Most Negative Treatment: Distinguished
Most Recent Distinguished: DCD Industries (1995) Ltd., Re | 2005 ABCA 139, 2005 CarswellAlta 392, 253 D.L.R. (4th) 171, [2005] A.W.L.D. 1737, 11 C.B.R. (4th) 246, 11 C.B.R. (5th) 246, 7 P.P.S.A.C. (3d) 251, [2005] A.J. No. 329, 363 A.R. 353, 343 W.A.C. 353, 138 A.C.W.S. (3d) 746, 43 Alta. L.R. (4th) 9 | (Alta. C.A., Apr 5, 2005)

1994 CarswellAlta 350
Alberta Court of Appeal

Chiips Inc. v. Skyview Hotels Ltd.

1994 CarswellAlta 350, [1994] 9 W.W.R. 727, [1994] A.W.L.D. 715, [1994] A.J. No. 562, 116 D.L.R. (4th) 385, 155 A.R. 281, 21 Alta. L.R. (3d) 225, 27 C.B.R. (3d) 161, 49 A.C.W.S. (3d) 384, 73 W.A.C. 281, 7 P.P.S.A.C. (2d) 23

CHIIPS INC. v. SKYVIEW HOTELS LIMITED, ERNST & YOUNG INC., B.C. CENTRAL CREDIT UNION, BANQUE LAURENTIENNE DU CANADA, SOCIETE GENERAL (CANADA), ROYNAT INC., ABN AMRO BANK CANADA and BANK OF TOKYO CANADA

Harradence, Hetherington and Foisy JJ.A.

Judgment: July 15, 1994
Docket: Doc. Calgary Appeal 14255

Counsel: *P.S. Jull* and *J.P. McMahon*, for appellant.
A.L. Friend, for respondents.

Subject: Corporate and Commercial; Insolvency; Property

Related Abridgment Classifications
Personal property security

IV Priority of security interest
IV.5 Subordination and postponement

Headnote
Personal Property Security --- Priority of security interest — Subordination and postponement

Secured creditors — Personal property security — Priorities — Secured creditor may subordinate its interest to other creditors with whom debtor deals on regular basis in order that debtor may carry on business — Subordination agreements being enforceable against prior security holder if collateral is subject to that subordination and if subsequent creditor is contemplated in subordination clause — Failure of subsequent creditor to make timely registration of conditional sales agreement not affecting its right to enforce subordination agreement — Section 40 of Personal Property Security Act not requiring subsequent creditor to be privy to subordination agreement — Personal Property Security Act, S.A. 1988, c. P-4.05, s. 40.

A group of companies (the "lenders") held five mortgages and debentures against the real and personal property of a company. The mortgages and debentures contained a fixed charge on lands and fixtures and a floating charge on all other assets. The mortgages and debentures were registered under the *Personal Property Security Act* (Alta.) ("PPSA"). Under the terms of the debentures, the company was not entitled to create charges on the security that

ranked equally or in priority to the debentures other than a mortgage, lien or other encumbrance on property to secure "all or any part of the funds required for the purchase of such property ... ". The debentures also provided that the company could not create any charge on the mortgaged property ranking equally or in priority to the debenture unless the charges were purchase money mortgages or other purchase money liens securing only property acquired by the company.

A supplier shipped furniture to the company pursuant to a conditional sales agreement. The company paid for the furniture by 16 post-dated cheques. When the company defaulted under the mortgages and debentures, a receiver-manager was appointed. At that time, the company owed the supplier $257,163.58. The supplier filed a financing statement under the PPSA with respect to its conditional sales agreement. It then made one more shipment of furniture.

A master determined that the lenders had priority over the supplier with respect to all but the last shipment. An appeal from this finding was dismissed and the supplier appealed again.

Held:

The appeal was allowed.

Per Foisy J.A.: Under s. 40 of the PPSA, a secured creditor may subordinate its interest to other creditors with whom a debtor deals on a regular basis. The clauses in the debenture related to the priority of certain charges were subordination clauses. Such clauses can be enforced against a prior security holder if the collateral in question is subject to that subordination and if the subsequent creditor is of the kind contemplated in the clause. The supplier's furniture was the subject of the floating charge. As the subordination clauses were silent as to who the subsequent creditor might be, it was possible to find that the clauses were enforceable by the supplier against the lenders. Commercial reality required this result. The reason for including subordination clauses in these security agreements was to give the company the right in the ordinary course of business to grant security to its suppliers, which would have priority over the floating charge in the debenture. Without such clauses, the company could not purchase goods on credit.

The supplier's failure to make a timely registration of its conditional sales agreement did not affect its right to enforce the subordination clause. Further, it was not necessary for the supplier to be a party to the debenture agreement in order to enforce it. To require registration or privity would render s. 40 meaningless.

Per Harradence J.A. (concurring): Section 40 of the PPSA provides that a subordination clause is given effect according to its terms. The clauses in question should be construed as subordination clauses because any other interpretation would not give business efficacy to the debenture agreements.

Per Hetherington J.A. (dissenting): The clauses in the debentures contained neither an explicit nor an implicit waiver of priority by the lender. There was nothing in the clauses indicating any intention on the part of the lenders to go any further than to permit the assuming or giving of security.

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By hetherington j.a. (dissenting)

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Statutes considered:

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s. 1(1)(pp) "security agreement"

s. 1(1)(qq) "security interest"

s. 3(1)

s. 23(1)

s. 25

s. 34(2)(a)

s. 35(1)(a)(i) [am. 1990, c. 31, s. 24]

s. 35(1)(a)(iii) [am. 1990, c. 31, s. 24]

s. 40 [am. 1990, c. 31, s. 29]

s. 74(2)(a)

s. 74(2)(b)

s. 75(3)

Personal Property Security Act, R.S.O. 1980, c. 375 —

s. 39

Appeal from judgment dismissing appeal from judgment granting lenders priority over appellant to all but final shipment of goods by appellant.

***Foisy J.A.*:**

Facts

1 The respondents in this appeal are: Skyview Hotels (in receivership); Ernst & Young Inc. (the receiver); and a group of companies holding five mortgages and debentures (all dated January 31, 1988) against the real and personal property of Skyview.

2 The mortgage and debentures are in the aggregate principal sum of $25 million. They contain a fixed charge on lands and fixtures, and a floating charge on all other assets. A representative sample of these instruments is reproduced at p. 32 of the Appeal Book. The mortgages and debentures were registered in the Corporate Registry on February 29, 1988. As a result of the enactment of the *Personal Property Security Act*, S.A. 1988, c. P-4.05, (hereinafter "P.P.S.A."), these interests were re-registered in the Personal Property Registry on June 23, 1992. Per s. 75(3) of the P.P.S.A. these interests were perfected and maintained their February 29, 1988 registration date.

3 The appellant, Chiips Inc., was a supplier for the refurnishing of six floors of the Skyline Plaza Hotel pursuant to a conditional sales agreement dated November 14, 1991. Skyview paid for the goods using 16 post-dated cheques, each in the amount of $38,197.01, to be used as a security deposit toward the contract. The appellant shipped a number of loads of furniture between December of 1991 and March of 1992.

