the legal advantages that factors had or perhaps simply because of the lawyers' tendency to copy familiar forms, the parties frequently characterized these [security] assignments as "sales" ... even though the assignor retained almost all of the benefits and burdens of owning the accounts. Despite the "sale" language, these transactions were primarily lending transactions.

Prior to Article 9 reform in the United States, the temptation to cast security assignments as sales must have been particularly acute in light of the hostility of the courts to wide open lending on the se-
pounded where the seller provides the buyer with a recourse or promises a fixed rate of interest. Credit recourse provisions are ambiguous in nature. Recourse may simply represent the assignor’s guarantee of the soundness of the assigned accounts consistent with a sales characterization, or it may represent a disguised deficiency claim consistent with a security characterization. Identifying its nature is labor intensive and involves an examination of other factors—principally the price paid and the terms of the servicing obligation—to determine the location of residual ownership.46

On a variant of the functional explanation, the official commentary to Article 9 states that the characterization problem is the reason for subjecting the sale of accounts and chattel paper to the same regulation as a security interest. Since accounts financing is conducted in such a way as to blur the distinction between the outright sale of accounts and their transfer by way of security, the inclusion of both within the Article 9 framework prevents the formation of a potential loophole with regard to the requirement for public notice.47 We question this rationale. The law does not require all property transfer transactions to be publicized on pain of subordination simply to avoid disputes about their true character. Moreover, while this technique may reduce the characterization problem, it does not eliminate it. Within Article 9, it remains necessary to distinguish sale and security assignments at the level of enforcement. Outside that framework, the distinction retains relevance for a wide variety of business and legal purposes.48 Finally, if characterization is the concern, it is not clear why it is


47 Official Comment 2 to U.C.C. § 9-102(1)(b): “Commercial financing on the basis of accounts and chattel paper is often so conducted that the distinction between a security transfer and a sale is blurred, and a sale of such property is therefore covered by section (1)(b) whether intended as security or not.” This comment first appeared in the 1972 Official Text for which Homer Kripke, a long standing proponent of the view that there is no meaningful distinction between sale and security assignments, was the Associate Reporter. See “Sacred Cows”, supra note 45 at 439, n. 196-97 and at 437, n. 188.

48 The distinction has substantive consequences for such varied purposes as accounting, taxation, and bankruptcy: see Ryan, supra note 46 at 559ff. Most significant, perhaps, are the bankruptcy repercussions of the distinction. If accounts are sold outright, there is no residual interest left for distribution to general creditors and the assignee’s collection rights are not affected by the bankruptcy proceedings. Yet if the assignment is by way of security, the trustee can still reach the assignor’s residual interest in the accounts and the assignee’s enforcement rights can be suspended by a reorganization. The bankruptcy implications are especially critical in the rapidly growing field of asset securitization. Asset securitization involves the issuance of securities representing designated assets, prototypically the accounts receivable of a business. The business creates a “bankruptcy-remote vehicle”, a separate
necessary to identify a sale as a security. An equally effective and logical solution would be to characterize security assignments as sales.

In our view, the only really persuasive justification for including both sale and security assignments of accounts and chattel paper within Article 9 and the PPSAs is that they both fall within the general regulatory objectives underlying the Article 9 and PPSA perfection and priority framework. Consider first the need to protect the informational and reliance interests of subsequent assignees. If the first assignee, whether taking by sale or security, were not required to publicize its interest, subsequent assignees would have no reliable means of knowing whether or not the assignor’s accounts and chattel paper had already been sold or encumbered. Ranking the assignments according to the order in which each is publicized by registration or possession ensures that prospective assignees are not exposed to the unfair surprise of a prior “secret” assignment. This enables them to calculate more efficiently the lending risk or the accuracy of the sale price, as the case may be.

Consider next the need to protect the assignee’s general creditors. In the case of a security assignment, mandatory registration coupled with a writing requirement provides objective evidence that an assignment by way of security is not an unjust prefer-

legal entity, to whom the accounts are sold. Securitization reduces the net financing costs for the business by eliminating the risk of bankruptcy to the bankruptcy-remote entity’s investors. Its success, therefore, depends on achieving a true sale of the accounts, requiring the originator to limit, if not forego altogether, any residual beneficial interest in the receivables. See generally S.L. Schwarz, “The Alchemy of Asset Securitization” (1994) 1 Stan. J. L. Bus. & Fin. 133 at 141-42. See also P.L. Mancini, “Bankruptcy and the UCC as Applied to Securitization: Characterizing a Mortgage Loan Transfer as a Sale or Secured Loan” (1993) 73 Boston U. L. Rev. 873.

A better explanation [than the characterization difficulties cited in the Official Comment to U.C.C. § 9-102] is that it is difficult to detect the change of ownership of accounts and (unless the buyer takes possession) chattel paper and therefore it is appropriate to require the buyer to take a step for perfection (filing of a financing statement or possession in the case of chattel paper).

See also D.G. Baird, “Security Interests Reconsidered” (1994) 80 Va. L. Rev. 2249 at 2267-69 observing that sales of accounts produce the same publicity problems as security assignments and advocating notice through public filing for both. The publicity justification explains why assignments that do not pose an “ostensible ownership” risk to third parties are excluded from Article 9. See U.C.C. § 9-104(f) which excludes the sale of accounts or chattel paper as part of a sale of the business out of which they arose, an assignment for purposes of collection only, a transfer to an assignee who is to assume performance under the contract, and a transfer of a single account in whole or partial satisfaction of indebtedness. As well, while not excluded from Article 9 as such, an assignment of accounts “which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor” is by Article 9-302(1)(e) excepted from filing. The PPSA exemptions are not quite so broadly cast, covering only the first three of these five categories: see e.g. New Brunswick PPSA, supra note 6, s. 4(d), (g), (h).

As a practical matter, taking possession of the collateral is feasible only in the case of an assignment of chattel paper where the obligation is embodied in documentary form. Accounts are pure intangibles for which registration is the only practical means of perfection.
ence. In the case of an outright sale, the same requirements reduce any dispute or necessity for proof of whether the purchaser extended new value thereby eliminating any suspicion of fraud. Admittedly, if the sale is at arm’s length, a challenge of this sort is unlikely to be a problem. However, the decision to sell its accounts outright may at times signal a firm’s financial distress. At the very least, it effects a radical change in the assignor’s financial condition that is not outwardly apparent to trade creditors in the absence of a publicity mechanism.  

This explanation is consistent with pre-reform, “pre-functionalist” policy. At common law, in the absence of actual notice, priority between competing assignments of the same debt was determined by the order in which the assignees gave notice to the third party obligor on the account regardless of whether the assignment was by way of sale or security. Though expressed as a rule of priority, one of the major rationales for this doctrine was the need for perfection or publicity. It can be argued that the rule enabled a prospective assignee to rely, with a measure of confidence, on the results of an inquiry of the third party debtors as to whether the assignor’s accounts had already been sold or encumbered. With the advent of non-notification accounts receivable financing, however, this method of perfection became unfairly arbitrary and did not protect the assignor’s general creditors. It was in response to these problems that the legislatures in the various states of the United States and provinces of Canada enacted registration legislation circa the 1920s and 1930s, making regis-


Just as public notice of a transaction (typically a filed financing statement) has been thought to ameliorate an ostensible ownership problem, so public notice has been thought to reduce the likelihood that a debtor and a third party will conspire to defeat the claims of a creditor by asserting that the third party took a security interest when, in fact, the third party did not.

Consider also ibid. at 2057: “For the most part courts and commentators have not distinguished between ‘ostensible ownership’ and ‘sham transaction’ fraud.”

32 Baird, supra note 49 at 2262.

33 This, at any rate, was the English and Canadian common law doctrine as embodied in the rule in Dearle v. Hall (1828), 3 Russ. 1, 38 E.R. 475 (L.C.). In the United States, prior to Article 9, while some states adhered to the same rule, others ranked assignments according to a simple first-in-time rule; see “Sacred Cows”, supra note 45 at 410. The greater publicity problems associated with the latter rule may explain why the United States courts required the assignee of accounts by way of security to exercise greater control over the accounts and their proceeds than its Canadian counterparts: see “Security Law, Formalism”, supra note 18.

tration of both sale and security assignments mandatory on pain of subordination to subsequent assignees and the assignor's creditors and trustee in bankruptcy.  

In the Canadian provinces, the need for such legislation was also prompted by changes in the federal bankruptcy law. Identifying the true basis for including the outright sale of accounts within Article 9 and the PPSAs illustrates the aversion to title analysis associated with the drafters' functionalism. It demonstrates that, at the level of perfection and priority, the distinction between security and ownership is indeed irrelevant. The significant question is not whether the interest should be characterized as one of ownership or security, but whether it raises the sort of problems that a publicity regime applicable to non-possessory security interests is best geared to address. In other words, the drafters did not necessarily view the location of title as irrelevant to the concept of security, but rather to the kinds of problems that a perfection and priority regime is designed to redress.

While the perfection and priority policies regulating security interests can be logically extended to other non-possessory property rights, we question the wisdom of effecting that extension by deeming them to be security interests. However convenient from the drafters' viewpoint, this technique can obscure consideration of whether other forms of transaction should be similarly regulated. Moreover, the concept of security in secured lending law should be consistent with—or at least, not overly inconsistent with—related bodies of commercial law. Yet, in combination with the drafters' aversion to conventional property analysis, the decision to call a sale of accounts a security interest might suggest that the buyer acquires something less than ownership. The fact that the buyer's interest can be defeated by the prior registration of a subsequent assignment under the Article 9 and PPSA regime may, therefore, contribute to analytical confusion to the extent it suggests that the seller retains a residual interest in the collateral.

5 "Judicial Reform in Nova Scotia", ibid. at 131, 134-35.
56 For a comprehensive criticism of this aspect of Article 9, see “Sacred Cows”, supra note 45 especially at 443, 474-88. See also S.L. Schwarcz, “A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures” (1995) 29 Ga. L. Rev. 909 at 930 [hereinafter “Fundamental Inquiry”] observing that the confusion created by the decision of the Article 9 drafters to deem a sale of accounts to be a security interest in order to avoid having to refer to both types of assignment demonstrates that “clarity does not always mean simplicity or economy of expression.”
57 For instance, as their title implies, the old bills of sale and chattel mortgages statutes applied to both the outright sale and the mortgage of goods where the buyer or mortgagee did not assume actual possession (and in the case of a sale, where the transaction took place outside the ordinary course of business, although this latter qualification was not included in all acts—with unfortunate repercussions). Yet among Article 9 and PPSA jurisdictions, only two—New Brunswick and Nova Scotia—have carried forward the old bills of sale policy. See New Brunswick PPSA, supra note 6, s. 1: “security interest”, and s. 3(2)(d). See also An Introduction, supra note 6, for commentary on s. 3.
58 “Fundamental Inquiry”, supra note 56 at 939.
59 See e.g White & Summers, supra note 35 at 67: “Since outright sales of accounts are covered by Article 9 it is hard to escape the inference that a debtor, having 'sold' nearly everything, still has some
This potential for confusion was present in a recent bankruptcy decision in the United States. This case held that accounts sold by a debtor prior to filing for bankruptcy nonetheless remained part of the bankrupt's estate since sales of accounts were treated as security interests under Article 9. This is the effective result in the event that the assignee-buyer fails to register. Under Article 9 and the PPSAs, an unperfected assignment is treated as ineffective or void against the assignor's trustee, and in this sense, it is as though the sale had never occurred. If the sale is properly perfected, however, the accounts remain outside the bankrupt's estate.

The court's ruling in Octagon Gas generated widespread concern. Treating a sale of accounts as a mere security interest threatened the legal foundation of asset securitizations involving accounts, the success of which depends on the legal ability of the originator of the accounts to effect their true sale to a bankruptcy-remote entity.

Within two weeks of the decision, the U.C.C.'s Permanent Editorial Board issued a property right, however remote. In fact, Article 9 and the PPSAs merely require that a debtor have "rights in the collateral" as a condition for the attachment (creation) of a security interest, including a deemed security interest. Although the meaning of this term is not free from controversy, it is clear that the debtor need not own the collateral (or have the consent of the owner). Otherwise, a debtor who had sold its accounts or chattel paper outright would have no property interest left to support the attachment of a second assignment so as to engage the Article 9 and PPSA first-to-register rule of priority, a conclusion that would defeat the central purpose of including both sale and security assignments within the same perfection and priority structure. Avoidance of this conceptual problem may explain why the Article 9 drafters replaced the requirement that the debtor have or acquire "an interest in the collateral," which appeared in the first draft, with the words "rights in the collateral." The latter term is sufficiently innocuous to include the debtor's "contingent" power under Article 9 and the PPSAs to defeat a buyer-assignee's interest by making a second assignment, i.e., "contingent" on the second assignee filing first. See D.T. Coenen, "Priorities in Accounts: The Crazy Quilt of Current Law and a Proposal for Reform" (1992) 45 Vand. L. Rev. 1061 at 1076-80; and "Sacred Cows", supra note 45 at 489-90, n. 42. See also Agent's Equity Inc. v. Hope ([Trustee of]) (1996), 40 C.B.R. (3d) 310, 29 D.L.R. (2d) 287 (Ont. Gen. Div.) [hereinafter Agent's Equity].

This was the reasoning of the Tenth Circuit Court of Appeals in Octagon Gas Systems, Inc. v. Rimmer, 995 F.2d 948 at 956 (10th Cir. 1993), online: WL (CTA) [hereinafter Octagon Gas] with the result that royalties sold outright to a third party prior to bankruptcy remained the property of the debtor and part of the bankruptcy estate. See also "Sacred Cows", ibid. at 453-60; and Baird, supra note 49 at 2267, n. 42.

This interpretation was recently confirmed in the PPSA context in Agent's Equity, supra note 59. A real estate agent who had sold commissions due on the sale of real estate to a factor became bankrupt before the commissions were paid. The factor had failed to file under the Ontario PPSA, supra note 6, triggering s. 20(1)(b) under which an unperfected security interest (extended to include a sale of accounts) is ineffective against the debtor's trustee in bankruptcy. The assignor challenged the trustee's priority on the basis that the accounts, having been sold prior to bankruptcy, were no longer the "property of the bankrupt" under s. 67(1)(a) of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3. In rejecting that argument, the court reasoned, first, that the trustee can rely on provincial law to determine what falls within or outside the bankrupt's estate and, second, because the PPSA makes an unperfected sale of accounts ineffective against the trustee, the assignment is tantamount to being void and the accounts therefore remain within the bankrupt's estate.

See generally supra note 48.
proposed commentary describing the holding as "erroneously stated".\(^4\) Article 9, it was emphasized, was not intended to prevent a transfer of beneficial title in accounts. It was simply a drafting technique aimed primarily at ensuring the application of the Article 9 perfection rules and was not relevant as such to the sale/security distinction.

Nor is the potential for mischief limited to the sort of context represented by Octagon Gas. Reformers in at least one other common law jurisdiction looking at Article 9's inclusion of the absolute assignment of accounts had difficulty explaining why absolute assignments should be subjected to the perfection and priority regime inspired by Article 9.\(^4\)

### B. The Unpaid Seller's Reservation of Title and Security

Even in a functionalist world, our analysis of sale and security assignments demonstrates the continued vitality of the distinction between ownership and security. The inclusion of conditional sales and analogous title reservation agreements\(^6\) stands, however, in apparent contradiction to this proposition. After all, it is precisely this factor—the location of beneficial title in the creditor/seller rather than the debtor/buyer—that prevented the common law from characterizing an unpaid seller's

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The application of Article 9 to the sale of accounts does not prevent the transfer of ownership from seller to buyer for bankruptcy purposes. The U.C.C. was not intended to take away the right of an owner of property to transfer ownership to another. The basic distinction between the sale and securing of accounts is seen in the fact that any surplus from collections goes to the buyer in the case of a sale and to the seller in the case of a security assignment. The limited purpose for which Article 9 applies to the sale of accounts is to avoid litigation on characterization and to notify third parties of the assignee's interest. But this limited purpose does not prevent characterization of absolute assignments as sales for other purposes albeit that Art. 9 does have a bankruptcy impact insofar as the failure of the buyer to file allows the trustee to grab the accounts under the "strong-arm clause" (art. 544(a)) of the Bankruptcy Code. But that impact does not affect the transfer of ownership between seller and buyer.


\(^4\) U.C.C. § 9-102(2) lists a variety of contractually-created security interests to which Article 9 is expressly applicable. These include a "conditional sale, trust receipt, [and] other lien or title retention contract and lease or consignment intended as security." As well, U.C.C. § 9-102(1)(a)—the general scope section for Article 9—expressly includes "the retention of reservation of title by a seller of goods" within the concept of "security interest" subject to the Article. Also included is a reservation of title under a lease or consignment, but only where it is intended as security. To put the matter beyond debate, U.C.C. § 1-201(37) expressly excludes leases and consignments not intended as security from the definition of "security interest".
reservation as a security interest in the strict legal sense, notwithstanding its evident security function.67

The U.C.C. drafters did not believe that conditional sales necessarily fell within their functionalist definition of "security". Instead, they found it necessary to formally reconceptualize the conditional sale as a security agreement in the conventional sense. This is made explicit in the definition of "security interest" in U.C.C. Article 1. Pursuant to Article 1, any retention or reservation of ownership by a seller is limited in its substantive effect to the reservation of a security interest, with the general property in the goods passing to the buyer.68 The Canadian PPSA provisions do not effect an equivalent express conversion. Nonetheless, PPSA analysts are of the unanimous opinion that it is necessary to reconceptualize the arrangement so as to involve an executed sale to the buyer followed by the grant back of a security interest to the seller in order to rationalize the application of the legislation to conditional sales and analogous title reservation security transactions. Pursuant to this approach, the seller is a "secured creditor and not an owner of the collateral; the owner of the collateral is the buyer,"69 and it is to the debtor's undivided ownership interest that the security interest attaches.70

This reconceptualization of reservation of title security suggests not only that the implications of formal property analysis had more power over the minds of the draft-

67 Under the conventional English common law view, "security" in the strict legal sense is limited to interests in property created by grant from the debtor: the possessory pledge and the non-possessory mortgage, lien, or charge. Interests that operate to reserve the creditor's original ownership—hire-purchase, chattel leases, and other title retention clauses—are not treated as security and, as such, are not subject to regulation: see e.g. "World of Secured Transactions", supra note 11 at 334. Before the passage of the PPSAs, the majority of Canadian courts likewise persisted in treating the conditional sale not as a security device on the analogy of an executed sale and mortgage back of the goods, but as an "agreement to sell" in the sale of goods law sense of an agreement executory as to the passing of the general property in the goods: see e.g. Ontario Law Reform Commission, Report on Sale of Goods, (Toronto: Ministry of the Attorney General, 1979) vol. 1 at 43. The relationship between the parties was characterized as one of divided ownership rather than security. The buyer's possession and any accumulated "equity" gave rise to an equitable beneficial ownership to that extent, but the seller's legal and beneficial ownership also persisted until the final payment had been made. This is not to say that the common law cannot develop a more fully elaborated notion of beneficial ownership of the equity of redemption sort. For signs of this from an (unreformed) jurisdiction, see Esanda Finance Corporation v. Plessnig (1989), 63 A.L.J.R. 238 at 246, 166 C.L.R. 131 (H.C. Aus.), Brennan J. (regarding a hire-purchase arrangement).

68 U.C.C. § 1-201(37): "[T]he retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (s. 2-401) is limited in effect to a reservation of a 'security interest'." See also U.C.C. § 2-401(1): "[A]ny retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to the reservation of a security interest."

69 Alberta PPSA Handbook, supra note 6 at 117-18.

70 Ibid.
ers than is commonly credited, but that they also believed their transformation was in some ways artificial; the seller's ownership was not wholly a security interest in substantive terms. Since it first emerged as a financing technique, the appropriate characterization of conditional sales has perplexed courts and analysts; it continues to do so outside the Article 9 and PPSA context as well. The characterization of a true executory sale does not fully accommodate the security aspect of the transaction. After all, both in a conditional sale and a chattel mortgage the creditor's title to the collateral is acquired via the mechanics of a sale transaction and, in both, title functions as security. At the same time, the characterization of a pure security interest fails to allocate sufficient jurisprudential significance to the different origin of title in the two transactions. Title rests with the debtor where there is a mortgage and with the creditor where there is a conditional sale. In the case of a mortgage, the transformation of the debtor's "equity of redemption" into a proprietary institution which is equivalent to beneficial ownership reflects the common law's historical commitment to the preser-

71 In land law, opinion remains divided to this day on whether an instalment sale contract is an executory contract to sell or a "security device dressed up in contract clothes" (J.L. Westbrook, "A Functional Analysis of Executory Contracts" (1989) 74 Minn. L. Rev. 227 at 257). See also Stern v. McArthur (1988), 165 C.L.R. 489 (H.C. of Australia), online: Australasian Legal Information Institute <http://www.austlii.edu.au/au/cases/cth/high_ct/165clr489.html> (date accessed: 16 August 1999), where the court awarded the defaulting purchaser relief against forfeiture of land subject to an instalment seller's reservation of title. Deane and Dawson JJ. held for the purchaser on the basis that the contractual provision for determination on default operated as security for the price, making it ipso facto unconscionable—by analogy to the mortgagee's obligation to respect the mortgagor's right of redemption—for the vendors to insist on their strict contractual rights. Mason and Brennan JJ., however, rejected the security analogy as an excessive interference with the parties' contractual intent as expressed in their selection of an instalment contract rather than a mortgage as the financing vehicle. They granted relief instead (as did Gaudron J.) on the basis that the "exceptional" circumstances of the case justified a factual finding of unconscionability.

72 In its origins, the mortgage assumed the form of an outright conveyance of title to the collateral subject to the express or implied understanding that the creditor would reconvey the property on repayment of the mortgage loan. However, what began as a remedial right in the debtor to call on equity to compel the mortgagee to reconvey title on payment eventually evolved into a proprietary institution (the "equity of redemption"). With that transformation, the mortgagee came to be seen as holding a mere security interest against the debtor's beneficial ownership, albeit one acquired by the mechanics of a sale. See E. Sykes & S. Walker, The Law of Securities, 5th ed. (Sydney: Law Book, 1993) at 145-147 on the common law legal mortgage of land, and critiquing this view in favour of one involving a division of ownership between the parties. For a contemporary reversion to the personal or remedial theory of redemption, see the dissenting opinion of Major J. in Alberta (Treasury Branches), supra note 44 at 627ff., responding to the conventional view espoused by the majority that the debtor's equity of redemption is the equivalent of residual beneficial ownership:

In determining whether the book debts, once assigned, are the "property" of the assignor or the assignee, the court must choose between two conflicting meanings of "property". One definition is the immediate legal title to what has been assigned and the other is a potential interest enforceable only in equity to reacquire property which has been assigned to another, contingent on successfully fulfilling the terms of the loan agreement. ... The plain and ordinary meaning of "property" is legal title and not a contingent future equitable right to reacquire property at a future date. The very term
vation of private property against alienation except by free consent, which is subject 
only to the constraints of due process. In the case of a conditional sale, that same first 
principle augured for preservation of the seller's original property in the goods against 
alienation except in accordance with the terms (payment of the price) agreed between 
the parties. From this perspective, the imposition of a security analysis on the seller's 
title constitutes a profound interference with the contractual bargain between the 
parties.

The fact is that neither characterization is wholly satisfactory. Under a true sales 
law analysis, the seller's ownership gives it a relatively free hand at the point of en-
forcement—the seller need not permit the defaulting buyer to redeem title, need not 
resell after repossession, and need not account to the debtor for any surplus in the 
event that it does not resell. This is in contrast to the elaborate protection which sur-
rounds the debtor when a secured party wishes to realize on collateral subject to a se-
curity interest.

If the default occurs early in the relationship, the remedy under a sales analysis is 
both fair and efficient. Unlike the owner-debtor under a conventional secured loan, the 
buyer under an instalment sales contract does not start out with a significant surplus

"equity of redemption" highlights the fact that property is not presently held by the as-
signor, but rather there is a limited right to reacquire property at a future date.

The conflict between the majority and the minority opinions in this case is discussed in Part I.H., 
below.

See e.g. "Good Faith Purchase Idea", supra note 11 at 606:

At all earlier times the common law had jealously protected the rights of ownership:
the true owner of property could not be despoiled or plundered or ousted by anyone 
under any circumstances. ... Consider the obstacles that the courts, having invented the 
mortgagor's equity of redemption in the seventeenth century, placed in the way of the 
mortgagee who wanted to foreclose his mortgage on default.

This thinking still dominates in Canadian law outside the PPSA context: see e.g. Kawai Canada 
da Music], leave to appeal to S.C.C. refused [1993] 3 S.C.R. ix, 104 D.L.R. (4th) vii. At issue was 
priority between a conditional seller and a chartered bank holding security in the debtor's present and 
after-acquired goods under s. 427 of the federal Bank Act, R.S.C. 1985, c. B-1. Under s. 427, the bank 
acquires security in property of which the debtor "is the owner" or subsequently "becomes the 
owner". In ruling that a supplier who had reserved title to goods delivered to the debtor thereby 
maintained priority over the bank, the court reasoned that to allow the bank's after-acquired security 
interest to capture the seller's title would amount to the expropriation of another's property without 
consent, a conclusion to be resisted in the absence of explicit legislative language requiring this inter-
pretation.

For this reason, even self-identified "functionalists" have difficulty with imposing a security label 
on an unpaid vendor's reservation of title. See Westbrook, supra note 71 at 241-42: Judicial recon-
ceptualization of the land instalment sales contract as a mortgage puts "many real estate sellers at risk 
of a fundamental post hoc change in the bargain they made, a result that threatens an important and 
legitimate type of real estate transaction." Compare J.M. Moringiello, "A Mortgage By Any Other 
Name: A Plea for the Uniform Treatment of Installment Land Contracts and Mortgages under the 
Bankruptcy Code" (1996) 100 Dick. L. Rev. 733.
equity in the collateral. So, a simple reclamation right merely restores the parties to their pre-default economic position. In these circumstances, to require the seller to go through the elaborate remedial process applicable to secured lenders results only in an unnecessary delay. This delay potentially lowers the realizable value of the collateral. This is a particular problem with personal property because it normally depreciates rather quickly and enables an unscrupulous buyer to sell or dissipate it.

The solution arrived at under a sales analysis becomes less persuasive, however, as the financing transaction evolves. With every payment, the buyer's interest evolves into something closer to ownership, and the potential prejudice from a forced repossession becomes correspondingly greater. This is particularly true if the seller has reserved a contractual right to claim a deficiency on a resale of the collateral. The buyer then loses its accumulated equity while it nevertheless remains liable for the price.

