



About Rebecca M. Morse

Rebecca's practice is focused on corporate and commercial litigation matters. She has experience in contractual disputes, bankruptcy, insolvency and restructuring matters, shareholder and partnership disputes, estate litigation, trust disputes, intellectual property disputes, and matters involving administrative law and judicial review. She has acted for a variety of corporations (both publicly listed and privately held), individuals and financial institutions.

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Priority Disputes Between the Bank Act and Provincial PPSA Legislation

Recent cases conclusively determine that unregistered security interests granted under provincial PPSA legislation takes priority over subsequently acquired Bank Act security interests.

Two recent decisions, handed down by the Supreme Court of Canada, may surprise those who have generally assumed that the first party to register their security interest will generally take priority over subsequently registered interests.

In the *Bank of Montreal v. Innovation Credit Union*, 2010 SCC 47, the debtor granted Innovation Credit Union a security interest in 1991. The credit union did not register its security interest until 2004. In the interim, the Bank of Montreal advanced a loan to the debtor and registered a security interest in much of the same collateral under the *Bank Act*. The question before the courts was who gets priority in these circumstances?

The Supreme Court of Canada determined that the credit union's security interest had priority. The Court reasoned that at the time bank took its *Bank Act* security, the debtor had already given the credit union a security interest under the *PPSA*, and the bank's security interest was subject to that prior interest.

During this case, the bank argued that allowing unregistered PPSA security interests to take priority in these circumstances would expose banks to unreasonable commercial risks. While the Supreme Court acknowledged this argument and the potential risks to the banks, it ultimately determined that they were bound by the legislation and giving the bank's security interest priority would run contrary to the *Bank Act* itself.

In its companion decision, *Royal Bank of Canada v. Radius Credit Union*, 2010 SCC 48, the Supreme Court of Canada looked at a slightly different issue. Here, the Court considered the priority of an unregistered PPSA security interest as compared to a subsequently granted *Bank Act* security interest in respect of after-acquired property. Like the decision in *Bank of Montreal v. Innovation Credit Union*, the Court determined that the credit union's security interest had priority over that held by the bank.

In this case, the debtor executed a general security agreement over all present and after-acquired property on January 24, 1992. The credit union did not register its interest until September 24, 1998. After the security agreement with the credit union had been executed, the debtor turned to the Royal Bank for further financing. The bank agreed to advance financing and was granted a security interest in all present and after-acquired property, and it registered its security interest. The debtor defaulted on his loan and the bank seized and sold the property that had been acquired after the debtor had granted a security interest to both the credit union and the bank.

The Court determined that the credit union acquired a statutory and recognizable security interest in the collateral (including the debtor's after acquired property) at the time the security agreement was executed, and the bank could acquire no greater interest than the debtor and the collateral. As a security interest in the debtor's after-acquired property had already been granted to the credit union, the Court determined that the *Bank Act* security was taken subject to that of the credit union, and the credit union's interest had priority.

Summary

The Supreme Court has made it clear that security interests granted pursuant to the provincial PPSA legislation (even when unregistered or "unperfected") will take priority over subsequently acquired security interests taken under the Bank Act, and the reasons behind this priority are found in the Bank Act itself.

It is now clear that banks will need to do much more than a simple PPSA search when evaluating the strength of any security being granted by a potential borrower. For instance, those banks that do not already do so may be advised to contact other likely lenders (such as local credit unions) and make enquiries as to whether any security has already been granted by the potential borrower. In many instances, however, it may be less onerous and more certain for a bank to simply take its security interest under the provincial PPSA regime and register that interest. After all, registered security interest under the provincial PPSA regime takes priority over any "unperfected" interests taken under that legislation.