Double Victories at Supreme Court of Canada

1. A Most Improbable Argument

Five years can be a long time. That is how long Layh & Associates and its clients, Innovation Credit Union and Radius Credit Union, were involved in a knotty priority determination between earlier-taken (but unregistered) PPSA security interests and later taken (and registered) Bank Act security interests.

Against conventional wisdom, Don Layh advised Innovation Credit Union to consider using a long forgotten and unregistered general security agreement to secure repayment of an outstanding mortgage debt.

He then advised the Credit Union to challenge the priority of Bank of Montreal which held a later-taken, valid Bank Act security interest in James Buist's farm machinery (but only after the bank fortuitously used its *Bank Act* enhanced powers to seize and sell Buist's machinery, a remedy not available to the Credit Union because the machinery was exempt from seizure by a provincial lender).

The legal battle began when Layh advised the bank that the Credit Union had priority to the machinery's sale proceeds. After several months of discussions, the bank refused to settle. The Credit Union then launched a court application to determine priority.

The *Innovation Credit Union* case soon had a companion case from Radius Credit Union, but on slightly different facts. Whereas in the *Innovation* case the debtor owned the machinery *before* he signed either security agreement, in the *Radius* case the debtor, Wayne Hingten, purchased his equipment *after* he signed the security agreements, first in favour of the Credit Union and then in favour of the Royal Bank of Canada. Again, although the Credit Union had originally registered a financing statement, the registration had lapsed by the time the bank took its *Bank Act* security interest.

In the Court of Queen's Bench both cases were heard by Justice Zarzeczny in late fall, 2007. The Credit Unions lost both applications. With the Credit Unions' confidence understandably shaken, Layh & Associates urged and ultimately convinced the Credit Unions to appeal the

decision to the Saskatchewan Court of Appeal (on an agreement that if the cases were lost no legal fees would be charged). A unanimous panel found in favour of both Credit Unions.

But the matter was not yet laid to rest. The banks sought leave to appeal to the Supreme Court of Canada. Hopeful that the decision of the Saskatchewan Court of Appeal would be the "last word," the Credit Unions argued that the issue at hand was not of "national significance," – the test applied by Canada's highest court before it hears an appeal – hoping that the Supreme Court of Canada would not hear the appeal.

With a mixture of fear that the Court of Appeal's decision might be overturned, but with the promise of national profile to resolve this matter, the Credit Unions soon learned that the Supreme Court of Canada wished to hear the appeal on April 19, 2010.

2. The Final Arbiter – the Supreme Court of Canada

On November 5, 2010 the Supreme Court of Canada released its decision, all nine justices concurring in the result. The answer to this perplexing problem has now been emphatically resolved and might be succinctly stated as follows:

> If a debtor executes a security agreement in favour of a provincial lender before executing a Bank Act security interest, the provincial lender has priority, whether or not the provincial lender has registered a financing statement.

3. Where from Here?

What does the Supreme Court of Canada's decision mean to provincial lenders, especially Credit Unions? To banks? Have we seen the end of *Bank Act* security in Canada? Will Parliament finally act to resolve the unsatisfactory state of Canadian law?

Until a national consensus is reached keep in mind these points:

- Provincial secured creditors must still search the Bank of Canada Registry to determine if a bank has registered a *Bank Act* interest in collateral subject to *Bank Act* security interests, farm assets and inventory being the major types of collateral. If a bank has registered a Notice of Intention under the *Bank Act*, provincial lenders will lack priority to the collateral subject to the *Bank Act* security.

- Provincial secured creditors cannot rely upon a purchase money security interest to defeat an earlier taken *Bank Act* security interest. Even if a secured creditor has properly perfected a purchase money security interest under the PPSA, an earlier-taken *Bank Act* security interest will defeat a provincially-taken purchase money security interest.

- Provincial secured creditors should not discard "old" security agreements, even if no financing statement remains registered in the Personal Property Registry. They may find themselves in the same situation as Innovation Credit Union and Radius Credit Union.

- Provincial secured creditors must always register a financing statement in the Personal Property Registry when reserving a security interest in personal property.

