CONTROL V. REGISTRATION: CONTEMPLATING A POTENTIAL PARADIGM SHIFT IN THE PPSA'S GOVERNANCE OF SECURITY INTERESTS IN DEPOSIT ACCOUNTS

BY

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ABSTRACT

The thesis explores and interrogates the *control* paradigm for perfection and priority ordering of security interests in deposit accounts. It subjects *control*, alongside *registration*, to a critical examination having regard for the traditional values of personal property security law. Drawn from these traditional values are a series of evaluative criteria designed to assist in a comparative evaluation of the broadly similar, yet distinct, statutory personal property security regimes of Canada, Australia and the United States, as well as a proposed new regime for the Province of Ontario. The comparative evaluative exercise is conducted in an effort to answer the current and pressing question of whether Canadian common law jurisdictions ought to amend the PPSA in a manner that permits or mandates a security interest in a deposit account to be perfected by control.

The thesis contributes to the literature on this important and timely subject through its detailed comparative accounts of various distinctive deposit account regimes and model-types, and its assessment of those regimes and model-types in accordance with traditional values of personal property security law. In short, the thesis pits various iterations of the control paradigm against the registration paradigm in a comparative evaluative exercise. This evaluative exercise reveals that the registration paradigm better adheres to the traditional values of personal property security law than the control paradigm. This, in turn, suggests that Canadian common law jurisdictions ought not amend the PPSA in a manner that

permits or mandates a security interest in a deposit account to be perfected by control.

PREFACE

This is an original work by Clayton Bangsund. A number of journal articles emanated from this research, and have already been published. Substantial portions of the following two articles are reproduced in Chapters 2 and 3 respectively:

- Clayton Bangsund, "PPSL Values" (2015) 57(2) C.B.L.J. 184.
- Clayton Bangsund, "Deposit Account Set-Off Under the PPSA" (2017) 80(1) Sask. L. Rev. 11.

I have also published or co-published three additional articles which either directly or tangentially touch upon the subject matter at hand:

- Clayton Bangsund, "Set-Off & Security Interests" (2017) 50(1) UBC L. Rev. 1.
- Clayton Bangsund & Jasmine Lothian, "Inequity in Equitable Set-Off: Telford v Holt Revisited" (2016) 94(1) Can. Bar Rev. 149.
- Clayton Bangsund, "The Deposit Account & Chose in Action at Common Law & Under the PPSA: A Historical Review" (2014) 30(1) B.F.L.R. 1.

Dedication

To Marlon

ACKNOWLEDGMENTS

A special thank you to my thesis supervisor, Roderick Wood, for your constructive criticism, guidance and support throughout this research project; it has been an honour working under your supervision. I am grateful, also, to supervisory committee members, Tamara Buckwold and Gail Henderson, for your valuable feedback throughout; your insights have improved the thesis immeasurably. Thank you to examination committee members, Eran Kaplinsky and Thomas Telfer, for your excellent questions and feedback. Barbara Billingsley, thank you for serving as my examination chair, and for encouraging me to pursue graduate legal studies and an academic path. Many thanks to the various others who played key roles during my tenure as a doctoral student, namely, Russell Brown, Frederick DeCoste, Joanna Harrington, Matthew Lewans, Steven Penny and Moin Yahya. Thanks also to the various organizations that assisted in funding my graduate research including the Law Society of Alberta, the University of Alberta, and the Social Sciences and Humanities Research Council of Canada.

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Thesis Overview

Control v. Registration: Contemplating a Potential Paradigm Shift in the PPSA's Governance of Security Interests in Deposit Accounts

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Chapter 4 ~ Description

GLOSSARY

Personal property security law is replete with terms of art, for use only where appropriate.[1] Our preoccupation with technicality and taxonomy, while perhaps bothersome to the non-lawyer, is necessary to ensure a sound conceptual framework for governance of security interests in personal property. Use of technical language facilitates clearer conveyance of ideas.[2] Accordingly, this glossary is a repository of the technical language introduced and/or used throughout the thesis.

DEFINED TERMS

"account combination theory" means the analytical approach governing deposit account set-off, described in Chapter 3 and preferred by Geva.

"ALI" means the American Law Institute.

"Article 9" means Article 9 of the Uniform Commercial Code.

"AUSPPSA" means the *Personal Property Securities Act* (Australia), Act. No. 130 of 2009.

"bank" means a "depository institution" or "deposit-taking institution", whether a (i) chartered bank under the Bank Act, (ii) credit union, (iii) caisse populaire, (iv) etc.

"*Bank Act*" means the Bank Act (Canada), S.C. 1991, c. 46.

"BIA" means the *Bankruptcy and Insolvency Act* (Canada), R.S.C. 1985, c. B-3.

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[1] Lewis Carroll, *Through the Looking-Glass* (New York: Penguin Books, 1960) at 188], per Humpty Dumpty: "When *I* use a word, it means just what I choose it to mean – neither more nor less."

