

Serial Numbers Versus Proceeds Under the *Personal Property Security Act*: Which Regime Should Prevail?

D A R C Y L . M A C P H E R S O N *

I. INTRODUCTION

Each of the twelve provincial *Personal Property Security Acts* (PPSAs)¹ contain within them (i) a regime for the proper registration of security interests against what are termed “serial number goods” (or “motor vehicles” under the Ontario PPSA²), and (ii) a concept of “proceeds.” Both

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¹ *Personal Property Security Act*, RSA 2000, c P-7 [PPSA (Alberta)]; *Personal Property Security Act*, RSBC 1996, c 359 [PPSA (British Columbia)]; *Personal Property Security Act*, CCSM, c P35 [PPSA (Manitoba)]; *Personal Property Security Act*, SNB 1993, c P-7.1 [PPSA (New Brunswick)]; *Personal Property Security Act*, SNL 1998, c P-7.1 [PPSA (Newfoundland and Labrador)]; *Personal Property Security Act*, SNWT 1994, c 8 [PPSA (Northwest Territories)]; *Personal Property Security Act*, SNS 1995-1996, c 13 [PPSA (Nova Scotia)]; *Personal Property Security Act*, SNWT (Nu) 1994, c 8 [PPSA (Nunavut)]; *Personal Property Security Act*, RSO 1990, c P-10 [PPSA (Ontario)]; *Personal Property Security Act*, RSPEI 1988, c P-3.1 [PPSA (Prince Edward Island)]; *Personal Property Security Act*, 1993, SS 1993, c P-6.2 [PPSA (Saskatchewan)]; *Personal Property Security Act*, RSY 2002, c 169 [PPSA (Yukon)].

² PPSA (Ontario), *supra* note 1.

of these regimes on their own are perfectly internally consistent. However, when the two are combined, a significant problem arises.

Under each of the Ontario³ and Manitoba PPSAs,⁴ a security interest in proceeds of collateral are automatically perfected. The other PPSAs give the right for a secured party to take an interest in proceeds, if the proper steps are followed.⁵

Yet, outside of the proceeds regime, the serial number good regime requires that the serial number be provided under many circumstances. What happens if a serial number good is proceeds of collateral of an earlier perfected security interest? Does it remain perfected under the proceeds regime, or is the security interest in the serial number goods not as well protected as a result of the non-provision of the new serial number? It is with this problem that this article is concerned.

II. A HYPOTHETICAL FACT-SCENARIO

In order to elucidate the issue that we wish to confront in the analysis below, a hypothetical fact scenario may be of assistance. Imagine that Debtor owns a car. This car is fully paid for. However, Debtor wishes to borrow money from Big Bank. Big Bank takes a security interest in all of Debtor's current property,⁶ including the car. All collateral, including the car, is listed by item or kind, with sufficient specificity that any court would be able to identify whether any particular piece of property is or is not

³ *Ibid* at para 25(1)(b).

⁴ PPSA (Manitoba), *supra* note 1 at para 28(1)(b).

⁵ PPSA (Alberta), *supra* note 1, ss 28(2); PPSA (British Columbia), *supra* note 1, ss 28(2); PPSA (New Brunswick), *supra* note 1, ss 28(3); PPSA (Newfoundland and Labrador), *supra* note 1, ss 29(3); PPSA (Northwest Territories), *supra* note 1, ss 28(2); PPSA (Nova Scotia), *supra* note 1, ss 29(3); PPSA (Nunavut); PPSA (Prince Edward Island), *supra* note 1, ss 28(3); PPSA (Saskatchewan), *supra* note 1, ss 28(2); PPSA (Yukon), *supra* note 1, ss 26(2).

⁶ It is possible for a secured party to take a security interest in all of the debtor's present and after-acquired property. The relationship between a security interest and after-acquired property and future advances can, in some scenarios, be quite a difficult one. In order to avoid potential difficulties extraneous to the question that we wish to confront directly here, we will concern ourselves with neither issues of future advances nor issues of after-acquired property that is not proceeds.

collateral⁷ pursuant to the security agreement⁸ between Big Bank, as secured party on the one hand, and Debtor, on the other.⁹ The security agreement is signed by Debtor.¹⁰ The funds borrowed by Debtor from Big Bank are in

