

Reproduced with permission of the publisher from National Banking Law Review, Vol. 29, No. 3, June 2010.

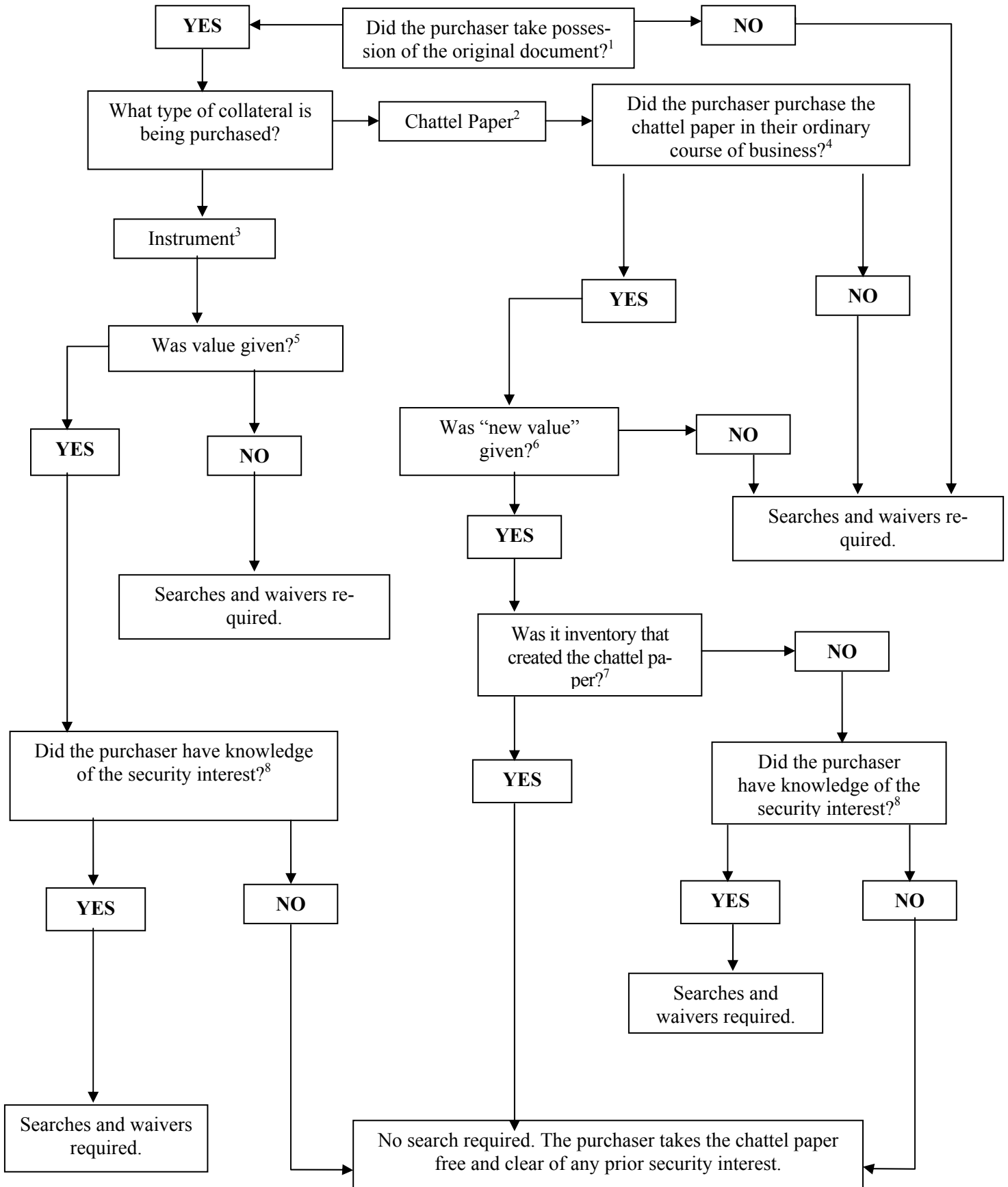
• PURCHASERS OF CHATTEL PAPER AND INSTRUMENTS •

Jonathan Fleisher and Jennifer Hansen
Cassels Brock & Blackwell LLP

EXECUTIVE SUMMARY

Whether to do a search prior to purchasing chattel paper or instruments has always been a topic of debate. There has been no new case law in this area, but it is a question we receive from our clients on a regular basis. As such, we thought it was appropriate to develop an analysis which our clients could follow. As will be set out below, there are circum-