The pre-PPSA Conditional Sales Acts ("CSAs") sought to accommodate the needs of both parties with a hybrid enforcement regime. The buyer was awarded a grace period to cure the default and complete the purchase. This was not a true equity of redemption in the sense of vesting the buyer with the status of owner so as to entitle the buyer to any surplus realized on a resale by the seller. It did, however, give the buyer protection against an unscrupulous seller seeking to take advantage of a minor or technical default. The legislature also restricted the seller's right to claim any deficiency left owing on the price following a repossession and resale. Not only did this have to be reserved expressly in the contract, but the seller's right to the deficiency was also made contingent upon the advance written notice of the sale and the state of the accounts between the parties to the buyer.

At the perfection and priority level, the CSAs took a similarly hybrid approach. Sales law, to be sure, already recognized the need to protect subsequent transferees

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77 See Delta Acceptance Corporation v. Redman, [1966] 2 O.R. 37, 55 D.L.R. (2d) 481 (C.A.). Canadian courts were initially sympathetic to giving the buyer, by analogy to the chattel mortgagor, a right to claim any surplus proceeds following a repossession and resale of the collateral: see C.C. Motor Sales Ltd. v. Chan, [1926] S.C.R. 485, [1926] 3 D.L.R. 712. It was only when the focus of litigation shifted to the seller's right to claim a deficiency that the security analogy was rejected and the conventional sales analysis reinstated: see Humphrey Motors Ltd. v. Ellis, [1935] S.C.R. 249, [1935] 2 D.L.R. 705 [hereinafter Humphrey Motors]. Since deficiencies, not surpluses, are the norm in the personal property security context, it may be that the Canadian judiciary's ultimate rejection of the security analogy was motivated more than incidentally by consumer protection policies.

78 Under the conventional sales analysis, the contract having been rescinded by the seller's act of repossession, the buyer was seen as released from its countervailing obligation to pay the purchase price unless the sale agreement expressly provided otherwise: see Humphrey Motors, ibid., but see Keneric Tractor Sales v. Langille, [1987] 2 S.C.R. 440, 43 D.L.R. (4th) 171. Even when a "deficiency" claim had been reserved in the contract, the seller's right to exercise it depended on strict compliance with the prior notice requirements imposed by the CSAs: see Humphrey Motors, ibid.
against the seller’s “secret lien”. This is evidenced in the fact that under the Sale of Goods Acts, the buyer was empowered to give good title if the transferee took without actual notice of the seller’s reservation of title. This kind of all-or-nothing approach made conditional sales a highly vulnerable form of financing. The buyer had the power to destroy the seller’s ownership by violating the seller’s reservation of title. Moreover, the protection afforded third parties was seen to be imperfect from a secured credit perspective: subsequent buyers were protected, but not subsequent secured parties, unless they took actual possession of the collateral as under a pledge or the relatively unusual possessory chattel mortgage.

In order to resolve these problems, the old CSAs mandated public registration of conditional sales on pain of subordination to subsequent buyers, secured parties, and the buyer’s general creditors. This solution afforded the seller protection from a buyer’s misconduct while also ensuring public disclosure of the seller’s interest. At the same time, mandatory registration did not completely eviscerate the historical super-priority interest inherent in the seller’s retention of ownership. The unperfected seller was only vulnerable to subsequent purchasers and mortgagees of the collateral who took without actual notice. A prior secured party holding a general security interest in the buyer’s present and after-acquired assets was not considered a subsequent purchaser unless the secured party extended new credit so as to come within the reliance policy of the CSAs. To this extent, the conditional seller’s reservation of ownership afforded a super-priority even without registration.

In reducing the seller’s status from an owner to a secured party, Article 9 and the PPSAs dramatically change the position of both immediate and third parties. At the enforcement level, the buyer-in-possession is apparently advantaged. This person now has a full-fledged right of redemption and a corresponding right to any surplus on a forced resale of the collateral. However, deficiencies and not surpluses are the norm in realizations against goods and the buyer is now also subjected to an automatic liability for any deficiency on the resale. This no longer needs to be reserved expressly in the contract; the obligation automatically flows from the conversion of the buyer’s obligation to pay the price into a secured debt. The seller’s remedial options are also more restricted. Upon repossession, the seller cannot repossess the assets, put them back in inventory, or dispose of them through other trade channels without having to further

79 See e.g. Sale of Goods Act, R.S.O. 1990, c. S-1, s. 25(2).
80 The assumption seems to have been that where the contest was between successive non-possessor interests, the seller’s ownership should trump the mortgagee’s “lesser” security interest.
83 This was the pre-reform law in both the United States and common law Canada. See L.T. Garvin, “Credit, Information, and Trust in the Law of Sales: The Credit Seller’s Right of Reclamation” (1996) 44 U.C.L.A. L. Rev. 247 at 260; and C. Walsh, Comment (1983) 43 N.B.R. (2d) 186.
account to the debtor and third parties. The only remedy is to sell." Notice of the sale must be given to the debtor and any subordinate claimants of record, the sale itself must be conducted in conformity with the standard of commercial reasonableness imposed on secured lenders, and the seller must render an accounting of the proceeds of resale.

At the level of perfection and priority, the seller's property interest in the goods—reduced from ownership to security—no longer ipso facto protects the seller from subordination to prior secured creditors. The historical priority advantage can be regained by the supplier only if the special perfection requirements applicable to purchase money security interests ("PMSI") are satisfied. A PMSI is an interest in favour of creditors whose extension of credit is intended to, and does in fact, facilitate the debtor's acquisition of the collateral. The distinction between PMSIs and general security interests is made for the purpose of awarding the purchase money financier a special or "super-priority" analogous to that historically enjoyed by the conditional seller and which has now been extended to third party institutional lenders. Nonetheless, super-priority is no longer built into the very nature of the seller's property right. Consequently, non-compliance with the special perfection requirements for PMSI status may even subdivide the seller's claim to that of a non-reliant prior secured party with a security interest in the debtor's after-acquired goods.

There is evidence of a growing discomfort with the wholesale relegation of the real rights of sellers to the world of security. We see this in the recent resurgence of support for expanding the post-delivery right of reclamation available to trade suppli-

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54 Although Article 9 and the PPSAs offer the alternative of a voluntary exchange of the collateral for the debt, this remedy likewise requires advance notice to the debtor and subordinate claimants of record. Moreover, if any one of these objects to foreclosure, the seller must proceed with a sale, unless a court confirms that the objection is unfounded. See e.g. New Brunswick PPSA, supra note 6, s. 61.

55 See e.g. New Brunswick PPSA, ibid, s. 1: "purchase money security interest."

56 See Ziegel & Denomme, supra note 6 at 258ff. This is an extension that English law has begun to make as a matter of common law doctrine: see Abbey National Building Society v. Cann, [1991] 1 A.C. 56, [1990] 1 All E.R. 1085 (H.L.).

57 In the early years of Article 9, some courts resisted this conclusion notwithstanding the clear intention of the U.C.C.: see e.g. International Harvester Credit Corp. v. American National Bank of Jacksonville, 296 So.2d 32 (Fla. S.C. 1974), online: WL (FL-CS) where the court ruled that an unperfected seller who had retained title to collateral retained priority over a prior secured creditor on the theory that since the seller had retained ownership to the collateral, the bank could take a security interest only to the extent of the buyer's "equity" in the collateral; the contrary result would violate "contractual constitutional requirements and equitable principles" (ibid. at 34). Similar arguments continue to be made, and uniformly rejected (although not without regret), under the Canadian PPSAs. See e.g. Haibeck v. No. 40 Taurus Ventures Ltd. (1991), 59 B.C.L.R. (2d) 229, 2 P.S.A.C. (2d) 171 (S.C.(T.D.)) [hereinafter Haibeck] where it was held that, notwithstanding that the equities favoured the seller who stood to lose the goods sold though it had not been paid, it was clear that under the PPSAs a buyer acquires sufficient rights in goods sold subject to a reservation of title to allow a prior security interest given by the buyer in its after-acquired goods to attach to the collateral as a whole and take priority in the event that the seller fails to comply with the perfection requirements for PMSI super-priority.
ers against an insolvent purchaser under U.C.C. § 2-702(2). Under the present version of this section, the seller must demand repossession within ten days of delivery, a time period that is generally impracticable unless bankruptcy has been declared. Nevertheless, even when the debtor is bankrupt, the reclaiming seller’s remedy is ineffective against bona fide purchasers—a concept that includes the holder of a prior security interest in the debtor’s after-acquired assets, whether or not there is evidence of reliance in the form of a fresh advance against the new assets. Under the proposed revision, the seller’s reclamation right would be strengthened so as to prevail at least over a non-reliant prior all-assets financier. This is done by limiting protection to purchasers who have offered new value.

While the proposed revision to U.C.C. Article 2 is consistent with a sales law perspective on the seller’s status, it conflicts with the trend toward further expansion of the rights of secured parties under Article 9. For this reason, its ultimate fate is still very contentious.

In Canadian law, a similar tension exists. A 1992 amendment to the federal Bankruptcy and Insolvency Act awarded unpaid suppliers a thirty day statutory right to repossess goods delivered to a bankrupt buyer. The remedy is somewhat more generous than its U.C.C. equivalent. In the Canadian version, the suppliers’ right lasts for thirty days and ranks ahead of all other statutory and contractual common law claims, except those of bona fide purchasers for value who did not have notice of the repossession demand. Notwithstanding the willingness of the courts to extend the time delay to avoid debtor-creditor collusion to “juice the trades”, the timing is still tight and renders the protection somewhat illusory. Nevertheless, attempts to liberalize recla-

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88 See e.g. Garvin, supra note 83 at 253-54: “Reclamation should be expanded—or, rather restored to its pre-Code vigour—in order to promote the interests of credit, information and trust.”

89 Ibid. at 273.

90 Ibid. at 258.

91 Ibid. at 260. See also ibid. at 251: “The revisers of Article 9 have consistently sought to advance the rights of secured parties over those of unsecured parties, including the trade creditors for whom reclamation is potentially a significant remedy.”

92 Supra note 61.

93 Under s. 81.1 of the Bankruptcy and Insolvency Act, ibid., a supplier may repossess goods from a business which has gone into bankruptcy or receivership within thirty days of delivery, provided the supplier presents a written demand for repossession within that same thirty day period, and provided the goods are still in the possession of the purchaser or its trustee or receiver, are identifiable, are in the same state, and have not yet been resold. The remedy is analogous to the unpaid seller’s right of revendication under the Civil Code of Quebec. See generally R.A. Klotz, “Protection of Unpaid Suppliers under the New Bankruptcy and Insolvency Act” (1993) 21 Can. Bus. L.J. 161 [hereinafter “Unpaid Suppliers”]; and R.A. Klotz, “Unpaid Suppliers and Trade Creditors” in Insight Educational Services & Globe and Mail (Firm), Who Takes Priority? (Toronto: Insight, 1996) 467 [hereinafter “Trade Creditors”].

94 “Trade Creditors”, ibid. at 473ff. The expression “juicing the trades” refers to the perceived tendency of a failing business to load up on inventory on the eve of insolvency in order to reduce the de-
mation met with strong opposition in the last round of revisions to the Bankruptcy and Insolvency Act, and reconsideration was put off for another five years.98

Even within the Article 9 and PPSA framework, there is an evident tension between a sales and a security perspective on the seller's real rights. Consider first the express exclusion under the Canadian PPSAs of an unpaid seller's right under sales law to ship goods under a bill of lading made out to the seller so as to reserve a right of disposal as "security" against the buyer's failure to pay the price at destination.99 This exclusion is typically explained on the basis that there is no need to invoke the PPSA perfection and priority regime to protect third parties where the buyer has not yet taken physical delivery.100 However, this cannot be the entire explanation, since the exclusion also operates to subject the seller and the buyer to the default rights and remedies of sales law as opposed to secured lending law. Implicit in this latter aspect of the exclusion is recognition that a buyer who has paid nothing on the price is not an owner of the collateral in any real sense so as to need the protection of the restrictions imposed on a creditor enforcing a security interest in the debtor's property.101

Consider next the appropriate resolution of a priority contest between competing supplier and lender PMSIs in the same item of collateral. The functional identity of sale and loan credit suggests that they should simply rank equally. While this is the proposed rule under Article 9,102 the Canadian PPSAs award priority to the supplier.103 This solution is variously explained on the basis that lenders are more likely to guard

\[98\] See F. Bennett, "Bill C-5: An Act to Amend the Bankruptcy and Insolvency Act" in Banking, PPSA, Bankruptcy Conference Papers (New Brunswick, C.L.E., 15-16 November 1996) 15. Bill C-5 does little more than eliminate some of the worst inconsistencies between the rights of unpaid suppliers in the event of a reorganization under the federal Company Creditors Arrangement Act, R.S.C. 1985, c. C-36 as opposed to the federal Bankruptcy and Insolvency Act.

\[99\] The drafting technique is more cumbersome under the Ontario PPSA than the other PPSAs. Compare Ontario PPSA, supra note 6, s. 4(2) (cross-reference to inapplicability of s. 20(2) of the Sale of Goods Act, supra note 79) and New Brunswick PPSA, supra note 6, s. 1: "security interest" (express general exclusion in para. (a) of the definition). See also Ziegel & Denomme, supra note 6 at 267-68; and Barclays Business Credit v. Fletcher Challenge Canada (1993), 13 O.R. (3d) 118, 5 P.P.S.A.C. (2d) 105 (Gen. Div.).

\[100\] Ziegel & Denomme, ibid. at 79-82.

\[101\] An Introduction, supra note 6 at 31.


\[103\] See e.g. Ontario PPSA, supra note 6, s. 33(3) which is discussed by Ziegel & Denomme, supra note 6 at 267-68.
against (by prior searching), and are better positioned (through volume lending) to absorb and redistribute losses flowing from a reduction in their priority than suppliers for whom the credit sale is central to their primary business. Whether or not this represents sensible policy, what is significant for present purposes is that the PPSA solution is readily intelligible in terms of the priority advantage inherent in title reservation security under a formal property analysis.

The final and more telling illustration of Article 9's residual preference for title-reservation security is the exemption afforded to suppliers of consumer goods, in contrast to third party purchase money financiers, from the need to register in order to maintain super-priority over both secured and general creditors. This feature of Article 9 has not been carried over to the Canadian PPSAs even though both regimes draw a sharp distinction between PMSIs in inventory and non-inventory collateral. Financiers of non-inventory collateral—i.e., capital equipment and, in the case of the Canadian PPSAs, consumer goods—enjoy an "automatic" super-priority over a prior perfected secured lender so long as registration is effected within the prescribed time period after the debtor takes possession of the collateral. In the case of a PMSI covering inventory collateral, the requirements for super-priority are more onerous. The inventory financier must not only register, but must also give advance written notice to earlier perfected secured parties before the debtor obtains possession of the collateral. Non-compliance means that the PMSI priority reverts to the ordinary first-in-time ranking.

The secured parties entitled to advance notice of an inventory PMSI are those with a perfected security interest in after-acquired assets of the same kind, and who might otherwise extend a fresh advance against the security of the incoming inventory in ignorance of the intervening PMSI. The same risk also presents itself in the case of a later PMSI taken in specific goods, especially if the item is a particularly valuable piece of capital equipment. Yet, in this instance, the PMSI holder acquires an automatic super-priority against the first lender provided only that registration is effected within the prescribed grace period after delivery. The onus is on the first lender to monitor the filings and wait out the prescribed period before relying on the new collateral to secure a fresh advance.

A functionalist might seek to justify the stronger priority status afforded to PMSIs in specific assets on the basis of risk alteration and efficiency with regard to searching

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3. U.C.C. § 9-312(4) (ten day grace period).

4. H. Kanda & S. Levmore, "Explaining Creditor Priorities" (1994) 80 Va. L. Rev. 2103 at 2139: "The [Article 9 PMSI priority] rules intimate that the acquisition of new inventory and its associated debt is more threatening to earlier creditors than the debt-financing of new equipment but that debt tied to new inventory is still less threatening than new money unlinked to particular assets."
Risk alteration refers to the propensity of debtors to engage in riskier behaviour as their ratio of assets to debt is diminished. A first-in-time priority rule responds to the risk alteration problem by fostering early lending and discouraging later borrowings. Its disadvantage is that, as the debtor's business evolves, later creditors, notably later purchase money financiers, may prove to be more informed lenders or more efficient decision makers.

If the later PMSI is restricted to specific non-inventory assets, the risk alteration problem is relatively minimal. Although the debtor has taken on a new debt, the new debt is counterbalanced by the acquisition of a new asset which, unlike inventory, is meant to remain within the estate and which may well be value enhancing. Even if it is not value enhancing, the impact on the prior creditor is relatively slight. In other words, not only is the later lender's super-priority restricted to the specific asset, but the prior creditor, presumably aware of the risk, can protect its interest by searching the registry before making fresh advances against specific assets.

Where the new assets consist of inventory, the first-in-time lender is typically the debtor's principal source of working capital; a significant component of this working capital may be dedicated to fund the acquisition of inventory on a revolving credit basis. In this case, the burden of having to continually monitor the records for intervening inventory PMSIs is all but infeasible. Placing the burden of notice on the subsequent creditor, therefore, ensures that the prior creditor will have an opportunity to react quickly to the increased risk posed by the new debt in order to avoid prejudicial reliance.

Whatever the merits of these explanations, what is significant for our purposes is the close identity between the Article 9 and PPSA rules on the one hand, and the rules arrived at under a formal property analysis on the other. Thus, pre-PPSA law drew a similar distinction between the priority status of suppliers of specific goods and inventory. Reservation of ownership as a security device, and the automatic super-priority associated with ownership, was available only to the unpaid supplier of specifically identified goods already delivered to the buyer. A supplier who wished to take security in inventory to be supplied to the buyer on an ongoing basis was forced to take a floating charge, with priority as against a prior floating interest in inventory determined on a first-in-time basis. The subsequent inventory supplier's super-priority therefore depended upon the willingness of the prior lender to subordinate its first-in-time priority. The practical result under Article 9 and the PPSAs is not very

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105 Ibid.
106 This was because the CSAs did not contemplate or allow the filing of a conditional sales contract covering after-acquired goods. It was thus impossible for a supplier to effectively reserve title in, for example, all inventory now or hereinafter delivered to the dealer. Rather, a new conditional sales contract had to be executed and filed with each fresh delivery of inventory to the dealer, a process that was infeasible for all but big ticket items of inventory where the profit margin and relatively slow turnover might warrant the high transaction costs of compliance.
107 See Re Benjamin Cope & Sons Ltd., [1914] 1 Ch. 800, 83 L.J. Ch. 699.
different. Although a subsequent inventory financier can, in theory, acquire super-priority under the PPSA simply by giving unilateral notice, the security agreement between the prior lender and the debtor will often contain a term prohibiting the debtor from granting any further security interests without obtaining the prior lender's permission. Unless the debtor can obtain the prior lender's consent to subordinate its claim, there exists a risk that the first loan will be called.

The distinction between specific assets and inventory financing is also reflected in the Article 9 and PPSA rules governing priority in the proceeds of a disposition of the collateral. As a general rule, the purchase money financier's super-priority extends prima facie to proceeds in all regimes. However, when it comes to the most common form of proceeds—accounts (and the proceeds of accounts)—Article 9 and the western Canadian PPSAs subordinate the PMSI to a prior-registered security interest taken in the accounts as original collateral for new value. This is implicit recognition of the weaker case for conferring super-priority once the purchase money financier seeks to transfer the security interest from specific assets into the debtor's larger liquid estate.108

C. Leases and Security

The drafters' recharacterization of conditional sales as security indicates that the intention is to transfer residual beneficial title in the collateral to the debtor on satisfaction of the secured obligation that converts a reservation of title agreement into a security device under Article 9 and the PPSAs. This kind of formalistic analysis is helpful in resolving one of the most intensively litigated issues under Article 9, i.e. the distinction between a true lease and a secured transaction in the form of a lease.109

The confused state of the jurisprudence on the "true lease/security lease" distinction is not surprising in view of the drafters' adoption of functionalism as the only distinguishing criterion.110 From a functionalist perspective, there is little to distinguish

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108 An Introduction, supra note 6 at 162-63. The exceptions are the Ontario and Atlantic PPSAs under which the inventory financier's super-priority survives over the accounts. However, except in Ontario, the inventory supplier is required to give advance notice of its claim on the accounts to a prior accounts financier, so that the difference in practical result is minimal. Note too that while the interest of a bank taking s. 427 Bank Act security in inventory is thought to extend by necessary implication into the proceeds of sale of the inventory, the bank's implied tracing rights terminate once the proceeds reach the hands of a bona fide purchaser for value without notice and are subject to equitable set-off: see Canadian Imperial Bank of Commerce v. Kernel Farms Ltd. (1982), 138 D.L.R. (3d) 128, 43 C.B.R. (N.S.) 72 (Ont. H.C.J.), aff'd (1984), 45 O.R. (2d) 88, 6 D.L.R. (4th) 384 (C.A.) [hereinafter Kernel Farms]; and Mercantile Bank of Canada v. Leon's Furniture (1992), 11 O.R. (3d) 713, 98 D.L.R. (4th) 449 (C.A.) [hereinafter Mercantile Bank].

109 This is the case notwithstanding the opportunity to avoid a characterization dispute by making an informational or a caution filing pursuant to U.C.C. § 9-408.

110 C. Cooper, "Identifying a Personal Property Lease under the UCC" (1988) 49 Ohio St. L.J. 195 at 199-200:

[I]f there is a problem in understanding what is a sale, lease, or a security interest, it is not because these are all really the same transaction, but because the basis in the law
the two leases. After all, a lease operates as a form of purchase money financing to the extent that it allows a lessee who lacks the wherewithal to buy the leased goods to nonetheless obtain their possession and use. The economic function of the transaction from the point of view of the lessor and the purchase money secured party is similar: both obtain the right to a stream of payments during the currency of the transaction and both can claim an in rem right to priority as against other creditors in the event of insolvency.111

In contrast to functionalism, formal title analysis offers a reasonably clear basis for distinction.112 In a true lease, the residual value remains in the lessor, and the lessor is entitled to the unconditional return of that residual value on the conclusion of the term of the lease. In a security lease, on the other hand, the debtor obtains the benefit (and suffers the burden) associated with the residual economic value in the collateral. The definition of “security interest” in U.C.C. § 1-120(37) was substantially revised in 1987 in order to clarify this point. The new version confirms the paramount relevance of the location of residual title (in the substantive sense of the residual economic value) in drawing the lease/security distinction;113 however, the message has not been received uniformly by the courts. Both true leases and security leases involve a separation of possession and property rights and, as such, raise a common ostensible ownership problem. In order to bring into play the publicity requirements applicable to security leases, there is an evident judicial temptation to continue subsuming true leases within the security rubric. This tendency is particularly strong under Article 9 and the Ontario PPSA114 but is far less pronounced under the other Canadian PPSAs, all of

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for distinguishing among them has become hopelessly blurred. ... Although the blame for this confusion may be placed on the concepts themselves, it seems that the responsibility is more logically placed on the minimal guidance provided by the current version [pre-1987] of the U.C.C.


112 Cooper, supra note 110.

113 See e.g. 1993 Law of Secured Transactions, supra note 64 at 1.35:

Under the new version of 1-201(37), the question is: Will the lessee enjoy possession and use of the goods for their entire economic life[? ... If so, the lease is a disguised security interest. The focus is on the economic realities of the transaction: Do the terms of the lease create an irresistible economic impulse on the lessee to become the owner, thereby suggesting that the lessor has no meaningful residual interest? That is the bottom line.

which deem true leases for a term in excess of one year to be security interests for the purposes of perfection and priority, but not for enforcement."

Deeming true leases to be security interests lessens the pressure to resolve the common publicity concern underpinning both forms via an expansive reading of the concept of security." However, this has generated its own conceptual problems. At issue in Re Giffen," recently decided by the Supreme Court of Canada, was the effect of the failure to register a lease under the British Columbia PPSA on the lessor's real rights against the insolvent lessee's trustee in bankruptcy. The intended effect under the PPSA was abundantly clear: under section 20, an unperfected security interest, deemed by section 1 to include the interest of a lessor under a true lease for a term of more than one year, is ineffective against the debtor's trustee in bankruptcy." The lessor argued that its failure to file was insufficient to vest its residual title in the trustee, whose interest is limited by federal bankruptcy law to property belonging to the bankrupt debtor." Reversing the trial court, the British Columbia Court of Appeal agreed with the lessor, even though it acknowledged that the scope of a bankrupt debtor's estate is defined principally by reference to provincial property law. The Court of Appeal held that nowhere did the PPSA effect an express transfer of the lessor's residual ownership thereby making the leased goods the property of the bankrupt lessee." Consequently, the lessor was entitled to the return of its property from the trustee.

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116 But the "true lease/security lease" distinction remains relevant at the enforcement level. True leases are excluded from the PPSA default enforcement regime: see e.g. New Brunswick PPSA, supra note 6, s. 55(1)(a). The remedial differences between lease and security can be profound in those PPSA jurisdictions which afford special protection to consumer debtors: see British Columbia PPSA, supra note 6, s. 58(3) which bars a secured party from enforcing a security interest in consumer goods where the buyer has paid at least two thirds of the total secured obligation. The British Columbia PPSA also incorporates a "seize or sue" limitation on a secured party's enforcement rights against consumer goods; i.e., if the secured party elects to sue the debtor personally on the secured debt, it thereby foregoes its real rights against the collateral. In such cases, the "true lease/security lease" distinction becomes critical in the event that the lessee is insolvent. If the lease is a true lease, the goods do not form part of the bankrupt's estate (assuming the lease is duly perfected) and the lessor can recover the goods from the lessee's trustee in bankruptcy. But if the lease is a security lease and the lessor has waived its real rights by suing the lessee personally for the rental payments, its status in the bankruptcy distribution is reduced to that of a mere unsecured creditor: see e.g. Re Bronson (1996), 18 B.C.L.R. (3d) 195, 39 C.B.R. (3d) 33 (S.C.(A.D.)).


118 The Court seems to have assumed that it was dealing with a true lease, not a security lease. There is reason to question that assumption, but for the purposes of this analysis, we will assume it is accurate.