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- ⁷ Under s 1 of the PPSA (Manitoba), *supra* note 1, “collateral” is defined as follows: “‘collateral’ means personal property that is subject to a security interest.” The other PPSAs use similar definitions. On this point, see PPSA (Alberta), *supra* note 1 at para 1(1)(g); PPSA (British Columbia), *supra* note 1, ss 1(1) “collateral”; PPSA (New Brunswick), *supra* note 1, ss 1(1) *sv* “collateral”; PPSA (Newfoundland and Labrador), *supra* note 1 at para 2(1)(g); PPSA (Northwest Territories), *supra* note 1, ss 1(1) *sv* “collateral”; PPSA (Nova Scotia), *supra* note 1 at para 2(1)(g); PPSA (Nunavut) *supra* note 1, ss 1(1) *sv* “collateral”; PPSA (Ontario), *supra* note 1, ss 1(1) *sv* “collateral”; PPSA (Prince Edward Island), *supra* note 1 at para 1(g); PPSA (Saskatchewan), *supra* note 1 at para 2(1)(g); PPSA (Yukon), *supra* note 1, ss 1(1) *sv* “collateral”.
- ⁸ Under s 1 of the PPSA (Manitoba), *ibid*, “security agreement” is defined as follows: “‘security agreement’ means an agreement that creates or provides for a security interest, and if the context permits, includes a writing that evidences a security agreement.” The other PPSAs use substantively similar, though not identical, definitions. On this point, see PPSA (Alberta), *ibid* at para 1(1)(ss); PPSA (British Columbia), *ibid*, ss 1(1) *sv* “security agreement”; PPSA (New Brunswick), *ibid*, ss 1(1) *sv* “security agreement”; PPSA (Newfoundland and Labrador), *ibid* at para 2(1)(oo); PPSA (Northwest Territories), *ibid*, ss 1(1) “security agreement”; PPSA (Nova Scotia), *ibid* at para 2(1)(aq); PPSA (Nunavut), *ibid*, ss 1(1) *sv* “security agreement”; PPSA (Ontario), *ibid*, ss 1(1) *sv* “security agreement”; PPSA (Prince Edward Island), *ibid* at para 1(qq); PPSA (Saskatchewan), *ibid* at para 2(1)(pp); PPSA (Yukon), *ibid*, ss 1(1) *sv* “security agreement”.
- ⁹ The ability to identify collateral by either item or kind by virtue of its description in the signed security agreement is one way to satisfy a step for the attachment of the security interest. On this point, see PPSA (Manitoba), *ibid*, s 10(1)(d)(i). The other PPSAs have similar requirements. On this point, see PPSA (Alberta), *ibid*, s 10(1)(d)(i); PPSA (British Columbia), *ibid*, s 10(1)(d)(i); PPSA (New Brunswick), *ibid*, s 10(1)(b)(i); PPSA (Newfoundland and Labrador), *ibid*, s 11(1)(b)(i); PPSA (Northwest Territories), *ibid*, s 10(1)(d)(i); PPSA (Nova Scotia), *ibid*, s 11(1)(b)(i); PPSA (Nunavut), *ibid*, s 10(1)(d)(i); PPSA (Ontario), *ibid*, s 11(2)(a)(i); PPSA (Prince Edward Island), *ibid*, 10(1)(b)(i); PPSA (Saskatchewan), *ibid*, s 10(1)(d)(i); PPSA (Yukon), *ibid*, ss 8(1)(d)(i)-8(1)(d)(ii).
- ¹⁰ A security agreement signed by the debtor is generally necessary to create the attachment of the security interest, at least vis-à-vis third parties. On this point, see PPSA (Manitoba), *ibid*, the opening words of para 10(1)(d). The other PPSAs have similar requirements. On this point, see PPSA (Alberta), *ibid*, the opening words of para 10(1)(d); PPSA (British Columbia), *ibid*, the opening words of para 10(1)(d); PPSA (New Brunswick), *ibid*, the opening words of para 10(1)(b); PPSA (Newfoundland and Labrador), *ibid*, the opening words of para 11(1)(b); PPSA

fact advanced to Debtor.¹¹ Debtor continues to have the right to use the collateral unless and until there is a default on the repayment obligation placed on Debtor.¹² In short, in this fact scenario, there can be no doubt

(Northwest Territories), *ibid*, the opening words of para 10(1)(d); PPSA (Nova Scotia), *ibid*, the opening words of para 11(1)(b); PPSA (Nunavut), *ibid*, the opening words of para 10(1)(d); PPSA (Ontario), *ibid*, the opening words of para 11(2)(a); PPSA (Prince Edward Island), *ibid*, the opening words of para 10(1)(b); PPSA (Saskatchewan), *ibid*, the opening words of para 10(1)(d)(i); PPSA (Yukon), *ibid*, the opening words of para 8(1)(d).

A signed security agreement is generally not required as to create a security interest vis-à-vis the direct parties to it (that is, the secured party and the debtor). On this point, see PPSA (Manitoba), *ibid* at para 12(1)(c). The other PPSAs have similar requirements. On this point, see PPSA (Alberta), *ibid* at para 12(1)(c); PPSA (British Columbia), *ibid* at para 12(1)(c); PPSA (New Brunswick), *ibid* at para 12(1)(c); PPSA (Newfoundland and Labrador), *ibid* at para 13(1)(c); PPSA (Northwest Territories), *ibid* at para 12(1)(c); PPSA (Nova Scotia), *ibid* at para 13(1)(c); PPSA (Nunavut), *ibid* at para 12(1)(c); PPSA (Prince Edward Island), *ibid* at para 12(1)(c); PPSA (Saskatchewan), *ibid* at para 12(1)(c); PPSA (Yukon), *ibid* at para 11(1)(c). Ontario appears to generally require a signed security agreement regardless of whether one of the parties to it seeks to enforce against the collateral with or without a situation where the interests of a third party are involved. See PPSA (Ontario), *ibid*, s 9, and the opening words of para 11(2)(a).

¹¹ In this scenario, this would satisfy the need that value be given by the secured party in return for the security interest given to it. On this point, see PPSA (Manitoba), *ibid* at para 12(1)(a). The other PPSAs have similar requirements. On this point, see PPSA (Alberta), *ibid* at para 12(1)(a); PPSA (British Columbia), *ibid* at para 12(1)(a); PPSA (New Brunswick), *ibid*, s 12(1)(a); PPSA (Newfoundland and Labrador), *ibid*, s 13(1)(a); PPSA (Northwest Territories), s 12(1)(a); PPSA (Nova Scotia), *ibid*, s 13(1)(a); PPSA (Nunavut); PPSA (Ontario), *ibid*, s 11(2); PPSA (Prince Edward Island), *ibid*, s 12(1)(a); PPSA (Saskatchewan), *ibid*, s 12(1)(a); PPSA (Yukon), *ibid*, s 11(1)(a).

Under the PPSA (Manitoba), s 1, “value” is defined as follows: “‘value’ means consideration sufficient to support a simple contract, and includes an antecedent debt or antecedent liability.” The other PPSAs use similar definitions. On this point, see PPSA (Alberta) at para 1(1)(ww); PPSA (British Columbia), ss 1(1) *sv* “value”; PPSA (New Brunswick), ss 1(1) *sv* “value”; PPSA (Newfoundland and Labrador) at para 2(1)(tt); PPSA (Northwest Territories), ss 1(1) *sv* “value”; PPSA (Nova Scotia) at para 2(1)(av); PPSA (Nunavut), ss 1(1) *sv* “value”; PPSA (Ontario), ss 1(1) *sv* “value”; PPSA (Prince Edward Island) at para 1(vv); PPSA (Saskatchewan) at para 2(1)(tt); PPSA (Yukon), ss 1(1) *sv* “value.”

¹² In this scenario, this would satisfy the need for the debtor to have rights in the collateral for the purposes of attachment. On this point, see PPSA (Manitoba), *ibid* at para 12(1)(b). The other PPSAs have similar requirements. On this point, see PPSA

that Big Bank has created a security interest in the car, and the security interest is therefore, in the parlance of the PPSA, attached to the car.