stances, if followed, that will not require a search to occur in order for the purchaser to buy the chattel paper free and clear. However, as part of the analysis is based on commentary as opposed to case law, we suggest caution if searches and waivers are not undertaken. Industry practice is to perform searches and obtain waivers, but that may not be strictly required.



1. "TAKE POSSESSION": ss. 28(3) AND 28(4)

The intention of the Ontario *Personal Property Security Act* (the "PPSA") is to provide notice to persons dealing with the collateral that the secured party claims an interest in the goods.¹ This is accomplished through a combination of a registration system and the ability to perfect by possession. The PPSA does not define what constitutes possession; however, s. 22 indicates that for the purposes of perfecting a security interest, possession must be taken by the secured party or be taken on its behalf by a person other than the debtor. If perfection is to be achieved by possession, the secured party must have the actual document in their possession, as control of an electronic document does not constitute possession for the purposes of the PPSA.² Ziegel and Denomme suggest that a similar interpretation be given to "taking possession" under s. 28(3), where the purchaser is required to take possession of the collateral in order to purchase it free and clear of any prior security interest. Consequently, under subs. 28(3), where there is a requirement for a purchaser to take possession, this requires actual, physical possession of the original chattel paper.

2. CHATTEL PAPER

(GOVERNED BY s. 28(3)): DEFINITION

Under the PPSA, "chattel paper" is defined as "one or more than one writing that evidences both a monetary obligation and a security interest in or a lease of specific goods."³ Typically, chattel paper is characterized by a conditional sale or lease when goods are sold on credit and the seller retains a security interest in the collateral. The definition of chattel paper requires that the goods be specified in the agreement.

3. INSTRUMENT

(GOVERNED BY s. 28(4)): DEFINITION

As defined in the PPSA, "instrument" means,

- (a) a bill, note or cheque within the meaning of the *Bills of Exchange Act* (Canada) or any other writing that evidences a right to the payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, or
- (b) a letter of credit and an advice of credit if the letter or advice states that it must be surrendered upon claiming payment thereunder,

but does not include a writing that constitutes part of chattel paper, a document of title or investment property.⁴

4. "ORDINARY COURSE OF BUSINESS OF THE PURCHASER" (s. 28(3)): COMMENTARY

For purchasers of chattel paper, only a purchaser taking possession in the ordinary course of his business receives protection. In contrast with the provisions under s. 28, which look to the seller who sells in the ordinary course of business; under subs. 28(3) the focus shifts to the purchaser who takes possession in its ordinary course of business.⁵ It remains an objective test, and the factors to consider in determining whether the transaction is ordinary course remain the same; it is merely a shift in focus as to whether the purchaser is purchasing, rather than if the seller is selling, in the ordinary course. In determining whether the transaction occurred in the ordinary course of business, the factors to consider are the place of sale, the parties to the sale, the quantity being sold, and the price.⁶

The market for chattel paper and instruments is financial institutions. To be entitled to protection, they are required to establish that they were following accepted business practices of such institutions.⁷ If the purchaser of the chattel paper is a financial institution that regularly engages in these types of transactions, and the sale occurred at fair market value, and according to accepted business practices, then it is likely that the sale occurred in the purchaser's ordinary course of business.