4 On May 14, 1992, a Receivership Order was granted as a result of a default by Skyview under the mortgages and debentures. Ernst & Young was appointed Receiver and Manager. The appellant received notice of this Order on May 19, 1992 and gave notice to the Receiver on May 21, 1992 when Skyview failed to pay for the goods supplied by the appellant. The amount outstanding at that date was $257,163.58.

5 On June 5, 1992 the appellant filed a financing statement under the P.P.S.A. with respect to its conditional sales agreement. One last load of furniture was shipped after the registration of the financing statement; that shipment was received on July 14, 1992. The respondents were not aware of the fact that the appellant had not perfected its security interest prior to the receivership order.

6 At the initial priority dispute which was heard by Master Alberstat on January 28, 1993, Chiips argued that s. 40 of the P.P.S.A. gave it priority due to certain purported subordination clauses in the mortgages and debentures. The response to this was that the debenture holders' re-registration gave them priority as perfection dated back to February 29, 1988. Master Alberstat determined that the debenture holders had priority to all but the last shipment (the fact that Chiips had registered its security interest prior to the last shipment resulted in "super priority" because the charge was in the nature of a purchase money security interest per s. 34 of the P.P.S.A.). On April 7, 1993, an appeal to the Justice was dismissed with costs.

7 Pursuant to the Order of Justice Moshansky granted on July 30, 1993, the Hotel has been sold by the Receiver, and a portion of the proceeds, $312,589, has been set aside pending the determination of this appeal. The issue in this appeal is the priority between the holder of a fixed and floating charge debenture and the vendor under what is essentially a conditional sales contract.

8 The appellants submit that the Chambers Judge erred in failing to give effect to the subordination provisions and failing to give effect to s. 40 of the P.P.S.A. The respondents submit that the provisions in question do not have the effect of subordinating the claim of the debenture holders and thus s. 40 has no application here.

Analysis

A. Subordination Clauses as Contemplated by the P.P.S.A.

9 Section 40 of the P.P.S.A. specifically provides for the use of subordination clauses in security agreements. The section reads as follows:

> 40 A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interest, and the subordination is effective according to its terms between the parties and may be enforced by a third party if the third party is the person or one of a class of persons for whose benefit the subordination was intended.

10 This provision of the Act is very important as it allows debtors to carry on their businesses effectively. The significance of the section lies in the fact that, under the P.P.S.A. regime, it is relatively simple for a secured creditor to take and perfect a very broadly based security interest (Cuming & Wood, *Alberta Personal Property Security Act Handbook*, 2nd ed. (Toronto: Carswell, 1993), at p. 301). Because the debtor has to be given some ability to carry on business (e.g., acquire goods on credit), the Act allows a secured creditor to subordinate its interest to other creditors with whom the debtor must deal on an ongoing basis. The reasoning behind the enactment of s. 40 was succinctly stated by Philp J. in *Royal Bank v. Gabriel of Canada Ltd.* (1992), 3 P.P.S.A.C. (2d) 305 at p. 309 (Ont. Gen. Div.):

> s. 38 of the P.P.S.A. conferred a statutory right on a secured party to waive the priority given by the P.P.S.A. and a corresponding right on the beneficiary of such a waiver ... to enforce it.

11 Because of the provision for subordination clauses, the Act will not prevent a subsequent credit grantor from claiming priority over a prior secured creditor where the latter has agreed to subordinate its claim. The question is whether the alleged subordination clause actually had that effect.

B. What is the Effect of cls. 4.05 and 6.01(c) of the Debentures?

12 The Appellant argues that the debentures contained subordination clauses which validly gave Chiips priority over the debenture holders pursuant to s. 40. There are two clauses in the debenture agreements which the Appellant says amount to subordination clauses; they read as follows (AB p. 38):

> **4.05 Possession, Use and Release of Mortgaged Property**
>
> Until the Security becomes enforceable, the Company may dispose of or deal with the subject matter of the floating charge provided for in Section 4.01(b) hereof in the ordinary course of its business and for the purpose of carrying on the same; provided that the Company shall not, without prior written consent of the holder, create, assume or have outstanding, except to the Holder, any mortgage, charge or other encumbrance on any part of the Mortgaged Property ranking or purporting to rank or capable of being enforced in priority to or pari passu with the Security, other than,
>
> (a) any mortgage, lien or other encumbrance upon property, created or assumed to secure all or any part of the funds required for the purchase of such property ...

AB pp. 42-43:

> 6.01 The Company covenants and agrees with the Holder that, so long as this Debenture is outstanding, the Company shall not ...
>
> (c) create or permit any mortgage, charge, lien or other encumbrance on any part or all of the Mortgaged Property ranking or purporting to rank in priority to or pari passu with the Security in order to secure any monies, debts, liabilities, bonds, debentures, notes or other obligations other than this Debenture and the Series of Mortgages and Debentures referred to in Section 8.01(n) hereof which are intended to rank in priority as pari passu with this

> Debenture; provided, however, that this covenant shall not apply to, nor operate to prevent, and there shall be permitted:
>
> (i) the assuming or giving of purchase money mortgages or other purchase money liens on property acquired by the Company or the giving of mortgages or liens in connection with the acquisition or purchase of such property or the acquiring of property subject to any mortgage, lien or encumbrance thereon existing at the time of such acquisition; provided that such purchase money mortgages or purchase money liens shall be secured only by the property being acquired by the Company and no other property of the Company ...

13 In order to determine whether the above clauses amount to subordination on the part of the debenture holders as contemplated by s. 40, it is useful to refer to two Ontario decisions. The decisions in question are helpful yet not determinative; in both cases the Court analyses clauses to determine whether an interest is subordinated, but both clauses are different from the clauses in the case at bar.

14 In *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 16 D.L.R. (4th) 289 (Ont. C.A.) (the Supreme Court of Canada refused leave to appeal on June 3, 1985 [55 C.B.R. (N.S.) xxvii (note)]), the Court was asked to determine priorities between a debenture holder and a subsequent conditional seller who had failed to register his interest. The debenture contained the following clause which the Court found had the effect of giving priority to the conditional seller (at p. 297):

> (e) Not Encumber — *The Corporation shall not, without the consent in writing of the Holder, create any mortgage*, hypothec, charge, lien or other encumbrance upon the mortgaged property or any part thereof *ranking or purporting to rank in priority* to or pari passu with the charge created by this Debenture, *except that the Corporation may give mortgages or liens in connection with the acquisition of property* after the date hereof or may acquire property subject to any mortgage, lien or other encumbrance thereon existing at the time of such acquisition *and any such mortgage, lien or other encumbrance shall rank in priority to the charge hereby created.*
>
> [emphasis added]

Houlden J.A., at p. 299, decided that the conditional sale by Euroclean gained priority over the debenture as a result of the above clause:

> By cl. (e), Brazier was permitted to give mortgages or liens in connection with the acquisition of property ... The purchase of the laundry equipment from Euroclean clearly comes within this wording; and if property is acquired in this way, the subordination clause provides that the mortgage, lien or other encumbrance is to rank in priority to the charge created by the debenture.

And at p. 302:

> Euroclean, by reason of s. 39, is, in my opinion, entitled to enforce the provisions of cl. (e) against Mady and, consequently, is entitled to priority over Mady's security interest.