Big Bank decides to perfect its security interest by registration.¹³ Its registration lists both the name of Debtor and the serial number for the car with no errors.¹⁴ Therefore, Big Bank has taken the requisite “perfecting

(Alberta), *ibid* at para 12(1)(b); PPSA (British Columbia), *ibid* at para 12(1)(b); PPSA (New Brunswick), *ibid* at para 12(1)(b); PPSA (Newfoundland and Labrador), *ibid* at para 13(1)(b); PPSA (Northwest Territories), *ibid* at para 12(1)(b); PPSA (Nova Scotia), *ibid* at para 13(1)(b); PPSA (Nunavut) *ibid* at para 12(1)(b); PPSA (Ontario), *ibid*, ss 11(2); PPSA (Prince Edward Island), *ibid* at para 12(1)(b); PPSA (Saskatchewan), *ibid* at para 12(1)(b); PPSA (Yukon), *ibid* at para 11(1)(b).

¹³ It is possible for a secured party to perfect its interest primarily by two different means. The first is the registration of a financing statement in a public registry. This applies regardless of the type of collateral. The second is possession of the collateral by the secured party, with respect to certain enumerated types of collateral. With respect to the latter, see PPSA (Manitoba), *ibid*, s 24. The other PPSAs have similar requirements. On this point, see PPSA (Alberta), *ibid*, s 24; PPSA (British Columbia), *ibid*, s 24; PPSA (New Brunswick), *ibid*, s 24; PPSA (Newfoundland and Labrador), *ibid*, s 25; PPSA (Northwest Territories), *ibid*, s 24; PPSA (Nova Scotia), *ibid*, s 25; PPSA (Nunavut); PPSA (Ontario), *ibid*, s 22; PPSA (Prince Edward Island), *ibid*, s 24(1); PPSA (Saskatchewan), *ibid*, s 24; PPSA (Yukon), s 22.

With respect to the former, see PPSA (Manitoba), s 25. The other PPSAs have similar requirements. On this point, see PPSA (Alberta), *ibid*, s 25; PPSA (British Columbia), *ibid*, s 25; PPSA (New Brunswick), *ibid*, s 25; PPSA (Newfoundland and Labrador), *ibid*, s 26; PPSA (Northwest Territories), *ibid*, s 25; PPSA (Nova Scotia), *ibid*, s 26; PPSA (Nunavut), *ibid*, s 25; PPSA (Ontario), *ibid*, s 23; PPSA (Prince Edward Island), *ibid*, s 25; PPSA (Saskatchewan), *ibid*, s 25; PPSA (Yukon), s 23.

¹⁴ Issues of errors made in the registration of either names of debtors or serial numbers with respect to serial number goods have taken up a great amount of both judicial and academic commentary. Different jurisdictions have arrived at different conclusions with respect to the effect of errors. Some examples of the relevant case law would include the following: *Re: Lambert* (1994), 119 DLR (4th) 93, 20 OR (3d) 108 (CA), Request for leave to appeal to the Supreme Court of Canada dismissed [1994] SCCA 555, 33 CBR (3d) 291n, L'Heureux-Dubé, Sopinka and McLachlin JJ (as she then was); *GMAC Leaseco Ltd v Moncton Motor Home & Sales Inc (Trustee of); Stevenson v GMAC Leaseco Ltd.*, 2003 NBCA 26, 227 DLR (4th) 154; *Gold Key Pontiac Buick (1984) Ltd v 464750 BC Ltd (Trustee of)*, 2000 BCCA 435, 189 DLR (4th) 668; *Re: Logan*, [1993] 2 WWR 82, (1992), 73 BCLR (2d) 377 (BCSC); *Kelln (Trustee of) v Strasbourg Credit Union Ltd*, 89 DLR (4th) 427, [1992] 3 WWR 310 (Sask. CA); *Ford Credit Canada Ltd v Percival Mercury Sales Ltd.*, [1986] 6 WWR 569, 50 Sask R 268 (CA); *Case Power & Equipment v 366551 Alberta Inc (c.o.b. MST Trucking Co) (Receiver of*

step.”¹⁵ Therefore, for our purposes, Big Bank has a perfected security interest¹⁶ in the car.¹⁷ As of the date of the final attachment step,¹⁸ the car is intended to be used by Debtor and his family as a family vehicle, that is, there is no business orientation to the use of the car.¹⁹

(1994), 157 AR 212, 118 DLR (4th) 637 (CA).

Certain jurisdictions have dealt with the matter of registration errors with respect to serial number goods statutorily. For example, PPSA (New Brunswick), *supra* note 1, ss 43(8)-(8.2); PPSA (Nova Scotia), *supra* note 1, ss 44(8)-(8B); PPSA (Prince Edward Island), *supra* note 1, ss 43(8).

The author of the current paper has, with a co-author, confronted issues around erroneous registration information previously. See Darcy L MacPherson and Edward D (Ned) Brown, “‘Billy, Don’t You Lose My Number’: Law Reform with Respect to the Serial Numbered Goods Regime under the Manitoba PPSA” (2013) 37(1) *Man LJ* 267-321.

- ¹⁵ On this point, see e.g. Ronald CC Cuming, Catherine Walsh & Roderick J Wood, *The Essentials of Canadian Law – Personal Property Security Law*, 2nd ed (Toronto: Irwin Law, 2012) at 299-301.
- ¹⁶ If one were to explain perfection as a mathematical equation, it would be as follows: “Attachment plus perfecting step equals a perfected security interest.”
- ¹⁷ Of course, there may be perfected security interests in other collateral as well, created by the same security agreement and registration. However, the potential security interests in other forms of collateral that are not serial number goods are really beyond the scope of this paper.
- ¹⁸ All goods, with the serial number goods or not, must be categorized into one of three categories for the purposes of the PPSA. The timing of this categorization is as of the date of attachment, that is, the date on which the last of the attachment steps occurs. On this point, see PPSA (Manitoba), *supra* note 1, ss 2(2). The first of these categories is inventory. Inventory is defined, under s 1 of the PPSA (Manitoba), as follows: “‘inventory’ means goods that are (a) held by a person for sale or lease, or leased by that person as lessor, (b) furnished or are to be furnished under a contract of service, (c) raw materials or work in progress, or (d) materials used or consumed in a business.” The second category is that of consumer goods. Consumer goods are defined as follows: “‘consumer goods’ means goods acquired or used by the buyer or members of the buyer’s family, primarily for personal, household or family purposes of the buyer or the buyer’s family.” The residual category is that of equipment, which is defined as follows: “‘equipment’ means goods that are held by a debtor other than as inventory or consumer goods.”
- ¹⁹ Since there is no business element to the use of this car (and there is no indication that the car is to be leased or sold as a regular part of the business), it is reasonably clear that this would qualify as “consumer goods”, and not “inventory.”