119 Bankruptcy and Insolvency Act, supra note 61, s. 67(1)(a).

120 This conceptual problem does not arise where the deemed security interest is created by grant from the debtor—as in an outright sale of accounts—rather than by reservation of ownership by the
The Court of Appeal’s reading of the PPSA has been uniformly criticized for being highly formalistic. After all, Canadian legislative precedent for the imposition of filing requirements on true leases pre-dates the PPSAs by many years; the registration provisions of the old CSAs—still in force in some Atlantic provinces—likewise extended to both conditional sales and true leases with an option to purchase. Unless filed, the lessor’s residual title was declared void as against subsequent purchasers, mortgagees, and the lessee’s creditors, including the lessee’s trustee in bankruptcy in its representative capacity.

As a matter of statutory interpretation, we agree that the analysis of the Court of Appeal in Re Giffen is wrong as the Supreme Court of Canada so held. It is true that the CSAs, unlike the PPSAs, expressly deemed the lessee under an unfiled lease to be the owner of the goods as against the classes of third parties protected by the filing requirement, including the lessee’s trustee in bankruptcy. The same conclusion is inherent in the operation of the PPSA attachment and priority structure, as the Supreme Court recognized. Although this did not form part of the Supreme Court’s reasoning,
we believe that this is most clearly seen in the PPSA and Article 9 requirement that a debtor, including a deemed debtor, need only have "rights in the collateral"\(^4\) in order for a security interest to attach. The term "rights in the collateral" is sometimes understood as an acknowledgment of the continuing pro tarto vitality of the common law theory of derivative property rights (\textit{nemo dat quod non habet})\(^5\) in the PPSA and, as such, as limiting the quantum of the property rights to which a competing creditor’s interest can attach to those held by the debtor.\(^6\) However, on this interpretation, a competing creditor’s interest in collateral to which a secured creditor, deemed or otherwise, had retained ownership would attach only to the debtor’s possessory rights and any accumulated equity. This cannot be correct. The internal logic of the Article 9 and PPSA priority regime is premised on a rejection of derivative title theory in favour of registration as the principal mechanism for ranking priority both among secured creditors and as between the secured creditor and the debtor’s general creditors including the trustee in bankruptcy.\(^7\) To give effect to this intent, “rights in the collateral” must be understood as requiring a mere bare right to possession or a power to convey a greater interest than has the debtor,\(^8\) a point confirmed in PPSA jurispru-

\(^{12}\) U.C.C. § 9-203(1)(c). For the equivalent PPSA provision, see \textit{e.g.} Ontario PPSA, \textit{supra} note 6, s. 11(2)(c).

\(^{13}\) One who has not cannot give.

\(^{14}\) See \textit{e.g.} Ziegel & Denomme, \textit{supra} note 6 at 114:

Read literally, [the PPSA requirement that the debtor have rights in the collateral] merely states the obvious: if the debtor has no rights in the collateral, there is nothing for him to convey to the secured party. \textit{Nemo dat quod non habet}. Likewise, if the debtor has only a limited interest, falling short of ownership, that is all he can convey to the secured party.

See also \textit{ibid.} at 115: “[The drafters’ use of the term ‘rights in the collateral’] was not intended to enlarge the debtor’s rights in the collateral.” The \textit{nemo dat} theory of “rights in the collateral” is also widely accepted among Article 9 analysts: see \textit{e.g.} I.J. Rusch, “The Article 9 Filing System: Why a Race Recording Model is Unworkable” (1995) 79 Minn. L. Rev. 565 at 566-69; M. Livingston, “Certainty, Efficiency, and Realism: Rights in the Collateral under Article 9 of the Uniform Commercial Code” (1994) 73 N.C. L. Rev. 115 at 119-120; and Tabac, \textit{supra} note 18 at 412, n. 24. Compare Board, \textit{supra} note 20 at 1029ff.

\(^{15}\) The difference is illustrated by comparing the PPSA perfection-driven priority regime with that applicable to security taken by the chartered banks under s. 427 of the \textit{Bank Act}, \textit{supra} note 74. The latter regime is premised on traditional derivative title ranking principles. Under s. 427, failure to file subordinates the bank only to “subsequent” mortgagees and purchasers. Moreover, the bank acquires an effective security interest only in property of which the debtor “is the owner” or subsequently “becomes the owner”: see \textit{e.g.} \textit{Kawai Canada Music}, \textit{supra} note 74, where it was held that, because the \textit{Bank Act} does not inflate the bank’s rights beyond what the debtor has to give, and because what the debtor has to give is determined exclusively by its contract with its transferor, a supplier who has reserved title to goods delivered to the debtor maintains priority over a bank which has taken s. 427 security notwithstanding the absence of any express provision for PMSI super-priority in the \textit{Bank Act}.

dence and expressly stated in some of the more recent PPSAs. On this interpretation, ostensible ownership—in the radical sense of bare possession or control of the collateral—has effectively replaced derivative title for the purposes of determining the scope of the secured debtor’s estate at the priority level. Thus, by the very act of deeming a true lease to be a PPSA security interest, ownership in the leased assets is effectively vested in the lessee as against the lessee’s secured creditors and trustee in bankruptcy.

We suspect, however, that a deeper concern was underlying the Court of Appeal’s reversion to formalism. The Court’s concern, we believe, was the perceived unfairness of extending a secured lending perfection and priority regime to true owners. The Supreme Court did not deal with this point. Its analysis in this respect was as formalistic

128 This alternative mode of analysis (i.e., rights in the collateral includes a contingent power to transfer better property rights than one has) is necessary to rationalize the operation of the Article 9 and PPSA first-to-register priority rules in the case where an assignor who has sold its accounts outright makes a second assignment to an assignee who registers first (since the assignor in such a case may not even have retained a right to collect or otherwise control the accounts after the first assignment). See also supra note 49.

129 See e.g. Marcel Equipment Ltd. v. Equipements Benoit D’Amours et Fils Inc. (1995), 9 P.P.S.A.C. (2d) 31 (Ont. Gen. Div.), online: QL (OJ). Here, a conditional seller had failed to register in time to qualify for super-priority over a prior security interest in the buyer’s after-acquired goods. The seller argued that because it had reserved title to the goods, the competing security interest could attach at most to the buyer’s right of possession and any accumulated “equity”. In rejecting that argument, the Court reasoned that the term “rights in the collateral” was sufficiently broad to encompass the possessory and equitable rights of a conditional buyer, with the result that the competing security interest attached to the collateral as a whole. To the same effect, see Euroclean Canada v. Forest Glade Investments (1985), 49 O.R. (2d) 769, 16 D.L.R. (4th) 289 (C.A.); and Haibeck, supra note 87. For recent confirmation that the same reasoning applies to deemed security interests in the form of a true lease, see Sprung Instant Structures v. Caswan Environmental Services, [1997] 5 W.W.R. 280, 47 Alta. L.R. (3d) 358 (Q.B.); [hereinafter Sprung] where it was held that, in a PPSA regime, the rule of nemo dat no longer dominates and one need not be an “owner” to give an effective security interest in collateral. Since true leases are deemed to be security interests under the Alberta PPSA, the priority status of the lessor against the lessee’s “other” secured creditors and bankruptcy trustee is likewise governed by the PPSA priority and registration rules, and not by the common law rule of nemo dat. See also Otto Timin, supra note 22, where possession under a conditional sales contract or even a simple bailment gives sufficient “rights in the collateral” for attachment.

130 Including the British Columbia PPSA, supra note 6, s. 12:

For the purposes of [satisfying the requirement that the debtor have rights in the collateral], a lessee under a lease for a term of more than one year or a consignee under a commercial consignment has rights in the goods when the lessor or consignee obtains possession of them under the lease or consignment.

131 For recent judicial confirmation, see Sprung, supra note 129. For a historical and comparative account of the transformation of the basis of ownership in personal property from derivative title to the ostensible ownership thesis implicit in the “rights in the collateral” attachment principle embraced by Article 9 and the PPSAs, see B. Kozolchyk, “Transfer of Personal Property by a Nonowner: Its Future in Light of its Past” (1987) 61 Tul. L. Rev. 1453.
as that of the Court of Appeal. Had the Supreme Court gone into the issue of perceived unfairness, we suggest that the analysis might have been as follows. It is one thing to require secured creditors to register on pain of subordination to the debtor’s other creditors since secured credit is after all an exception to the normal principle of equal ranking among creditors; however, it is quite another thing to allow a debtor’s non-reliant creditors to sweep up property belonging to a third party. The PPSAs implicitly recognize that the lessor’s residual ownership interest is entitled to a higher quality of protection since they deem a true lease to be a PMSI which qualifies for the same purchase money super-priority enjoyed by an unpaid vendor who has reserved a security interest. However, as with any PMSI in non-inventory goods, super-priority is conferred on the lessor’s interest only if it is perfected within ten days of delivery of the leased goods to the lessee. Otherwise, the lessor’s interest is swept into the dragnet of a prior security interest in the lessee’s after-acquired goods, or rendered part of the lessee’s estate for the purposes of a bankruptcy administration or judgment enforcement lien.

It might be said that the lessor has only itself to blame for failing to publicize its non-possessory title. This, however, begs the question of whether the priority repercussions of non-compliance should be as severe for owners—who never agreed to convey their residual title and whose ownership interest by definition is apt to be of more substantial value—as for the holder of a security interest in another’s property contingent on default. Of course, to the extent that the priority consequences of a failure to file differ between true and security leases, the incentive to litigate characterization will remain, thereby eliminating a major advantage of bringing both types of leases within the same filing structure. Viewed in this light, a more nuanced resolution of the issue in Re Giffen might have turned instead on the level of prejudice to creditors occasioned by the scope of the collateral subject to title reservation. This

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132 The closest the Supreme Court comes to acknowledging the point is in the reference to the legislature’s resolution of competing policy concerns in the PPSA’s text: see Re Giffen, supra note 117 at 115.

133 It is this concern that has thus far doomed proposals to extend the Article 9 filing regime to cover true leases. See C.W. Mooney, “The Mystery and Myth of ‘Ostensible Ownership’ and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases” (1988) 39 Ala. L. Rev. 683 at 706-24. Compare D.G. Baird & T.H. Jackson, “Possession and Ownership: An Examination of the Scope of Article 9” (1982) 35 Stan. L. Rev. 175, arguing that the holders of all non-possessory property interests, whether ownership or security, should be under the same obligation to cure the problem of ostensible ownership created by their delivery of possession of assets to another. It is no answer to this concern that the creditors had the opportunity, prior to bankruptcy supervening by reducing their claims to judgment and gaining execution, to gain priority over the unperfected security interest, and after bankruptcy, the trustee, as their representative, should be able to assert a form of transmuted execution. This, in essence, appears to be the Supreme Court’s answer to the point in the text. See Re Giffen, ibid. at 110.

134 See Sprung, supra note 129.

D. Consignments and Security

As with leases, Article 9 and the PPSAs distinguish a true commercial consignment from its security counterpart according to whether the agreement functions to secure payment or the performance of an obligation. Once again, a functional analysis raises more questions than it answers. A true consignment is simply a bailment of goods in which the bailee, for a commission, acts as the consignor’s agent to sell the goods. As such, it functions as a form of purchase money inventory financing as it thereby enables a retailer without up-front cash to nonetheless acquire stock and earn a profit—its agency commission—on its resale. Once again, a formal title analysis provides for a more helpful characterization. Is the consignee ultimately intended to acquire the benefit or burden of ownership? For instance, at the end of the day must the consignee pay for the goods even if they have not been sold? Only in cases of such potential acquisition does the consignment qualify as security device, and then only by analogy to Article 9’s reconceptualization and relocation of the unpaid vendor’s reservation of title within the general security rubric.

Nonetheless, the consignment/security distinction has not occasioned the same level of litigation and debate as the lease/security distinction. While this may be a result of the less widespread use of consignments in commerce, we suspect that there

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136 See e.g. Canadian Imperial Bank of Commerce v. A.K. Construction (1988) Ltd. (1996), 39 Alta. L.R. (3d) 216, 11 P.P.S.A.C. (2d) 280 (Q.B.) [hereinafter A.K. Construction]. At issue was priority between two secured parties over the proceeds of sale of certain mobile equipment (two trenchers). Although both security interests had been taken and registered under the Alberta PPSA, supra note 6, perfection lapses under s. 7(3) if the debtor relocates or “transfers an interest in the collateral to a person located in another jurisdiction” unless the security interest is re-perfected in the other jurisdiction within a prescribed grace period. At issue was whether the debtor’s delivery of the trenchers to a Minnesota dealer for resale on an agency-consignment basis constituted a “transfer of an interest in the collateral” within the meaning of s. 7(3) so as to trigger the re-perfection obligation in s. 7(2). If so, the priorities would be reversed. Although both security interests had been re-filed in Minnesota, the holder of the first-registered security interest in Alberta had re-filed in Minnesota outside the prescribed grace period. The Court, having in mind the policy objectives of s. 7(2) (protection of reliant transferees at the new location), held that the term “transfer” should be interpreted to require more than the transfer of a bare right of possession. Consequently, the re-perfection obligation was triggered only in the case of a security consignment, i.e., one under which title or ownership was intended to pass to the consignee and not merely through the consignee as agent for sale. One can quarrel with the court’s interpretation of the meaning of “transfer”. Since the reason that even true consignments are deemed to be security interests under the Alberta PPSA is to protect reliant transferees, a transfer of possession under a true consignment ought to constitute a sufficient transfer to trigger the s. 7(2) policy. What is significant here, however, is the court’s reliance on the location of title as the criterion for distinguishing between true security consignments and deemed security consignments.
are two additional factors in operation. The first factor is that, with the single exception of Ontario, all Article 9 and PPSA jurisdictions subject commercial consignments to the perfection and priority framework applicable to PMSIs. Under the PPSAs, this is accomplished by deeming commercial consignments to be security interests for the purposes of perfection and priority, and under the U.C.C., by extending the Article 9 perfection rules for PMSIs to true consignments via U.C.C. Article 2. Although more circuitous, the U.C.C. technique avoids the dangers inherent in deeming something to be that which it is not. The first danger is that the courts take the artificial security label at face value and extend the unnatural meaning beyond the limited context for which it was intended. Second, the drafters themselves may forget that they

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17 See e.g. New Brunswick PPSA, supra note 6, s. 3(2), s. 1: “commercial consignment” and “purchase money security interest.”

18 While Article 9 as such does not apply to “true” consignments, U.C.C. § 2-326 classifies them as contracts of “sale or return” and subjects the consigned goods to the claims of the consignee’s creditors unless the consignor satisfies one of three alternative “publicity” requirements: (i) compliance with any applicable law (e.g. the sign statutes in force in some of the states) regarding the giving of notice of the consignor’s interest; (ii) establishing that the consignee’s creditors knew that the consignee was in the business of selling the goods of others; or (iii) compliance with the Article 9 filing requirements. Since many states do not have sign statutes for consignments, and in light of the problems of proof associated with establishing the requisite knowledge in the second criterion, an Article 9 filing is by far the most commonplace publicity mechanism used by consignors. If a consignment is made subject to Article 9’s filing requirements by U.C.C. § 2-326, then U.C.C. § 9-114 requires the consignor to also comply with the rules governing purchase money financiers of inventory; i.e., in addition to effecting an Article 9 filing, the inventory financier must also give actual notice of the consignment to prior inventory secured parties before the consignee receives possession of the goods.

19 For a comprehensive critique of the use (or misuse) of the deeming technique in the context of Article 9, see “Sacred Cows”, supra note 45.

20 This was done in Octagon Gas, supra note 60. In a recent New Brunswick decision, the trial court fell into the same error in the case of a true commercial consignment, extending the PPSA security label beyond that framework to a priority contest between the consignor and the consignee’s landlord exercising distress rights against the consigned inventory: Khoury Real Estate Services v. Max International Fashions (1996), 184 N.B.R. (2d) 172, 469 A.P.R. 172 (Q.B.), rev’d (1997), 190 N.B.R. (2d) 8, 148 D.L.R. (4th) 379 (C.A.). The consignor did not qualify for super-priority under s. 34(2) of the New Brunswick PPSA, supra note 6, against other secured parties because it had registered out of time and had not given notice to prior inventory financiers. Because the New Brunswick PPSA includes consignments within the s. 1 definition of “purchase money security interest,” the Court ruled that the landlord took priority. The ruling is wrong because compliance with s. 34(2) is irrelevant to a priority contest between a landlord’s non-consensual distress lien and a security interest, deemed or otherwise. Priority is instead governed by the Landlord and Tenant Act, R.S.N.B. 1986, c. L-1 under which the landlord’s right of distress is limited to goods “owned” by the tenant, thereby excluding goods owned by a consignor: see R. Wood & M.I. Wylie, “Non-Consensual Security Interests in Personal Property” (1992) 30 Alta. L. Rev. 1055 at 1084-85. Indeed, even if the consignment had been a “true” security interest (in the sense of a “disguised” conditional sale) the landlord still would have been subordinated because the landlord and tenant legislation in PPSA jurisdictions affords a super-priority to PMSIs provided only that they are registered at the date of distress (which was the case here). This latter point—the less stringent requirements for super-priority of title reservation security
have artificially extended the meaning of the term and may draft with only the natural meaning in mind. This point aside, bringing commercial consignments into the Article 9 and PPSA filing framework via an expansive "functional" interpretation of the concept of security has greatly reduced the pressure on the courts to resolve the publicity problem shared by true consignments and security consignments.

The second factor relates to the weaker proprietary basis for the consignor’s beneficial ownership claim relative to that of the equipment lessor. Unlike the lessor, the true consignor’s reservation of title in the consigned goods is not meant to endure until it is paid and moves to the consignee. If the transaction proceeds as both parties intend, title will remain in the consignor only until the goods are sold by the consignee and replaced by a claim to the proceeds secured by a trust, minus the agent’s selling commission. In other words, the collateral base in a consignment arrangement is likely to comprise the same shifting mix of personal property assets as that on which the consignee’s creditors rely for satisfaction of their claims. Given the heightened risk of prejudice to creditors posed by commercial consignments, and their far closer identity with inventory security arrangements, it is not surprising that courts have felt less compunction than in the case of equipment leases to effect a wholesale subordination of such interests for failure to register.

E. Simple Bailments and Security

Apart from leases, neither the U.C.C. nor the PPSAs purport to extend their reach to a non-security bailment under which the only performance that the bailor’s reservation of title secures is the bailee’s obligation to return the goods to the owner at the conclusion of their relationship. So long as the bailor’s reservation of title is stable, i.e., the parties have selected a transactional form under which title is not meant to pass through the debtor to third parties (unlike a consignment), it is not subject to regulation even as a deemed security interest. So, for instance, the delivery of grapes to a juice processor for processing and storage, or the delivery of cattle to an agistor devices outside the PPSA framework—affords yet another example of the PPSA drafters’ residual "formalistic" deference to title-based security.

141 Thus, the intended scope of s. 7(3) of the Alberta PPSA, supra note 6, as interpreted in A.K. Construction, supra note 136, would have been clarified had the drafters remembered that the words "transfer an interest in the collateral," while clearly sufficient to capture the transfer of a proprietary interest in the nature of security, are at least ambiguous when it comes to a deemed security interest under which the subject of the transfer is a bare right to possession coupled with an agency to sell.

142 There is a close analogy in "unreformed" common law jurisdictions to the treatment of conditional sale arrangements of the "Romalpa" type under which attempts have been made to extend the seller’s interest into the buyer’s proceeds of resale. For further discussion, see the text accompanying notes 245ff., below.

143 See e.g. Glenshaw Glass Company v. Ontario Grape Growers’ Marketing Board, 67 F3d 470 (U.S.C.A. 3d Cir. 1995), online: WL (CTA), where the Court held that the delivery by grape growers of their grapes to a juice processor for processing and storage was a simple bailment, not a consignment, notwithstanding that the processors held an "option" to purchase some of the grape product,
for grazing, feeding, and fattening on the agistor's land, do not even qualify as deemed security interests in the nature of consignments so long as the bailee is not authorized to sell the final product.

Our comparison of equipment leases and consignments suggests that a simple title-retention bailment is unlikely to generate the same level of third party prejudice as one in which the owner seeks to extend its title into the proceeds of the secured or bailment assets. Nonetheless, where the goods which are subject to a bailment for processing are of the same generic type as the bailee's own inventory, lack of publicity generates obvious detrimental reliance problems for the bailee's creditors, and in particular the bailee's inventory financier. For this reason, some courts have succumbed to the temptation to make public notice by filing a requirement in order to protect the owner's interest under a processing bailment against a prior secured lender. Rather than simply reverting to Article 9's functional definition of security—i.e., the bailor's ownership functions to secure the bailee's obligation to return the goods—the courts have employed a variant of title analysis. The variant in question is that a bailee vested with physical possession and processing control has sufficient "rights in the collateral" under Article 9 to support attachment of the competing Arti-

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A contract of agistment is a bailment arrangement of medieval origin, still in popular commercial use particularly in western Canada and the United States, under which one person (the agistor) takes another's cattle or other animals for grazing, feeding, and fattening on the agistor's land until they are ready to be redelivered to their owner for market. In Cargill Ltd. v. Hoeppner (1996), 109 Man. R. (2d) 81, 40 C.B.R. (3d) 102 (Q.B.) [hereinafter Cargill cited to C.B.R.], the agistor purported to grant a security interest in the bailed cattle to the plaintiffs. On the agistor's bankruptcy, the plaintiffs challenged the owner's claim to the return of the cattle, contending that because the concept of "title" is irrelevant to the characterization of security in a PPSA regime, the bailor's ownership constituted a "security interest" subordinate to that of the plaintiffs for want of perfection. In remitting that issue to trial, Master Harrison correctly recognized that to say that the location of title is not relevant to the characterization of security under the PPSA is not equivalent to saying that the location of beneficial ownership is irrelevant: "[N]o one has contended that the mere delivery of a chattel ... triggers the application of the security legislation" (Cargill, ibid. at 106). See also Re Zwagerman, 115 B.R. 540 (U.S. Bankr. Ct. 1990), online: WL (FBKR-CS), aff'd 125 B.R. 486 (W.D. Mich. 1991), online WL (FBKR-CS) where cattle were likewise delivered for feeding, fattening, and preparing for sale by a bailee. At issue was whether the bailment constituted a consignment subject to the Article 9 inventory perfection requirements via U.C.C. § 2-236 as against an inventory security interest granted by the agistor in its own cattle. In ruling that the transaction was not a consignment (and therefore effective against the agistor's inventory financier notwithstanding the absence of an Article 9 filing) the court focused on the fact that delivery of the cattle to the debtor was not primarily for resale.

Homold, Harris & Mooney, supra note 135 at 266, observing that while Article 9 does not require a "pure" bailee to cure any public notice problems by filing or otherwise, some courts have been influenced—in distinguishing between a "pure" bailment for processing on the one hand, and security or consignment transactions on the other—by the perception that creditors of the bailee, especially Article 9 inventory financiers, may rely to their detriment on the bailee's "apparent ownership" of the bailed goods.
cle 9 financier's inventory security interest. This mode of reasoning is inaccurate
and incomplete. A bare right of possession, even independently of any processing
authority, constitutes sufficient rights in the collateral to support attachment of an
Article 9 or PPSA security interest. This, however, does not mean that the secured
lender has priority as over the bailor. Article 9 and the PPSAs do not purport to regu-
late priority as between an antecedent ownership interest (other than a deemed secu-
ritv interest) and a security interest. The competition is instead governed by the
common law maxim nemo dat quod non habet, under which a security interest taken
in bailed goods is presumptively defeasible against the true owner unless the owner is
estopped from denying the bailee's authority to sell or encumber the collateral. Even
if the analysis is erroneous in doctrinal terms, what is significant for present pur-
poses is the courts' analytical reliance on formal property concepts rather than unquali-
fied functionalism to resolve the security characterization problem.

116 See e.g. Kinetics Technology International Corporation v. Fourth National Bank of Tulsa, 705
F.2d 396 (U.S.C.A. 10th Cir. 1983), online: WL (CTA) where, in a priority contest between a bailor of
goods and the bailee’s Article 9 inventory financier, it was held that the delivery of goods for pro-
cessing along with other goods gives a bailee sufficient “rights in the collateral” to support attachment
of an Article 9 security interest given by the bailee. In ruling that the Article 9 financier therefore took
priority over the bailor, the court stressed that otherwise the inventory security interest could be de-
feated by the kind of “hidden title subterfuge” that the U.C.C. was designed to prevent and that a
bailor in such a case could easily protect itself against by filing an Article 9 PMSI, thereby advancing
the U.C.C. policy of providing notice and certainty to inventory financiers. Compare Evergreen Ma-
rine Corporation v. Six Consignments of Frozen Scallops, 4 F.3d 90 (lst Cir. 1993), online: WL
(CTA) where in awarding priority to the carrier of a cargo of scallops as against the secured creditor
of the debtor—the debtor having fraudulently induced delivery without surrendering the bills of lad-
ing which were still held by a Dutch bank—the court ruled that the temporary entrustment of posses-
sion to the debtor was insufficient to support attachment of an Article 9 security interest granted by
the bailee in its goods.

117 For further discussion, see the text accompanying notes 116-23, above. See also Gray v. Royal
where X, the potential buyer of a motor home, asked the owner to vacate in order to facilitate the sale,
then forged documents of title to the home and resold it to the debtor, who had obtained purchase
money financing from a bank. When the owner discovered what had happened, he successfully sued
X and the debtor in conversion and obtained an order for possession. The debtor stopped paying un-
der the security agreement and the bank seized the home. In the ensuing litigation between the owner
and the court ruled that the debtor had sufficient rights in the collateral by derivation from
X’s possession to support the grant of a PPSA security interest. However, the PPSA did not purport to
regulate priority between an antecedent owner of the collateral (unless deemed to be a secured credi-
tor) and a PPSA secured party. Consequently, priority was governed by the supplementary common
law, specifically the common law maxim nemo dat quod non habet, under which the bank acquired
only a bare possessorv title, defeasible against the owner, unless the owner was estopped by his con-
duct—pursuant to s. 26 of the British Columbia Sale of Goods Act, R.S.B.C. 1996, c. 410—from de-
nying X’s authority to sell. The mere handing over of possession was insufficient to clothe X with the
apparent authority to sell. Consequently, the owner’s right prevailed.

118 Gray, ibid. See generally Board, supra note 20.
119 Gray, ibid.
F. Security and Trust

The appropriate characterization of transactions in the form of Quistclose trusts has given rise to particular difficulties in the PPSA literature. In a Quistclose type transaction, a lender advances money to a debtor on strict terms that it be applied to a specific purpose, e.g., payment by the debtor of a specific third party obligation. Before the purpose can be accomplished, however, the payee becomes insolvent or misappropriates the money to another purpose. On a trust analysis, the payer has a right of reclamation against the specific funds to the extent they remain identifiable or traceable. Since the money has come into the payee’s hands impressed with a trust for a specified purpose, the payee holds it as trustee and, on the failure of that purpose, the payer is entitled to its return on the basis of a resulting trust.