15 The respondents in the case at bar argue that s. 40 makes it clear that the wording of any purported subordination clause is critical in assessing the rights of the parties. The decision of *Euroclean* is used to support this position as the clause in that case makes it abundantly clear that purchase money charges "shall" rank in priority to the debenture. The respondent puts forward the case of *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 50 O.R. (2d) 267 (C.A.), in support of its argument that case law indicates that nothing short of a clause like the one in *Euroclean* will act to validly subordinate the prior creditor's claim.

16 The priority dispute in *Sperry* was between a bank holding a general security interest with an equipment dealer and a manufacturer/supplier of farm equipment who had a prior registered security interest with the dealer. Both of the creditor's registrations lapsed and the bank claimed that it had priority because their security interest re-attached

before the supplier had renewed its financing statement. The bank's security agreement contains the following clauses (at pp. 269-270):

> 1. As a general and continuing collateral security for payment of all existing and future indebtedness and liability of the undersigned [Allinson] to Canadian Imperial Bank of Commerce (the 'Bank') wheresoever and howsoever incurred and any ultimate unpaid balance thereof, *the undersigned hereby charges in favour of and grants to the Bank a security interest in the undertaking of the undersigned and all property of the kinds hereinafter described of which the undersigned is now or may hereafter become the owner* and which, insofar as the same consists of tangible property, is now or may hereafter be in the place or places designated in paragraph 14 hereof; and the undersigned agrees with the Bank as hereinafter set out ...
>
> **4. Ownership of Collateral**
>
> *The undersigned represents and warrants that, except for the security interest created hereby and except for purchase money obligations, the undersigned is, or with respect to Collateral acquired after the date hereof will be, the owner of the Collateral free from any mortgage, lien, charge, security interest or encumbrance*. 'Purchase money obligations' means any mortgage, lien or other encumbrance upon property assumed or given back as part of the purchase price of such property, or arising by operation of law or any extension or renewal or replacement thereof upon the same property, if the principal amount of the indebtedness secured thereby is not increased.
>
> [Emphasis Morden J.A.'s.]

17 Though the result was in favour of the equipment supplier on other grounds, the Court, per Morden J.A., at p. 274, held that the above clauses in the Bank's general security agreement fell far short of showing an agreement by the bank to subordinate its security interest to that of the supplier. The learned Appeal Justice supported his finding using the specific wording in the subordination clause found in *Euroclean*.

18 Looking at these two cases as outlined above, we are not in much better a position for determining whether the clauses in the case at bar amount to a valid subordination of the debenture holders' interests to the conditional seller. The subordination clause in *Euroclean* was included in the security agreement for the express purpose of putting the interest of a purchase money security holder ahead of the interests of the debenture holders. The Court found this to be the intention based on the clear and unambiguous wording of cl. (e). Conversely, the Court in *Sperry* found that the clauses fell far short of the clear and unambiguous wording of the clause in *Euroclean*, and were therefore not read as having the effect of subordinating the Bank's interest to that of the supplier.

19 Given the above two decisions, we know two things: first, where a general security holder specifically states that a subsequent security holder "shall rank in priority to the charge hereby created", that subsequent holder will be entitled to enforce the provisions of that agreement per s. 40 of the P.P.S.A. Second, clauses in security agreements which fall far short of that type of express wording (for example the impugned clauses in *Sperry* did not even mention the word priority) will not be enforceable under s. 40.

20 These decisions represent opposite ends of a spectrum: at one end we have a clause directing exactly who will be given priority, and at the other, a clause which mentions nothing about priority. Consequently we are left with very little direction as to what should result in cases where the alleged subordination clauses fall somewhere in between, as in the case at bar. We therefore look to other authority, which, though not directly deciding the point, address it nonetheless. There are a number of cases which are of assistance in this regard; they are outlined below.

21 The discussions of the courts in following two cases lead to a positive inference by this Court that the alleged subordination clause in the case at bar acts to validly give priority to Chiips.

22 The case of *Canadian Imperial Bank of Commerce v. International Harvester Credit Corp. of Canada* (1986), 6 P.P.S.A.C. 273 (Ont. C.A.), involved a debtor who had entered into a fixed and floating charge debenture with C.I.B.C.

Later, the debtor entered into a conditional sales agreement for nine trucks. Both security interests were registered, but the bank's registration preceded the vendor's. At trial the vendor was given priority over the trucks because there were subordination clauses in the bank's security agreement. The clauses were virtually identical to the clauses in this case, they read as follows (at pp. 274-275):

> 2.1 As security for the due payment of all moneys payable hereunder, the Corporation as beneficial owner hereby:
>
> (a) grants, assigns, conveys, mortgages and charges as and by way of a first fixed and specific mortgage and charge to and in favour of the Bank, its successors and assigns all machinery, equipment, plant, vehicles, goods and chattels now owned by the Corporation and described or referred to in Schedule A hereto and all other machinery, equipment, plant, vehicles, goods and chattels, hereafter acquired by the Corporation; and
>
> (b) charges as and by way of a first floating charge to and in favour of the Bank, its successors and assigns, all its undertaking, property and assets, both present and future, of every nature and kind and wherever situate including, without limitation, its franchises.
>
> In this Debenture, the mortgages and charges hereby constituted are called the 'Security' and the subject matter of the Security is called the 'Charged Premises'
>
> 2.2 *Until the Security becomes enforceable, the Corporation may dispose of or deal with the subject matter of the floating charge in the ordinary course of its business and for the purpose of carrying on the same provided that the Corporation will not, without the prior written consent of the Bank, create, assume or have outstanding, except to the Bank, any mortgage, charge, or other encumbrance on any part of the Charged Premises ranking or purporting to rank or capable of being enforced in priority to or pari passu with the Security, other than any mortgage, lien or other encumbrance upon property, created or assumed to secure all or any part of the funds required for the purchase of such property* or any extension or renewal or replacement thereof upon the same property if the principal amount of the indebtedness secured thereby is not increased, or any inchoate liens for taxes or assessments by public authorities.
>
> [emphasis added]

23 The emphasized portion of cl. 2.2 above is the same as cl. 4.05 in the case at bar. At trial the learned judge held that by reason of ss. 2.1 and 2.2 of the debenture, the Bank had subordinated its security interest to the seller (4 P.P.S.A.C. 329 at p. 336). The Appellate Court allowed the Bank's appeal based on the fact that the trucks in question were the subject of the fixed charge as stated specifically in Sched. A of the debenture agreement; the subordination clause only applied to the floating charge. In overturning the lower court's decision, Brooke J.A. states the following (at p. 276):

> In my opinion, the subordination provision in the debenture does not apply to the nine trucks as they form part of the fixed charge. I think the subordination clause is limited to the floating charge which, it is conceded, did not apply to the trucks. While the drafting of the clauses leaves much to be desired, I think that it makes provision only as to the manner of the floating charge until it becomes enforceable. For that period of time it provides that Prospect can deal with the subject matter of the floating charge in the ordinary course of its business provided that it cannot encumber any part of that property except where necessary to finance the purchase of its property and then only to the extent provided for in the clause.