5. VALUE (s. 28(4)): DEFINITION

Under s. 28(4), a purchaser of an instrument must provide "value", which is defined in the PPSA to include simple consideration that would support a contract, and includes an antecedent debt or obligation.⁸

6. NEW VALUE (s. 28(3)): COMMENTARY, OTHER JURISDICTIONS

Unlike for purchasers of instruments, a purchaser of chattel paper must provide "new value." The term "new value" is used as distinct from "value," which is defined by the Ontario PPSA to include antecedent debts and past value.⁹ "New value" has not been defined in the Ontario PPSA nor has it been subject to judicial interpretation. However, it has been defined in other jurisdictions as "value other than an antecedent debt or liability."¹⁰ According to Ziegel and Denomme, the *United States Uniform Commercial Code* (the "UCC") gives insight as to when an interest is deemed to be given for new value. Under the UCC, "new value" arises in the making of an advance, the incurring of an obligation, or the releasing of a perfected security interest, as opposed to being security for an

antecedent debt. This is significant in the interpretation of the *PPSA*, as it was modelled on the *UCC* Article 9.¹¹ Ziegel and Denomme suggest that new value means more than consideration sufficient to support a promise.¹² As there exists no case law on point, this discussion is based on commentary and is not certain. It would be prudent for a purchaser of chattel paper wishing to eliminate any uncertainty to obtain a release from every prior secured party.

7. INVENTORY (s. 28(3)(B))

Where the chattel paper arises out of the proceeds of inventory, s. 28(3)(b) applies. Inventory is defined as “goods that are held by a person for sale or lease or that have been leased or that are to be furnished or have been furnished under a contract of service, or that are raw materials, work in process or materials used or consumed in a business or profession.”¹³ When chattel paper is the actual proceeds of inventory, regardless of the extent of the purchaser’s knowledge of any prior security interest, the purchaser will take the chattel paper free and clear of any prior security interest.

8. KNOWLEDGE

(GOVERNED BY s. 69): DEFINITION

Under the *PPSA*, “knowledge” is determined by whether a person learns or knows or has notice, or when information comes to his or her attention under circumstances in which a reasonable person would take cognizance of it.¹⁴ This does not require the purchaser of chattel paper or inventory to do a search, but if a search is done then the purchaser cannot claim that they do not have knowledge of the prior security interest.

[*Editor’s note:* Jonathan Fleisher is a partner in the Financial Services and Business Law Groups of Cassels Brock & Blackwell LLP. His financial services practice focuses on the commercial finance industry with a particular emphasis on innovative cross-border transactions and equipment finance.

Jennifer Hansen is an articling student at Cassels Brock & Blackwell LLP]

¹ *Re Raymond Darzinskis*, [1981] O.J. No. 3189, 34 OR (2d) 782, 132 D.L.R. (3d) 77 (Ont. H.C.J.).

² *Electronic Commerce Act*, 2000, S.O. 2000, c. 17 s. 8(4).

³ R.S.O. 1990, c. P.10, s. 1(1) [*PPSA*].

⁴ *Ibid.*

⁵ Jacob S Ziegel and David L Denomme, *The Ontario Personal Property Security Act: Commentary and Analysis*, 2d ed. (Toronto: Butterworths, 2000) at p. 238 [Ziegel].

⁶ *Ibid.* at p. 231; *Fairline Boats Ltd. v. Leger*, [1980] O.J. No. 216, 1 P.P.S.A.C. 218 (Ont. H.C.J.) followed in *Associates Commercial Corp. of Canada v. Dependable Transportation Inc.*, [1994] O.J. No. 2516, 8 P.P.S.A.C. (2d) 172 (Ont. Gen. Div.).

⁷ *Camco Inc. v. Frances Olson Realty (1979) Ltd.*, [1986] S. J. No. 519.

⁸ *Supra* note 3, s. 1(1).

⁹ *Supra* note 5, at p. 238.

¹⁰ R.S.B.C. 1996, c. 359, s. 1 (British Columbia); R.S.A. 2000, c. P-7, s. 1 (Alberta).

¹¹ 9 UCC § 108.

¹² *Supra* note 5, at p. 240.

¹³ *Supra* note 3, s. 1(1).

¹⁴ *Ibid.*, s. 69.