Subsequently, Debtor decides to trade in the car (hereinafter referred to as the “old car”) on a new business vehicle (hereinafter referred to as the “new car”), used to get him to and from business meetings. Debtor therefore goes to a Car Dealership and receives an appraisal of \$1,000 worth of trade-in value on the old car that he currently owns. The Car Dealership agrees to finance the remaining amount of the new car. Again, Car Dealership registers properly against both the name of the Debtor and serial number of the new car.²⁰

Six months later, the Debtor agrees to sell the new car to a third party, again as a business vehicle (not as inventory) for \$20,000. The third party finances its acquisition of the new car with a loan from the Credit Union.

The Credit Union searches the serial number of the new car. It finds the security interest of the Car Dealership, and makes an agreement (with the consent of Debtor) that the Car Dealership should be paid out of the sale amount (that is, part of the funds from the Credit Union would be paid directly from the Credit Union to the Car Dealership so to reimburse the Car Dealership). The Car Dealership would then remove its security interest in the new car. The Credit Union would then register against the name of the buyer, and the serial number of the new car. The registration of the Credit Union’s security interest occurs more than 15 days after the acquisition of the new car by the third party.²¹

²⁰ There is a reason why the Car Dealership may not care about the interest of Big Bank. The interest of Car Dealership is a purchase-money security interest.

Under the Manitoba PPSA, the definition reads as follows: “‘purchase money security interest’ means (a) a security interest taken or reserved in collateral, other than investment property, to the extent that it secures all or part of its purchase price, (b) a security interest taken or reserved in collateral, other than investment property, by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire the rights, (c) the interest of a lessor of goods under a lease for a term of more than one year, and (d) the interest of a consignor who delivers goods to a consignee under a commercial consignment, but does not include a transaction of sale and the lease back to the seller; and for the purpose of this definition,” The Ontario definition is largely equivalent, except that it does not include paragraph (d), largely because Ontario does not include “commercial consignments” (as defined under the Manitoba PPSA) within the ambit of its PPSA at all.

²¹ The final sentence in this paragraph is added to the problem so as to avoid fully adding a third regime within the PPSA into an already complicated mix. This third regime will be that of purchase money security interests or PMSIs. Technically, the interest of the Credit Union fits within the definition of a “purchase money security

The issue then becomes, in the event that Debtor does not repay in full his obligation to Big Bank, who wins the priority competition between Big Bank, on the one hand, and the Credit Union, on the other, with respect to the new car? Big Bank will claim that it has a perfected security interest in the old car, and that the new car is proceeds of the old car. Therefore, the argument goes, Big Bank has a perfected security interest in the new car. But, the Credit Union also has a perfected security interest in the new car.

As a general rule, where there are two perfected security interests in the same collateral, sub-para. 35(1)(a)(i) of the PPSA (Manitoba)²² and para.

interest". See the definition of PMSI, *ibid.*

The Manitoba PPSA has specific rules about the interaction between PMSIs taken in collateral when that collateral was the original collateral, on the one hand, and PMSIs taken in collateral when that collateral was proceeds of a dealing with the original collateral, on the other. The most immediately relevant to our discussion here is subsection 34(7), which reads as follows: "34(7) A non-proceeds purchase money security interest has priority over a purchase money security interest in the same collateral or proceeds, if the non-proceeds purchase money security interest is perfected (a) in the case of inventory, at the date a debtor, or another person at the request of a debtor, obtains possession of the collateral, whichever is earlier; and (b) in the case of collateral other than inventory, not later than 15 days after a debtor, or another person at the request of a debtor, obtains possession of the collateral, whichever is earlier."

In crafting the argument made here, I made a specific decision to not address the issues around PMSIs. The obvious reason for this is that there is no direct equivalent to subsection 34(7) of the Manitoba PPSA in its Ontario counterpart. There are, however, counterparts to subsection 34(7) of the Manitoba PPSA in many of its counterparts in other, common-law provinces. Rather than getting into an even more convoluted discussion of the various textual differences between the various PPSAs on this point, the hypothetical fact scenario has been crafted in such a way that these textual differences are outside the scope of what we are dealing with herein.

²² *Supra* note 1. The relevant portion of s 35 reads as follows: "35(1) Where this Act provides no other method for determining priority between security interests, (a) priority between conflicting perfected security interests in the same collateral is determined by the order of the occurrence of the following: (i) the registration of a financing statement without regard to the date of attachment of the security interest"

30(1)1 of the PPSA (Ontario)²³ provide that the secured party²⁴ who registers the financing statement²⁵ first will win the priority competition²⁶ with respect to the car. Based on this rule, if both Big Bank and the Credit Union each hold a perfected security interest as against the new car, then it should follow that since Big Bank registered its security interest first in time (as compared to the Credit Union) as against the same collateral, Big Bank will win the priority contest between the two.²⁷

²³ *Ibid.* The relevant portion of s 30 reads as follows: “30. (1) If no other provision of this Act is applicable, the following priority rules apply to security interests in the same collateral: 1. Where priority is to be determined between security interests perfected by registration, priority shall be determined by the order of registration regardless of the order of perfection”.

²⁴ Under the PPSA (Manitoba), s 1, “secured party” is defined as follows: “secured party” means (a) a person who has a security interest, (b) a person who holds a security interest for the benefit of another person, and (c) a trustee, if a security interest is embodied in a trust indenture”.