24 The second case, a recent decision of the Alberta Court of Queen's Bench, is *Transamerica Commercial Finance Corp., Canada v. Imperial T.V. & Stereo Centre Ltd. (Receiver of)* (October 12, 1993), Doc. Edmonton 9303-12285 (Q.B.) [reported at 22 C.B.R. (3d) 297]. That case involved a determination of priority between the holder of a floating charge debenture and the holder of a purchase money security instrument. The subordination clause was outlined by Nash J. as follows (at p. 2) [p. 299]:

> Imperial, by the terms of the Debenture, agreed not to assume any other charges against the assets of the company, without the prior written consent of the Credit Union, that would have priority over the Credit Union's debenture unless, inter alia (The Subordination Clause):
>
> > The same be given to or *in favour of the bankers of [Imperial]* on the security the accounts receivable or the inventory of [Imperial] to secure current loans required for the usual purposes of the business of [Imperial] and whether given pursuant to the provisions of the Bank Act or otherwise.
>
> [emphasis added]

25 The Court accepted the decision of the Court of Appeal in Ontario in *Euroclean* and applied it in giving effect to subordination clauses where applicable. However, the subordination clause outlined above only applied where the party giving new credit was a bank; Transamerica was held not to be a bank. The following finding is made in relation to that point (at p. 10) [p. 105]:

> When the subordination clause is given its plain and ordinary meaning, I am satisfied that the parties to the Debenture intended that "bankers" not mere "creditors" or "lenders" were to be entitled to enforce the subordination clause and rank above or equal to the Credit Union.

26 It would therefore appear, from the above cases, that the Ontario Court of Appeal and the Alberta Court of Queen's Bench accept that subordination clauses can be enforced against the prior security holder if the collateral in question is subject to that subordination (*International Harvester*) and if the subsequent creditor is of the kind contemplated in the subordination clause (*Transamerica*).

27 Applying these cases here, it is my view that the clauses in the debenture are subordination clauses; the only questions remaining are whether the furniture was subject to the subordination, and whether Chiips was the kind of creditor that was contemplated by the clause. The furniture is certainly the subject of the floating charge rather than the fixed charge as indicated by cl. 4.01 which outlines the security taken by the debenture holders. Further, the subordination clauses in the debenture agreement are silent with respect to who the subsequent creditor might be; if the debenture holders had intended to limit the granting of priority to a particular group of creditors, they should have outlined this limitation in the agreement. As no such limitation exists it is open for this Court to find that the subordination clause may be enforceable by Chiips as against the debenture holders.

28 The policy rationale for finding that the clauses in question should be enforceable by Chiips is one of commercial reality. The whole purpose for including these kinds of clauses in security agreements is to "remove any obstacles the debtor might encounter in acquiring new collateral for the conduct of his business" (see Ziegel, "The Scope of Section 66*a* of the OPPSA and Effects of Subordination Clause: *Euroclean Canada Inc. v. Forest Glade Investments Ltd.*" (1984), 9 C.B.L.J. 367, at p. 372). Clauses such as those in this case are intended to confer priority on purchase money security interests; without this clause the debtor would not be able to purchase goods on credit as the potential creditor would not be able to get any sort of security from the debtor.

29 I think it is clear that the clauses gave Skyview the right in the ordinary course of business to grant security to its suppliers (in the form of purchase money security interests) which would have priority over the floating charge in the debentures. At the time the debentures were granted, the law was clear that the language used in the debentures acted to subordinate the floating charge to a conditional sale or purchase money charge (see *Savin Canada Inc. v. Protech Office Electronics Ltd.* (1984), 8 D.L.R. (4th) 225 (B.C. C.A.)); the debenture holders ought to have known then that the provisions had that effect. Clearly, the parties intended that the floating charge would be subordinated to allow Skyview to carry on its business.

30 It is interesting to note that it is possible under the Act to prove a subordination in fact without the existence of a specific subordination agreement (see *Greyvest Leasing Inc. v. Canadian Imperial Bank of Commerce* (October 28, 1993),

Doc. Toronto C11119 (Ont. C.A.) [reported at 5 P.P.S.A.C. (2d) 187], and *Royal Bank v. Tenneco Canada Inc.* (1990), 72 O.R. (2d) 60 (H.C.). I do not need to discuss this possibility here because the subordination clauses themselves are enough to give Chiips priority over the debenture holders with respect to the furniture supplied.

31 Having found that the clauses in the case at bar amount to a valid subordination of the debenture holders' interests, it is now necessary to decide two issues: whether the lack of registration on the part of Chiips affects the subordination agreement, and whether the fact that Chiips was not a party to the debenture agreements has any effect on the enforceability of the subordination clauses.

C. Does s. 40 Require Registration?

32 This issue was examined very carefully in *Euroclean* with the majority of the Court holding that registration is not necessary in the enforcement of a subordination agreement. Houlden J. referred to an academic comment by Ziegel (9 C.B.L.J. 367) which was a case comment on the lower court decision. In that article at p. 372, Ziegel made the following criticism of the Trial Judge's findings:

> Fitzpatrick J. went on to hold however that cl. (e) also conferred no priority on Euroclean's security interest unless it had been perfected in time. This is a much more debatable conclusion. The learned judge said:
>
> > I find that there was nothing in the provision or elsewhere which rebutted the presumption that the parties intended Mady's security interest to attach, nor does the provision give priority to Euroclean's security interest. The fact that Brazier was permitted by the debenture it gave to Mady to take the equipment from Euroclean, subject to a security interest which would have ranked ahead of Mady's had it been registered in time, does not give any priority to Euroclean's security interest when it was not registered in time.
>
> There are several difficulties about this passage. First, it reads into cl. (e) a requirement of registration not to be found in it. Had there been such a requirement cl. (e) would have conferred no benefit on Euroclean since Euroclean would have been entitled to priority in any event pursuant to s. 34(3) of the OPPSA. Second, the court's reasoning ignores the purpose of cl. (e) ... cl. (e) is intended to confer priority on purchase money security interests ("PMSI"). That being the case, what difference does it make to the debenture holder whether or not the purchase money security interest has been perfected? Lack of perfection does not prejudice him since he has agreed to the PMSI-holder's priority in advance.
>
> [Footnote omitted.]

33 The Appellate Court agreed with Ziegel's analysis of the trial judgment. The Court specifically finds, at p. 300, that the failure to make timely registration does not affect the claimant's right to enforce a subordination clause. This finding of the Ontario Court of Appeal was adopted by Nash J. in *Transamerica* at p. 8 [p. 302].

34 The situation in the case at bar is very similar to the facts in *Euroclean*: there was no requirement in the subordination clauses that the subsequent interest had to be registered in order to claim priority. Had there been such a requirement, Chiips would not have had to rely on the subordination agreements as it would have had "super priority" as a PMSI-holder under s. 34 of the P.P.S.A. Accordingly, enforcement of a subordination agreement does not require that the subsequent creditor register his interest.