From a purely functionalist point of view, Michael G. Bridge has elsewhere argued that the Quistclose payer is a secured party in that a transaction of this type evidences a “clear express intention that the payer is to be protected from the claims of other creditors of the payee” on the latter’s insolvency and therefore “clearly evinces an intention to seek and provide security.” While these same priority attributes attend any purpose trust, the Quistclose variation is distinguished by its coexistence with a debt. This element seems to take us closer to a security device which is likewise characterized by the coexistence of debt and a property-based preference over other creditors upon the debtor’s insolvency.

Nonetheless, if the Quistclose trust is a secured transaction, it operates in a “somewhat eccentric way.” In a normal secured transaction, the collateral is independent of the loan advance and secures its repayment. In a Quistclose transaction, however, the creditor is in effect asserting a security interest in the advance itself; in practice, its traceable proceeds. If the advance is applied to the specified purpose, the debt will remain but the collateral will be exhausted and the creditor will only be left with an unsecured claim. Thus, it is not the debtor’s failure to repay the advance against which the Quistclose payer is secured, but the debtor’s failure to carry out the trust purpose. Analysts fear that making this point is “a betrayal of the liberal notions underlying the PPSA and the policy objectives it seeks to foster.” After all, on a functionalist definition, a security interest secures payment or performance of an obligation. While the Quistclose trust may not secure the payment of a loan obligation, it

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150 Named after the English case in which the trust analysis was first employed to protect the lender qua trust beneficiary: Barclays Bank v. Quistclose Investments Ltd. (1968), [1970] A.C. 567, [1970] 3 W.L.R. (H.L.) [hereinafter Quistclose].
153 Ibid. See also ibid. at 345-46, 360-61.
154 Ibid. See also ibid. at 345-46, 360-61.
155 Klinck, supra note 151 at 71.
156 Ibid.
does secure performance of the debtor's obligation to carry out the purpose of the advance.\textsuperscript{157}

It is here that the formal title-based limits on functionalism come into operation. The Quistclose payer's interest does not conform to the prototype of a security interest because beneficial title to the collateral—\textit{i.e.}, the payer's advance—never resides in the debtor. The beneficial title either vests in the third party payee or remains in the payer depending on whether or not the purpose of the trust is carried out.\textsuperscript{158} The debtor is simply a conduit through whom the advance is channelled to carry out the purpose of the trust; its title is the bare legal title of the trustee, not the beneficial title of the secured debtor.

\textit{PPSA} analysts are understandably reluctant to rest the characterization of the Quistclose trust on this kind of "atavistic" title-based thinking.\textsuperscript{159} Yet, at the enforcement level, it is clearly pointless to impose a security characterization on the Quistclose payer's interest in the funds advanced. The essence of the Article 9 and \textit{PPSA} enforcement regime is protection of the debtor's residual beneficial interest in the collateral. However, in a Quistclose trust transaction, the debtor never acquires beneficial ownership of the advanced funds. By definition, there is no surplus equity in the debtor to protect.

As with other title reservation devices, however, misgivings about giving effect to the entailments of the trust concept have more to do with ostensible ownership concerns \textit{vis-à-vis} third party creditors than with its appropriateness as a vehicle for giving effect to the business objectives of the immediate parties. Trust law, after all, does not require that trust funds be kept separate and apart from the trustee's own assets, but merely that they remain identifiable or traceable. Indeed, a stipulation to this effect is not even seen as essential to the implication of a trust relationship.\textsuperscript{160} This makes sense from the viewpoint of trust law. A strict rule requiring segregation would be

\begin{itemize}
  \item \textsuperscript{157} \textit{Ibid.} at 70. See also "English Experience", \textit{supra} note 10 at 203: "A security interest is one that secures payment or performance [of an obligation]; it does not have to ensure it."
  \item \textsuperscript{158} Zielgel & Denomme, \textit{supra} note 6 at 63.
  \item \textsuperscript{159} "English Experience", \textit{supra} note 10 at 203: "Discomfort at the prospect of Quistclose trusts being treated as security agreements may be seen as the atavistic expression of title-based thinking." See also Klinck, \textit{supra} note 151 at 65:
    The approach suggested by [the \textit{PPSA} definition of "security interest"] is different from that which would be taken in a setting where "title" was regarded as critical and which might say: "This is a trust. The payer retains equitable title. Therefore the asset cannot be the subject of a charge in favour of other of the payee's creditors. It doesn't belong to the payee."
  \item \textsuperscript{160} \textit{Air Canada v. M & L Travel Ltd.}, [1993] 3 S.C.R. 787, 108 D.L.R. (4th) 592. In concluding that an agreement under which a travel agency was to sell passenger tickets on behalf of an airline, collect the proceeds, and hold them in trust pending remission (less its sale commissions) gave rise to a trustee-beneficiary relationship, the Court ruled that the absence of any express prohibition in the agreement against comingle the proceeds with the agency's own money did not necessarily convert the parties' relationship into one of debtor-creditor.
\end{itemize}
tantamount to saying that the trust, and with it the rights of the trust beneficiaries, could be destroyed by the trustee's breach. From the perspective of insolvency law, however, if the trust funds are not in fact segregated, how are we to protect the publicity needs of the payee's general and secured creditors? This concern is what prompted a United States court to rule that receivables attributable to air freight services performed by an insolvent freight forwarding agent for an air carrier were subject to a prior all-assets security interest granted by the agent to its financing bank. The Court so ruled notwithstanding the fact that the receivables were subject to an express trust in favour of the carrier under a standard International Air Transport Association ("IATA") trust-agency agreement:

Clearly, the real purpose of the IATA [trust-agency] agreement was an attempt to ensure that carriers would be paid regardless of the debtor’s insolvency. Clearly, the parties did not intend to create a trust; but sought merely to secure their payment from Shulman by means of a secret lien in contravention of the Uniform Commercial Code. There is a general bankruptcy policy against such secret interests, ... and general creditors should not be limited by these endeavors. Pan Am is therefore only entitled to share in the estate pari passu with other general unsecured creditors.

If a trust-agency arrangement is ineffective to protect the carrier against its agent's secured and unsecured creditors in cases of this type, presumably the carrier's only recourse is to take and register a security interest in the proceeds of sale of its products and to seek a subordination agreement from any prior secured parties of record. In other words, recourse to a security label in this case is not premised upon either the formal or functional identity of trust and security transactions, but on the common publicity concerns posed by both. Thus, analysts who resort to title analysis to take Quistclose trusts outside the PPSA go on to say that if the Quistclose arrangement "becomes a significant financing technique, it may become desirable to bring it under the umbrella of the legislation, but this is not the same as saying that it is there already."

It is difficult to see how the imposition of a security label would be advantageous to the general creditors in these types of cases. Assuming registration and filing are effected, security law, as much as trust law, would, in any event, award the carrier a property-based preference over the claims of the general creditors. Why require filing at all? From the viewpoint of general creditors, the principal rationale is so as to protect themselves against the risk that a property-based claim to priority by another creditor represents an unjust preference. Trust law, however, already recognizes and responds to the need to limit and legitimize the real preference afforded the trust beneficiary. The beneficiary is not simply entitled to a preference against the insolvent trustee's estate equal to the value of the trust assets; its preference, even under trust

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161 Klinck, supra note 151 at 74-76.
163 Ziegel & Denomme, supra note 6 at 63.
law analysis, subsists only so long as the trust assets remain identifiable in specie or traceable as proceeds.

Of greater concern is the need to protect the reliance interest of prior secured parties of record who hold a security interest in the agent’s receivables. If the proceeds derived from the sale of the carrier’s products are not segregated, the prior assignee may be misled by the agent’s ostensible ownership into making further advances. The problem is illustrated by the facts in Canadian Pacific Air Lines Ltd. v. Canadian Imperial Bank of Commerce.164 This case involved a standard-form IATA agreement between a travel agency and several airlines, under which the proceeds of sale of the airlines’ tickets were to be held in trust by the agency pending satisfactory accounting and settlement. The agency, however, deposited the proceeds into its general bank account, and the bank, which held a general security interest in the agency’s receivables, applied the deposits against its secured debt. Asserting their tracing rights as trust beneficiaries, the airlines claimed the return of the proceeds from the bank.

On an Article 9 and PPSA analysis, we would presumably want the drafters to award an express super-priority to the carrier over the bank. This is analogous to an inventory purchase money financing agreement or, more accurately, to a commercial consignment under which an agent effects a sale of its principal’s products without itself acquiring any beneficial interest in those products. On the same analogy, we would want to qualify this super-priority by implying a condition that the bank be given advance notice of the existence of the airline’s prior trust claim so as it could protect itself from being misled into making further advances on the security of the fresh assets injected by the carrier into the debtor’s ostensible collateral base.

Again, however, we are not convinced that the security solution is necessarily superior to that which results from a trust analysis. Trust law seeks to protect reliant third parties by terminating the beneficiary’s right to trace into the trustee’s estate when the property is transferred to a purchaser for value without notice. Thus, even under a trust law analysis, a prior accounts financier would take free and clear of the carrier’s interest to the extent it could show lack of actual knowledge and prejudicial reliance in the form of later advances.165

The principal difference between Article 9 and PPSA solutions and trust solutions thus lies in the need to show actual reliance to acquire priority over the beneficiary’s interest. Pursuant to the Article 9 and PPSA solution, the carrier’s omission to register and to deliver a written advance notice of its interest to the bank would effect a subordination of its interest regardless of whether the bank’s advances pre-dated the car-


165 The bank in Canadian Pacific Air Lines asserted that argument, albeit unsuccessfully. The Court ruled that the bank had knowledge of the nature of its clients’ business operation and therefore should have known that monies deposited in the account had been collected purely as agent for the airline. In these circumstances, it was not entitled to claim the benefit of the bona fide purchaser rule under trust law.
rier's injection of new value into the debtor's estate, and regardless of whether the bank had knowledge of the carrier's interest in the accounts. Pursuant to a trust analysis, the bank would have to demonstrate both absence of knowledge and actual prejudicial reliance in the form of subsequent advances. Thus, the principal advantage of the security solution is the elimination of the problems of proof inherent in the application of an actual reliance test. Is this sufficient to justify the corresponding increase in transaction costs associated with the imposition of the burden of public registration and the corresponding reduction in the parties' bargaining flexibility? To what extent should the formal distinction between ownership and security influence where this balance is to be struck?

G. The Analysis So Far: The Utility of Formalism

Our analysis thus far illustrates the continued vitality of the formal conception of security—it is necessarily by grant rather than by reservation of ownership—and the preservation of the distinction between ownership and security that that proposition entails. Relatedly, it suggests that there can exist interests in property that function to secure an obligation but that do not thereby become "security interests". The apparent exceptions to that proposition—conditional sales, leases, and consignments—have not served as a watershed for expanding the concept of security to encompass all non-possessory interests. Instead, they have been found capable of regulation as security only through a formal reconceptualization of the location of title under the transaction. This is so whether it is for all purposes, as in the case of conditional sales and analogous postponed title-transfer transactions, or for the more limited purposes of perfection and priority, as in the case of "true" leases and "true" consignments. The need to resort to formal techniques to accomplish the security characterization in these exceptional cases illustrates two points: (i) that security interests and other non-possessory property interests share a common problem—the need for publicity—and not a common character, and (ii) that functional analysis alone is inadequate to resolve this common problem. However compelling the case for making public notice a prerequisite for protection, extension of the Article 9 and PPSA filing framework beyond conventional security transactions requires an explicit legislative policy directive.

Rather than being a ground for concern, recognition of the formal limits of functionalism avoids obscuring the basic policy issue at stake in extending the Article 9 and PPSA framework beyond the world of security. The policy issue in question is whether or not ownership is intrinsically deserving of a higher level of protection at the priority level than the interest of a secured creditor. Canadian PPSA jurisdictions have gone much further with regard to assimilation than their Article 9 counterparts, as reflected in two above-noted differences in their relative scope. First, under the PPSAs, all suppliers are required to perfect as a condition for priority over the buyer's prior secured creditors and general creditors—even when the results of non-
compliance are largely a windfall. Second, with the exception of Ontario, the PPSAs subject even true leases to the same perfection and priority requirements as security interests.

These differences in the Canadian and United States policies demonstrate that even when jurisdictions share a common functionalist perspective, they may disagree on how the implications of functionalism operate in terms of their relative emphasis on the values associated with the "formal" distinction between security (publicity and certainty) and ownership (private property and freedom of contract). Most notably, what explains the Canadian PPSAs' position is the strength of the commitment of these jurisdictions to the reliability and integrity of their registration systems, and to the perceived utility of these systems not just as means of protecting reliant third parties, but as vehicles for regulating priorities in a manner that reduces the need for a litigation-intensive, case-by-case analysis of the substantive nature of the parties' transaction. In this respect, the history of registration legislation in common law Canada suggests that a framework weighted toward the values of registration will continue to dominate.

Wherever the balance is struck in a particular jurisdiction, there will always remain a residue of cases where looser concepts such as estoppel will have to be relied upon to protect third parties. First, the transaction may not be so commonplace as to make imposition of a filing burden of this type fair or efficient. Second, the formal framework out of which the transaction arose—as our analysis of trust law illustrated—may well provide at least as commercially responsive a solution to the need for publicity as public registration.

H. The Limits of Formalism

The continued relevance of conventional title analysis, even within a functionalist world, is confirmed by a recent decision of the Supreme Court of Canada. The issue in Alberta (Treasury Branches) was who had priority in a debtor’s accounts, between Revenue Canada exercising its statutory garnishment remedy under federal tax legislation, and the holder of a general assignment of book debts taken and registered under the Alberta PPSA. The federal legislation defined a “secured party” over whom the Minister’s interest was to prevail as someone holding a “security interest in the

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166 This is evidenced in the case of a sale of consumer goods where the risk of prejudicial reliance by other creditors is virtually non-existent.

167 This is seen most dramatically in the scope of the former Canadian CSAs. As noted earlier, these acts, unlike their pre-Article 9 counterparts in the United States, extended beyond conditional sales transactions to include true leases: see supra note 122 and accompanying text.

168 See generally Rusch, supra note 126.

169 See e.g. Re Zwagerman, supra note 144, regarding testimony that prudent cattle owners were unlikely to appreciate the need for an Article 9 filing in contracts of agistment covering cattle delivered for custom feeding so that the publicity problem was, therefore, better resolved through branding.

170 Supra note 44.
property of another. The federal legislation clearly intended that Revenue Canada was to have priority over prior secured parties holding an interest in the tax debtor's receivables by way of security, but not over the interest of an assignee who had purchased the accounts since these had been removed from the property of the tax debtor. Thus, Revenue Canada's priority turned on whether the assignment was by way of sale or security.

On its face, the assignment purported to effect an absolute transfer of the accounts, rendering the debtor an agent for collection and trustee of the proceeds. Yet the debtor was simultaneously empowered to use the proceeds of collection in the ordinary course of business pending default. Most significantly, the debtor was entitled to redeem unqualified beneficial ownership in the accounts upon payment of the obligation secured by the assignment. In upholding Revenue Canada's argument in favour of a security characterization, the majority decision focused on this feature:

If an instrument is an absolute assignment ... there cannot be a residual right remaining with the debtor to recover the assets. By definition, a complete and perfect assignment cannot recognize the concept of an equity of redemption. An absolute assignment cannot function as a means of “securing” the payment of a debt since there would be no basis for the debtor to recover that which has been absolutely assigned. As long as that redemption right persisted, the assignee remained a secured party. In other words, it was the residual beneficial title in the accounts residing with the debtor

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171 Income Tax Act, S.C. 1970-71-72, c. 63, s. 224(1.3); and Excise Tax Act, R.S.C. 1985, c. E-15, s. 317(4) defining “security creditor” for the purposes of the sections establishing the Minister's superpriority (Income Tax Act, s. 224(1.2) and Excise Tax Act, s. 317(3)) as “a person who has a security interest in the property of another.” Alberta (Treasury Branches) was decided on facts which preceded the effective date (November 30, 1992) of amendments to the Bankruptcy and Insolvency Act which classified Crown claims (with only very limited exceptions) as unsecured for the purposes of ranking in bankruptcy and insolvency proceedings (Bankruptcy and Insolvency Act, S.C. 1992, c. 27, adding new s. 86). However, the views expressed by the Court in Alberta (Treasury Branches) on the proper interpretation of the definition of “secured party” in the Income Tax Act and the Excise Tax Act are not affected by the Bankruptcy and Insolvency Act's amendment.

172 Alberta (Treasury Branches), supra note 44 at 619 [emphasis in original].


[The proposition that the bank holds legal title] does not recognize that a section 178 [now s. 427] assignment is essentially a security interest. The conveyance of [legal] title ... does not mean that the bank is the absolute owner. The conveyance secures the obligation to pay in much the same way as any other fixed security interest. There are restrictions on the bank with respect to default and the debtor may redeem the collateral and there are circumstances where the debtor may convey good title to another (Ford Motor, ibid. at 67-68).
during the currency of the arrangement that was treated as the critical characterization criterion.

In drawing this distinction, the majority conceded that, to the extent that the secured obligation exceeded the economic value of the accounts at any given time, it was unrealistic to treat the debtor as the owner of the collateral in any sense. However, it was thought that this kind of functionalist insight should not affect the characterization exercise. To have the status of the relationship between the parties fluctuate between secured party/debtor and seller/buyer depending on the state of the accounts between them at any given moment would undermine certainty in commercial dealings. Indeed, it was feared that if every general assignment of a firm’s accounts was interpreted as an absolute transfer of ownership, this might have prejudicial implications for the ordering of bankruptcy priorities. Bankruptcy regimes are premised upon the ability to draw a distinction between that which is the property of the bankrupt and that which is not. Obliteration of that line of demarcation might become a means by which an unscrupulous debtor and creditor could order their affairs so as to remove protection from other bona fide creditors.

For the functionalist minority, the presence of a purely theoretical residual ownership interest in the debtor was an insufficient basis of distinction. After all, accounts are as liquid a form of collateral as one can have next to cash. If the debtor is insolvent, there is unlikely to be any residual value left in the collateral over and above the amount of the secured loan. In this sense, then, it is as though the debtor had sold its accounts outright even if the presence of a redemption right makes the assignment notionally by way of security.

The minority opinion is not without merit. Article 9 and the PPSAs have removed virtually all impediments to a debtor’s ability to grant a first-ranking security interest in all present and after-acquired personal property to secure all present and future advances.174 Although priority is still nominally property based, the result comes perilously close to awarding the all-assets financier an automatic preference over other creditors in the debtor’s entire estate.175 From an insolvency perspective, the distinction

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174 U.C.C. § 9-204(1) (after-acquired property) and § 9-204(3) (future advances). For the equivalent PPSA provisions, see e.g. New Brunswick PPSA, supra note 6, s. 13 (after-acquired property) and s. 14 (future advances). See also s. 10(1)(b)(iii), endorsing the effectiveness of a collateral description covering “all of the debtor’s present and after acquired property”; s. 20, recognizing the effectiveness of a perfected security interest against the debtor’s judgment creditors and trustee in bankruptcy; and s. 35, awarding first priority, as a general rule, to the first secured party to perfect by registration or taking possession.

175 See e.g. P.F. Coogan, “Article 9—An Agenda for the Next Decade” (1978) 87 Yale L.J. 1012 at 1019 observing that Article 9 has transformed our conception of security from a “property right in specific assets that a secured party can possess and sell to something more like a prior claim against a debtor’s fungible assets”; L.M. LoPucki, “The Unsecured Creditor’s Bargain” (1994) 80 Va. L. Rev. 1887 at 1899: “Security is an agreement between A and B that C take nothing”; and Kanda & Levmore, supra note 104 at 2124-25:
between secured debt and third party ownership of the debtor's assets has become correspondingly less meaningful in that they both offer functionally identical means by which the insolvent debtor can judgment-proof its estate from the claims of other creditors.¹⁷⁶

II. Personal Property Security or Personal Property Securities?

By starting with [the presumption that all secured transactions should be subject to the same rules] we create the risk that we make a Procrustean bed, one that may be as confining as the one from which the drafters of Article 9 escaped when they abolished the distinctions between the many different legal forms that governed economically identical transactions. Instead of beginning with the idea that there are artificial legal forms that are part of the landscape, we should begin with the idea that the world of secured transactions is one that is flat and has discrete boundaries. This assumption has its own dangers.¹⁷⁷

Our analysis of title-reservation security in Part I illuminates the nature of Article 9 and PPSA security more generally. Notwithstanding the open-ended characterization invited by a functionalist concept of security, the legislation has largely been interpreted as a means of regulating transactions that conform to the common law's prototypical security institutions, and it is these institutions, not the "function" of the transactions as such, that have driven the characterization exercise.

Article 9 itself can best be understood as leaning toward a debtor-based regime for the first-in-time lender and an asset-based regime for late-in-time (non risk-altering) favorites [e.g. purchase money financiers]. An early lender can create a security interest in virtually all of the debtor's assets by specifying and filing appropriately for all categories of collateral. The security interest can cover future advances and can extend to after acquired property. This arrangement, though nominally asset based, comes close to ... automatic priority for the first substantial financier.

¹⁷⁶ "Death of Liability", supra note 38 at 90, describes the problem in the following colourful yet grim terms:

For the liability system to survive, it must command players to risk whatever wealth they have by putting it into the pot. But the system has no words with which to say that. In both the popular and legal culture the words we use to describe the system relate only to form. We take concepts such as ownership, entity, property, and secured creditor seriously. We assume they identify real things of importance when they do not. The judgment proof debtor who sails the yacht, drives a Mercedes and lives in the house on the hill remains wealthy, whether these items are fully encumbered, owned by the debtor's spouse or titled to a Cook Island trust. But neither property nor legal language describes such a debtor as wealthy.

¹⁷⁷ Baird, supra note 49 at 2262.
Formalism, nonetheless, has its limits. Perhaps more accurately, Article 9 and the PPSAs have given birth to their own brand of formal analysis. For however deep its roots in the forms of institutionalized security, the Article 9 and PPSA security interest is ultimately a creation separate and apart from the institutions which gave rise to it. Its incidents are not located in the old forms and classifications of security, but within the interstices of the legislation itself. The implications of that transformation both within, and especially beyond, the PPSA framework are the subject of this Part.

A. From Property Rights to Priority Rules

Secured creditors have traditionally enjoyed a super-priority over subsequent creditors, including the general body of unsecured creditors. In doctrinal terms, super-priority is rationalized on a conveyance model or conveyance metaphor for security. The secured party owns the property charged with the debt to the extent of the value of its secured obligation. The debtor already having conveyed its property to the first creditor, subsequent creditors necessarily take but the residual value that remains: nemo dat quod non habet.

The intuitive appeal of the conveyance metaphor as a basis for priority reflects traditional jurisprudential justifications for private ownership, i.e., the concept of property as involving the exercise of control by an individual over a material thing. Translated into the world of security, if the necessary connection can be made between a specific creditor and a specific asset, the values associated with private property—self-ownership, identification, moral development, desert—lend support to the creditor’s claim for a privileged claim to that asset. From this perspective, the property analogy is at its strongest in the case of a reservation of security by an unpaid vendor where ownership of the very asset against which the privilege is claimed originates with the creditor. However, the analogy progressively loses its intuitive appeal as the secured creditor seeks to extend its claim beyond a specific asset into its products and proceeds, or to attach floating assets such as inventory or accounts. In this case, the collateral is “more of an accounting concept than a specific piece of

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175 S. Knippenberg, “The Unsecured Creditor’s Bargain: An Essay in Reply, Reprisal, or Support?” (1994) 80 Va. L. Rev. 1967 at 1968, n. 5: “[T]o understand security in terms of the property concept of conveyancing is to employ a metaphor: the value of assets hypothecated is property that can be conveyed in the manner of other property” [emphasis in original].
176 Knippenberg, ibid. at 1975:

[O]nce it is concluded that the creation of a security interest is (rather than shares certain dimensions with) a conveyance of property, the entailments of that conclusion are themselves a justification for the subordination of unsecured claims to secured claims. There is simply no value remaining for unsecured creditors because it has been conveyed away in the security agreement [emphasis in original].

Moreover, the classic element of control by the property claimant is typically absent. The analogy is at its weakest when it comes to “all assets” or “universal” business charges, namely, security interests covering a commercial debtor’s present and future assets to secure present and future debt. In this case, the collateral is essentially the debtor’s estate, the same estate for which legal systems have traditionally established an insolvency distribution scheme informed by a principle of equal ranking among creditors. To allow a debtor to convey that entire estate to the first creditor comes dangerously close to awarding a contract-based, as opposed to a property-based, privilege. This may, therefore, bring secured transactions law into potential conflict with the policy against the conferral of unjust preferences on particular creditors inherent in the equal ranking principle.

Pre-PPSA secured transactions law was attuned both to the jurisprudential limits of the conveyance metaphor and to the distributional implications of giving it unqualified effect at the level of insolvency. The pre-PPSA solution was based on a theory of relative property rights. The ability of a secured creditor to appeal to the conveyance metaphor for priority was related to the proprietary strength of the particular security institution measured in terms of the scope of the collateral it purported to cover and the level of the secured party’s control over the debtor’s right of alienation. In Part I, one aspect of the old security hierarchy was explored, namely, the historical superpriority awarded to an unpaid vendor’s reservation of ownership in specific goods over other creditors, prior and subsequent, secured and unsecured. Distinctions were also drawn among security interests created by grant from the debtor’s existing estate. Only the holder of a legal mortgage covering specifically-identified and presently-owned goods was entitled to the full-fledged protection of the *nemo dat* ranking principle implicit in the conveyance metaphor. As the collateral base extended into the debtor’s future estate or covered more amorphous or shifting classes of property, the power of the conveyance metaphor progressively diminished, eventually reaching the point of virtual disappearance in the case of an uncrystallized floating charge security.\(^{103}\)

The floating charge characterization was imposed on a transaction whenever a secured creditor purported to take security against circulating classes of assets, notably

\(^{103}\) J.S. Rogers, “The Impairment of Secured Creditors’ Rights in Reorganization: A Study of the Relationship between the Fifth Amendment and the Bankruptcy Clause” (1983) 96 Harv. L. Rev. 973 at 992, n. 74 (as quoted by Knippenberg, *supra* note 179 at 1974, n. 29). The full quotation can be found in the text accompanying note 360, below.