²⁵ A financing statement is the document submitted to the appropriate public registry to memorialize the security interest for third parties. The PPSA does not require registration of the security agreement itself. Rather, certain “bare bones” information is required to be placed in the financing statement so that third parties can contact the relevant parties to the security agreement to discover further information, should the party require it. Put another way, the PPSA is a “notice filing” system, not a “document filing” system. The relevant document is the security agreement. The notice of the interest is provided through the registration of the financing statement. On this point, see Cuming, Walsh & Wood, *supra* note 15, at 324-325.

²⁶ It is of course possible that more than one security interest may exist in the same piece of property at the same time. The concept of priority, therefore, exists to resolve conflicts between two or more parties (whether secured parties or not) who have an interest in the same piece of collateral. Priority may be analogized to a line. The party that wins the priority contest will be first in line to receive value upon the sale of the underlying asset. If there is value remaining once the interest of the winner of the priority contest is paid in full, the party that is second in line would receive any remaining value. The process would repeat itself until either the value is exhausted (which is most common), or all parties claiming an interest in the collateral have been repaid in full. If the latter situation does occur, then the debtor would receive any remaining value.

²⁷ With respect to purchase-money security interest claims, see *supra* note 21.

III. THE PROCEEDS REGIME

First, the definition of proceeds is as follows:

"proceeds" means:

- (a) identifiable or traceable personal property, fixtures and crops
 - a) derived directly or indirectly from any dealing with collateral or the proceeds of collateral, and
 - b) in which the debtor acquires an interest,
- (b) a right to an insurance payment or any other payment as indemnity or compensation for loss of or damage to the collateral or proceeds of the collateral,
- (c) a payment made in total or partial discharge or redemption of an intangible, chattel paper, instrument or investment property; and
- (d) rights arising out of, or property collected on, or distributed on account of, collateral that is investment property.²⁸

The starting point for a discussion of proceeds is s. 28 of the PPSA (Manitoba),²⁹ and s. 25 of its Ontario counterpart.³⁰ They read as follows:

Manitoba	Ontario
<p>28(1) Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest</p> <p style="padding-left: 40px;">(a) continues in the collateral unless the secured party expressly or impliedly authorizes such dealing; and</p> <p style="padding-left: 40px;">(b) extends to the proceeds;</p>	<p>25 (1) Where collateral gives rise to proceeds, the security interest therein,</p> <p style="padding-left: 40px;">(a) continues as to the collateral, unless the secured party expressly or impliedly authorized the dealing with the collateral free of the security interest; and</p> <p style="padding-left: 40px;">(b) extends to the proceeds.</p> <p style="padding-left: 40px;">(2) Where the security interest was perfected by registration when the proceeds arose, the security interest in the proceeds remains continuously</p>

²⁸ On this point, see PPSA (Manitoba), *supra* note 1, s 1.

²⁹ PPSA (Manitoba), *supra* note 1.

³⁰ *Ibid.*

<p>but where the secured party enforces a security interest against both the collateral and the proceeds, the amount secured by the security interest in the collateral and the proceeds is limited to the fair market value of the collateral at the date of the dealing.</p> <p>28(1.1) The limitation of the amount secured by a security interest as provided in subsection (1) does not apply where the collateral is investment property.</p> <p>28(2) Where the security interest was perfected by registration when the proceeds arose, the security interest in the proceeds remains continuously perfected so long as the registration remains effective or, where the security interest is perfected with respect to the proceeds by any other method permitted under this Act, for so long as the conditions of the perfection are satisfied.</p>	<p>perfected so long as the registration remains effective or, where the security interest is perfected with respect to the proceeds by any other method permitted under this Act, for so long as the conditions of such perfection are satisfied.</p> <p>(3) A security interest in proceeds is a continuously perfected security interest if the interest in the collateral was perfected when the proceeds arose.</p> <p>(4) If a security interest in collateral was perfected otherwise than by registration, the security interest in the proceeds becomes unperfected ten days after the debtor acquires an interest in the proceeds unless the security interest in the proceeds is perfected under this Act.</p> <p>(5) Where a motor vehicle, as defined in the regulations, is proceeds, a person who buys or leases the vehicle as consumer goods in good faith takes it free of any security interest therein that extends to it under clause (1) (b) even though it is perfected under subsection (2) unless the secured party has registered a financing change statement that sets out the vehicle identification number in the designated place.</p>
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From these provisions, it is very clear that the security interest in the original collateral extends automatically to the proceeds that are generated by a dealing³¹ with the original collateral. In the case of the hypothetical

³¹ Though the term “dealing” is not specifically defined by the PPSA, it is clear, in this context, that a “dealing” must include a transaction wherein the original collateral is transferred to a party separate from the debtor. The consideration or value received as

fact-scenario referred to above, the old car referred to would be “the original collateral” and the new car for which the old car was traded would constitute the “proceeds.” Therefore, Big Bank should, in the absence of other factors, be able to assert its security interest against the new car. But these “other factors” may be found within the serial number goods regime.

With respect to s 28(2), the general purpose of the subsection is to link the attachment of the security interest of the proceeds collateral (in our case, the new car) back to the timing of the original registration of a financing statement. This has at least two effects. First, it acknowledges that the secured party need not register a separate financing statement in order to perfect their interest in the proceeds. Second, for the purposes of the general rule (contained in s 35 of the Manitoba PPSA, and in s 30 of the Ontario version), the secured party’s interest will be considered to have been registered as of the date of the registration of the financing statement with respect to the original collateral. These two effects are clear. However, as we will see below, beyond these two facts, the impact of the subsection 28(2) may be significantly murkier, especially where the serial number goods regime is engaged.

IV. THE SERIAL NUMBER GOODS REGIME

The provisions of the Manitoba serial number goods regime that are most relevant to the discussion of the problem that is considered here are as follows:

part of this transaction (in the form of personal property) would be proceeds of the original collateral.

However, this is not to suggest that every transaction involving the collateral necessarily will result in proceeds. For example, one of the issues with which judges have had to deal over time is whether proceeds exist in a transaction where collateral is used to pay a debt. For example, if, in our earlier example, Debtor (instead of trading the old car in on the new car) had sold the car outright, received cash in return, and then use that cash to pay off, for example, his mortgage, there would be a serious issue as to whether or not the transaction had generated any proceeds after which the secured party (in our case: Big Bank) could have sought recourse. On the issue of what is called “tracing through a debt”, see, for example, Cuming, Walsh & Wood, *supra* note 15 at 576-577. See also, for example, *Flexi-coil Ltd. v Kindersley District Credit Union Ltd.*, [1994] 1 WWR 1 (Sask. CA), *per* Justice Jackson, for the Court.