D. Does Enforcement of a Subordination Clause Require that the Claimant be a Party to the Original Agreement?

35 At common law (see *Greenwood Shopping Plaza Ltd. v. Beattie*, [1980] 2 S.C.R. 228), Chiips, because it was not a party to the debenture agreement, might not be able to enforce the clause. I say "might" because the position at common law is not clear. Section 40 of the P.P.S.A. removes any doubt regarding the common law with respect to privity:

> 40 A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interest, and the subordination is effective according to its terms between the parties and *may be enforced by a third party if the third party is the person or one of a class of persons for whose benefit the subordination was intended.*
>
> [emphasis added]

36 The cases considering s. 40 have similarly come to the conclusion that the section allows third parties to enforce subordination agreements (see *Euroclean*, and *Royal Bank v. Gabriel*). The effect of the enactment of s. 40 is clearly explained by Houlden J.A. in *Euroclean* at pp. 301-302:

> In my opinion, s. 39 is intended to confer a statutory right on a secured party to waive the priority given him by the P.P.S.A. and to confer a corresponding right on the beneficiary of such a waiver to enforce it, *even though he is not a party to the agreement which created it or has no knowledge of its existence*.
>
> [emphasis added]

37 This reasoning was adopted and applied by Philp J. in *Royal Bank v. Gabriel* at p. 309. There is no other reasonable interpretation of s. 40 but that in order to enforce a subordination agreement, the subsequent creditor need not be a party to the contract.

38 This Court's finding that there is no registration requirement or privity requirement for PMSI-holders to enforce subordination clauses is completely in line with the rules of statutory interpretation. The principle is stated clearly in *Subilomar Properties (Dundas) Ltd. v. Cloverdale Shopping Centre Ltd.*, [1973] S.C.R. 596 at p. 603:

> It is of course trite law that no legislation whether it be by statute or by-law should be interpreted to leave parts thereof mere surplusage or meaningless ...

39 To hold that either registration or privity is required would have the effect of rendering s. 40 meaningless. If registration is required, there is no need for s. 40 whether the PMSI-holder is a party to the agreement or not because "super priority" would already have been achieved via s. 34. If privity is required, there is no need for s. 40; as stated by Houlden J.A. in *Euroclean* at p. 301, it would be "bootless" as it would have the effect of adding nothing to the common law.

E. Conclusion

40 For the above reasons, the appeal by Chiips should be allowed. As PMSI-holders Chiips is entitled to enforce the subordination clause and claim priority over the furnishings supplied. The funds which have been set aside pursuant to the Order of Moshansky J. should be released to the Appellant.

***Harradence J.A. (concurring)*:**

41 I have had the advantage of reading the judgments of Foisy J.A. and Hetherington J.A. I agree with the conclusions reached by Foisy J.A. and the reasons he has given. With respect, I would, however, add the following comments.

42 In light of the wording of s. 40 of the P.P.S.A., it is most important to look at the terms of the purported subordination clause in deciding whether it is indeed a valid subordination clause. Section 40 reads as follows:

> 40 A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interest, and the subordination is effective according to its terms between the parties and may be enforced by a third party if the third party is the person or one of a class of persons for whose benefit the subordination was intended.

43 Two cases provide the benchmark against which subordination clauses must be measured and in so doing provide guidance in this area. *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 16 D.L.R. (4th) 289 (Ont. C.A.)

[leave to appeal to the Supreme Court of Canada refused (1985), 16 D.L.R. (4th) 289n], and *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 50 O.R. (2d) 267 (C.A.), set the standard for interpretation of subordination clauses.

44 In *Euroclean*, the court considered s. 39 of the Ontario *Personal Property Security Act* (R.S.O. 1980, c. 375), to determine priority between a debenture holder and a subsequent conditional seller. The subordination clause in *Euroclean* reads as follows (at p. 297):

> (e) Not Encumber — The Corporation shall not, without the consent in writing of the Holder, create any mortgage, hypothec, charge, lien or other encumbrance upon the mortgaged property or any part thereof ranking or purporting to rank in priority to or pari passu with the charge created by this Debenture, except that the Corporation may give mortgages or liens in connection with the acquisition of property after the date hereof or may acquire property subject to any mortgage, lien or other encumbrance thereon existing at the time of such acquisition and any such mortgage, lien or other encumbrance shall rank in priority to the charge hereby created.

45 *Euroclean* sets a very high standard for subordination clauses. The wording of the *Euroclean* clause contains a very specific waiver of priority. The clause explicitly sets out that purchase money charges "shall" rank in priority.

46 This clause can be contrasted to the clause set out in *Sperry*. In *Sperry*, the court was asked to consider the following clause in a general security agreement (at p. 270):

> **4. Ownership of Collateral**
>
> *The undersigned represents and warrants that, except for the security interest created hereby and except for purchase money obligations, the undersigned is, or with respect to Collateral acquired after the date hereof will be, the owner of Collateral free from any mortgage, lien, charge, security interest or encumbrance*. 'Purchase money obligations' means any mortgage, lien or other encumbrance upon property assumed or given back as part of the purchase price of such property, or arising by operation of law or any extension or renewal or replacement thereof upon the same property, if the principal amount of the indebtedness secured thereby is not increased.
>
> [Emphasis Morden J.A.'s.]

47 Counsel for *Sperry* argued this clause was a valid subordination clause which gave them priority over the bank. The court, however, disagreed and stated (at p. 274):

> As may be gathered from my interpretation of paras. 1 and 4 of the general security agreement I think that the document falls far short of showing an agreement by the bank to subordinate its security interest to that of Sperry.

48 It is understandable that the court found that this clause "falls far short" of an agreement to subordinate the bank's interest. This clause is very vague and does not at any point mention the terms "rank" or "priority".

49 From the above cases, the parameters are clear. An explicit and specific waiver clearly gives rise to a valid subordination clause. A vague and non-specific clause is not to be construed as a subordination clause. The question that arises is simply where on the continuum do the purported subordination clauses in the case at bar lie?

50 The clauses which the appellant relies on read as follows:

> **4.05 Possession, Use and Release of Mortgaged Property**
>
> Until the Security becomes enforceable, the Company may dispose of or deal with the subject matter of the floating charge provided for in Section 4.01(b) hereof in the ordinary course of its business and for the purpose of carrying on the same; provided that the Company shall not, without the prior written consent of the Holder, create, assume or have outstanding, except to the Holder, any mortgage, charge or other encumbrance on any part of the Mortgaged

> Property ranking or purporting to rank or capable of being enforced in priority to or pari passu with the Security, *other than*,
>
> (a) any mortgage, lien or other encumbrance upon property, created or assumed to secure all or any part of the funds required for the purchase of such property ...
>
> 6.01 The Company covenants and agrees with the Holder that, so long as this Debenture is outstanding, the Company shall not ...
>
> (c) create or permit any mortgage, charge, lien or other encumbrance upon any part or all of the Mortgaged Property ranking or purporting to rank in priority to or pari passu with the Security in order to secure any monies, debts, liabilities, bonds, debentures, notes or other obligations other than this Debenture and the Series of Mortgages and Debentures referred to in Section 8.01(n), hereof which are intended to rank in priority as pari passu with this Debenture; *provided, however, that this covenant shall not apply to, nor operate to prevent, and there shall be permitted*:
>
> (i) the assuming or giving of purchase money mortgages or other purchase money liens on property acquired by the Company or the giving of mortgages or liens in connection with the acquisition or purchase of such property or the acquiring of property subject to any mortgage, lien or encumbrance thereon existing at the time of such acquisition; provided that such purchase money mortgages or purchase money liens shall be secured only by the property being acquired by the Company and no other property of the Company ...
>
> (Emphasis added)

51 The respondent argues these clauses do not specifically give priority to the appellant and therefore no effect should be given to them. The respondent argues that because the wording does not meet the high standard set by *Euroclean*, these clauses do not constitute valid subordination clauses. The clauses, it is argued, merely permit Skyview to give security for purchase money.