Certainly a floating charge does not do much for the creditor prior to crystallisation. He cannot exercise proprietary or possessory rights over the assets as against either the company or as against third parties, nor does he have a *locus standi* to obtain an injunction against the company to restrain dealings with its assets in the ordinary course of business where the dealings are not in breach of the debenture or subject to the creditor’s veto and his security is not in jeopardy [emphasis in original].
inventory or book debts, while still allowing the debtor a licence to deal freely with those assets in the ordinary course of business. While the debtor was free to deal with the assets, the floating charge was nonetheless treated as an effective present security interest from the moment of its inception, although the security interest per se remained unattached until the secured party crystallized its charge, i.e., terminated the debtor's freedom to manage and deal with the charged collateral. Pending crystallization, the charge hovered over the circulating classes of assets as a contingent property right, unattached to any specific asset, with the result that intervening interests, including intervening encumbrances, attached in priority so long as they arose in the ordinary course of business without notice of any relevant restriction in the floating charge.

The unitary theory of security embraced by Article 9 and the PPSAs is based on the premise that the distinctions drawn between security interests made pursuant to the old property rights analysis were simply a reflection of atavistic formalism and

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184 The essential hallmarks of a floating charge security are that it cover present and future assets of a shifting or circulating character (notably inventory and book debts) and that the creditor undertake to leave the management of these assets in the hands of the debtor to deal with in the ordinary course of business free of control by the secured party: see Legal Problems, ibid. at 48-49, 52-53. In determining whether a security arrangement satisfies these characteristics, the pre-PPSA Canadian courts generally—though not invariably—adopted a substance over form approach; i.e., even if the charge instrument purported to impose formal controls on the debtor's freedom to deal with the collateral, evidence that the debtor in fact was empowered to manage and dispose of the charged assets without regard to these controls was enough to make the charge a floating charge: see e.g. Great Lakes Petroleum Co. v. Border Cities Oil Co., [1934] O.R. 244, [1934] 2 D.L.R. 743 (C.A.); and Legal Problems, ibid. at 58-59.

185 A point with respect to which, however, there rages a debate in "unreformed" jurisdictions, notwithstanding the references in infra note 186: see S. Fisher, Commercial and Personal Property Law (Sydney: Butterworths, 1997) at 8.18-8.22.

186 Evans v. Rival Granite Quarries, [1910] 2 K.B. 979 at 999, 79 L.J.K.B. 970 (C.A.), Buckley L.J.: A floating security is not a future security; it is a present security which presently affects all the assets of the company expressed to be included in it ... but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallize into a fixed security.

To effect crystallization, the floating charge holder generally has to intervene in a sufficiently active manner to give public notice that the debtor's freedom to deal with the collateral in the ordinary course of business is terminated: see The Queen in Right of British Columbia v. Consolidated Churchill Copper Corp. (1978), 90 D.L.R. (3d) 357, 30 C.B.R. (N.S.) 27 (B.C.S.C.); and Esket Wood Products (Receiver of) v. Starline Lumber (1991), 61 B.C.L.R. (2d) 359, 8 C.B.R. (3d) 224 (S.C.T.D.). In its willingness to recognize a floating charge as an effective present, albeit unattached, security, English and Canadian common law were more accommodating to secured lending than pre-Article 9 United States law, which regarded the absence of any exercise of control by a nominal secured creditor over the debtor's freedom to deal with collateral as incompatible with the existence of a genuine security interest and void as a fraud on creditors: see "Good Faith Purchase Idea", supra note 11 at 620-27.

were antithetical to the functionalism that ought to inform commercial law and allow for unrestricted access to credit in order to fuel business expansion. So while security is still defined as a property-based institution,\textsuperscript{188} the old security hierarchy is eliminated. All security interests attach with uniform proprietary vigour whether the collateral is a specific automobile, circulating assets such as inventory or accounts, or the debtor’s entire personal estate.\textsuperscript{189} The need to qualify the priority entailments of the conveyance metaphor in the interests of third party protection is recognized at the level of publicity.\textsuperscript{190} However, this merely shifts the first-in-time ranking inherent in the conveyance metaphor to the perfection plane. Otherwise, all security interests are now presumptively equal in conventional property terms and, as such, presumptively subject to, and privileged by, a strict chronological ordering.\textsuperscript{191}

In our view, there was more functionalism in the prior property rights approach with regard to the ranking of security interests than the rhetoric of Article 9 and PPSA functionalism would suggest. Consider the most well-known of the exceptions to first-in-time priority recognized by Article 9 and the PPSAs: the super-priority afforded purchase money financiers over the holder of a prior-registered security interest in the debtor’s present and after-acquired assets. As was noted in Part I, there are minute differences among the various regimes as to where the line is drawn. However, the strength of the super-priority afforded the PMSI lender steadily diminishes, and the conditions governing its availability become more onerous as the PMSI security interest is sought to be extended from a specific capital or consumer asset to circulating inventory or products and proceeds of inventory. A functionalist might justify these distinctions on the basis that they constitute a reasonable means of enabling the debtor, who has granted a general security interest to an early lender, to access more specialized or efficient sources of financing as its business evolves, while minimizing the risk alteration problem posed by recognizing any exceptions to the first-in-time priority.\textsuperscript{192} However, in linking PMSI super-priority to the specificity of the collateral, and the probable level of control exercised by the secured party over its disposition,

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\textsuperscript{188} Supra note 25.

\textsuperscript{189} Under all the Canadian PPSAs, all security interests are subject to the same attachment requirements, \textit{i.e.}, that the secured party extend value, that the debtor have rights in the collateral, and (for the purposes of third party enforceability) that the security interest be evidenced by either possession by the secured party or the execution of a written security agreement. See \textit{e.g.} New Brunswick PPSA, \textit{supra} note 6, s. 12. For references which confirm that the old rules postponing attachment of a floating charge security until crystallization no longer operate in a PPSA regime, see \textit{supra} note 22.

\textsuperscript{190} Under all the Canadian PPSAs, failure to perfect by possession or filing subordinates the security interest to competing perfected security interests, the interest of a buyer or lessee of the collateral, the interest of an unsecured judgment creditor, and the debtor’s trustee in bankruptcy: see \textit{e.g.} New Brunswick PPSA, \textit{ibid.}, ss. 20, 35.

\textsuperscript{191} Under all the Canadian PPSAs, in the absence of a specific rule to the contrary, security among competing perfected security interests in the same collateral is presumptively determined by the order in which the perfecting step in relation to each was taken: see \textit{e.g.} New Brunswick PPSA, \textit{ibid.}, s. 35.

\textsuperscript{192} Kanda & Levmore, \textit{supra} note 104.
the Article 9 and PPSA rules are equally consistent with a classic property rights analysis.

The priority scheme articulated by Article 9 and the PPSAs is limited to the redistribution of an insolvent debtor’s estate among secured creditors. The impact of all-assets financing on the claims of the debtor’s unsecured creditors is not addressed beyond requiring perfection as a condition for awarding priority to the debtor’s secured creditors. Otherwise, the conveyance metaphor is applied against them only now with increased force. Because all security interests are now subject to the same attachment rules, the super-priority historically available to the unsecured creditor as against the holder of a security interest in floating collateral is no longer available.

The drafters of Article 9 were not indifferent to the impact of unrestricted secured financing on the unsecured creditors of the debtor. However, they reasoned that in one way or another the law had already progressed to the point where the debtor could, in any event, grant an effective security interest in virtually all its assets. This being the case, why not legitimize the defacto result directly and thereby also reduce the transaction costs associated with the circumvention of existing formal restraints?

The drafters of the PPSA responded somewhat more aggressively to the same concern, incorporating a number of explicit measures aimed at minimizing the resulting prejudice. First, the more recently reformed PPSAs explicitly confirm the freedom of the debtor, whatever the terms of the security agreement, to utilize its liquid assets in the voluntary payment of ordinary course of business debts pending enforcement of the security interest. Second, by giving notice of their intervening in-

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193 See e.g. New Brunswick PPSA, supra note 6, s. 19.
194 Official Comment 2 to U.C.C. § 9-204, as reproduced in “Taking Debtors’ Choices Seriously”, supra note 51 at 2022, n. 4.

The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a commercial borrower should not be allowed to encumber all his assets present and future, and that for the protection not only of the borrower but of his other creditors, a cushion of free assets should be preserved. That inarticulate premise has much to recommend it. Article 9 decisively rejects it not on the ground it was wrong in policy but on the ground that it was not effective.

195 See e.g. Baird, supra note 49 at 2257-60, observing that the history of secured credit is one in which debtor’s assets have become increasingly available as security and that while this is not desirable, not much can be done to avoid it.

Since the drafters of the Saskatchewan [PPSA] made no provision for the continued use of floating charges, there was a need to give debtors who encumber all or most of their assets, including their liquid assets, the power to pay their unsecured creditors. Without this power, their ability to obtain unsecured credit would be severely restricted because secured creditors would have the right to prohibit any disposition of their collateral in the process of paying unsecured claims. Accordingly, a provision was included in the Saskatchewan [PPSA] under which a creditor who receives money or an instrument
terest to the secured party, judgment creditors can arrest the secured party's ability to further erode the debtor's residual equity in the collateral with the making of further advances. Finally, several PPSA jurisdictions provide that registration of a judgment, rather than the actual seizure of the collateral pursuant to judgment enforcement proceedings, constitutes the relevant point at which the first-in-time priority status of the secured creditor is to be assessed as against the interest of the judgment debtor.

These measures do nothing, however, for the unsecured creditor whose debtor refuses or is unable to pay. Under the old floating charge learning, the judgment creditor at least enjoyed a super-priority as against the floating charge holder provided that the judgment creditor's interest attached before the secured party crystallized its charge. Under the PPSA, all security interests attach at the moment the financing transaction is entered into, even when the collateral is floating in nature and the debtor's powers of management and control remain unrestricted. This means that an unsecured creditor who seeks to enforce payment of its debt against the collateral now takes subject to all prior perfected security interests, including those held in the debtor's liquid or floating assets. Indeed, the judgment creditor's ability to enforce

drawn or made by a debtor and delivered in payment of a debt owing to him by that debtor takes free from a security interest in the money or instrument drawn or made by the debtor whether or not the creditor has notice of the security interest.

Provisions along these lines appear in all the newer and reformed PPSAs: see e.g. New Brunswick PPSA, supra note 6, s. 31. For an alternative drafting approach, see Ontario PPSA, supra note 6, s. 29 providing that the rights of a holder in due course of a bill, note, or cheque under the federal Bills of Exchange Act, R.S.C. 1985, c. B-4, and a transferee from the debtor of money, “are to be determined without regard to” the PPSA.

97 See e.g. New Brunswick PPSA, ibid., s. 35(6).

98 See e.g. ibid., s. 20(1) providing that an unperfected security interest is subordinate to the interest of a judgment creditor who has registered a notice of judgment in the Personal Property Registry pursuant to the Creditor’s Relief Act, R.S.N.B. 1986, c. C-33; and s. 35(6) providing that a perfected security interest has priority over the interest of a judgment creditor who has registered a notice of judgment only to the extent of advances made before notice of the registration of the judgment is given to the secured party. Note that the Creditor’s Relief Act referred to in these provisions has been amended to provide that registration of the notice of judgment “binds” the judgment debtor’s present and after-acquired personal property as against third party interests (subject to the same exceptions that apply to the priority afforded by the PPSA to a perfected security interest covering present and after-acquired property). Under the old law, the judgment debtor’s property was bound only on seizure of the assets pursuant to judgment enforcement proceedings. Similar provisions exist in Alberta and Saskatchewan and have been proposed for British Columbia.

99 “Second Generation”, supra note 196 at 40:

Admittedly this provision [providing that an unsecured creditor takes free of a perfected security interest in money and cheques] is confined in its operation to situations where the debtor voluntarily pays its unsecured creditors. It does not permit unsecured creditors to enforce judgment against the collateral free from the intervention of a secured creditor who has a prior perfected security interest.

against the debtor’s residual equity in the collateral is problematic. The problem arises
because of the accounting difficulties in valuing the debtor’s residual interest in cir-
culating collateral subject to a secured obligation, the amount of which is also con-
stantly fluctuating.

While acknowledging the problem, PPSA analysts have tended to see further re-
form as the province of non-security law, notably the federal law of bankruptcy and
insolvency. After all, in practice most unsecured creditors are no worse off under the
new rules. Under the old law, unsecured creditors prevailed only if they were able to
obtain judgment and attach that judgment to specific items of collateral before the
charge crystallized. Since the floating charge holder usually moved to crystallize its
charge at the first threat of judgment enforcement proceedings, the unsecured credi-
tor’s super-priority was often illusory.

What this reasoning underestimates, however, is the protection that the mere ex-
istence of the risk of subordination to judgment enforcement creditors afforded the
debtor’s general creditors during the currency of a financing arrangement covering as-
sets over which the debtor had retained freedom of management and disposition. The
existence of that threat forced the secured party to monitor the debtor’s dealings with
its general creditors to ensure that it received early warning of the threat of judgment
enforcement proceedings. Removal of that threat not only reduces the secured credi-
tor’s incentive to monitor the debtor’s general business dealings with its other credi-
tors, but also reduces the secured financier’s incentive to move quickly to terminate

On learning that the monies had been paid into court, the secured creditor claimed priority to the
monies as proceeds of an account in which it held security. The secured loan was not in default and
the evidence showed that the debtor was free under the security arrangement to use the proceeds of
accounts collected in the ordinary course of business. The court nonetheless held in favour of the se-
cured creditor. The PPSA had abolished the concept of crystallization as a condition for attachment of
a security interest in the nature of a floating charge with the result that the unsecured creditor’s gar-
nishee summons was necessarily subject to the prior attached and perfected interest of the secured
party. The court reached this conclusion not without regret: “It may be that in the PPSA ...
there is a
balance in favour of secured creditors over unsecured creditors” (Rehm, ibid. at 303).

See e.g. “Second Generation”, supra note 196 at 42:

Canadian federal legislators ... have refused to employ bankruptcy concepts to limit the
very dominant position that secured creditors have acquired under reformed personal
property security law. In this respect, Canada has 21st century personal property secu-
arity law and nineteenth century bankruptcy law.

See e.g. J.S. Ziegel, “Canadian Perspectives on ‘How Far Article 9 is Exportable’” (1996) 27
Can. Bus. L.J. 226 at 237:

[T]he equitable floating charge promises more than it can deliver. It only assists the un-
secured creditor so long as the charge has not been crystallized. Given the ease with
which a floating charge may be crystallized, the unsecured creditor is left empty-
handed just when she needs equity’s help most. This result comes about because a
floating charge does not create an estoppel in favour of unsecured creditors after as
well as before the debtor’s insolvency. At best it provides only a small window of op-
portunity for an extremely nimble and fleetfooted unsecured creditor.
the debtor’s powers of management and control. As long as there is sufficient value
remaining in the collateral—which of course includes the liquid assets that would
otherwise go to pay ordinary course of business debts—the secured party can safely
ignore signs that at least some creditors are going unpaid.\(^{203}\) Even if enforcement pro-
ceedings are initiated and completed long before the secured party moves to terminate
the debtor’s powers of management, the secured party still prevails over the interests
of the judgment creditor.\(^{204}\) This increases the likelihood that the debtor will be al-
lowed to remain in business piling up further unsecured debt after it has ceased to be a
viable business entity and is effectively operating in an insolvent state.

In contrast, the old floating charge learning linked the all-asset financier’s priority
over unsecured creditors to monitoring considerations. So long as the secured party
allowed the debtor to deal with shifting or circulating collateral in the ordinary course
of business without imposing specific controls, said collateral remained available for
execution at the hands of the debtor’s judgment creditors.\(^{205}\) The threat of execution
creditor super-priority operated to significantly encourage closer monitoring as well
as crystallization and enforcement on the first sign of cessation of the debtor’s eco-
nomic viability. Absent that threat, unsecured creditors can no longer rely on the
debtor’s general secured lender to terminate the debtor’s business dealings sufficiently
early to minimize their losses.\(^{206}\) This point, and the broader implications for PPSA jur-
risdictions of the detachment of priority from its historical property law roots, are il-

\(^{203}\) It is sometimes argued that awarding priority to secured creditors over unsecured creditors is jus-
tified because it lowers the debtor’s overall borrowing costs by focusing the monitoring incentive in a
single creditor (who is rewarded for its monitoring efforts by being awarded priority): see S. Levmore,
However, as Shupack has observed, “it is not at all obvious how the general creditors are helped by
monitors whose advantage lies in the collateral rather than the debtor” (P.M. Shupack, “Defending
Purchase Money Security Interests Under Article 9 of the U.C.C. from Professor Buckley” (1989) 22
Ind. L. Rev. 777 at 782, n. 16). The Article 9 and PPSA regimes, by removing any incentive for the
secured party to exercise control over the debtor’s management of collateral of a shifting or circulat-
ing nature, can be seen to encourage specific monitoring of the collateral (of benefit to the secured
party only) rather than general monitoring of the debtor’s management of the collateral (of benefit to
all creditors).

\(^{204}\) Rehn, supra note 200; Highfield Development v. Little-Borland Ltd. (1997), 154 Sask. R. 74,
(MJ).

\(^{205}\) The development of automatic crystallisation clauses qualifies this point, but only partly. Such
clauses, making the charge crystallise on actions or events limited only by the parties’ imaginations,
provide a protection vulnerable to the inference, at the least, that the failure to intervene represents
waiver of the operation of the clause on the action or event in question. See H.A.J. Ford, R.P. Austin
& I.M. Ramsay, Ford’s Principles of Corporations Law, 8th ed. (Sydney: Butterworths, 1997) at 19-
220, 19-230.

\(^{206}\) For the value of secured credit from a business governance perspective, see G.G. Triantis & R.J.
illustrated by a recent Supreme Court of Canada decision to which this article now
turns.

**B. Implications of the Unitary Concept of Security Beyond the
PPSAs: Royal Bank of Canada v. Sparrow Electric Corp.**

In *Royal Bank of Canada v. Sparrow Electric Corp.* the operations of the debtor,
an electrical contractor of substantial size, were financed by a bank which secured its
loans through two mechanisms: (i) the bank held a general PPSA security interest in
the debtor's present and after-acquired personal property, and (ii) the bank held a se-
curity interest in the debtor's inventory pursuant to section 427 of the *Bank Act*. In
1992, the debtor began to experience financial difficulties, and by August had been
given formal written notice of default by the bank. In October, a "standstill agree-
ment" was reached, allowing the debtor to continue its business in an effort to correct
the default, but empowering the bank to enforce its security forthwith if there was no
improvement. By November, the financial picture had not improved. The bank ap-
pointed a receiver and it was discovered that, during the greater part of 1992, the
debtor had not been setting aside and remitting payroll deductions for employee in-
come taxes as required by the federal *Income Tax Act*. The amounts that should have
been withheld and remitted had instead been used as part of the general working
capital of the business, artificially extending its economic viability past the point of *de
facto* insolvency. In January 1993, the receiver obtained the court's permission to sell
the debtor's remaining inventory. However, the Court ordered that an amount equiva-
lent to that owing to the federal government—some $626,000—be set aside pending
resolution of the priority of its claim as against the bank's claim which was in excess
of $1.6 million.

The government's claim to the proceeds of the debtor's inventory was based on
the then section 227(5) of the *Income Tax Act* which established a deemed trust in fa-
vour of the government. Under section 227(4) of the *Income Tax Act*, an employer
who deducts income tax owed by its employees is deemed to hold the relevant amounts in trust for the benefit of the Crown. In the normal course of events, the deductions are made, paid into a discrete trust fund, and promptly remitted to the Crown. In practice, however, the deductions may be nothing more than a notional book entry, whereby the monies that should have been withheld and remitted are misappropriated by the debtor and intermingled with other assets which are then utilized elsewhere in the business to meet more pressing obligations. At this point, the Crown’s interest under a conventional trust analysis is that of a beneficiary under a non-existent trust. It is this conceptual difficulty that section 227(5) of the Income Tax Act was enacted to resolve. Section 227(5) stipulates that, on the assignment, receivership, or bankruptcy of the employer, an amount equal to the amount deemed to be held in trust is deemed to be held separate and apart from the employer’s estate and as such forms no part thereof. The section effectively seeks to attach a trust in favour of the Crown ex post facto to whatever assets the employer presently holds, and to make these assets the property of the Crown retroactive to the point at which the claim for deductions arose.

Although the bank’s claim was based on both its PPSA and Bank Act security interests, the PPSA does not apply directly to non-consensual security interests of the kind created by the Income Tax Act. Nor does the PPSA purport to resolve priority in the event that a consensual security interest created under its framework comes into competition with such a non-consensual interest. The assumption of the drafters was that such issues were really matters of public or state policy to be addressed in the legislation establishing the non-consensual statutory interest. Where the relevant statute contains an explicit Crown priority rule, that should resolve the matter. But section 227 of the Income Tax Act, at least as it then read, stated nothing about the relative priority of the Crown’s section 227 claim in the highly predictable event that the debtor’s assets were already the subject of a security agreement when Revenue Canada’s claim arose.

Revenue Canada based its priority on two arguments. The first argument was premised on the conventional property law repercussions of the distinction between
fixed and floating security interests. The bank's security interest, it was argued—at least so far as it extended to inventory—was in the nature of a floating charge. As such, it did not attach to the inventory until the charge was crystallized, at which point the deemed trust for tax withholdings had already attached. The second argument was premised on an implied contractual waiver of priority by the bank. Even if the charge was characterized as fixed and specific from its inception so as to have attached to the inventory before the deemed trust, the bank had tacitly ceded its priority by licensing the debtor to deal freely with its inventory and the proceeds from its disposition in the ordinary course of business.

Although the Supreme Court was divided in the result, the majority and minority opinions were ad idem on the first issue regarding the proprietary character of the bank's security interest: it was fixed and legal in nature. It was conceded that the application of that characterization to a charge on inventory—a dynamic collection of present and future assets—challenged traditional notions of the fixed charge which emphasized the ability to settle on specific assets. The distinction between floating and fixed security was rooted in pre-PPSA property law doctrine. In a PPSA regime, all security interests attach on execution of the security agreement and the debtor's acquisition of rights in the collateral. This is regardless of whether the collateral is specific or circulating, present or after-acquired, and regardless of the scope of the debtor's licence to deal. Thus, in establishing a unitary attachment regime independent of the concept of crystallization, the PPSA legislatures intended that all security interests be treated as equal in their proprietary effect, and as such, be presumptively entitled to priority on a first-in-time basis.

It was regarding the second argument, the impact of the debtor's licence to deal with the collateral, that the Court split. The argument that the existence of such licences constitutes an implicit waiver of first-in-time priority originates in the decision of McLachlin J.A. (as she then was) in R. v. F.B.D.B. At issue was the priority be-

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212 For further analysis, see the text accompanying notes 183ff., above.
213 Like the other Canadian PPSAs, the Alberta PPSA, supra note 6, s. 12(1) provides that a security interest attaches only once the debtor has rights in the collateral.
214 Although the Court in Sparrow did not find it necessary to deal with the nature of the bank's interest in the inventory under its s. 427 Bank Act security, there is convincing authority that is likewise to be characterized as fixed from the outset, i.e., as attaching to the collateral immediately, notwithstanding that the arrangement would be classified as floating in nature under a common law property rights approach: see Ford Motor, supra note 173. Moreover, the Bank's security interest, like a PPSA security interest, is thought to extend to the proceeds of sale of the inventory (although by implication and not by explicit statutory provision, as in the case of the PPSA): see Canadian Imperial Bank of Commerce v. Surkan (1978), 5 Alta. L.R. (2d) 323, 11 A.R. 556 (Dist. Ct.); Roynat Inc. v. Ja Sha Trucking & Leasing Ltd. (1992), 10 C.B.R. (3d) 41 at para. 18, 89 D.L.R. (4th) 405 (Man C.A.); and Kernel Farms, supra note 108. However, the implied tracing rights of the bank, unlike the express tracing rights of a PPSA secured party, terminate on disposition of the proceeds to a bona fide purchaser for value without notice and are subject to equitable set-off rights: see Mercantile Bank, supra note 108.
between a consensual security interest in inventory and its proceeds, and a statutory lien
securing provincial sales tax that had been collected by the debtor on the sale of the
inventory but not remitted to the government. In awarding priority in the proceeds to
the tax lien claimant, McLachlin J.A. reasoned that since a licence to sell inventory
necessarily encompasses a licence to satisfy obligations incidental to such sales—
such as the payment of sales tax—the secured creditor must be taken to have tacitly
ceded priority to the tax lien claimant in the amount of the taxes collected and not re-
mitted from the proceeds.

In refusing to extend the licence theory to encompass Revenue Canada’s deemed
trust for employee source deductions, the majority in Sparrow distinguished the
F.B.D.B. decision on two grounds. First, in the case of sales taxes, there is at least a di-
rect connection between the claim for taxes and the subject matter of the deemed
trust, namely, the proceeds of sale of the inventory.216 In contrast, the payment of in-
come tax on employee wages is not a necessary incident of the sale of inventory. At
best, a connection between proceeds and the payment of employee wages exists if the
debtor is authorized not merely to sell inventory but to apply the proceeds of that sale
to the payment of wages. The debtor’s licence in Sparrow extended that far. In the
majority’s view, however, this did not assist Revenue Canada. The inventory to which
its deemed trust attached was not sold by the debtor pursuant to its licence to deal, but
by the receiver after the debtor’s default. The majority held:

There is a great difference between saying ... that if a debtor sells inventory and
applies the proceeds to a debt to a third party, then the third party takes the pro-
ceeds free of any security interest and saying ... that because a third party could
take the proceeds free of any security interest, no security interest exists in the
proceeds as against that third party.217

The majority’s second, and for our purposes more significant, basis of distinction
related to the impact of the PPSA on the implied waiver theory. Whereas F.B.D.B. had
been decided before the enactment of a PPSA in British Columbia, the security inter-
est in issue in Sparrow had been taken within the framework of the Alberta PPSA. In
a PPSA regime, security interests are presumptively ranked on a first-in-time basis re-
gardless of the nature of the collateral.218 Even when the debtor is authorized to dis-
pose of the collateral, the statute does not contemplate defeasance of the security in-
terest unless and until the collateral is actually sold. It is at this point that the security
interest, along with the secured party’s priority ranking, automatically transfers to the
proceeds.219 Taken to its logical conclusion, the licence theory would effectively evi-
cerate the ability of a secured party in inventory or accounts to rely on its first-in-time ranking. In such transactions, it was essential to the continued economic viability of the debtor that it be left free to use the collateral in the ordinary course of business. However, if every authorized use of the collateral was interpreted as a waiver of priority, the last claimant would effectively become the first only because the last claimant would not be subject to some subsequent claim arising in the ordinary course of business.