- 35(4) A security interest in goods that are equipment and are of a kind prescribed as serial numbered goods is not registered or perfected by registration for the purpose of subsection (1), (7) or (8) or subsection 34(2) unless a financing statement relating to the security interest and containing a description of the goods by serial number is registered.
- ...
- 43(6) The validity of the registration of a financing statement is not affected by a defect, irregularity, omission or error in the financing statement or in the registration of it unless the defect, irregularity, omission or error is seriously misleading.
- 43(7) An error in the spelling of any part of the name of a debtor set forth in a financing statement or other document required or authorized to be registered in the Registry invalidates the registration and destroys the effect of the registration if a search of the Registry under the correct name of the debtor would not reveal the registration.
- 43(8) Subject to subsection (10), where one or more debtors are required to be disclosed in a financing statement, or where collateral consists of consumer goods prescribed as serial numbered goods, and a seriously misleading defect, irregularity, omission or error appears in
- (a) the disclosure of the name of any of the debtors, other than a debtor who does not own or have rights in the collateral; or
 - (b) the serial number of the collateral;
- the registration is invalid.
- 43(9) Nothing in subsection (6) or (8) requires as a condition to a finding that a defect, irregularity, omission or error is seriously misleading, proof that anyone was misled by it.
- 43(10) Failure to provide a description in a financing statement in relation to any item or kind of collateral does not affect the validity of the registration with respect to other collateral.³²

In the aforementioned scenario, the security interest of Big Bank in the old car was created when the old car was characterized as a consumer good.

³² PPSA (Manitoba), *supra* note 1.

There is an issue as to whether or not a security interest of Big Bank in the new car would remain similarly characterized. On the one hand, academic commentary would suggest that the continuous perfection of proceeds means that the security interest retains its character even as it shifts to proceeds (that is, the new car).³³

However, based on the language of the PPSA, there is also an argument to the converse. Such an argument would run as follows: the new car can only have the security interest attached to it at the time that the debtor receives rights in the new car.³⁴ At the time of the purchase of the new car, the security interest of Big Bank becomes attached to the new car (primarily because either of the following is true: (i) prior to this time, the new car was not yet “proceeds” of the old car, and therefore, the security interest of Big Bank did not extend to it [based on the wording of subsection 28(1) of the Manitoba PPSA, or subsection 25(1) of Ontario PPSA, as applicable]; or (ii) the debtor does not have rights in the collateral (the new car) prior to this time). Therefore, there is no attachment prior to this time. It is at this time therefore that we must assess the categorization of the goods.³⁵ At the time of purchase, the goods were equipment, as they were being purchased for a business purpose unrelated to inventory. If this argument were to be accepted, the goods would be equipment at the time of the attachment and perfection of the security interest in the new car.³⁶

In any event, for the purposes of the arguments made here, it is not relevant whether the security interest in the proceeds (the new car) held by Big Bank is categorized as a security interest in consumer goods, on the one hand, or in equipment, on the other.³⁷

³³ On this point, see Cuming, Walsh & Wood, *supra* note 15 at 299, 556-558.

³⁴ PPSA (Manitoba), *supra* note 1, s 12(1)(b).

³⁵ *Ibid*, s 2(2).

³⁶ The resolution of these competing arguments will have to wait to another day.

³⁷ However, it would matter whether the third party who ultimately acquired the new car received it as consumer goods. If the ultimate purchaser were ready to use this as consumer goods at the time of acquisition, then subsection 25(5) of the PPSA (Ontario), *supra* note 1, may potentially apply. As the hypothetical fact-scenario is now described, there are no “consumer goods” at issue at all. To the extent any purchaser were intending to use this vehicle as consumer goods, it is possible that the purchaser would take free of any prior security interests in which the serial member of the motor vehicle is not properly listed at the time of the acquisition of the motor vehicle by the

Ignoring the proceeds regime (for the moment), the serial number goods regime would indicate that vis-à-vis the new car, Big Bank will not be considered to be perfected as against any other security interest where the serial number of the new car is included in the registration as against the new car, based on the wording of ss 35(4).³⁸

As such, we now have a very serious conflict between the serial number goods regime, on the one hand (which would seem to indicate that Big Bank is not perfected as against the new car), and the proceeds regime, at least in Ontario and Manitoba, on the other (which would appear to indicate that the legislature's intention was that if the secured party was perfected as against the old car, that perfection would translate itself to the new car as well). How, then, do we resolve this conflict? It is with this question of policy which the next section of this paper is concerned.

V. FINDING A WAY FORWARD

If, in the hypothetical presented, the PPSA does not provide a clear and specific resolution to this problem, then the first matter that needs to be confronted will have to consider the policy issues that animate each of these regimes. I begin my analysis with the virtually axiomatic assertion that the backbone of the PPSA's approach to priority is generally based on the importance of the Registry system.³⁹ This is true regardless of which regime one considers in this analysis.

The policy that, for me at least, animates the serial number goods regime is that there is the possibility of multiple pieces of collateral

third party.

³⁸ The effect of subsection 35(4) is that a security interest where the collateral is equipment which is serial number goods and the financing statement does not include the relevant serial number, the security interest of the secured party is considered to be perfected as against certain other parties, whereas it is unperfected against other parties. As against the trustee in bankruptcy, *bona fide* purchasers for value without notice and unsecured creditors who have seized the collateral, the secured party who has registered a financing statement against serial number goods which are equipment without the requisite serial number. However, as against any other security interest that has registered the financing statement properly including the serial number, a prior financing statement without the serial number will be considered to be ineffective to create perfection. In other words, subsection 35(4) is an exception to the general rule provided for in section 35(1)(a).

