CLARIFICATION FROM THE SUPREME COURT OF CANADA: PRIOR TAKEN UNPERFECTED *PPSA* SECURITY V. SUBSEQUENTLY TAKEN *BANK ACT* SECURITY

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Introduction

The Supreme Court of Canada recently released decisions in the companion cases of *Innovation Credit Union v. Bank of Montreal* ("*Innovation v. BMO*") and *Radius Credit Union v. Royal Bank of Canada* ("*Radius v. RBC*"). The decisions bring clarity to the interaction between provincial personal property security interests taken under the *Personal Property Security Act* (the "*PPSA*") and federal personal property security interests taken under the *Bank Act*.

Background

Each province (except Quebec) and territory has enacted a substantially similar version of the *PPSA*. Meanwhile, the *Bank Act* is federal legislation, originally enacted in the nineteenth century and adapted by Canadian Parliament from time to time thereafter. The *Bank Act* permits chartered banks to take a special form of security (herein called "*Bank Act* security") in certain types of commercial property (common examples are crops, livestock and agricultural equipment).

The *PPSA* and the *Bank Act* are conceptually distinct pieces of legislation, each relying on a completely different set of legal principles and priority rules. Because the priority regimes between the two systems have not been legislatively dovetailed, various areas of Canadian personal property security law have been rife with uncertainty. The clash between these two incongruous systems has spawned a great deal of litigation since the provinces enacted modern *PPSA* legislation.

Issue

The decisions in *Innovation v. BMO* and *Radius v. RBC* are the latest in a long line of court decisions that have attempted to reconcile the two personal property security regimes. Specifically, the tandem of decisions resolves the inevitable, and greatly anticipated, conflict between previously taken unperfected *PPSA* security and subsequently taken *Bank Act* security.

Analysis

Facts

In both *Innovation v. BMO* and *Radius v. RBC*, the debtor signed a general security agreement in favour of the Credit Union prior to granting *Bank Act* security to the Bank. The Credit Union did not register notice of its interest in the Personal Property Registry in either instance, and therefore did not "perfect" its security interest under the *PPSA*. The debtor failed to disclose the existence of the Credit Union's security interest to the Bank in both cases.

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Although the basic issue is the same in both cases (i.e. whether previously taken unperfected *PPSA* security has priority over subsequently taken *Bank Act* security), each case poses a slightly different variation on the issue. In *Innovation v. BMO*, the dispute was in respect of property acquired by the debtor prior to obtaining financing from the Bank. In *Radius v. RBC*, the dispute was in respect of property acquired by the debtor after obtaining financing from the Bank.

*Decision*s

The Supreme Court of Canada held as follows in its decisions in *Innovation v. BMO* and *Radius v. RBC*:

In resolving priority disputes between the federal and provincial regimes, one must first look to the *Bank Act* (under the constitutional doctrine of paramountcy) to determine whether there is an applicable priority rule. Because the *Bank Act* is silent respecting the priority resolution between a prior taken unperfected *PPSA* security interest and a subsequently taken *Bank Act* security interest, one must then look to the common law (including provincial property law) to resolve the priority dispute. In both cases, the legal principle of *nemo dat quod non habet* (i.e. one cannot give what one does not have) applied in favour of the Credit Union because it had obtained a signed general security agreement (and therefore, a proprietary interest in the disputed property) prior to the Bank acquiring its interest. Therefore, the prior taken unperfected *PPSA* security interest had priority over the subsequently taken *Bank Act* security interest.

Conclusion: Implications of the decisions

Although the decisions clarify previously unsettled points of law, and bring a measure of closure to a particular debate, they reinforce the need for legislators to address the deficiencies prevalent in the existing system. The harsh reality facing banks holding *Bank Act* security is that they are susceptible to losing priority to pre-existing and undiscoverable interests (i.e. "hidden liens") taken under the *PPSA*. Indeed, in its decisions, the Supreme Court of Canada acknowledged the cry for legislative reform, and reiterated that it is open to Parliament to address the deficiencies prevalent in the existing bilateral system.

Until legislative reform is introduced, banks wishing to obtain *Bank Act* security should be mindful of these recent decisions of the Supreme Court. Specifically, in jurisdictions where it is permissible, banks should take separate security in the debtor's property under the *Bank Act* and the *PPSA* to ensure they are not defeated by hidden liens taken under the *PPSA*. Meanwhile, in jurisdictions like Saskatchewan, where a bank may not simultaneously hold security in the same property under both the *PPSA* and the *Bank Act*, banks must choose between the certainty of the *PPSA*, on the one hand, and the constitutional advantages (i.e. circumvention of provincial exemption protection and agricultural realization procedures) and vulnerability of *Bank Act* security, on the other.