At a broader policy level, the majority considered any extension in the licence theory to be antithetical to the desire of the PPSA legislators to enhance commercial accessibility to credit by minimizing uncertainty in the resolution of priority disputes. Moreover, the Court considered issues of priority to be policy-charged. For both these reasons, the Court believed that judicial innovation in this area should be discouraged. The Court was of the view that legislative rules were more reliable sources of policy and were apt to be clearer than judicially developed standards based on such open-ended concepts as a "licence to deal", the precise bounds of which would become clear only through expensive and lengthy litigation.

The minority opinion acknowledged the values of certainty and predictability in the determination of priority, particularly in light of the contemporary enactment of statutory priority regimes. It attempted to meet that objection by limiting the scope of the waiver implicit in the existence of a licence to sell inventory. The critical issue was not the existence of the licence as such, but the limits imposed by the secured party on the range of uses to which the proceeds from the sale of inventory might be put. It was one thing if a secured party required the debtor to remit the proceeds and actually monitored the debtor's behaviour to ensure that the proceeds were dealt with as directed. In such cases, there could be no presumption of a waiver of priority against third parties. However, in Sparrow the secured party was the debtor's principal financier, its main source of general working capital, and it held a security interest not just in the debtor's inventory, but in all the debtor's business assets as well. Unless the debtor was able to use the proceeds generated by its business to pay wages and to meet other ordinary course of business obligations, its economic viability was lost. In these circumstances, the all-assets financier must be taken to have implicitly consented to the use of the collateral to meet all ordinary course of business obligations, including the payment of wages and statutory withholdings from wages. Indeed, the secured party in this case had explicitly authorized the debtor to use the proceeds from inventory to pay taxes and other assessments when due, and had in fact required the debtor to covenant that it would do so. In so doing, the secured party must be taken to have bound itself to observe the statutory incidents attaching to the deductions, i.e., section 227(5) of the Income Tax Act under which the debtor's assets became superimposed with a trust to secure the deductions.

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290 Sparrow, supra note 207.
At the level of distributional fairness, the minority opinion is attractive. Revenue Canada is a non-consensual creditor. It cannot refuse to extend credit on income tax withholdings to employers who pose unusual credit risks. Its right to be paid depends upon the employer's observation of its statutory obligations. If the employer misappropriates the withholdings and applies them to the payment of other debt or other business obligations, the effect is to artificially increase the debtor's supply of working capital. The temptation to misappropriate funds is at its highest when the debtor is, as in Sparrow, encountering financial difficulties and its regular lender is unwilling to take on any additional risk. The subordination of Revenue Canada effectively transforms it into a financier of emergency working capital. This financing is, in essence, provided to the debtor's business against Revenue Canada's volition, without its knowledge, and without the kind of increased risk controls and premiums that a consensual financier would be likely to demand in the same circumstances. As a potential involuntary supplier of emergency capital, Revenue Canada is surely entitled to protect itself by legislating super-priority rights in the debtor's business assets.

In the wake of Sparrow, the federal government has in fact signalled its intention to amend the Income Tax Act so as to clarify its super-priority for income tax withholdings over prior consensual secured creditors. Presumably, this will encourage closer monitoring by secured creditors to ensure that the debtors observe their income tax remission obligations. More significantly, the debtor will no longer have access to the money represented by those obligations to artificially extend its business operations past the point of de facto insolvency. This benefits the debtor's unsecured creditors. The longer an insolvent debtor is allowed to remain in business, the more debt it is likely to accumulate vis-à-vis trade suppliers, utility providers, and the like. Consequently, the monitoring incentive created by the threat of subordination to Revenue Canada increases the likelihood that the debtor's principal financier will enforce its security at the point of de facto insolvency, thereby reducing the ability of a failing debtor to increase unsecured debt which it has no hope of repaying.

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21 See generally “Unsecured Creditor's Bargain”, supra note 11. See also “Priority of Secured Claims”, supra note 8.

22 Department of Finance Canada News Release, online: <http://www.fin.gc.ca/newse97/97-030e.html> (date accessed: 17 August 1999). The amendments will apply retroactive to June 15, 1994. The amendments to s. 227(4), (4.1) of the Income Tax Act, supra note 208, would give Revenue Canada, to the extent of unremitted deductions, a beneficial interest in the property of the debtor, including property that, but for the interest of a secured party (as defined by the Act), would be the property of the debtor, which is deemed to be held separate and apart from the debtor's other property and which has priority over the interest of any such secured creditor, notwithstanding any other law. The Ministerial statement associated with these changes points to the way current law credits employees with amounts that ought to have been deducted regardless of whether that has occurred, amounts that in any event are to be paid over by the federal government to the relevant province party to the Federal/Provincial Tax Collection Agreements.
C. Conclusions

Sparrow confirms that the PPSA's unitary concept of security is not confined to the PPSA framework, but has, and will have, a profound impact on the administration and evolution of secured transactions law in general. What is most disquieting about the decision in Sparrow is the Court's recourse to conventional property characterizations—albeit as informed by the statutory incidents attached to the conventional property categories—to justify what amounts to a transfer of creative responsibility for the overall setting of insolvency distribution policy, from the realm of private ordering to the realm of public policy. As such, Sparrow confirms the transformation from a property interest rooted in the form of the legal institution selected by the parties to a status-based privilege rooted in statutory law. This transformation is effected by a unitary theory of security.

A better approach, which is more consistent with the subtlety that property analysis instantiates, would have revolved around the competing statutory policies in operation, and the ineluctable need for the judiciary to work in order to accommodate those policies.

III. Understanding English Resistance to the Call of Article 9

A. Introduction

Now we move away from the Article 9 and PPSA world to a jurisdiction whose law grounded that of the Canadian provinces before they embarked upon the PPSA enterprise. England has thus far resisted the call of Article 9 and, as will be noted, there is no real prospect of change. English law can, nevertheless, help one to better understand the tradition with which Article 9 broke, as well as sharpen one's appreciation of the analysis of functionalism that we have been pursuing thus far.

In England, there is no general concept of a “security interest” as that expression would be understood in Article 9 and PPSA jurisdictions. Security is differentiated from title retention and understood in a strict sense as consisting of certain types,

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222 See Ford Motor, supra note 173, where the court awarded priority to Revenue Canada on facts very similar to Sparrow. The decision was subsequently reversed by the Supreme Court of Canada in light of its intervening ruling in Sparrow. Nevertheless, it is instructive to compare Jackson J.'s reasoning in Ford Motor with the analytical approach taken by the Supreme Court in Sparrow. In her view, property rights analysis was inapposite and artificial to resolve a priority dispute between competing “security interests” created by separate legislative regimes, preferring an approach that construed the statutes in question and their competing policies rather than one which attempted to characterize the interests.

224 For just such an effort, now overruled, see Ford Motor, ibid.

225 Occasionally, there will be frank judicial recognition that something which is not really a security in fact operates as though it were: see e.g. Banque Financière de la Cité v. Parc (Battersea) Ltd. (1998), [1999] A.C. 221, [1998] 1 All E.R. 737 (H.L.) [hereinafter Battersea cited to All E.R.].
each with its own characteristics. According to classic analysis, English law knows of only three nominate consensual securities: the mortgage, the charge, and the pledge.\(^6\)

A mortgage that complies with the necessary forms and deals with property that exists at common law will be a legal mortgage, otherwise it will be an equitable mortgage. A charge exists only in Equity, while a pledge is a common law creation (though occasionally the question has been raised whether there can be an equitable pledge). The legal or equitable status of a security does not matter when the security is asserted against unsecured creditors or their insolvency representatives, but will frequently matter when it comes to determining priority contests among secured creditors. Apart from this, there is rarely any practical significance in the distinction between mortgages and charges, and the distinction between them is commonly eliminated in the drafting of debentures.\(^2\)

Consequently, the English law of security is more appropriately divided into the non-possessory—which mortgage and charge do not have to be but usually are—and the possessory. As a possessory security, pledge is confined for business purposes to documentary intangibles, such as share certificates and bills of lading, and is usually of a short-term nature. The word is increasingly used nowadays in a loose sense when referring to non-possessory security over dematerialised and immobilised shares and bonds held in systems such as Euroclear (in Brussels) and Cedel (in Luxembourg).

Any survey of the security position of creditors would, however, be seriously deficient if it failed to mention certain security rights arising by operation of law. Like consensual security, they provide the creditor with a resource additional to membership of the dividend pool on the debtor's insolvency. Statute law provides a number of such instances\(^2\) while the common law supplies well-known examples like special

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an undertaking given to an unsecured creditor—that a secured creditor would postpone its right to be paid by the debtor until the unsecured creditor had been paid—was treated as a form of security for the purpose of the doctrine of subrogation (see *ibid.* at 752, Lord Hutton). In fact, the contract containing the undertaking did not bind the secured creditor but, because the secured creditor was unjustly enriched in consequence of the unsecured creditor's advance to the debtor, the restitutionary outcome was (supposedly) the same as if the contract had been held binding on the secured creditor.\(^2\)

In *Re Cosslett (Contractors) Ltd.*, [1997] 4 All E.R. 115 at 126, [1996] 3 W.L.R. 299 (C.A.), Millett L.J. includes in the *numerus clausus* of consensual securities a "contractual lien". In so far as the lien arises contextually in contractual relationships by operation of law, then it is not a consensual security. It may, however, be a case of a general lien, building contractually upon the narrower incidents of a special lien arising by operation of law: see *infra* note 228. Although the matter cannot be regarded as beyond dispute, it has recently been held that a general lien created by contract in this way does not have to be registered as a company charge: see *Re Hamlet International plc*, [1998] All E.R. 83, [1998] 2 B.C.L.C. 164 (Ch.D.).


and general liens29 and the landlord’s right to distrain chattels found upon the leased premises.30 While these rights flow from status rather than contract, this is not to say that the relationship between landlord and tenant, or between repairer and customer, is just a matter of status. There will almost invariably be a contract supplemented by the incidents of status. The common law, it would seem, is long past the age of creating new status rights by way of lien. Moreover, rights of lien and distress fit awkwardly into any scheme of rights based upon contract and are inevitably difficult to explain in terms of the values of the modern law, especially when they bear upon the rights of strangers to the accompanying contract.31

Other rights of a security or proprietary nature which are significant in a debtor’s insolvency include equitable (non-possessory) liens (which are imposed by law in certain infrequent and unpredictable cases32), trust rights of the Quistclose or other similar type (which are voluntarily created33), and a range of proprietary rights imposed in accordance with restitutional principles.34 It is not an easy matter to discover when a restitutional right will extend beyond the personal to the proprietary zone, and from a world of two parties to the world at large.35 It cannot be imagined that the law will encourage the expansion of proprietary claims in the pursuit of restitutional justice,36 and yet there is little sign of a principled and general approach to

29 Special liens are granted to certain providers of services such as innkeepers and repairers for entitlements arising from the instant transaction: see Hatton v. Car Maintenance Company (1914), [1915] 1 Ch. 621, [1911-13] All E.R. Rep. 890 (Ch.D.). General liens are granted to professionals, such as solicitors, for all monies owing to them no matter when the services were rendered. A special lien may be contractually expanded to a general lien, commonly done in the case of carriers: see George Barker Ltd. v. Eynon (1973), [1974] 1 All E.R. 900, [1974] 1 W.L.R. 462 (C.A.).
30 The landlord’s common law rights are restricted in various ways by the Law of Distress (Amendment) Act, 1908 (U.K.), 7 & 8 Edw., c. 53.
34 For a general statement of the availability of personal and proprietary remedies in restitution, see e.g. A. Burrows, The Law of Restitution (London: Butterworths, 1993) at 28-29.
35 Consider the difference between recovering money (personal) and recovering goods (proprietary) when a contract is rescinded for misrepresentation. See e.g. M.G. Bridge, The Sale of Goods (Oxford: Clarendon Press, 1997) at 361-64 [hereinafter Sale of Goods].
36 See Re Goldcorp Exchange Ltd., [1995] 1 A.C. 74, [1994] 3 W.L.R. 199 (P.C.) where, given the absence of certainty of the subject matter, the Privy Council refused to infer a trust from statements by a gold depositary that it held gold for various investors. A similar caution in the creation of proprietary restitutional rights is apparent in Westdeutsche Landesbank Girozentrale v. Islington L.B.C., [1996] A.C. 669, 2 All E.R. 961 (H.L.) and in Battersea, supra note 225, where the House of Lords granted a personal right, not a real subrogation right, to an unsecured lender mistaken in its belief that a second secured lender would not seek repayment when monies were advanced so that a first secured
this issue at the higher judicial levels. This will doubtless happen when the creative
rush evident in the recent manufacture of a modern law of restitution has died down.
The manufacture of restitutionary proprietary rights would not threaten to undermine
the principle of pari passu distribution to unsecured creditors in insolvency, for that
principle has already been subverted by the ease with which security rights may be
obtained. Rather, the creditors threatened by restitutionary proprietary rights are, first,
preferred creditors, and secondly, secured creditors, unless their claims as subse-
quent bona fide purchasers of the legal estate without notice override a restitutionary
right of an equitable character. Unsecured creditors will take no comfort from com-
pelling a restitutionary claimant to join their ranks if preferred or secured creditors, or
both, will, in any event, scoop up the debtor's assets.

Finally, any round-up of security and its cognates in English law would be very
much incomplete if it failed to take into account title reservation clauses as bargained
for by trade suppliers as well as by banks and finance houses supplying equipment on
hire-purchase, lease, and conditional sale terms. The power of restitutionary proprie-
tary rights and title reservation clauses lies in the fact that they circumscribe the assets
which can be used to give security or which can be distributed to creditors upon the
debtor's insolvency. Consequently, there is no priority conflict as such to resolve
between holders of restitutionary proprietary rights or title reservations and secured
creditors, and therefore no practical legal medium through which to assess the com-
peting merits of any such claimants.

The finite vision of consensual security, stated above, as confined to mortgage,
charge, and pledge is not laid down in any code or statute. Nor are there sweeping judi-
cial statements condemning any attempt to manufacture new security concepts.
Needless to say, no code or statute exists laying down a numeros clausus of consen-
sual security devices. Legal creativity, for reasons that will be made obvious, has not
been concerned with the manufacture of novel types of consensual security. There are
no appreciable restrictions on the assets that may be subjected to one of the three
nominate consensual securities. For the most part, the rights of the creditor are de-
fined by the terms of the contract that the creditor is (usually) able to impose upon the

lender could be paid in part. Nevertheless, the Privy Council, departing in this respect from Lister v.
Stubbs (1890), 45 Ch.D. 1, [1886-90] All E.R. Rep. 797 (C.A.), has recently ruled that a principal has
a proprietary remedy against an agent who has received a bribe: see Attorney General for Hong Kong
v. Reid, [1994] 1 A.C. 324, [1994] 1 All E.R. 1 (P.C.). The House of Lords has also, for ease of distri-
bution of monies in a reinsurance case, granted proprietary rights in Lord Napier and Ettrick v.

38 For example, a later creditor taking a legal mortgage of the property in question. See also Taylor
39 They necessarily rank ahead of consensual secured creditors. Sellers claiming the benefit of title
reservation clauses are vulnerable to exceptions to the rule of nemo dat quod non habet, notably the
buyer in possession exception in s. 25 of the Sale of Goods Act 1979 (U.K.), 1979, c. 54. Restitution-
ary property rights of an equitable (but not common law) character are more broadly vulnerable to the
claims of bona fide purchasers of the legal estate without notice and for value.
debtor. For various reasons, such as the priority battle with secured creditors and the need to create off-balance-sheet financing, legal ingenuity has largely gone into defining the attributes of a particular type of security right, and into creating proprietary and title rights of one kind or another.

B. The Importance of Title

Title reservation has long played an important role in reinforcing creditors' personal rights against debtors. As stated above, it is more important to define "property" than its sub-category, "proprietary security", in matters of insolvency distribution. As we have seen, a superficial reading of Article 9 and the PPSAs encourages the belief that title has been demystified by assimilating it to security. So triumphant appears the functionalist ethic that the drafters were able to allow contracting parties to call their arrangement whatever they liked, since the functional definition of security would, in any event, overrule their efforts. It was unnecessary to proscribe contracting on conditional sale and similar terms since conceptual differences flowing from the various terms would not be recognized. Nevertheless, as was duly noted above, the visceral importance of property, in the form of title reservation, breaks through in important areas. This is particularly apparent in the way that the functional definition of "security" is reluctantly applied as in the areas of leasing transactions and the Quistclose trust.

A survey of the importance of title in English law should not be confined to matters of insolvency distribution. In the law of sale of goods, the seller's implied undertaking that he has a right to sell the goods is defined in the legislation as a contractual condition. In fact, it is more than just a condition. So important is this obligation that, upon breach by the seller, a buyer who has paid part or all of the price in advance may recover it in full regardless of the rules dealing with the treatment of conditions as ex post facto warranties. For the purpose of the restitutionary action for the recov-

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241 This is a common problem in defining the range of modern personal property security legislation.

242 See Ziegel & Denomme, supra note 6 at 63. See also the curious and unsuccessful way that it was argued that a Quistclose advance gave rise to a registrable company charge in England: Carreras Rothman Ltd. v. Freeman Matthews Treasure (1984), [1985] Ch. 207, [1985] 1 All E.R. 155 (Ch.D.).


ery of money on a failure of consideration, "consideration" is defined as the lawful benefit conferred by the seller onto the buyer. The actual use of the goods is not regarded as a qualifying benefit if the buyer may be ousted at any time from enjoyment of the goods by the true owner. Again, the seller's obligation may not as a matter of law be excluded in the contract, even if the parties are commercial parties operating at arm's length. This statutory manifestation of the fundamental breach doctrine has survived the judicial abolition of its common law equivalent. Title exclusion remains, however, distinct, but barely distinguishable, from a limited title sale by which the parties are free to agree that the seller duly performs by conveying to the buyer something that is, or may be less than, full ownership.

In matters of insolvency distribution and competition with secured creditors, the unpaid seller is free to manipulate the passing of property of the goods to the buyer in order to secure payment of the price. At first sight, this represents a serious threat to the all-encompassing security rights of the buyer's bank and to the insolvency distribution rights of preferred and unsecured creditors. The bank's security cannot attach to assets in the buyer's hands that are still owned by the seller. Likewise, the buyer's insolvency representative has no right to deal with such assets. Furthermore, sellers can achieve this result by the simple expedient of inserting a reservation of title clause in their standard condition of sale contract. There is no need to register, which means that ordinary commercial sales can be executed from day to day without a lawyer looking over the seller's shoulder. These powerful title reservation rights belonging to unpaid sellers have drawn fire from the buyer's other creditors.

Nevertheless, one should not underestimate the difficulties that liquidators and receivers can create, in practice, for sellers. Tracing the goods supplied to the buyer into...
the buyer's possession may be a matter of some difficulty.\(^{251}\) Furthermore, as the dust has settled in the wake of the decision in *Aluminium Industrie Vaaseen R.V. v. Romalpa Aluminium*,\(^{252}\) which focused attention on the ability of sellers to help themselves by means of title reservation clauses, it has become clear that sellers' rights are more limited than first thought. Various attempts have been made by sellers to "reserve" title in goods manufactured by the buyer with materials supplied by the seller. Robert Goff L.J. was of the view that a competently drafted clause could achieve this effect;\(^{253}\) however, the practical outcome of a series of later cases has put it beyond doubt that "extended" title reservation clauses will not work. A buyer who manufactures a new product out of goods supplied by the seller thereupon becomes the owner of the new thing. Any contractual clause that treats the seller as the owner will therefore amount to a grant back from the buyer and is therefore a registrable charge.\(^{254}\) Attempts to treat the buyer as the seller's agent in disposing of the goods supplied to the buyer or of new goods have met a similar fate. Any rights conferred by the contract over book debts due from the sub-buyer will be judicially characterised as the product of a charge over those debts. A buyer cannot, by a stroke of the draftsman's pen, be treated as an agent or other fiduciary if commercial reality points to an arm's length relationship of seller and buyer.\(^{255}\)

On one view, the seller's efforts are not completely unsuccessful. The seller with an extended title reservation clause is left with a charge. However, the cramp imposed by the law on taking security for future advances,\(^{256}\) coupled with the absence of a simple notice filing system, has for all practical purposes conferred upon sellers rights that they cannot protect by registration. Given the brief industrial life of raw materials and the rapid depreciation of capital goods—especially of computer and similar

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\(^{251}\) Tales are told of receivers and liquidators inviting sellers to rummage among a mountain of nuts and bolts to recover those that they supplied.


\(^{256}\) The Law of Property Act, 1925 (U.K.), 15 & 16 Geo. V, c. 20, s. 94, limits so-called "tacking" of future advances onto pre-existing mortgages (which include charges: s. 205(1)(xi)) to cases where the mortgagee makes the advance pursuant to commitment, or has no notice of intervening mortgages, or has the consent of intervening mortgagees. If title reservation clauses had to be registered under the present system, the seller would be at a disadvantage. A seller of goods on repeated occasions could rely upon a single registration only if the contract were an output or similar type of contract obliging the seller to supply goods as and when called for by the buyer. If the contract took the form of a requirements contract, obliging the buyer to place orders with the seller, the goods would not be supplied pursuant to commitment unless the seller were already bound to supply the goods when ordered by the buyer. It is the seller's commitment that would be necessary for a single registration; the buyer's commitment is neither necessary nor sufficient.
equipment—the threat posed by reservation of title clauses both to banks as well as preferred and unsecured creditors has proved, in the end, to be a relatively modest one. In matters of reservation of title, English law has now moved into calmer waters.

C. Artificiality

If English law were hostile to artificial transactions, this could well produce calls for law reform in the credit industry. However, English law is not a law of narrow nominate categories. A system of law that largely lacks nominate contracts was never likely to define security transactions in terms that blocked legal creativity. The most prominent feature of the law in this area is freedom of contract. Secured lending takes place on terms proffered by the banks and prepared by the leading City of London law firms, with no opportunity afforded in practice to borrowers to negotiate terms. It follows, therefore, that the economics of repeat transactions in an accommodating legal system encourages the preparation of lengthy documents that give the banks every advantage which experience and imagination can yield. The examination of a few artificial transactions captures the flavour and thrust of English law in the area of secured transactions. The freedom thus accorded to powerful institutional lenders helps to explain their evident opposition to any fundamental reform of the present system. With the exception of charges masquerading as reservation of title clauses—and these clauses protect the interests of trade creditors rather than major lenders—English law has been receptive to the drafting of artificial agreements.

While artificiality may be condoned, the law has stopped short of countenancing sham transactions.27 The avoidance of sham transactions is accomplished when contracting parties remain faithful, in fact, to the forms of the transaction that they conclude. The success of hire-purchase shows how undemanding the law has been in this respect. It is well known that hire-purchase consists of the bailment for a term between the bailor, a financier, and a bailee who is seeking to acquire the subject matter of the agreement on instalment terms. The bailee undertakes to pay hire for the use of the chattel until, at the end of the stipulated term, the whole of the agreed sum due for hire has been paid and the bailee is left with an option, usually exercised for a nominal fee, to purchase the chattel outright. A conjunction of a bailment with the payment of hire at intervals, coupled with an option leading to a unilateral contract taking the form of a sale, is hardly the most natural way to finance the acquisition of a chattel that all along the bailee eventually wishes to acquire. Much more natural would have

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27 There is a cloud on the horizon. The doctrine of tenancy in common has been strongly boosted in recent times in sales law: see Re Stapylton Fletcher Ltd., [1994] 1 W.L.R. 1181, [1994] B.C.C. 532 (Ch.D.); Mercer v. Craven Grain Storage Ltd., [1994] C.L.C. 328 (H.L.), online: QL (HL); and Sale of Goods (Amendment) Act 1995 (U.K.), 1995, c. 28. This points to an artful clause conferring on the unpaid seller tenancy in common rights over newly manufactured goods. Whether such a clause would escape characterisation as a registrable charge is uncertain.

been a conditional sale contract containing the buyer’s commitment to purchase at the outset with payment taking place according to an incremental plan for a set period of time.

The reason for the artificial formula of hire-purchase was mainly twofold: bailors sought to avoid having the bailee treated as a buyer in possession under factors and similar legislation dealing with title disputes between owners and good faith purchasers. At the same time, bailors did not want to structure the transaction as a security bill of sale for that would bring in a complex body of legislation designed to do two things: (i) to protect the borrowing bailee from catching behaviour by grasping creditors, and (ii) to protect the bailee’s other creditors from the deceptive impact of his apparent ownership of chattels in his possession. In two decisions rendered in 1895, the House of Lords gave financing bailors everything they desired. In Helby, the bailee was not a buyer in possession. At no time during the existence of legal relations between bailor and bailee had the latter agreed to purchase the chattel. The bailee was never committed, but only had an option to purchase the chattel. This option was contingent until the hire had been paid in full but was obviously larger as the bailment came to the end of its term. When all the instalments had been paid, it might make overwhelming economic sense to purchase a chattel that far exceeded in value the cost of exercising the option, but it still could not be said that the buyer had “agreed” to buy the chattel. In McEntire, the transaction was not a security bill of sale because at no point had the bailee been the owner of the chattel such that it could be regarded as the subject of a grant to the bailor. This would be so whether the financing bailor had assigned to it the benefit of a hire-purchase agreement already concluded between a merchant bailor and the bailee, or whether the merchant sold the chattel to the bailor immediately before the latter bailed it on instalment terms. Structured in this artful way, hire-purchase did not tell a lie. It would be a different matter, of course, if someone who was already the owner of a chattel wished to use it to raise financing by entering into an agreement that on its face was a hire-purchase agreement.

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259 The relevant legislation at the time was the Sale of Goods Act, 1893 (U.K.), 56 & 57 Vict., c. 71, s. 25(2); and the Factors Act, 1889 (U.K.), 52 & 53 Vict., c. 45, s. 9.

260 Bills of Sale Act, 1878 (U.K.) 41 & 42 Vict., c. 31; and Bills of Sale Act 1878 (Amendment) Act, 1882 (U.K.) 45 & 46 Vict., c. 43.


262 Ibid.

263 See also Lee v. Butler, [1893] 2 Q.B. 318, [1891-4] All E.R. Rep. 1200 (C.A.) (commitment to buy). In Forthright Finance Ltd. v. Carlyle Finance Ltd., [1997] 4 All E.R. 90, [1997] C.C.L.R. 84 (C.A.), an agreement, though called a hire-purchase, was held to be a conditional sale since it required the “hirer” to pay all instalments and deemed the option to be exercised unless the “hirer” gave prior notice that this was not to be the case.