³⁹ Cuming, Walsh, & Wood, *supra* note 15 at 324-326.

legitimately fitting any collateral description. Take, for example, the following description “the 2010 Black Chevrolet Cavalier.” Absent the serial number, this description, as detailed as it is, may fit many motor vehicles that are on the road in any given city of any size. Therefore, the use (and even the necessity) of the serial number goods regime is that it manages to distinguish between these many vehicles, in a way that is generally not easily altered, neither by the debtor nor by any subsequent purchaser. It objectively distinguishes one piece of collateral from anything that looks similar to it.

At the same time, it also allows the subsequent searcher to make the same distinction. This is to say, if a subsequent searcher is a potential secured party who has before him or her the actual vehicle on which he or she is willing to take security, he or she can search specifically for the particular serial number which applies to the vehicle in which he or she is directly interested at the time. This purpose explains the differential treatment of consumer goods, on the one hand, and inventory on the other, as well as the halfway position taken with respect to equipment. With respect to inventory, the entire purpose of the lender is to ensure that the proceeds of the transactional disposition of the serial number good (generally, its retail sale to a consumer) will still allow the secured party to have a security interest in the economic value received by its debtor (often, a car dealer). Therefore, in the ordinary course of things, neither the secured party nor the debtor actually has a strong interest in the car itself. The expectation is that the retail customer of the debtor will generally take the car, without complaint from anyone. If the debtor goes into default of the loan, the expectation is that the economic value received by the debtor in return for the transfer (whether that be in the form of cash, a check or a bank account) will be the main source of recovery for the secured party.

Conversely, where the goods are characterized as consumer goods, there is not generally an expectation of quick turnover of the consumer goods by the debtor. After all, the goods are needed by definition for personal or family use. Therefore, one would generally expect that this might be a highly valuable asset against which an individual borrower may need to provide security. Therefore, we would expect that the secured party should have to take additional steps to protect him-or herself, because to make it too easy for the secured party, may threaten some of the basic needs of living of the debtor (such as a vehicle to get to work or to transport children or other family members). Given this reality, we expect that the burden should be

somewhat heavier on the secured party to ensure that he or she has followed the steps required of a secured party before we deprive consumers of their needed assets.

Somewhere between these two extremes, we find the consideration of equipment that also falls under the category of serial number goods. Here, we give an advantage to the secured party who registers the serial number, but we do not pretend that the secured party who does not register the serial number, did not register at all (as we do with consumer goods). Instead, the non-registration of the serial number with respect to equipment means only that a different secured party who has registered the serial number will rank in advance of the party that did not register the serial number, but the party that did not register the serial number is not defeated by the interest of unsecured execution creditors, nor by the interest of the debtor's trustee in bankruptcy. In other words, the treatment of equipment is calibrated such that there is a fiscal incentive on the part of secured parties to register the serial number. But, if the secured party does not register the serial number, the secured party is still treated as such for the purposes of the PPSA, although ranking behind secured parties who have registered the serial number. In other words, the level of protection offered by the registration of the serial number varies in accordance with the reasonable expectation of the use of the goods, and in accordance with the effect on the debtor and the secured party. We want secured parties to register the serial number, where it is reasonable to do so, and where continuing registration would not be unreasonable. It would, for example, be unreasonable to expect the registration of the serial number with respect to inventory, because the more successful the business, arguably at least, the more they would be "turning over" the goods. This would therefore result in multiple registrations, where none of the parties to the security agreement would in fact be relying upon the original collateral as a means of ensuring payment of the obligation underlying the security agreement.

Thus, the purposes of the serial number goods regime is to provide an incentive for the secured party to give a meaningful description of the goods, particularly where the goods are of high value (often over \$10,000), fungible (how else does one distinguish one 2008 black Ford Focus from another?) and ubiquitous in today's society. What, then are the policy reasons for the proceeds regime? More particularly, what are the policy reasons underlying the automatic perfection of proceeds under the Manitoba and Ontario PPSAs? It is to be noted here that most other PPSAs do not provide for

automatic perfection of proceeds, unless the financing statement provides for an intention to take security over proceeds, and the collateral that is the proceeds of the original collateral continues to fit into the description of collateral provided in the financing statement.

Of course, there is a plausible argument that neither the prior registered secured party (in the original collateral) nor the subsequent searcher (who will undoubtedly search the serial number of the later collateral, that is, the proceeds collateral of the prior registered secured party) has a reasonable opportunity to protect him-or herself through proper searches. While this is undoubtedly true, the prior registered secured party at least has the opportunity to determine (if he or she wishes to) whether in fact the debtor with whom the prior secured party has made his or her security agreement has subsequently dealt with the collateral, so as to create any type of proceeds. The subsequent searcher, on the other hand, has no ability to protect any interest he or she might have through vigilance beyond doing a proper search of the registry.

If a reasonable search can be carried out on the serial number alone (also referred to as a “single search requirement”), as is the case in the majority of Canadian jurisdictions,⁴⁰ it must follow that there is an obligation on a registrant to register all of the relevant information and to do so correctly. If the serial number good is traded in, partly to allow the purchase of a subsequent serial number good, it then follows that a reasonable searcher will often not have the relevant information with respect to the original collateral in order to search for (and presumably find) the original financing statement of which the serial number good over which the searcher wishes to take security.

It is undoubtedly true that some will argue that this places an unreasonable expectation on a secured party. After all, the secured party has done everything that can be reasonably expected of him or her, pursuant to the statutory framework in place. But choosing where to place this risk is not a matter of blameworthiness. Neither the prior registered secured party, nor the subsequent searcher, is blameworthy in the sense that either one deserves to lose a priority competition as between the two of them with respect to the collateral over which each has a perfected security interest. Each claim is meritorious in its own sense. The prior registered secured party would simply rely upon the basic rule that the secured party who

⁴⁰ *Supra* note 14.

registers first should defeat the interest of a subsequent secured party who registers later.⁴¹ The subsequent searcher would point out that he or she did a reasonable search of the Registry, searching the serial number of the particular good over which he or she wished to take security. The PPSA then provides that there is now an error.⁴²

If both claims are meritorious, and neither party is in a particularly good position to alleviate the risk, how is it reasonable to place that risk upon one party only, that being the prior registered secured party? First of all, the prior registered secured party is not restricted in the way that the subsequent secured party is. Since the prior registered secured party is claiming an interest in the new car by virtue of proceeds, there is a second interest that may continue. This second interest is the prior registered secured party's interest in the original collateral (that is, on the facts offered here, in the old car). The subsequent registered secured party, on the other hand, has no right to claim an interest in the old car. Therefore, it seems to me at least, that given the second potential pool of assets against which one of the parties can proceed, and against which the other of the two parties cannot proceed, it then follows that the first party should not take precedence over the second (in respect of the asset over which both have an interest).