52 These clauses are not as specific as those clauses found in *Euroclean*, but they clearly go much further than those found in *Sperry*. Nowhere in *Sperry* do the words "rank" or "priority" appear. The clauses now being considered include the terms "ranking", "priority" and "purporting to rank". In construing the language of the clauses, it is apparent that the debenture holders have at least impliedly granted priority. Both cls. 4.05 and 6.01 set a general rule that there shall be no charges created that rank or purport to rank in priority. The clauses then go on to create an exception. The present situation is one that is contemplated by this exception. By setting out a rule that nothing shall rank in priority and then drafting an exception, the debenture holders were acknowledging that in this situation, they will subordinate their claim. For example cl. 6.01 sets out that an encumbrance shall not be created that ranks in priority. It then creates an exception using the following language:

> provided, however, that this covenant shall not apply to, nor operate to prevent, and there shall be permitted:
>
> (i) the assuming or giving of purchase money mortgages or other purchase money liens on property acquired by the Company ...

53 The exception set out is exactly the situation that has arisen in the present case. The debenture holders by using this language are not only permitting Skyview to create such charges, they are clearly acknowledging that these charges rank ahead in priority. With respect, any other interpretation would render the exception devoid of any practical meaning.

54 The cases cited by counsel for both the appellant and respondents, other than *Euroclean* and *Sperry*, add little to this analysis. However, *Canadian Imperial Bank of Commerce v. International Harvester Credit Corp. of Canada* (1986), 6 P.P.S.A.C. 273 (Ont. C.A.), provides some insight into interpreting a clause of this nature. The subordination clause being considered in *Canadian Imperial Bank of Commerce v. International Harvester* is identical to cl. 4.05 in the debentures.

The trial judge gave effect to the subordination clause but was overturned by the Court of Appeal on the grounds that the subordination clause did not affect fixed charged security. Brooke J.A. of the Court of Appeal stated (at p. 276):

> I think the subordination clause is limited to the floating charge ...

55 Neither court did an analysis of the subordination clause; however, both courts accepted this clause to be a subordination clause. It was not an issue at the trial or Court of Appeal level whether this clause was indeed a valid subordination clause. Nor did the bank, the drafters of this clause, ever challenge this as an invalid subordination clause. The Ontario Court of Appeal in reversing the lower court's decision at all times referred to this clause as a subordination clause. When one considers that in the present case only a floating charge is at issue, the logical conclusion is that the subordination clause found in this debenture should be declared valid.

56 In construing these clauses it is also very important to look at commercial reality. These clauses are included to allow Skyview to carry on its business. Without such clauses, it would be impossible to enter into contracts with suppliers. Suppliers will not ship goods on credit to a company if their security interest is not given priority. An interpretation that rejects these particular clauses as valid subordination clauses does not give business efficacy to the document and completely ignores the commercial reality of transactions of this nature. One must look to the intention of the debenture holders at the time of drafting. The question to be asked is: what did the debenture holders intend when they included this clause? The debenture holders, in including these clauses, clearly intended the subordination of their interests in certain situations. It is doubtful they intended that a third party must register under the P.P.S.A. to get priority because this debenture was drafted two years prior to the P.P.S.A. coming into effect. It is recognized that the appellant could have obtained "super priority" merely by registering a financing statement in timely fashion. This they did not do, save for the last shipment. Does this mean they should not be able to rely on the subordination clause to obtain priority? Surely not. The debenture holders contemplated and acquiesced to the subordination of their interests to suppliers of Skyview. Commercial reality requires this contemplation be given effect. Even though the appellant did not obtain "super priority", as they could have, by timely registration, this does not prevent them from relying on the subordination clause in the debenture.

Conclusion

57 In summary, s. 40 of the P.P.S.A. specifies that a subordination clause is given effect according to its terms. As pointed out, the terms of this clause are not as specific as those in *Euroclean*. The terms are, however, much more specific and clear than those in *Sperry*. This clause, by its terms, contemplates the subordination of the debenture holder's interests. It, at the very least, impliedly allows suppliers, such as the appellant Chiips, to rank ahead of the debenture holders in regards to the goods supplied. Again, commercial reality requires that documents of this nature be given effect. For these reasons, the appeal should be allowed and the funds set aside should be released to the appellant.

***Hetherington J.A.* (dissenting):**

58 The respondents B.C. Central Credit Union, Banque Laurentienne du Canada, Societe General (Canada), Roynat Inc., ABN AMRO Bank Canada and The Bank of Tokyo Canada hold five debentures issued by the respondent, Skyview Hotels Limited. The wording of the debentures is identical. Under the debentures Skyview gave these respondents, as holders of the debentures, floating charges on all of its property, present and future, except that which was subject to fixed charges under the debentures. These floating charges were to secure payment of the sums of money referred to in the debentures, as well as performance of the obligations of Skyview under the debentures.

59 Subsequently the appellant, Chiips Inc., supplied goods to Skyview pursuant to an agreement which provided that the ownership of the goods would remain with Chiips until they were paid for in full.

60 Skyview defaulted under the debentures. The debenture holders then applied to a master of the Court of Queen's Bench for an order appointing the respondent Ernst & Young Inc. receiver and manager of all of the existing and future assets of Skyview. The master granted this order.

61 Skyview also failed to pay Chiips in full for the goods supplied under the agreement referred to above.

62 Later the assets of Skyview were sold. The judge of the Court of Queen's Bench who approved this sale ordered that Ernst retain the sum of $312,589, such sum to "stand in the stead of" the goods claimed by Chiips, that is, the goods which it had supplied to Skyview.

63 Chiips contends that its security interest in the money held by Ernst in place of these goods, has priority. It relies on what it says are subordination clauses in the debentures. The debenture holders claim that their security interests in this money have priority. These competing claims must be reconciled in accordance with the provisions of the *Personal Property Security Act*, S.A. 1988, c. P-4.05.

64 The chronology of the events described above and others is important in this case. I will set it out below:

1988	
January 31	Skyview issued debentures.
February 29	Debentures registered at Corporate Registry under the Business Corporations Act, S.A. 1981, c. B-15.
1990	
October 1	Personal Property Security Act came into force.
October 1	Security interests of debenture holders deemed to have been registered and perfected under the Personal Property Security Act (s. 75(3)).
1991	
November 14	Chiips entered into agreement in writing to supply goods to Skyview.
December	First load of goods sent by Chiips to Skyview.
1992	
January to March	Many loads of goods sent by Chiips to Skyview.
May 14	Ernst appointed receiver and manager of assets of Skyview.
June 5	Chiips perfected its purchase-money security interest in goods supplied under its agreement with Skyview by registering a financing statement at the Personal Property Registry, in accordance with s. 25 of the Personal Property Security Act.
June 23	Registration of security interests of debenture holders continued by filing of financial statements at Personal Property Registry under s. 23(1) and s. 25 of the Personal Property Security Act.
July 14	Skyview received final shipment of goods from Chiips.
1993	
January 28	Chiips applied to master of Court of Queen's Bench for determination of priority.
April 7	Chiips appealed from order of master to judge of Court of Queen's Bench.

