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DAVIS LLP SUCCESSFULLY DEFENDS SECURED CREDITORS IN PRIORITY DISPUTE AT THE BC COURT OF APPEAL.

A REVIEW OF
RE PERIMETER TRANSPORTATION



Davis LLP's Business Solutions & Restructuring Group assists all insolvency and financial stakeholders by providing strategic advice and advancing appropriate resolutions to their situations. Our lawyers advise with respect to security instruments, registration and priorities of claims and secured charges, the Personal Property Security Act, Bankruptcy and Insolvency Act, Companies' Creditors Arrangement Act, Income Tax Act and other federal and provincial legislation affecting debtors and creditors.

In an important recent decision of the BC Court of Appeal, Davis LLP successfully represented its clients Century McMynn Leasing Partnership and GE Finance in *Re Perimeter Transportation Ltd.*, 2010 BCCA 509. The case related to a priority dispute between a trustee in bankruptcy of a lessee, a lessor who had not perfected the security interest of its lease, and a validly registered and perfected secured creditor of the lessor. The interplay between these roles was the source of disagreeing trial-level decisions in Alberta and Saskatchewan, and *Perimeter* is the only appellate level decision on this matter.

Facts

The case revolved around three buses which were leased by Century McMynn to Perimeter Transportation. The leases were for a term greater than a year and required that Century McMynn file a financing statement in the Personal Property Registry of BC (the "PPR") to protect its interest pursuant to the BC *Personal Property Security Act* ("PPSA"). However, Century McMynn failed to do so.

Following the lease transaction, Century McMynn entered into a financing agreement with GE Finance. As security GE Finance took, among other things, a security interest in the buses. A financing statement was registered in the PPR to perfect GE's interest in the buses and disclosed Century McMynn as the debtor and listed the buses by serial number. There was no suggestion at either the trial or

appellate level that the GE Finance registration was in any way deficient.

Perimeter went bankrupt and a priority dispute arose as to who had priority to the buses: the trustee in bankruptcy of Perimeter on behalf of the unsecured creditors, Century McMynn or GE Finance. The trustee obtained legal advice and took the position that the buses were subject to GE Finance's security interest. Accordingly the trustee unconditionally returned the buses to Century McMynn at GE Finance's direction. The trustee later decided the return was in error and brought a motion for the return of the buses or their value to the estate.

Law

The priority dispute focused on two sections of the PPSA. Section 20 provides that:

A security interest

...

(b) in collateral is not effective against

(i) a trustee in bankruptcy if the security interest is unperfected at the date of the bankruptcy...

Section 30(2) provides that:

A buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free of any perfected or unperfected security interest in the goods given by the seller or lessor or arising under section 28 or 29, whether or not the buyer or lessee knows of it, unless the buyer or lessee also knows that the sale or lease constitutes a breach of the security agreement under which the security interest was created.

Accordingly, s. 20(b)(i) meant that (without addressing the effect of the return of the buses), the trustee was able to defeat the interest of Century McMynn because the deemed security interest formed by the lease was not registered and accordingly was not effective against the trustee. This is consistent with the Supreme Court of Canada's finding in *Re Giffen*, [1998] 1 S.C.R. 91 where the Court held that the effect of s. 20(b)(i) is to alter the common law and to *de facto* give trustees a greater interest in property than that held by the bankrupt. The Court of Appeal noted in *Re Perimeter* at paragraph 24 that:

The *PPSA*, then, supplants the common law rule of *nemo dat quod non habet* in priority contests between a trustee in bankruptcy and the holder of an unperfected security interest, as described in s. 20(b)(i). It was, the Court stated, a “policy choice of the Legislature that an unsecured creditor’s position, as represented by the trustee, is more meritorious than the unperfected security interest of a secured creditor.” (Para. 54.) In the result, the trustee in bankruptcy in *Giffen* was found to be entitled to the proceeds of sale of the car, and could pass title to the car to a purchaser as a result of the operation of both s. 20(b)(i) of the *PPSA* and s. 81(2) of the *BIA*. (Paras. 57-9.).

The Court of Appeal was therefore faced with answering the question: if Perimeter took its interest in the buses 'free of GE's security interest' at the date of the lease, to what extent? Did this mean that the trustee of Perimeter's estate need not worry about GE Finance's security interest post-bankruptcy because of s. 30(2), and could then use s. 20(b)(i) to take the buses free of Century McMynn's interest?

Davis LLP argued on behalf of Century McMynn and GE Finance that s. 30(2) meant Perimeter took the buses free and clear of GE's security interest *to the extent of Perimeter's leasehold interest*. Accordingly, so long as Perimeter (and its trustee) kept the lease in good standing, GE Finance could not enforce its interest against the buses even if Century McMynn defaulted on its obligations to GE Finance. GE Finance, however, retained a security interest in the reversionary interest of Century McMynn in the buses. Once the lease came to an end (either by expiration or through a default by Perimeter), GE Finance could again assert its interest.