[2] Aristotle, *The Nicomachean Ethics,* trans. by Harris Rackham (Hare: Wordsworth, 1996) at 43, Book II, vii, 11; Robert Nozick, *The Nature of Rationality* (Princeton: Princeton University Press, 1993) at xvi.

“cash collateral” means collateral posted in the form of a deposit account.

“charge-back” means the security interest of a depository bank in a customer’s deposit account maintained with such depository bank.

“*Civil Code of Québec*” means the *Civil Code of Québec*.

“*Constitution Act 1867*” means the *Constitution Act, 1867*, 30 & 31 Victoria, c. 3.

“cumulative adherence score” means the cumulative adherence score of a regime having regard for the evaluative criteria developed in Chapter 2.

“cumulative adherence table” means a table collating the adherence grades and cumulative adherence scores of the various regimes under investigation according to particular weighting. Cumulative adherence tables are generated in Chapter 7.

“deposit account” means an interest bearing or non-interest bearing account debt payable by a depository bank to its customer depositor on demand. A deposit account is also known, colloquially, as a ‘bank account’.

“deposit account set-off” means a depository bank’s set-off of a customer’s credit balance against an outstanding deposit account balance.

“depository bank”, with reference to any given deposit account, means the bank at which the deposit account is maintained.

“evaluative criteria” means the standardized evaluative criteria developed in Chapter 2, comprised of Criterion A (Creation & Perfection), Criterion B (Risk Assessment), Criterion C (Dispute Resolution), Criterion D (Competitive Market) and Criterion E (Proceeds).

“*Financial Administration Act*” means the *Financial Administration Act*, R.S.C., 1985, c. F-11.

“Former Article 9” means Article 9 of the Uniform Commercial Code in force immediately prior to the NCCUSL’s and ALI’s 1998 adoption of a pure bank-directed control model with a control paradigm.

“general account” or “general account receivable” means ‘account’ as that term is defined in the PPSA, or, in the context of a regime other than the PPSA, the closest analogue to that term. The term is introduced in Chapter 8.

“implicit priority rule theory” means the analytical approach governing deposit account set-off, as set out, but ultimately rejected, by Cuming. The ‘implicit priority rule theory is described in Chapter 3.

"*Income Tax Act*" means the *Income Tax Act*, R.S.C. 1985, c. 1.

"ISDA" means the International Swaps and Derivatives Association, Inc.

"model" has the meaning given to it in Chapter 1.

"NCCUSL" means the National Conference of Commissioners on Uniform State Law.

"non-depository creditor" means a creditor, whether secured or unsecured, who is not the depository bank. Such creditor may, in fact, be another depository bank, but not the one with whom the deposit account is maintained.

"non-depository secured party", with reference to a deposit account, means a secured creditor who is not the depository bank. Such secured creditor may, in fact, be another depository bank, but not the one with whom the deposit account is maintained.

"NZPPSA" means the *Personal Property Securities Act 1999* (New Zealand).

"OBAPPSA" means the personal property security regime that would be brought about by the adoption of the OBA Proposal.

"OBA PPSL Subcommittee" means the subcommittee tasked by Business Law Section of the Ontario Bar Association to undertake a review of Ontario's deposit account regime.

"OBA Proposal" means the proposal by the OBA PPSL Subcommittee for adoption of a hybrid bank-directed control model with a control paradigm.

"Original Article 9" means the UCC Article 9 originally promulgated by the NCCUSL and ALI, and enacted across the United States of America.

"paradigm" has the meaning given to in in Chapter 1.

"Pattern β (*beta*)" means the standardized fact pattern, described in Chapter 5, involving, among others, a retail merchant (Retailer), a depository bank (Bank) and an inventory supplier (Supplier).

"Pattern Ω (*omega*)" means the standardized fact pattern, described in Chapter 5, involving, among others, a wholesale merchant (Wholesaler), a depository bank (Corrigan Bank), an inventory supplier (Supplyco) and an accounts financier (Accounts Financier).

"Pattern Ψ (*psi*)" means the standardized fact pattern, described in Chapter 5, involving an operating company (Opco), a lending bank (Lending Bank) and a depository bank/derivatives counterparty (Derivative Bank);

"Pattern Σ (*sigma*)" means the fact pattern, described in Chapter 8, involving an operating company (Opco), a derivatives counterparty (Empire Derivatives), a depository bank (Wembley Bank), and general lending bank (Newton Bank).

"Pattern Φ (*phi*)" means the fact pattern, described in Chapter 8, involving an operating company (Opco), a derivatives counterparty (Empire Derivatives), a depository bank (Mulberry Bank) and general lending bank (Carlton Bank).

"*Payment Clearing and Settlement Act*" means the *Payment Clearing and Settlement Act*, S.C. 2012, c. 31.

"PPR" means the Personal Property Registry or an equivalent public registry for registering notice of security interests in personal property.