Such an approach does find favour in some areas of the common law, including with respect to the PPSA. The common-law concept of "marshalling" is an example of this. Where each of two secured parties ("Secured Party X" and "Secured Party Y") has an interest in an asset ("Asset A") but the Secured Party Y also has an interest in a second asset ("Asset B"), when Secured Party Y seeks enforcement of this security interest, Secured Party Y is expected to realize with respect to (that is, sell) Asset B before moving on to Asset A.⁴³ The approach offered here is similar, in that it recognizes that the secured party who may have recourse to the original

⁴¹ *Supra* note 22 and 23, and accompanying text.

⁴² Manitoba is a "single search requirement" jurisdiction (PPSA, s 43(8)). Ontario is a dual search jurisdiction. However, the facts of the hypothetical operative the beginning of this article, the Credit Union has no reason to search for the name of Big Bank.

⁴³ For a description of marshaling in a PPSA context, see e.g. *Holnam West Materials Ltd. v Canadian Concrete Products* (1993), [1995] 1 WWR 155; 159 AR 296; 22 Alta LR (3d) 394 (QB), *per* Justice Bielby.

collateral should rank behind the subsequent secured party, who has no ability to access the original collateral as a means of repaying the debt owed.

A careful reader may point out that there are many occasions where recourse to the original collateral may be either restricted or denied entirely. For example, where there is an authorized dealing with the goods,⁴⁴ this security interest in the original collateral may be put to an end. However, the object of this section of the paper is not to suggest that there is an ideal or perfect solution. Rather, it is to suggest that there are reasons why one might choose to place the risk on the prior secured party, as opposed to the subsequent secured party. While recourse to the original collateral is not a perfect solution, it is a solution available only to the prior secured party, and not the subsequent secured party.

Similarly, if the solution advocated here were adopted, secured parties would quickly become aware of the additional risk being placed on them through this policy. In other words, if the solution offered here were adopted, secured parties could (and most likely would) be able to deal with this risk. They could deal with this additional risk in any number of ways. The first of these would be to simply increase the cost of credit where it is based largely or exclusively on serial number goods. Secondly, the prior secured party could also take the step of monitoring that the serial number goods at issue continue to be in the possession of the debtor at regular intervals, and make it a requirement of the security agreement that upon the sale or other transfer of the original collateral, the debtor is required to provide to the secured party the serial number of any serial number goods received in return for the sale or other transfer. The debtor has every reason to provide this information to the prior secured party, given that the relationship is presumably an ongoing one, and the debtor would presumably like to avoid violating the security agreement.

With respect to the subsequent secured party, however, they are not of the position to make demands with respect to knowing the provenance of the serial number good over which the subsequent secured party now wishes to take a security interest. Put another way, it is unlikely the subsequent secured party in beginning their relationship with a potential debtor will be in the best position to know the existence of the prior secured party. However, it is possible that the prior secured party may be in a position to protect his, her or its interests through a properly-worded security agreement with the original debtor.

⁴⁴ PPSA (Ontario), *supra* note 1, s 25(1)(a); PPSA (Manitoba), *supra* note 1, s 28(1)(a).

In order to clarify how this matter would be resolved statutorily, I would suggest adding a new subsection to the proceeds section of the PPSA, which would read as follows:

Notwithstanding paragraph 1(b) above, where the proceeds are [a motor vehicle/serial number goods (in Ontario or Manitoba, as the case may be)], the security interest in such proceeds shall remain perfected where the [VIN/serial number] of the proceeds is registered:

- (a) not later than 60 days after the security interest in the [motor vehicle/serial number goods] attaches;
- (b) not later than 15 days after the day the secured party has knowledge that the security interest in the [motor vehicle/serial number goods] has attached;
- (c) before perfection in the proceeds ceases for any other than the non-provision of [the VIN/the serial number] of the proceeds;

whichever is earliest.

The suggestion offered here is consistent with the approach of the PPSA with respect to the transfer of collateral between jurisdictions.⁴⁵ Similar to the problem that is the subject of direct discussion here, the transfer of collateral between jurisdictions can be done without the consent or even knowledge of the party that maintains a security interest of the collateral. The PPSA needed to balance the rights of the prior secured party (who had, for example, registered a security interest in goods under the law of Alberta) where the debtor had transported the goods to another jurisdiction (say, Ontario). The same debtor that offers security interest in the same collateral to a creditor located in Ontario. The new creditor (located in Ontario) then searches the Registry in Ontario to determine whether or not there are any security interest granted as against the collateral. The second secured party knows nothing of the history of the collateral, and does not have a reason to search in other jurisdictions, including Alberta. Finding no registration against the debtor in Ontario, the Ontario creditor takes a security interest in the collateral, believing, based on the public registry in Ontario, that he is first in line as against the collateral. The Alberta creditor then attempts to assert security interest given under the law of Alberta so as to defeat the interest of the subsequent creditor in Ontario.⁴⁶ The “automatic

⁴⁵ PPSA (Manitoba), *supra* note 1, ss 5-7; PPSA (Ontario), *supra* note 1, ss 5-7.

⁴⁶ These are the facts of *Hughes (Re)*, 2016 ONSC 6832 (Bkcty) varied 2017 ONSC 2421 (SC).

perfection”⁴⁷ provided under the PPSA recognizes that the prior secured party may lose a priority competition to the subsequently registered secured party without knowledge that its security interest is in jeopardy. It is at least arguable that the prior secured party cannot reasonably protect their interest. But, where neither party is to blame, sometimes, the statute just has to make a decision, usually based on policy grounds. In my view, in the hypothetical offered in this paper and other similar circumstances, the policy arguments favour the protection of the subsequent secured party.

⁴⁷ See Cuming, Walsh & Wood, *supra* note 15 at 312-317.