Both the chambers judge of the BC Supreme Court and the Court of Appeal agreed. The Court of Appeal noted:

In my view, nothing in s. 30(2) contemplates or requires that the Trustee acquires title to the buses free of the interest of GE in Century's perfected reversionary interest. It is true that in *Giffen*, the Supreme Court of Canada held that the principle of *nemo dat* has been modified "through the policy choices of the Legislature represented in s. 20(b)(i) of the *PPSA*". (Para. 56.) But the Court was construing s. 20(b)(i), which on a plain reading made an unperfected security interest of a lessor "ineffective" as against the lessee's trustee in bankruptcy. The Court emphasized that the *PPSA* does not deal with title but with competing priorities. Here, we have a contest between the trustee of a lessee, and the holder of a perfected security interest granted by the lessor. That holder did what it was required to do by the *PPSA* to protect its interest. It is not a necessary result of the operation of s. 30(2), in my opinion, that the Trustee acquire ownership of the goods themselves free of the interest granted by Century to GE. Both the policy underlying s. 30(2) and the wording of the section itself require only that the Trustee remain entitled to the bankrupt's interest under the lease, free of all interests described in the section. This ensures that as long as the lease is extant, the lessee's rights will not be affected by the security interest granted by the lessor. The public interest in ensuring that the lessee gets what it bargained for is fulfilled and the Trustee may continue to enjoy the benefit of the lease as long as it is extant. In this regard, I agree with GE's submission at para. 53 of its factum:

As summarised in Cuming above, a *buyer* of goods takes free and clear of prior security interests pursuant to s. 30(2). This is because a buyer contracts for ownership of the goods being sold, and s. 30(2) ensures that the buyer gets what he or she bargained for. A lessee, however, contracts for temporary use and possession of the goods under the lease. The lessee's interest is given protection under s. 30(2) to the extent of what he or she contracted for. A security interest given by the lessor cannot be asserted against the lessee to the extent of denying the possessory rights of the lessee. However, s. 30(2) does not negate the security interest in the lessor's reversionary interest in the same way that it negates a security interest given by a seller (who has no reversionary interest). The role of this section is to ensure that the lessee's limited possessory rights

are not affected by the security interest in the subject-matter of the lease.
[Emphasis added.]

The Court of Appeal went on to find that the lease between Century McMynn was terminated, at the very latest, when the buses were returned, and accordingly at that time GE Finance was able to assert its security interest in the buses.

Important Points to Take Away

Perimeter provides an important decision on the interplay of s. 20(b)(i) and s. 30(2) of the PPSA. This is particularly true in respect of the financiers of leasing companies. The Court of Appeal held that GE Finance, by doing all it was required to do to perfect its interest against Century McMynn would not be defeated by the trustee in bankruptcy of a lessee. When evaluating risks, this provides some certainty to lenders who may not be able to track all of the leases made by their borrowers who are in the business of leasing.

The Court of Appeal's decision that the return of the buses terminated the lease meant they did not have to decide if the trustee would have been required to make payments under the lease had it wished to retain the buses. However, this would appear to be the logical extrapolation of this decision.

It is important to note, however, that this case only provides that a party in the position of GE Finance can defeat the ultimate lessee's *trustee in bankruptcy*. It does not address the scenario between a party in the position of GE Finance, and a perfected secured creditor of the ultimate lessee.

This outline of the Re Perimeter decision is only a summary and should not be applied to a fact scenario without seeking legal advice. The lawyers of Davis LLP's Business Solutions and Restructuring Group and National Banking and Financial Services Group would be happy to discuss any specific situations.

Recent Group Additions



Davis LLP is pleased to announce that Mary Buttery has joined the firm as a partner in the Vancouver office. Specializing in insolvency matters and commercial litigation, Ms. Buttery is leading the Vancouver office's insolvency team.

"Mary is an excellent addition to the firm and to our growing national Business Solutions and Restructuring team," says Robert Seidel, National Managing Partner of Davis. "She has been involved in numerous significant insolvency files in B.C. and is recognized on the national stage as a leader in her field."

Ms. Buttery has received numerous accolades from the legal community, including being named a Lexpert Rising Star. She lectures on insolvency and litigation matters, and has authored several articles on varied topics in her areas of practice. Ms. Buttery has appeared in all levels of the Ontario and British Columbia courts, the Federal Court, and has been lead counsel in the Supreme Court of Canada.



Additionally, the firm recently welcomed Karen Fellowes to the firm's Calgary office as an associate.

"We are very pleased to have Karen's expertise in insolvency matters at Davis," says Trevor Wong-Chor, Managing Partner in the Calgary office. "Over the past year, the firm has doubled the size of its Business Solutions & Restructuring team and Karen will be a valuable addition to the group."

Ms. Fellowes practice is focused primarily on proceedings under the Bankruptcy and Insolvency Act and Companies' Creditors Arrangement Act, as well as receiverships, foreclosures and other creditor's remedies. She acts on behalf of financial institutions and secured creditors, trustees, receivers, monitors, unsecured creditors, landlords/tenants, equipment lessees and lessors, insurers, debtors and individuals.

As part of the firm's commitment to enhancing client services, Davis has recently strengthened its national Business Solutions and Restructuring team. In addition to Ms. Buttery and Ms. Fellowes, seven distinguished insolvency lawyers from Montréal and Calgary have recently joined Davis, resulting in a team with exceptional depth and expertise in insolvency and restructuring matters.

For a full list of group contacts, please see the next page.

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