264 Supra note 261.

265 But see Manchester, Sheffield and Lincolnshire Railway Co. v. North Central Wagon Co. (1888), 13 A.C. 554 (H.L.) where, under a refinancing scheme, a second financier bought out the interest of a
A different example of the law’s tolerance of artificiality is afforded by a recent Court of Appeal decision. In so far as this case rewards legal ingenuity, it has a natural tendency to quell demands from secured creditors for the reform of the law. The case concerned a financier extending credit to ease the cash flow problems of a manufacturer exporting computer software and having to wait for payment from its overseas customers. The natural form of a transaction of this kind would be for the financier to purchase, or take a charge over, the accounts generated by these overseas sales. For unstated but predictable reasons, the financier wished instead to take an interest in the software before it generated accounts receivable. It did so by purchasing the software outright. This ensured that the financier would not be in competition with other creditors who had security over the accounts or the inventory of the manufacturer.

The scheme worked as follows. When an export sale was arranged, the manufacturer sold the inventory in question to the financier before selling it to the overseas buyer as agent for the undisclosed principal, i.e., the financier. The manufacturer’s authority to bind the principal was confined to cases where the software attained the warranty standards required by the overseas sale contract. Moreover, although payment by the overseas buyer was made to the manufacturer, it was paid into an account that in reality was controlled by the financier. These precautions served to insulate the financier from the realities of dealing with overseas buyers whilst preserving the form of the transaction adopted by manufacturer and financier. In the brief period between selling the software to the financier and reselling it as agent to the overseas buyer, the manufacturer could be regarded as holding the software as bailee for the financier in accordance with a constructive delivery of the software to the financier. The transactional form may have told a far-fetched story, but it did not tell a lie.

Another example of artificiality that comforts institutional lenders concerns the so-called “lightweight” floating charge. This is perhaps the best example of English law creating a climate receptive to the interests of institutional lenders. The lightweight floating charge responds to the apparently conflicting interests of a secured lender seeking to maximise its priority rights against other creditors—secured, preferred, and unsecured—whilst simultaneously fending off any attempts to appoint an administrator under Part 2 of the Insolvency Act 1986. Briefly, the priority rules favour fixed charges over floating charges, even if the latter are granted earlier in time.

first financier in railway rolling stock and also made a further advance. This was held not be a registrable bill of sale.


(U.K.), 1986, c. 45.

Re Castell & Brown Ltd., [1898] 1 Ch. 315, 67 L.J. Ch. 169 (Ch.D.). It would be different if the later fixed chargee took with notice of restrictions imposed under the terms of the floating charge on the grant of later charges: see R.M. Goode, “The Exodus of the Floating Charge” in D. Feldman & F. Meisel, eds., Corporate and Commercial Law: Modern Developments (London: Lloyds of London Press, 1996) 197. Such restrictive clauses, sometimes called negative pledge, are not registrable par-
More importantly, an advantage of the fixed charge is that when the chargor is in receivership or liquidation, the chargee ranks ahead of preferred creditors, such as the Inland Revenue and employees of the chargor. A creditor whose security consists of a floating charge ranks after preferred creditors, even if that charge has crystallised before the appointment of the receiver or liquidator.  

Nevertheless, a creditor who relies solely on a fixed charge will surrender a powerful advantage that goes with a floating charge. Secured debentures almost always contain a clause granting the chargee the right to appoint a receiver on behalf of the chargor company. This contractually-appointed receiver may owe certain basic duties to the chargor but is entitled to act in the exclusive interest of the chargee in the event of a conflict of interest between the chargor and the chargee. An administrator, on the other hand, is appointed to act in the interests of all of a company's creditors and not just those who have security. The administrator is therefore given certain powers to deal with assets which are the subject of a security and to enter into dealings in conducting the affairs of the company serving to diminish the priority positions of 

peculiarities of a charge and so will not bind third parties deemed to have notice of registered company charges: see Wilson v. Kelland, [1910] 2 Ch. 306, 79 L.J. Ch. 580 (Ch.D.). It is a common practice for such clauses to be insinuated into the particulars of charge where they will commonly be seen by any third party who actually does inspect the register. However, this does not mean that a third party who does not inspect, even one who knows of the practice, will have constructive notice of the clause.  

279 Insolvency Act 1986, supra note 268, ss. 40, 175, 251: "floating charge".

277 Shamji v. Johnson Matthey, [1986] B.C.L.C. 278, [1986] 2 B.C.C. 98 (Ch.D.), aff'd (1986), [1991] B.C.L.C. 36, [1986] 1 F.T.L.R. 329 (C.A.). In dealing with the chargee's assets, the contractually-appointed receiver does not owe a duty of care in tort to the chargee. This has been criticised on the ground that the chargee would be adequately protected by a rule that the receiver may prefer the chargee's interest in the event of a conflict with the chargor's interest. To this effect, see R.M. Goode, Commercial Law, 2d ed. (London: Penguin, 1995) at 691, n. 79. See also J.S. Ziegel, "The Privately Appointed Receiver and the Enforcement of Security Interests: Anomaly or Superior Solution?" in J.S. Ziegel, ed., Current Developments in International and Comparative Corporate Insolvency Law (Oxford: Clarendon Press, 1994) 459. Despite having managerial powers, this receiver exercises them on behalf of the debenture holder and therefore does not owe the company the conventional duties of a manager: see Re B Johnson & Co (Builders), [1955] Ch. 634, [1955] 2 All E.R. 775 at 661-62 (C.A.). The receiver is nevertheless under an equitable duty to avoid acting fraudulently or recklessly when dealing with the company's property: see Kennedy v. de Trafford, [1897] A.C. 180, [1896] 1 Ch. 762 at 772 (C.A.); and Downsview Nominees v. First City Corporation, [1993] A.C. 295, [1993] 3 All E.R. 626 (P.C.) [hereinafter Downsview]. This duty, besides being owed to the company, will be owed to anyone else (such as a guarantor with subrogation rights) who has an interest in the equity of redemption: see Standard Chartered Bank v. Walker, [1982] 3 All E.R. 938, [1982] 1 W.L.R. 1410 (C.A.) [hereinafter Standard Chartered Bank]. Although the language of Downsview puts the matter in some doubt, the better view is that the receiver's equitable duty extends to taking care when conducting the sale (as opposed to deciding when to sell): see Standard Chartered Bank, ibid.; and Cuckmere Brick Co. v. Mutual Finance, [1971] 1 Ch. 949, [1971] 2 All E.R. 633 (C.A.).

existing secured creditors. Consequently, it will be very much in the interest of an institutional lender to block the appointment of an administrator in order to send in its own contractual receiver instead.

An administrator may not be appointed if there is an administrative receiver already in place. An administrative receiver is not just any receiver, but specifically one “appointed by or on behalf of the holders of any debentures of the company secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities.” Moreover, this receivership must extend to “the whole (or substantially the whole) of a company’s property.” At first glance, the secured creditor has two choices. The first is to bargain for high-ranking security, which means taking the path of the fixed charge. The second is to obtain the right to appoint an administrative receiver thereby blocking the appointment of an administrator, which points to a floating charge and a lower-ranking security. On closer analysis, however, the secured creditor can have the best of both worlds. Provided the secured creditor has a combination of floating and fixed charges covering at least substantially the whole of a company’s property, then the appointment of an administrator can be blocked. Finally, the floating charge can be a purely artificial construct sweeping up residual assets, or even only the unlikely prospect of there being residual assets, once the fixed charge has swept up the lion’s share of the company’s assets. This was sanctioned in one case where the non-trading company, a special corporate vehicle, had, for practical purposes, nothing left once its only substantial asset was taken up by the fixed security. The lightweight floating charge thus created was very unlikely to embrace assets of any real value, and was wholly different in kind from the charge over the company’s undertaking that was one of the distinctive creations of nineteenth century English corporate law.

A thread running through this last case is the reluctance of English law to see issues of public policy in the way that individual creditors maximise their advantages—in bilateral deals with debtors—at the expense of other creditors. This same theme emerges in Re New Bullas, where it was common ground between the parties that there was no issue of public policy at stake in the litigation. The debtor company gave

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273 Ibid., s. 9(3): unless the chargee procuring the administrative receiver’s appointment consents to the appointment of an administrator, which is exceptionally unlikely.
274 Ibid. [emphasis added].
275 Ibid., s. 29(2).
276 Note the words emphasized in the text accompanying note 275, above.
278 There is also the technical possibility of the equity of redemption remaining after account is taken of the fixed charge becoming subject to the floating charge. The very need to mention this gives a flavour of the artificiality of English law whose only orientation appears to be the manufacture of a system that maximises the interests of institutional secured lenders.
279 Supra note 240.
a so-called “fixed charge” over its book debts to a financier under the terms of a debenture providing that, in the event of monies being paid “[d]uring the continuance of this security,” they should “stand released from the fixed charge ... and shall stand subject to the [residual] floating charge [in the debenture].” It was the contention of the financier, or rather of the administrative receivers appointed at its behest, that the book debts (as opposed to their proceeds) were not subject to the preferred claim of the Inland Revenue since at all times they were caught by a charge that was fixed from its inception. The administrative receivers argued that when they intervened, the release from the fixed charge no longer took effect and they were at liberty to pay over to the financier the proceeds of the debts as and when received. The disputed debts were by now not those that had been collected in the past, but those that had not yet been paid. The Court of Appeal, enforcing the freedom of contract principle, agreed with the administrative receivers. In the result, the financier was freed from having to assert control over the book debts and their proceeds during the normal conduct of the debtor company’s business, which is the conventional requirement of a fixed charge. Moreover, the court drew a distinction between book debts and their proceeds, when recognizing the existence of separate charges over them, which has been roundly criticised as untenable in practical terms and as flouting the legislative will to put preference creditors ahead of certain types of chargee.

In our view, Re New Bullas may not survive a determined challenge. If it were to be overturned, it is most unlikely that the decision to do so would attract anything like the opprobrium that was visited upon Millett J. when, in Re Charge Card Services Ltd., he gave his opinion that a bank could not take a charge (or so-called “charge-back”) over its own indebtedness to a depositor who was indebted to the bank under the terms of a separate advance. It is a common practice for banks to insist on compensating balances being maintained with them as security for advances. Banks could in most cases protect themselves by claiming generous insolvency set-off rights and by conditioning their duty to repay the deposit so that it did not spring until their advance to the depositor had been repaid. However, it was certainly true that, if Millett J. was correct, the bank could not take a charge over the deposit when other creditors could and when there were advantages accruing to it from a charge-back that other

281 Ibid. at 488.
282 Ibid. at 489.
288 The so-called “flawed asset” approach.
expedients could not provide. The technical reason advanced against the charge-back was that enforcement entailed the bank having to sue itself and so would take effect as a release of the debt in full or in part, which was an evident absurdity. Nevertheless, as cogent as this reasoning might be for a mortgage, it could not be put forward so readily in the case of a charge, since a charge (unlike a mortgage) does not involve conveyance of the encumbered property to a chargee. Moreover, a charge can be enforced by a bank by simply effecting a book entry, which is a long way from the world of Lewis Carroll and a bank suing itself.

Millett J.'s opinion was criticised on a number of occasions, both judicial and otherwise. It was nevertheless upheld by the Court of Appeal in Re Bank of Credit before the House of Lords in the same case came down with a ringing endorsement of charge-backs. The reasoning of Lord Hoffmann is more confident than scientific and, as receptive as he is to commercial needs, it is perhaps a pity that he did not reconcile the practical reasons behind the recognition of charge-backs. He does, nevertheless, appear to have settled the law on the subject and to have reinstated the reputation of English law as being accommodating to commerce. In this area of law, freedom of contract is to be equated with commercial need.

D. Registration

In matters of security, English law does not have a notice-filing system of the type contained in modern security legislation like the Canadian PPSAs, though the introduction of such a system is under review by the Department of Trade and Industry.
Rather, the chargor or chargee sends to the Registrar of Companies both the instrument of charge and what are called the "prescribed particulars of charge." The latter of these are entered on the register after the Registrar's staff have checked the particulars against the instrument to verify the accuracy of the particulars. Reservation of title clauses are not registered. Conditional sale and hire-purchase agreements have never been subject to registration in England. Furthermore, only those charges that are on the statutory list have to be registered. The list has been expanded over the years but still falls short of a comprehensive coverage of charges over all types of property.

The restrictions in English law on the taking of security for future advances, together with the system of sending in the instrument and the prescribed particulars of charge, produce a system that creates quite a high entry cost for those creditors seeking to compete with the major institutional lenders. There are also other advantages in the present system for institutional lenders. For example, in respect of a failure to register within the required twenty-one days running from the creation of the charge, the leave of the Registrar, which is discretionary, will be backdated. Though subject to the rights of intervening secured creditors, the leave will not be subject to the interests of those who become unsecured creditors during the period of non-registration. Unsecured creditors have no standing to challenge the security between creditor and lender. Their protection reposes in the general refusal to permit late registration where liquidation is imminent. Once late registration is allowed, it is conclusive and may not be challenged by a subsequently-appointed liquidator unless the permission for late registration was subject to the condition that it not occur within a stated period.

Finally, another feature of the present system that is attractive to institutional lenders is that once issued, the Registrar's certificate is conclusive evidence that the requirements of registration have been met. It is important to understand that the

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Act 1985 (U.K.), 1985, c. 6, contains some of the features of a notice-filing system. It is a matter of some embarrassment that its provisions have not yet been, nor ever will be, brought into force. An alternative statutory replacement for Part 12 of the 1985 Act is shortly expected.

Companies Act 1985, ibid., ss. 399(1), 401(1); and Companies Forms Regulations, S.I. 1985/854 (Form No. 395).

Companies Act 1985, ibid., s. 396(1).

It does not include, for example, fixed charges over the chargor's own shareholdings in other companies and over insurance policies.

Companies Act 1985, supra note 296, s. 395(1).

Ibid., s. 404.


Re Ehrmann Brothers Ltd., [1906] 2 Ch. 697, 75 L.J. Ch. 817 (C.A.).


The so-called "Charles Order", taking its name from Re L.H. Charles & Co Ltd. (1934), [1935] W.N. 15, 10 Digest (Reissue) 870 (Ch.D.).

Companies Act 1985, supra note 296, s. 401(2)(b).
certificate protects the chargee, not to the extent of the contents of the prescribed particulars of charge, but to the extent of what is contained in the instrument of charge itself. Yet, it is only the prescribed particulars that are entered on the register and are open to inspection by members of the public. In one notorious case\textsuperscript{10} the particulars of charge submitted by the chargee failed to state that the charge over certain premises extended also to chattels on the premises. Despite the carelessness of the chargee, the Registrar's conclusive certificate served to protect the chargee against competing claims to the chattels. More than anything else, it is opposition to the abolition of the conclusive character of the Registrar's certificate that has prevented Part 4 of the \textit{Companies Act 1989}\textsuperscript{10} from being brought into force.\textsuperscript{30}

\textbf{E. Conclusion on English Law}

The above statement of the English law of security is necessarily a selective one. It does, however, point to aspects of the present law that have developed over a period of many years to produce a system that operates strongly in favour of institutional lenders. This is similar to the Article 9 and \textit{PPSA} position.\textsuperscript{31} English law has never imposed restrictions on the taking of security over future assets, one of the major impulses behind the reform movement that produced Article 9. It has allowed the creation of the private receiver acting nominally in the name of, and as agent for, the debtor company, yet has promoted the exclusive interests of the creditor who procured the appointment. This receiver, moreover, is treated in some ways as an office-holder with some of the powers of a liquidator.\textsuperscript{32} English law has confined the PMSI of a financing seller to the original goods supplied. Even if a reform of the present law were to bring in certain advantages to these lenders, there is a danger that these hard-won advantages would be lost. It is hardly surprising, therefore, that there should be a distinct lack of enthusiasm for a reform of the present system of security in England. Institutional lenders appear to have more influence in the councils of government than do trade creditors.

\textsuperscript{50} Supra note 296.
\textsuperscript{10} Certain company charges also have to be registered as land charges, in which case the conclusive character of the certificate issued by the Registrar of Companies is regarded as vital. See "D.T.I. Consultation Paper", supra note 296.
\textsuperscript{31} See the references at supra note 10.
\textsuperscript{32} \textit{Insolvency Act 1986}, supra note 268, ss. 230-37 on enforced cooperation of directors and officers, inquiries into the company's dealings, power to apply to the court for assistance, etc. See also \textit{Re Aveling Barford Ltd.} (1988), [1988] 3 All E.R. 1019, [1989] 1 W.L.R. 360 (Ch.D.).
IV. Exporting Article 9 and PPSA Models to Other Jurisdictions: The Case of Quebec

A. Introduction: The Background to Reform of Quebec's Law of Secured Transactions

As our analysis thus far is meant to have made plain, Article 9 and PPSA thinking—in whatever is its recognizable local form—is a creature of legislation and history, and represents a set of policy choices that cannot be seen as other than socially contingent. Hence, it is possible for a sophisticated legal system like that of the United Kingdom to arrive at a system of secured transaction law that has no need for the functionalism of the Article 9 and PPSA regimes.

In this Part, it is argued that it is also possible for legal systems with economies similar to those of common law Canada which are committed to function over form to take quite a different position on the utility of the Article 9 and PPSA regime. Beyond this rather conventionalist description of the issues of commercial law reform, it is possible for a jurisdiction to resist Article 9 and PPSA analysis because of the problems with functionalism identified in the Introduction, and with the ways in which the law has had to contend with such problems as have been described throughout this analysis.

Consider the case of the civil law jurisdiction of Quebec. Between 1955 and 1993, reform of the private law, including the law of security on property, preoccupied Quebec jurists. In 1978, the Civil Code Revision Office charged with managing this reform process released a Draft Civil Code proposing, inter alia, the adoption of something akin to Article 9 for the law of secured transactions. The regime envisioned by the Draft Civil Code featured the establishment of a single, solely consensual security device called the hypothec which could be taken over immovable and movable property, and over corporeal as well as incorporeal property. The hypothec would also be capable of charging single assets as well as universalities of property. The proposal of the Civil Code Revision Office also contained a "substance of the transaction" rule in the form of a "presumption of hypothec". Much of the regime proposed by the Revision Office was, following at least two further legislative iterations in the form of Draft Bills, ultimately adopted in the Civil Code of Quebec.

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313 See e.g. J.E.C. Brierley & R.A. Macdonald, eds., Quebec Civil Law (Toronto: Emond Montgomery, 1993) at 88-93 for a history of the Civil Code revision process.
315 For a brief review and counterpoint to the position that Article 9 should serve as the model for the modernization exercise, see R.A. Macdonald, "The Counter-Reformation of Secured Transactions Law in Quebec" (1991) 19 Can. Bus. L.J. 239.
316 Draft Civil Code, supra note 314, vol. 2 at 431-35.
"(C.C.Q.)" which was proclaimed into force on January 1, 1994. The "presumption of hypothec" was, however, not carried forward into the C.C.Q.

For an Article 9 enthusiast, this outcome is paradoxical. How could it have been that the National Assembly of Quebec was able to buy into almost all of the modernizing and rationalizing proposals of Article 9 (carrying some of these even farther than Article 9 itself) but was not able to imagine a legal technique which would sweep standard title-based transactions into the security regime whenever they were being deployed as security? In other words, the C.C.Q. has suppressed almost all non-consensual security devices, has reformulated a panoply of disparate possession-based, "fictitious title"-based, and extra-codal sui generis security devices, and has also created a generic security concept applicable not only to single assets, universalities, corporeal and incorporeal property, but also to immovable property as well as movable property. This appears to have all the characteristics of a comprehensive effort at rationalization.

Yet the C.C.Q. does not announce a "substance of the transaction" principle in any of its possible variations. Indeed, to the surprise of many commentators, the new Code represented a regression in this respect from the regime already in place under the Civil Code of Lower Canada ("C.C.L.C.") , at least in so far as immovable security was concerned. Under articles 1040a to 1040e of the C.C.L.C., various title security devices—e.g. sales under suspensive or resolutory conditions, promises of sale, sales with a right of redemption, giving in payment clauses, etc.—were made subject to a mandatory procedural regime at the moment of their enforcement. What is more, when practitioners sought to escape the limitations of articles 1040a to 1040e by imagining novel title-security devices, the courts did not hesitate to extend the principles of these articles to all these novelties.

The answer to this paradox lies less in an imagined atavistic commitment to form and rejection of functionalism than it does in the way that the civil law negotiates the relationship between form and function. To understand the manner of this negotiation one must first understand basic civil law approaches to obligations, property, and security devices and the epistemology of a true codification. One must also consider the fact that the civil law has long had a highly developed notion of security, and has not, like the common law, had to drag itself out of the swamp of title-transactions corrupted as security, with the mortgage, of course, being the paradigmatic example.

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38 For a detailed discussion of the policy debates surrounding the decision not to incorporate a "substance of the transaction" rule into the C.C.Q., see e.g. R.A. Macdonald, "Faut-il s’assurer qu’on appelle un chat un chat? Observations sur la méthodologie législative à travers l’Énumération limitative des sûretés, la présomption d’hypothèque et le principe de ‘l’essence de l’opération’" in E. Cuparros, ed., Mélanges Germain Brière (Montreal: Wilson & Lafleur, 1993) 527.
39 See especially Nadeau v. Nadeau, [1977] C.A. 248, online: QL (AQ), where a nine-member panel of the Quebec Court of Appeal (which usually sits in panels of three) decided that an unregistered promise of sale transaction was captured by the procedural regime of arts. 1040a-1040e C.C.L.C.
B. Civil Law Conceptions of Property, Contract, and Security

Much more than the common law, the civil law distinguishes between owing and owning. It has a relatively clean conception of ownership as a direct right in a thing that may be asserted independently of a right to possession or even of material detention itself. It does not nuance the concept with a theory of equitable interests designed to palliate deficiencies in the logic of property rights, and it sharply distinguishes between real rights in things (ius in re) and personal rights relating to property (ius ad rem trans personam) or obligations (ius ad personam). In the traditional framework of the civil law, what are characterized as “real” rights (droits réels)—whether ownership itself, or fractional dismemberments of ownership (personal servitudes), charges on land (real servitudes), or collateral rights intended to secure an obligation (real security)—may be claimed only in things.²⁰⁹

Real rights themselves may be enforced by particular remedies known as real actions which, like the action in revendication, have for their object the recovery of title or possession from the defendant. Personal rights, by contrast, may be enforced only by means of a personal action directed against the debtor of the obligation in question. Their enforcement presupposes, after judgment, the seizure and sale of the defendant’s assets. The consequence of this central distinction is that the civil law has a relatively clean conception of the asset base upon which creditors of personal rights may seek payment of their claims, namely, the debtor’s patrimony.²¹⁰ A person’s patrimony is, in principle, comprised of all assets and liabilities that can be translated into a pecuniary value. It is that patrimony, viewed in terms of its present assets at the time of seizure and sale, that is made liable for the fulfilment of a debtor’s obligations.²¹¹ The patrimony is known as the “common pledge” of creditors. Absent some other principle of law, creditors who seek payment of their claims against a debtor’s patrimony will share pro rata in the realization value of that patrimony should there be a shortfall.²¹²

Unsurprisingly, therefore, security on property in the civil law has traditionally been understood as a mechanism by which a creditor may escape the pari passu rule of distribution of the proceeds of a sale in execution,²¹³ i.e., security is a right in the property (or some fraction of the property) of a debtor. It is a ius in re. While a claim, or the right of a debtor to receive payment of a personal right from another person, is a species of property and forms part of the common pledge upon which creditors may realize a judgment, it is not property that can be owned. For this reason, historically,

²⁰⁹ This classical conception of real rights is, however, somewhat nuanced in the C.C.Q.: see D.-C. Lamontagne, Biens et Propriété (Cowansville, Qc.: Yvon Blais, 1995), and compare R.A. MacDonald, “Reconceiving the Symbols of Property: Interests, Universalities and Other Heresies” (1994) 39 McGill L.J. 761.
²¹⁰ Art. 2644 C.C.Q.
²¹¹ Art. 2646(i) C.C.Q.
²¹² Art. 2646(ii) C.C.Q.
²¹³ Arts. 2646(ii), 2647 C.C.Q.
claims could not really be given in security in the classical sense. Finally, as its name suggests, security was conceived as an accessory to a principal obligation. Any right in property, such as title, could not be a security device because it was not an accessory but the manifestation of the obligation itself.

The essentials of security on property in the civil law may be deduced from these principles. At the point of enforcement, security is a creditor's conditional right: (i) to extract the value of secured assets either actually falling within the debtor's patrimony or, if no longer in the debtor's patrimony, having been charged by the debtor when previously in that patrimony; (ii) to extract the value of secured assets at a judicial sale or in some other legally-authorized process of realization; and (iii) to obtain payment of the secured obligation by preference from the proceeds thereby generated. Historically, as a general rule, the concept of security neither comprised nor commanded a right to take possession of the charged property (a right to its use-value), the pledge being the sole exception because, at its creation, the creditor would be vested with possession of the pledged property. Historically, moreover, the concept of security neither comprised nor commanded a right of foreclosure as an enforcement remedy (a right to its capital-value). In brief, at the point of enforcement, security was neither use nor capital, but only the right to extract (by means of a liquidation) the capital value of the asset up to an amount sufficient to pay off the secured obligation.

Of course, like a common law lawyer, a civil law lawyer could allow that a right ultimately maturing into a preferential payment upon a debtor's bankruptcy might arise through other means, or might have a different form. At the time of recodification, these quasi-security rights were numerous. Some, like the pure execution privilege which is characterized in the C.C.Q. not as "privileges" but as "prior claims", had no consensual foundation. Nor, given that they were not real rights, did they give rise to a right to follow the charged asset upon its disposition by the debtor. Nor, finally, did they depend (like common law possessory liens) on the creditor actually taking or retaining possession of the assets in question. Furthermore, other quasi-securities, like an unpaid seller's and a repairer's lien, neither had a consensual foundation, nor gave rise to a right to follow but, being grounded in possession (and in the case of the unpaid seller's lien, fictitious possession for thirty days following delivery), they did protect the creditor's right to possession against all other creditors.

