

# TAB 4

tion will be resolved through application of the PPSA priority rules that govern competitions between secured parties.<sup>112</sup>

## 1) Trust Property Acquired before the Creation of a Security Interest

A person who holds property in trust may subsequently grant a security interest in it to secure an obligation. If the transaction is unauthorized, the trustee will have acted in breach of the trust and the beneficiary will have a variety of potential remedies against the trustee.<sup>113</sup> However, the beneficiary may also assert a claim to the trust property in respect of which a security interest was granted to the secured party. The trustee holds legal title to the trust property, and thus has sufficient rights in the property to permit attachment of the security interest.<sup>114</sup> Both the beneficiary and the secured party claim competing interests in the same property, and it is therefore necessary to apply the appropriate priority rule to resolve this competition. The PPSA does not contain any express priority rules that govern the competition. In such a case, the PPSA directs that principles of the common law and equity continue to apply.<sup>115</sup> The competition will therefore be resolved through application of common law and equitable rules that generally govern competing claims to property.

It is the view of the authors that the competition should be resolved through use of the principle that a *bona fide* purchaser for value of a legal interest in the trust property acquires the property free of any trust obligations. Equity is willing to extend personal trust obligations to third parties who obtain legal title to the property, but will not do so if the person acquired the interest for value and without notice of the trust obligation.<sup>116</sup> A secured party therefore cannot escape the imposition of equitable obligations in respect of the trust property unless the secured party can bring itself within the *bona fide* purchase principle. In applying this rule, the old categories of security devices, such as the legal mortgage and equitable charge, should not be resurrected. Instead, a PPSA security interest should be characterized as a legal in-

<sup>112</sup> See chapter 2, B.4 "Security Trusts."

<sup>113</sup> See P. Birks and A. Pretto, eds., *Breach of Trust* (Oxford: Hart, 2002).

<sup>114</sup> See chapter 4, C.2 "Exceptions to Nemo Dat."

<sup>115</sup> PPSA (M, NWT, Nu, S) s. 65(2); A s. 66(3); BG s. 68(1); (NB, PEI) s. 65(1); (NL, NS) s. 66(1); O s. 72; Y s. 63(1).

<sup>116</sup> See J. Pennet, *The Law of Trusts*, 2d ed. (London: Butterworths, 2000) at 34.

terest, since the attributes of this form of proprietary interest are now defined by legislation.<sup>117</sup>

## 2) Trust Property Acquired after the Creation of a Security Interest

A priority competition may arise between a prior secured party and a subsequent trust beneficiary. The resolution of the priority competition is straightforward where the debtor creates an express trust in relation to property that is already subject to a PPSA security interest. The security interest is a legal interest, and by virtue of the *nemo dat* principle of the common law, it is entitled to priority over any subsequent interest.

The issue is more complex where the debtor agrees to give a secured party a security interest in after-acquired property and thereafter acquires property, falling within the description of the property in the security agreement, as trustee from another person. This may occur where a third party transfers property to the debtor in trust for a beneficiary. It may also occur where the debtor acquires property from a third party under circumstances in which a court would impose a resulting or constructive trust. One approach is to resolve the issue through the application of traditional property law principles. However, the characterization of a PPSA security interest as a legal interest now creates a potential difficulty. The secured party may attempt to claim the benefit of the *bona fide* purchaser rule on the basis that the after-acquired property provision has given it a legal interest in the subsequently acquired trust property. Under prior law, this type of priority competition could not arise. A promise to mortgage after-acquired property did not convey legal title to the property upon its acquisition by the debtor.<sup>118</sup> However, under the PPSA there is no longer any differ-

<sup>117</sup> A similar transformation has occurred in other contexts. The common law did not give legal recognition to an assignment of an intangible, although it was recognized by equity. Legislation was passed which provided for the assignment of intangibles, and thereafter an assignment that conformed to the statute was considered to be a legal assignment. The equitable priority rules were still used for the resolution of priority competitions where a legal assignment was involved, but the reason for this was that the legislation expressly preserved these rules. See *E. Pfeiffer Weinkeller-Weineinkauf G.m.b.H. v. Arbuthnot Factors Ltd.*, [1988] 1 W.L.R. 150 (Q.B.D.).

<sup>118</sup> It would, however, be effective to convey the equitable interest in the property. See *Holroyd v. Marshall* (1862), 10 H.L.C. 191.

ence in characterization between a security interest in existing property and a security interest in after-acquired property.<sup>119</sup>

If the non-PPSA rule were to prevail, it would subordinate a trust beneficiary in circumstances where there has been no prejudice to the secured party. As the situation did not arise under prior law, it involves a novel point that requires judicial determination. Although the *bona fide* purchaser principle was originally conceived as "an inherent jurisdictional limitation upon a court of equity to entertain claims against those whose consciences were clean," the modern tendency is to explain the defence on the basis that it protects innocent parties from prejudice.<sup>120</sup> On this basis, the *bona fide* purchaser defence should be limited to cases where the legal interest in the trust property is subsequently created. If, however, the secured party makes a further advance without notice of the intervening equitable interest, a much stronger case can be made in favour of the secured party.<sup>121</sup>

#### FURTHER READINGS

BUCKWOLD, T.M., "From Sherwood Forest to Saskatchewan: The Role of the Sheriff in a Redesignated Judgment Enforcement System" (2003) 66 Sask. L.Rev. 219

CUMING, R.C.C., "The Spreading Influences of PPSA Concepts: The Uniform Liens Act" (1999) 15 B.F.L.R. 1

CUMING, R.C.C., "When an Unsecured Creditor is a Secured Creditor" (2003) 66 Sask. L. Rev. 255

WILLIAMSON, J.R. & C.P. CURRAN, "Judgment Enforcement and the *Personal Property Security Act*: The Newfoundland Experience" (1999) U.N.B.L.J. 351.

WOOD, R.J. & M. WYLIE, "Non-Consensual Security Interests in Personal Property" (1992) 30 Alta. L.Rev. 1055

WOOD, R.J., "Enforcement Remedies of Creditors" (1996) 34 Alta. L. Rev. 783

<sup>119</sup> See chapter 4, C.6 "After-acquired Collateral."

<sup>120</sup> K. Barker, "Bona Fide Purchase as a Defence to Unjust Enrichment Claims: A Concise Restatement" [1997] R.L.R. 75 at 76.

<sup>121</sup> See *Hopkinson v. Rolt* (1861), 9 H.L. Cas. 514.

# THE EFFECTS OF BANKRUPTCY AND INSOLVENCY PROCEEDINGS ON SECURITY INTERESTS

## A. INTRODUCTION

When a debtor defaults on his credit obligations, it is very common that a range of creditors' claims are affected. If bankruptcy or insolvency proceedings have been invoked either by the debtor or by one or more creditors, a regime different from that otherwise applicable to the regulation of the various claims comes into play. This regime draws on both federal bankruptcy and insolvency law and rules contained in the PPSA that expressly apply to insolvent or bankrupt debtors who have given security interests in their property. The most significant features of this regime are examined in this chapter.

However, the chapter has not been designed to be a comprehensive exposition of all features of bankruptcy and insolvency law that affect the position of secured creditors. Its intended role is to highlight issues that directly affect rights that arise in the context of the PPSA.