July 30 Sale of assets of Skyview approved.

65 On the 28th of January, 1993, Chiips applied to the master for an order:

— determining that it had priority and was entitled to the goods which it had supplied to Skyview, and

— for permission to enforce its security by repossessing and removing the goods from the premises of Skyview.

The master found that Chiips had security and priority only in relation to the goods which Skyview received on the 14th of July, 1992. He gave Chiips permission to enforce this security by repossessing and removing these goods from the premises of Skyview. Chiips appealed from this order to a judge, who dismissed the appeal. It appealed again to this court.

66 There is no doubt that the *Personal Property Security Act* applies to the transactions in question in this case. Section 3(1) of the Act says:

> 3(1) Subject to section 4, this Act applies to
>
> (*a*) 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, and
>
> (*b*) without limiting the generality of clause (*a*), a ... conditional sale, floating charge ... where they secure payment or performance of an obligation.

Section 4 is not relevant.

67 Both Chiips and the debenture holders had security interests in the goods which Chiips supplied to Skyview, according to the definition of a security interest in s. 1(1)(*qq*) of the Act. Their interests secured payment, and in the case of the debenture holders, performance of obligations. In addition, the sale of the goods by Chiips to Skyview was a conditional sale, and the respondent debenture holders had a floating charge on these goods. Therefore, under both subs. (*a*) and subs. (*b*) of s. 3(1), the dealings of Chiips and the debenture holders in relation to the goods supplied by Chiips to Skyview come under the Act.

68 It is true that the *Personal Property Security Act* did not come into force until the 1st of October, 1990, and Skyview issued the debentures on the 31st of January, 1988. However, s. 74(2)(*a*) and (*b*) of the Act say that it applies to every security agreement and every security interest not validly terminated in accordance with the prior law before October 1, 1990. The debentures are security agreements according to the definition of a security agreement in s. 1(1)(*pp*) of the Act. It is not suggested that they were validly terminated before October 1, 1990.

69 The question is — which security interest or interests, that of Chiips or that of the debenture holders, has priority under the Act?

70 The security interest of Chiips is a purchase-money security interest as that phrase is defined in s. 1(1)(*ii*). To the extent that Chiips met the requirements of s. 34(2) when it perfected its purchase-money security interest by registering a financing statement, it has priority over any other security interest in the money standing in the stead of the goods. The relevant parts of s. 34(2) read as follows:

> (2) A purchase-money security interest in
>
> > (*a*) collateral or, subject to section 28, its proceeds, other than intangibles or inventory, that is perfected not later than 15 days after the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, or ...

has priority over any other security interest in the same collateral given by the same debtor.

71 Chiips supplied many loads of goods to Skyview before the end of March, 1992. However, it did not register a financing statement until June 5, 1992. In doing so it perfected its purchase-money security interest, but not within the time stipulated in s. 34(2). It cannot, therefore, claim priority under s. 34(2) in relation to goods supplied before the end of March, 1992.

72 Chiips supplied one load of goods to Skyview after it registered its financing statement. That load was delivered on the 14th of July, 1992. The master found that Chiips had priority in relation to these goods. The judge did not vary this finding, and the debenture holders have not appealed from it. It appears, therefore, that it is not disputed that Chiips' security interest in the money held by Ernst has priority to the extent of the value of this shipment.

73 So far as the bulk of the goods supplied by Chiips to Skyview is concerned, Chiips cannot claim priority under s. 34(2). It is necessary, therefore, to see what other sections of the Act apply.

74 Section 35(1) of the Act contains residual priority rules. The relevant parts of it read as follows:

35(1) Where this Act provides no other method for determining priority between security interests,

(*a*) priority between perfected security interests in the same collateral is determined by the order of occurrence of the following:

(i) the registration of a financing statement, without regard to the date of attachment of the security interest,

... or

(iii) perfection under section ... 75,

whichever is earlier ...

75 Under s. 75(3) the security interests of the debenture holders were deemed to have been registered and perfected when the Act came into force on the 1st of October, 1990. The debenture holders filed financial statements on the 23rd of June, 1992, before the registered and perfected status of the security interests ceased to be effective under s. 75(3). The security interests were therefore continuously perfected (ss. 23(1), 25 and 75(3)). Chiips did not perfect its security interest until it registered a financial statement on the 5th of June, 1992. The debenture holders appear, therefore, to have priority pursuant to s. 35(1) of the Act.

76 Counsel for Chiips argued, however, that each of the debentures contained clauses which in effect subordinated the security interest of the debenture holder to that of Chiips. It is not clear that at common law Chiips could rely on these clauses, because it is not a party to the contracts in which they are found, that is, the debentures. Authority for the proposition that it cannot is found in *Greenwood Shopping Plaza Ltd. v. Beattie*, [1980] 2 S.C.R. 228, and in *Euroclean Canada Inc. v. Forest Glade Investments Ltd.* (1985), 16 D.L.R. (4th) 289 (Ont. C.A.) (leave to appeal to S.C.C. refused (1985), 16 D.L.R. (4th) 289n), at p. 300. *Savin Canada Inc. v. Protech Office Electronics Ltd.* (1984), 8 D.L.R. (4th) 225 (B.C. C.A.), a contest between the holders of two different debentures, would appear to be authority to the contrary. However, the right of one debenture holder to rely on clauses in a debenture held by another was not discussed in the judgment, nor was the *Greenwood* case referred to.

77 In any event, priority in this case must be determined, not under the common law, but under the *Personal Property Security Act*. Section 40 of the Act reads as follows:

> 40 A secured party may, in a security agreement or otherwise, subordinate his security interest to any other interest, and the subordination is effective according to its terms between the parties and may be enforced by a third party if the third party is the person or one of a class of persons for whose benefit the subordination was intended.

78 In *Euroclean* the court considered (at pp. 299-302) the corresponding section in the *Personal Property Security Act* (R.S.O. 1980, c. 375) then in effect in Ontario, that is s. 39. That section read as follows:

> 39. A secured party may, in the security agreement or otherwise, subordinate his security interest to any other security interest.

79 In *Euroclean* Mr. Justice Houlden, writing for the court, concluded at pp. 301, 302:

> In my opinion, s. 39 is intended to confer a statutory right on a secured party to waive the priority given him by the P.P.S.A. and to confer a corresponding right on the beneficiary of such a waiver to enforce it, even though he is not a party to the agreement which created it or has no knowledge of its existence.

80 The effect of s. 40 of the Alberta Act is the same as that of s. 39 of the Ontario Act referred to above. Two questions must then be answered. First, did the debenture holders waive the priority given to them by the Alberta Act? Second, is Chiips the person or one of a class of persons for whose benefit the waiver was intended?