More radically, creditors were able to assert preferential rights over certain of a debtor's incorporeal assets. Where this incorporeal property was a dismemberment of the right of ownership, of course, no particular intellectual difficulty was created since


326 See "A Quebec Perspective", supra note 9.
such rights (emphyteusis, usufruct, use, habitation) were by definition real rights giving an immediate access to the corporeal object in which they could be claimed. Similarly, if a claim were corporealized in an instrument that itself was the value—e.g., a negotiable instrument—rather than mere evidence of the value—e.g., a certificate of deposit—they were deemed to be corporealized and, as such, capable of being owned and pledged as security. Ordinary claims like certificates of deposit and book debts that, having no corporeal embodiment, were not capable of being owned, could not be given in security. Nonetheless, as an object of property, a claim could be transferred or assigned. When transferred conditionally, the claim could be deployed like a security device, but it is important to note that the technique being deployed was not a classical security technique; it was, rather, a transfer of title.

This observation, of course, leads to a discussion of the most common form of quasi-security historically known to the civil law: the title transaction. The *pari passu* rule for bankruptcy distributions could be avoided by a creditor manipulating title to property so that at or upon default, the asset in question is not part of the debtor’s patrimony. In other words, a bankruptcy preference could be generated either by means of a disruption to the principle of the equality of creditors—i.e., a true security or an execution preference—or it could be generated by means of a disruption to the principle that a debtor’s property is the common pledge of creditors—i.e., by using title to remove assets from the debtor’s patrimony. While both the panoply of transactions that are quasi-securities or incomplete security rights and title-security raise the question of what is the proper limit of a regulatory regime designed to manage a system of secured transactions, the focus here will be on the manipulation of title as a means for exploring the logic of the new codal regime. 327

Before examining these title-type transactions, however, it is helpful, following the traditional classificatory approach of the civil law, to situate them in a broader context. Four basic forms of right in property capable of securing the performance of an obligation, which are distinguishable depending on the locus of title and possession, are imaginable. First, there are those where the creditor takes both title to and possession of the secured asset. This was the Romanist *fiducia cum creditore* and is today the model of the civil law sale with a right of redemption and general assignment of book debts. Second, there are those where the creditor retains, takes, or reserves the right to take title, but puts or leaves the debtor in possession until default. This is the classical civil law instalment sale, the resolutory condition in sale, the seller's right of revendication, the foreclosure agreement (*pacte commissoire*), and the finance lease. Third, there are those where the creditor leaves the debtor as owner, but retains or takes possession of the secured assets. This is the Romanist *pignus*, or today

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327 It should be emphasized, however, that the overall logic of the regime of the C.C.Q. is best revealed when all these various devices are explored together, as elements of the larger framework relating to the compulsory performance of obligations. For a general review, see e.g. R.A. Macdonald, *Teaching/Learning Materials on the Law of Security on Property*, 3d ed. (Montreal: McGill University, Faculty of Law, 1995), especially Chapters 5-11 [hereinafter *Law of Security*].
the civil law pledge or pawn, the unpaid seller's lien, and the right of retention. Fourth, there are those where the creditor takes neither title not possession, but merely a right to seize and sell the secured asset, either by judicial process or privately. This is the Romanist hypotheca, or today the civil law hypothec, and the execution privilege or prior claim.

As noted, of these four forms only the last two—pignus and hypotheca—have typically been considered as security devices, because only in these cases is the creditor truly a creditor, rather than an owner or contingent owner. Up to and throughout the recodification period, the regime of security on property in Quebec remained largely faithful to its historical roots and intellectual premises. The two paradigmatic consensual security devices were the hypothec over immovables and the dispossession pledge of movables. Nonetheless, especially during the decades since the end of World War II, the legislative regime began to diversify beyond traditional codal devices. By special statute, a general charge over corporate assets was instituted, as were the non-possession pledge of commercial and agricultural equipment, the pledge/assignment of accounts receivable, the finance lease, and the mortgage-like transfer of property in stock patterned on the then section 178 (now section 427) of the Bank Act. In addition, over this same time the courts also came to recognize the validity of some title-based transactions, even when it was apparent that they were being deployed as security. To understand the courts' thinking about why certain transactions—especially in connection with movable property where they were clearly designed to overcome the prohibition on non-dispossessor security—should be permitted, it is necessary to review how the civil law conceptualizes these various title transactions.

C. Civil Law Conceptions of Title Security Devices and Their Regulation

Civilian legal thinking contemplates four main archetypes of title-based transactions that can be deployed primarily or secondarily to secure the performance of an obligation. Two appear to be genuine vendor transactions. The first is where the creditor of the secured obligation initially owns the property and simply retains title, whether or not there is any present or future obligation to convey title to the debtor of the obligation. Examples are an instalment sale, a promise of sale, and an ordinary lease or finance lease either with or without option to purchase. The second main archetype is where the creditor initially owns the property, transfers title to the debtor, but reserves the right to reacquire title upon default. Examples are the legal right of resolution for breach of a buyer's obligations to pay the sale price and to take delivery.

and the sale under contractual resolutory condition. In both of these situations, the locus of title or possession at the instant of default is only a secondary consideration. In both, the root transaction is essentially a sale; an asset is added to the debtor's patrimony. In economic terms, the bargain is for a capital asset (the contingent acquisition of property by the purchaser) as against a revenue obligation (the payment of its price over time to the seller).

The other two main archetypes of title security are lender transactions. One occurs where the debtor initially owns the property and the creditor takes title when the security right is set up, promising to reconvey title when the secured obligation is performed. This, of course, is the classical common law mortgage transaction. A second example is a sale by the debtor with a right of redemption. This is a legal technique that originally arose as a method for money lenders to escape the medieval religious prohibition on loans with interest. The initial sale price was the capital of the loan, and the repurchase price was the time-value of the money during the currency of the loan. Further examples are a double sale by the debtor to the creditor and by the creditor back to the debtor, and a sale-leaseback which is a sale by the debtor to the creditor and a lease back to the debtor with an option to repurchase the asset. The other archetype is where the debtor initially owns the property and is forced to surrender ownership only upon default. Examples are the giving-in-payment clause, the pacte commissoire, and the sale by a debtor to the creditor under a suspensive condition (the condition being the debtor's default). In both of these situations, the locus of title or possession at the instant of default is only a secondary consideration. In both, the root transaction is a loan, the addition of cash, rather than a new corporeal asset to a debtor's patrimony. The logic of the transaction is one in which the debtor of an obligation offers title to an asset as a hostage to secure its performance. The bargain is for a revenue asset (the receipt of money) as against a capital obligation (the contingent surrender of property).

As noted, not all of these forms of transaction were accepted by courts, especially when they related to movables. There was some certainty in the immediate post-codification period in 1866 about whether the common law rule of consensualism in sale had been adopted in Quebec, and consequently about whether delivery and title could be dissociated in contracts of sale. However, by the end of the last century courts were prepared to accept that sellers could deploy all manner of title-reservation or title-recovery techniques to enhance their chances of receiving full payment of their claim where a non-cash sale was in question. If vendor title-security was understood and accepted by courts, acceptance of lender title-security had a longer gestation. By the early twentieth century, it was typically enforced only in one of three situations. First, the title device had to be auxiliary to a recognized security device such as the giving-in-payment clause in deeds of hypothecs or the pacte commissoire in pledge. Both of these were essentially foreclosure remedies attached to a recognized security. Second, the title device had to be a long-recognized and codally authorized security-

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type transaction. The only device of this nature was the mortgage-like sale with a right of redemption that had been codified both in France and Quebec and, as noted, had an ancient pedigree in the civil law. Third, as analogous to the rights of a seller, the title device had to be deployed as a means of purchase money finance by a lender (the interposed sale and, especially, the assignment of receiveables in conjunction with the transfer of the vendor's contingent title rights).

One can conclude that by the turn of the century, courts in Quebec had already come to understand the subtle interplay of formalism and functionalism in the characterization of security devices. This understanding was further developed during the post-War expansion of the consumer economy, when lenders sought alternative ways to finance the acquisition of consumer durables. Two devices in particular—the double sale and sale-leaseback—found favour with financers. In both, a consumer purchaser would purport to sell the object purchased to a finance company remitting the sale price to the merchant. The finance company would then either resell the object to the consumer under an instalment sale or sale with a resolutory condition, or would lease it back to the consumer with an option to purchase. The monthly payments on the instalment sale, or the monthly lease payments, would be equal to the instalments due on the money initially advanced to the consumer as the price of the original sale to the financier. However, when finance companies sought to use the devices as a technique to overcome the prohibition on the hypothecation of movables—i.e., as a disguised chattel mortgage transaction security for an ordinary loan of money—courts were not hesitant to strike down the transactions.

By this time, the legislature had learned the lesson as well. In 1938, it began to regulate foreclosure-type security devices, notably the sale with a right of redemption. In the mid-1960s, it subjected all foreclosure recourses relating to immovables to a mandatory enforcement procedure that gave the debtor a sixty-day period to remedy any defaults. Within the decade, it had also required the registration of inventory title-security, instalment sales, assignments of book debts, and non-possessory pledges, and strictly regulated the enforcement of title-security (including long-term leases) in consumer transactions.

D. Policy Perspectives on the Regulation of Title Security in the Civil Law

Given this history, it is hardly plausible to claim that when, after much debate, the National Assembly demurred to the "presumption of hypothec" proposal, it did so unknowingly. Policy debate on the question of whether some general control over title

31 Art. 2022 C.C.L.C.
33 See e.g. Brierley & Macdonald, supra note 31 at 642-86.
security should be imposed was both sustained and informed between 1978 and 1993. Several different approaches to regulating title-type and other quasi-security transactions, and their rationales, were considered. These approaches were of two broad types. Either they were of a type that purported to be comprehensive and uniform, or they were of a type that sought to particularize solutions for different kinds of transactions.

A first means for controlling title security would be its outright prohibition. No right in property securing performance of an obligation other than a hypothec could be taken. A second approach would be the enactment of a general deeming provision that would not prohibit title transactions, but would simply recharacterize them as hypothecs. An example is the “presumption of hypothec” suggested by the Civil Code Revision Office. Instalment sales and financial leases, for example, would automatically become ordinary sales with a hypothec back in favour of the seller, regardless of the intention of the parties to them. Third, the legislature could adopt a “substance of the transaction” principle. The transaction would remain as the parties intended, but the registration and enforcement regime would be the same as that applicable to ordinary hypothecs. In fact, this was the approach taken by the legislature in 1964. Fourth, the legislature could simply leave all forms of title transaction unregulated as security devices. Each of these four approaches purportedly regulate all transactions on the basis of their intent, their object, or their consequence.

A fifth approach would be the adoption of a variant of the policy ostensibly found in France that prohibits certain title transactions. Unless deployed by a bona fide vendor or lessor, a title mechanism could not be set up against third parties. Sixth, title transactions might simply be regulated selectively. Certain vendor-initiated transactions—e.g. instalment sales—and certain lender-initiated transactions—e.g. sales with a right of redemption—would be made subject to the registration and enforcement regime applicable to ordinary hypothecs, but others would not. Finally, the legislature might regulate certain title transactions selectively, but even then do so only partially. Modest registration requirements and enforcement procedures falling short of those applicable to the hypothecary regime would be imposed on specified transactions. The three latter approaches all require a more finely grained approach to determining the nature and purposes of the transaction in question than any of the outright prohibition, or presumption of hypothec, or even substance of the transaction approaches.

When the legislative policy options are presented in this manner, the central distinction between both the first four strategies—including the presumption of hypothec and the substance of the transaction approaches—on the one hand, and the remaining three strategies—those in fact adopted by the National Assembly of Quebec—on the other, becomes obvious. It is not, as is often supposed by “progressive Article 9 proselytizers,” related to a choice between formalism and functionalism; it is between unity and diversity, and a choice about dominating taxonomies. In short, the question

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34 See generally Law of Security, supra note 327.
is whether non-security concepts are seen as parasitic upon the concept of security, or whether the concept of security is parasitic upon the other basic concepts of private law, notably those relating to property and obligation.

Article 9, in the form of the functionalist analysis herein described, and the proposal of the Civil Code Revision Office both rest on universalizing solutions. Criteria "a, b, and c," which remain inexplicit in the U.C.C., are taken as evidence that the substance of the transaction is the generation of a security right "S," from which conclusion consequences "x, y, and z" follow. That is, Article 9, unless functionalism is in some manner reined in, presumes that if security is one among the multiple objects of a transaction, that characterization necessarily trumps all others, at least in so far as registration and enforcement of non-possessory rights are concerned. However, the substance of the transaction rule is not complete in itself as a means of regulating security. It is capable of leading to over-inclusion in relation to some transactions of the sorts discussed above in Part I. It can also lead to obfuscation of the underlying issues in the rationalization of the regulation, as indicated above in Part II.

E. Quebec's New Civil Code on Secured Transactions

These concerns about under- and over-inclusiveness were clearly present in the mind of the National Assembly in 1993. Moreover, the commitment to comprehensive conceptual codification which is characteristic of civil law legal epistemology offered a prudent rationale against inverting the conceptual priority of property and obligation on the one hand, and security on property on the other. Together, these factors led to the legislature adopting in the C.C.Q. a regulatory regime that actually rests on drawing the distinctions that functionalist analysis tends to elide. The regime begins from the premise that ostensible ownership, especially of movable property, is a general problem with the law of debtor-creditor relations, and not just in connection with secured transactions. It then attempts to identify solutions to the problem of ostensible ownership in the variety of possible situations: sale, lease, mandate, substitution, loan, trust, dismemberment of ownership (or personal servitude), hypothec, etc. The functional characterization of the object and intent of the transaction permits identification of the relative importance of the parties' differing objectives and leads to a variegated regulatory scheme depending thereon. The relative density of the property and security elements of different transactions and some of their regulatory entailments can be illustrated as follows.

In some title transactions, call them a "Sûreté-propriété," the security element dominates and excludes any other conception of the transaction. These transactions directly expropriate a debtor's equity. The giving-in-payment clause and the pacte...
commissaire, for example, are prohibited. Others, call them a “sûreté-propriété”, where the security and property elements are more balanced—e.g. the instalment sale, the legal right of resolution, and the sale with a right of redemption—are (in the manner of the logic of Article 9) subjected to the regulatory controls that apply to the paradigmatic security right: the hypothec. Still others, call them a “propriété-sûreté”, function as security. However, where there is no underlying logic of title transfer, notably the finance lease, they are subjected to the publicity but not enforcement regime of hypothecs. Finally, those transactions, call them a “propriété-sûreté”, that might resemble on some logic a security device, but where the property element dominates—e.g. consignments, assignments, exchanges, leases, and loans—are left to be regulated solely according to the logic of assignments, exchanges, leases, etc., as the case may be.

In other words, the regime of the C.C.Q. is a well worked out amalgam of formalism and functionalism. It differs from the Article 9 regimes in that its formal limitations on functionalism as applied to security devices are self-conscious. It also differs from the Article 9 regimes in that it presumes that there is no necessary primacy of functionalism as applied to secured transactions in comparison with, for example, functionalism as applied to sale, mandate, or lease. This point can be best understood by identifying some of the central assumptions of Article 9 and contrasting the specific approach taken in the C.C.Q. with the Article 9 regime.

First, Article 9 presumes that the most pleasing functional aesthetic is to treat vendors and lenders similarly. This, to one trained in the civil law (and to the traditional common law lawyer), is counter-intuitive, in that one would expect a bona fide prior owner of property to have a different interest in that property than a person who is merely concerned with its realization value in the case of default. The C.C.Q. retains some elements of what functionalists would desire, but in a manner that respects the logic of a veritable vendor transaction. The hypothecary regime rests on a number of constitutive formalities that limit lender financing; for example, physical persons not carrying on an enterprise may not grant hypothecs over movables without delivery.\^37 The regime of vendor financing, by contrast, has no such prudential prohibitions. Thus, physical persons not carrying on an enterprise may purchase property under an instalment sale,\^38 even though neither the lender nor the vendor can take a purchase money hypothec.\^39

Second, Article 9 presumes that because there is a market for information about any non-apparent security rights attaching to movable property, this market requires an identical regime for enforcing whatever non-apparent rights are identified. The

\(^{37}\) Art. 2683 C.C.Q.

\(^{38}\) Art. 1745 C.C.Q.

\(^{39}\) Art. 2683 C.C.Q. The inclusion of the vendor in this prohibition is an anomaly that resulted from a last minute political compromise on the eve of the final vote adopting the C.C.Q. In amendments to the Code tabled in December 1997, the government proposed to amend art. 2683 C.C.Q. to permit non-possessory vendor’s hypothecs, an outcome that was foreseen in all the previous drafts of the Code up until the moment of its final adoption.
C.C.Q. establishes a comprehensive publication requirement for hypothecs,\textsuperscript{340} including the possibility of publication by possession for movable hypothecs,\textsuperscript{341} but publication of other rights in movables is only required when specifically prescribed by law.\textsuperscript{342} Thus, sellers have certain rights flowing from their possession of property owned by their purchasers, which are justified by the logic of the sales transaction. As with the hypothec, possession is the indicium of these rights. However, some of these rights may also be projected for a limited time as against purchasers in possession, even without registration—e.g. the legal right of resolution for thirty-day goods.\textsuperscript{343} Where, however, the interest is extended past a certain time, some other regime of publicity may be indicated—hence the logic of registration of finance leases,\textsuperscript{344} most instalment sales,\textsuperscript{345} and rights of redemption granted to secure the loan of money.\textsuperscript{346}

Third, Article 9 presumes that because there may be an interest in protecting debtors from predatory realization practices, the full procedural mechanisms for enforcement of security should apply equally to all situations involving security sales and leases. Under the C.C.Q., the four enumerated hypothecary recourses are exclusive,\textsuperscript{347} and require a creditor to give a prior notice of its intention to exercise a recourse,\textsuperscript{348} during which time the debtor has a right to remedy the default and defeat an acceleration clause,\textsuperscript{349} or force the realizing creditor to abandon the taking in payment recourse.\textsuperscript{350} Should these procedures necessarily apply to sales and leases? After all, enforcement of a hypothec over claims, which amounts to a deferred sale of the claims in question, is only minimally regulated.\textsuperscript{351} Sometimes, but not universally, these enforcement procedures are imposed where the logic of the sale is dominated by its financing, rather than its property aspect—e.g. instalment sales\textsuperscript{352} and sale with a right of redemption.\textsuperscript{353} In general, however, ordinary codal rules relating to the conditions for resolving sales or resiliating leases, completed with a fully elaborated regime of restitution of prestations in the law of obligations, fairly resolve the conflicts that can arise in such cases without recourse to an artificial logic of secured lending. Indeed, the \textit{Consumer Protection Act}\textsuperscript{354} provides further regulation of sales financing by

\begin{itemize}
\item Art. 2663 C.C.Q.
\item Art. 2702 C.C.Q.
\item Art. 2938(iii) C.C.Q.
\item Art. 1741 C.C.Q.
\item Art. 1847 C.C.Q.
\item Art. 1745(ii) C.C.Q.
\item Art. 1756 C.C.Q.
\item Art. 2748 C.C.Q.
\item Art. 2758 C.C.Q.
\item Art. 2761 C.C.Q.
\item Arts. 2778-80 C.C.Q.
\item Arts. 2743-47 C.C.Q.
\item Art. 1745 C.C.Q.
\item Art. 1756 C.C.Q.
\item R.S.Q. c. P-40.1.
\end{itemize}
controlling creditor repossession and foreclosure,"\(^5\) regardless of the form of the title transaction,"\(^6\) and also regulates creditor remedies in long-term consumer leases.\(^7\)

Finally, Article 9 presumes that because foreclosure is a legitimate creditor recourse provided the debtor has an adequate opportunity to remedy the default, indiscriminate use of title to secure various obligations is also legitimate as long as the publicity and enforcement regime for security is respected. This simply begs the question: why is foreclosure a legitimate recourse? Might there not be some contracts, for example, where creditors seek to create innominate title transactions that are parasitic upon the loan of money where, given the relationship of debtor and creditor, a free-standing foreclosure recourse is abusive? For this reason, article 1801 C.C.Q. deems as not written “[a]ny clause by which a creditor, with a view to securing the performance of the obligation of his debtor, reserves the right to become the irrevocable owner of the property or to dispose of it.” Thus, unless the attempted foreclosure can be linked to a recognized security such as the hypothec, or a permitted title transaction such as the legal right of resolution, the instalment sale, or the sale with a right of redemption, it will not be enforced.

**F. Conclusion on Quebec Law**

The above discussion of Quebec law has been limited to the particular problems of accommodating title security into a modernized regime of secured transactions. It has not dealt with various other quasi-securities or legal techniques designed to generate an enforceable execution preference. Nor, more importantly, has it considered one other legal technique that can be deployed in the manner of a title transaction to secure the performance of an obligation: the trust. However much the trust device opens new horizons in secured financing in Quebec, its fundamental logic is that of title security.\(^8\) In view of this, it is perfectly consistent for the National Assembly to subject the trust to the regulatory regime governing the enforcement of hypothecs in exactly those circumstances where, like the instalment sale, it can be characterized as a “sûreté-propriété”.

To conclude, while the C.C.Q. acknowledges that title to property may be affected to secure the performance of an obligation, it does not presume that just because title transactions can be used to generate quasi-security rights, that they ought, by priority over any other characterization, to be understood as security. It presumes, in other

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words, that there can be occasions where the very conceptual and moral differences implied by ownership and security are at the heart of the parties’ desire to recur to title.\(^{39}\)

**Conclusion**

The notion that the secured creditor’s remedial right is a “property” right may derive much of its intuitive force from the perception of the mortgage on Blackacre as the paradigm of secured financing. Secured financing law, however, has become far more complex. One of the most significant forms of modern secured financing... is financing on the security of the inventory or accounts receivable of an enterprise. The collateral in such arrangements is more of an accounting concept than a specific piece of property. Once we move from a mortgage on Blackacre to a floating lien... the “property rights” perspective becomes blurred.\(^{360}\)

It seems clear, as was argued above in Parts I and II, that notwithstanding the functionalist flavour of Article 9 and PPSA regimes, formalist modes of approach to solving problems under the regimes or involving their security interests are simply inescapable.

The apparent contradiction between the substance of the transaction rule and the continued importance of distinguishing between ownership and security under the PPSAs may reflect a deeper tension in the law. This may be put as a tension between resolving priority according to a property-based theory and according to a rights-based theory. The former theory\(^{361}\) resonates with the sort of analysis under the PPSAs of various forms of commercial arrangement against the chattel mortgage and the conditional sale rehearsed in Part I, and considered further in Part II. The latter theory\(^{362}\) flows readily from the perception in the quotation in this Part of the significance of modern undertaking-based financing. This is a form of financing which it has been seen to be the particular office of Article 9 and PPSA regimes to facilitate,\(^{363}\) but which


\(^{360}\) Rogers, *supra* note 182 [footnotes omitted].

\(^{361}\) Perhaps “metaphor” would be a better characterization. This is brought out in the view that a security interest is in the property of the debtor: that is the point. This view was forcefully propounded by Professor Charles Mooney in his presentation at the 15th Annual Workshop on Commercial and Consumer Law, Faculty of Law, University of Toronto, 20-21 October 1995, a view he had propounded in more detail in his article with his fellow Reporter for the Drafting Committee to Revise U.C.C. Article 9, Professor Steven L. Harris: see “Taking Debtors’ Choices Seriously”, *supra* note 51.

\(^{362}\) For which as will be evident, the relevant metaphor is one of distribution of the debtor’s estate, as on a bankruptcy.

\(^{363}\) See e.g. Scott, *supra* note 99 at 1786-87.
has its origins in common law Canada in the floating charge, discussed in its Canadian context in Part II, and whose continuing significance to English law was reviewed in Part III. The requirement that the debtor have rights in the collateral in order for a security interest to attach under the PPSAs, considered in Part I, might be seen to represent a reaffirmation of property as the basis of a creditor’s right to claim priority against third parties. However, this article attempted to show that the Article 9 drafter in fact appears deliberately to have refrained from using proprietary interest language so that the courts would not be preoccupied with such matters. On the other hand, the paramountcy of order of registration in preference to traditional *nemo dat quod non habet* ranking causes the Article 9 and PPSA framework to function in much the same way among secured creditors as a bankruptcy code does among unsecured creditors. That is to say, the framework is aimed more at distributing the “secured” portion of the debtor’s estate among competing creditors than with protecting consensually-derived property rights. That view, in turn, can provoke inquiry in an Article 9 and PPSA jurisdiction into the legitimacy of continuing to draw a sharp distinction, not only between secured creditors holding purchase money and other sorts of security interests, but also between secured and unsecured creditors in general.

This inquiry, a matter of lively interest among scholars in Article 9 and PPSA jurisdictions, is another way of appreciating the point this article has endeavoured to make about the problems in the functionalism that lies at the heart of the Article 9 and PPSA enterprise. That last point is for us much more readily appreciated when considering the way Quebec has resisted importation of Article 9 and PPSA models, that point being the burden of Part IV of this article. It is not that the models are technically deficient, or that their encouragement to work out modern schemes of analysis of secured transactions has, regrettably for legal uniformity or modernism, been sternly rebuffed in the name of legal atavism. Rather, the decision of the National Assembly of Quebec to organize the province’s formal categories so as to give the best functional coherence with the aims and ambitions of contracting parties suggests the conclusion that Article 9 may be addressing the wrong problem.

By this it is meant that the policy issues at stake in debtor-creditor law with special reference to secured transactions are not best conceived of by asking whether one should continue to be distinguishing the “functionally indistinguishable”, i.e., between financing by title and financing by charge. Rather, they are best resolved by asking, as a first question, what are the legal forms that suggest when transactions are “function-

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34 For just this view, see the reference to the property metaphor in this connection, supra note 361.
35 For an introduction to its complex working out in common law doctrine, see Ziegel & Cuming, supra note 115 at 194-95.
36 For the flavour of the continuing character of which, see A. Schwartz, “Taking the Analysis of Security Seriously” (1994) 80 Va. L. Rev. 2073, a comment on “Taking Debtors’ Choices Seriously”, supra note 51.
ally indistinguishable”. That is, on what basis should legislatures conclude that vendors and lenders are involved in the same economic activity?

As the C.C.Q. reveals, probably better than any other source we have dealt with, functionalism is not the answer. *Functionalism is the question*. After all, the merit of any regime of legal regulation lies primarily in the character of the questions it asks: does the way in which legal inquiry is organized permit lawyers and judges to ask questions and debate solutions in a way that is recognizable to the parties to the transaction in question? Does the logic of the law take adequate cognizance of the underlying economic logic of the operation in question, or does it sacrifice the parties’ own ordering of their priorities and expectations upon the altar of a lawyer’s conception of aesthetic elegance?