DIFFERING OPINIONS ON RESULTS OF SUPREME COURT

Commentary, even from learned authors, has widely differed when describing the effects of the results of the Supreme Court of Canada decision.

Some commentators have suggested that the decision from the Saskatchewan Court of Appeal (upheld by the Supreme Court of Canada) encourages provincial secured creditor, especially Credit Unions, to deliberately not register financing statements in the Personal Property Registry. Consider the following preposterous statement from Professor Crawford from Ontario who wrote:

> When a credit union knows that it can defeat a rival bank creditor whose documentation is subsequent in time, whether or not it complies with the registration requirements of the PPSA, the former policy [inherent in a public registry] is subverted. The credit union does not fear competition from a rival credit union, since they operate in discrete areas of the province. There is an obvious temptation for farmers to conceal their prior arrangements with the credit union when applying for desperately needed cash from the bank. A legal rule that favours the credit union despite its creation of the conditions in which such concealment will be successful at the expense of the bank rewards unreasonable and unconscionable conduct.
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> …
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> Is there a technical ground on which the decision in Innovation Credit Union can be reversed so as not to reward secured lenders who create conditions in which banks are easily defrauded? Fortunately, I think that there is, and I have proposed to the bank's legal counsel in the case, on an ex gratia basis.

These statements are inaccurate and disparaging of Saskatchewan Credit Unions and farmers. Provincially controlled secured creditors certainly understand their obligations to register financing statements to protect their interests from other secured creditors, sheriffs, purchasers of collateral and trustees in bankruptcy. And nothing from the Supreme Court of Canada has changed this sound practice.

Even Professor Ron Cuming, Canada's foremost personal property expert from the College of Law at the University of Saskatchewan, and Don Layh (who argued the cases) differ on the results of the case. For example, following are quotations from *The Lawyers Weekly* on November 19, 2010:

> Cuming predicted the decision's impact will be limited, since he said banks vetting potential clients for loans normally go beyond merely checking for registered security interests. "For example, if you are lending to a farmer in a region, you could expect

maybe that the farmer is [a] member of a credit union," Cuming suggested. "You would call up the credit union manager…[and ask] 'Do you have an interest?.' That's just good banking."

Don Layh, on the other hand, was quoted, stating a completely different result from the Supreme Court's ruling:

> Counsel for both credit unions, Donald Layh of Layh & Associates in Langenburg, Sask. said banks will now have to worry about their *Bank Act* secured loans being compromised by dusty unregistered prior security agreements sitting credit union vaults.
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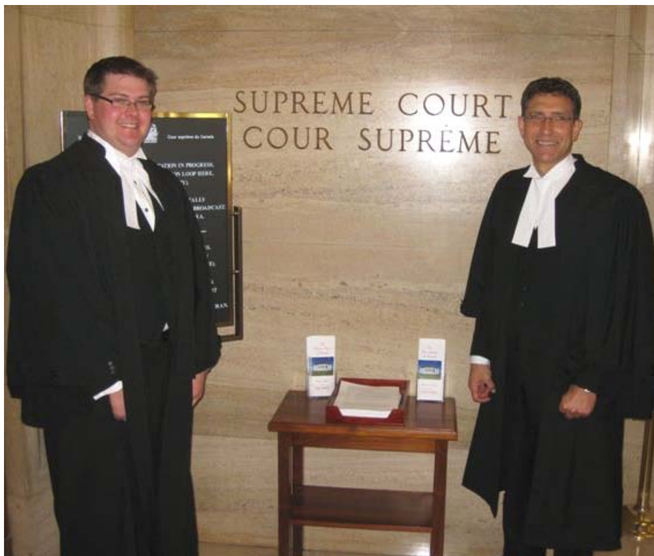
> "Literally we have destroyed *Bank Act* security, it seems to me, because banks will never know that they have priority," Layh told *The Lawyers Weekly.* "If they want priority, then what they have to do is abandon *Bank Act* security interest and come and take a security interest under the provincial system and register.



Shawn Patenaude and Don Layh at Supreme Court of Canada

View the two cases at http://scc.lexum.umontreal.ca/en/2010/2010scc48/2010scc48.html and http://www.canlii.org/en/ca/scc/doc/2010/2010scc47/2010scc47.pdf