81 The clauses on which counsel for Chiips relied are the following (AB 38 and 42, 43):

> 4.05 *Possession, Use and Release of Mortgaged Property*
>
> ... the Company shall not, without the prior written consent of the Holder, create, assume or have outstanding, except to the Holder, any mortgage, charge or other encumbrance on any part of the Mortgaged Property ranking or purporting to rank or capable of being enforced in priority to or in pari passu with the Security, other than,
>
> (a) any mortgage, lien or other encumbrance upon property, created or assumed to secure all or any part of the funds required for the purchase of such property or any extension or renewal or replacement thereof upon the same property if the principal amount of the indebtedness secured thereby is not increased; or ...
>
> 6.01 The Company covenants and agrees with the Holder that, so long as this Debenture is outstanding, the Company shall not ...
>
> (c) create or permit any mortgage, charge, lien or other encumbrance upon any part or all of the Mortgaged Property ranking or purporting to rank in priority to or pari passu with the Security in order to secure any monies, debts, liabilities, bonds, debentures, notes or other obligations other than this Debenture and the Series of Mortgages and Debentures referred to in Section 8.01(n) hereof which are intended to rank in priority as pari passu with this Debenture; provided, however, that this covenant shall not apply to, nor operate to prevent, and there shall be permitted:
>
> (i) the assuming or giving of purchase money mortgages or other purchase money liens on property acquired by the Company or the giving of mortgages or liens in connection with the acquisition or purchase of such property ...

82 Clearly these clauses do not contain an explicit waiver of priority. They are, for example, quite different from the clause in question in *Euroclean*. It read as follows (at p. 297):

> (e) Not Encumber — The Corporation shall not, without the consent in writing of the Holder, create any mortgage, hypothec, charge, lien or other encumbrance upon the mortgaged property or any part thereof ranking or purporting to rank in priority to or pari passu with the charge created by this Debenture, except that the Corporation may give mortgages or liens in connection with the acquisition of property after the date hereof or may acquire property

> subject to any mortgage, lien or other encumbrance thereon existing at the time of such acquisition *and any such mortgage, lien or other encumbrance shall rank in priority to the charge hereby created.*

83 (Emphasis added)

84 It is not surprising that the court in *Euroclean* found this to be a subordination clause (at p. 299). The part of it which is emphasized above contains a clear and explicit waiver of priority. There is no such explicit waiver in the clauses in question in this case.

85 Do these clauses give rise to an implied waiver of priority by the debenture holders? In my view they do not.

86 In each debenture the exception in cl. 4.05(a) and the proviso in cl. 6.01(c)(i) are permissive. They permit Skyview to assume or to give security for purchase money, which security ranks or is capable of being enforced in priority to or pari passu with, among other things, the floating charge. If it were not for this exception and proviso, the assuming or giving of such security by Skyview would constitute a breach of the covenants made by it in these clauses, and an event of default under the debenture. There is nothing in the clauses to suggest any intention on the part of the debenture holders to go further than to permit the assuming or giving of such security. Nor was anything further required to permit Skyview to carry on business.

87 There is nothing in these clauses to suggest that security for purchase money will rank or be capable of being enforced in the manner described because of any waiver on the part of the debenture holders. Nor is there anything to suggest that where security for purchase money does not rank or is not capable of being enforced in priority to or pari passu with, among other things, the floating charge, which is the case here, the debenture holder waives any of its rights. I do not see how any waiver of priority can be implied in these clauses.

88 Beyond that, the priority with which we are concerned is priority under the *Personal Property Security Act*. Skyview issued the debentures in which the clauses in question are found on the 31st of January, 1988. The *Personal Property Security Act* was not assented to until the 6th of July, 1988. It did not come into force until the 1st of October, 1990. No doubt on the 31st of January, 1988, the debenture holders could have waived any right to priority which they might have in the future. However, they did not do so explicitly, and I do not think that such a waiver can be implied from the clauses quoted above.

89 Since in my view the debenture holders did not waive any priority given to them by the Act, it is not necessary for me to consider whether Chiips is the person or one of a class of persons for whose benefit the waiver was intended.

90 I will deal briefly with the cases relied on by counsel. Counsel for Chiips referred us to the *Euroclean* case, which I have already discussed, and to *Canadian Imperial Bank of Commerce v. International Harvester Credit Corp. of Canada* (1986), 6 P.P.S.A.C. 273 (Ont. C.A.). In that case the trial court ((1985), 4 P.P.S.A.C. 329 (Ont. H.C.)) and the Court of Appeal were required to consider a clause which was almost identical to cl. 4.05 quoted above. It appears that both at trial and on appeal it was assumed that it was a subordination clause. The trial judge found that it applied to the trucks in question even though they formed part of the fixed charge. The Court of Appeal disagreed. It was of the view that the clause only applied to the floating charge, and did not therefore apply to the trucks. In these circumstances the Court of Appeal did not need to decide whether the clause was in fact a subordination clause, and did not discuss this question.

91 Counsel for Chiips also referred us to *Transamerica Commercial Finance Corp., Canada v. Imperial T.V. & Stereo Centre Ltd. (Receiver of)* (1993), 146 A.R. 30 (Q.B.). In that case Madam Justice Nash was required to interpret a clause which she described as follows (at p. 33):

> Imperial, by the terms of the Debenture, agreed not to assume any other charges against the assets of the company, without the prior written consent of the Credit Union, that would have priority over the Credit Union's debenture unless, inter alia;

> The same be given to or in favour of the bankers of [Imperial] on the security of the accounts receivable or the inventory of [Imperial] to secure current loans required for the usual purposes of the business of [Imperial] and whether given pursuant to the provisions of the *Bank Act* or otherwise.

(The Subordination Clause) Madam Justice Nash found this to be a subordination clause (at p. 35). In doing so she relied on *Euroclean*. She found that the above clause was similar to the clause under consideration in that case. With respect, I do not agree. The clause in question in *Euroclean* contained an explicit waiver of priority. The one quoted above does not.

92 Counsel for the debenture holder referred us to *Sperry Inc. v. Canadian Imperial Bank of Commerce* (1985), 50 O.R. (2d) 267 (C.A.). In that case the court was required to interpret the following clause in a general security agreement (at p. 270):

> 4. *Ownership of Collateral*
>
> *The undersigned represents and warrants that, except for the security interest created hereby and except for purchase money obligations, the undersigned is, or with respect to Collateral acquired after the date hereof will be, the owner of the Collateral free from any mortgage, lien, charge, security interest or encumbrance*. 'Purchase money obligations' means any mortgage, lien or other encumbrance upon property assumed or given back as part of the purchase price of such property, or arising by operation of law or any extension or renewal or replacement thereof upon the same property, if the principal amount of the indebtedness secured thereby is not increased.

93 (Emphasis added by Ontario court) In that case Mr. Justice Morden, writing for the court, referred to extrinsic evidence on which the trial judge had relied, and concluded (at p. 274):

> Sperry also submitted that the evidence disclosed an agreement by the bank to subordinate its security interest to that of Sperry. An agreement of this kind is recognized by s. 39 of the Act. As may be gathered from my interpretation of paras. 1 and 4 of the general security agreement I think that the document falls far short of showing an agreement by the bank to subordinate its security interest to that of Sperry. Contrast the terms in the debenture in *Euroclean* ...

I agree with counsel for the debenture holders that this case is analogous to the one before us.

94 After considering these cases, and for the reasons set out above, it is my view that the debenture holders did not, in the clauses in the debentures on which Chiips relies, waive their priority under the *Personal Property Security Act*. They did not subordinate their security interests to any other security interest. Under s. 35(1) of the Act, therefore, their security interests in the money held by Ernst in place of the goods supplied by Chiips to Skyview, has priority.

95 I would therefore dismiss the appeal.

Appeal allowed.

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