"PPSA" means, and is a generic reference to, the Canadian PPSA. Citations for the PPSA are as follows: Personal Property Security Act, R.S.A. 2000, c. P-7 (Alberta, APPSA); R.S.B.C. 1996, c. 359 (British Columbia, BCPPSA); C.C.S.M. c. P35 (Manitoba, MPPSA); S.N.B. 1993, c. P-7.1 (New Brunswick, NBPPSA); S.N.L. 1998, c. P-7.1 (Newfoundland, NFPPSA); S.N.W.T. 1994, c. 8 (Northwest Territories, NWTPPSA); S.N.S. 1995-96, c. 13 (Nova Scotia, NSPPSA); S.N.W.T. 1994, c. 8 (Nunavut, NPPSA); R.S.O. 1990, c. P.10 (Ontario, OPPSA); R.S.P.E.I. 1988, c. P-3.1 (Prince Edward Island, PEIPPSA); S.S. 1993, c. P-6.2 (Saskatchewan, SPPSA); R.S.Y. 2002, c. 169 (Yukon, YPPSA). Unless otherwise specified in this thesis, the APPSA serves as a proxy for the PPSA. In other words, unless otherwise specified, all statutory references to the PPSA are to the provisions of the APPSA.

"PPSL definiteness values" or "family of PPSL definiteness values" means the PPSL values of 'predictability', 'certainty' and 'clarity', each carrying connotations of 'definiteness', 'sureness' and/or 'confidence', as described in Chapter 2.

"PPSL values" means the values of personal property security law, as described in Chapter 2, comprised of the prime value of 'facility', and the supporting values of 'transparency', 'flexibility', 'simplicity', 'efficiency', 'predictability', 'certainty', 'clarity', 'equality', 'balance', 'comprehensiveness', 'uniformity' and 'coherency'.

"regime" has the meaning given to it in Chapter 1.

"Revised Article 9" means the UCC Article 9 brought about by, *inter alia,* the deposit account amendments, as promulgated by the NCCUSL and ALI, and enacted across the United States of America, and as the context requires, as amended since. Revised Article 9 is commonly referred to throughout as "Article 9".

"Scenario 1" means the scenario, described in Chapter 3, involving C, D and Bank.

"Scenario 2" means the scenario, described in Chapter 3, involving E, F and Bank.

"Scenario 3" means the scenario, described in Chapter 3, involving G, H and Bank.

"Scenario 4" means the scenario, described in Chapter 3, involving J, K and Bank.

"Scenario I" means the scenario, described in the Appendix, involving A, C and Bank.

"Scenario II" means the scenario, described in the Appendix, involving A, C and Bank.

"Scenario III" means the scenario, described in the Appendix, involving A, C and Bank.

"Scenario IV" means the scenario, described in the Appendix, involving A, C, D and Bank.

"Scenario V" means the scenario, described in the Appendix, involving A, C, D and Bank.

"Scenario VI" means the scenario, described in the Appendix, involving A, C, D and Bank.

"Scenario VII" means the scenario, described in the Appendix, involving A, B, C.

"Scenario VIII" means the scenario, described in the Appendix, involving A, B, C.

"securities account credit balance" is an interest bearing or non-interest bearing credit balance held in a securities account as a form of investment property, payable by a securities intermediary to its customer on demand.

"STA" means the *Securities Transfer Act*, S.A. 2006, c. S-4.5.

"UCC" means the Uniform Commercial Code of the United States of America.

"UNCITRAL" means the United Nations Commission on International Trade.

"uniform equitable set-off theory" means the analytical approach governing deposit account set-off, described in Chapter 3 and enunciated by Cuming.

Book I ~ Introduction

PROLOGUE

Since the inception of personal property security legislation in Canadian common law jurisdictions, beginning in the 1970s, registration has been the operative paradigm for deposit accounts as items of personal property security. Under the *Personal Property Security Act* ("PPSA"), registration serves (i) an effectuation function, as a simple and efficient method of perfecting a security interest, (ii) a due diligence function, facilitating the discovery of competing interests by searching third parties, and (iii) an evidential function, setting out a fair and objectively determinable standard upon which priority disputes are resolved. Despite the *registration* paradigm's virtues, a push for adoption of a *control* paradigm – a statutory system which makes "control" an available method of perfection and the primary determinant of priority – in the PPSA deposit account arena has been underway for some time. The pressure, applied by the financial industry, intensified in the wake of the 2009 Supreme Court of Canada decision *Caisse populaire Desjardins de l'Est de Drummond v. Canada*.

CHAPTER 1 ~ RESEARCH PROJECT

I. TOPIC

A. DEPOSIT ACCOUNT & CASH COLLATERAL

The "deposit account" – commonly referred to as a "bank account"[1] – plays a central role in the lives of many Canadians. Deposit accounts are variously used for depositing and withdrawing funds, paying invoices and expenses, and otherwise receiving and storing revenues, commissions, salaries and other sources of payment. Indeed, the deposit account performs an important "reservoir function"[2] for individuals and artificial entities alike. The deposit account is the "lifeblood of commerce,"[3] constituting a ubiquitous medium through which commerce is effectuated and sustained.

In addition to storing wealth and facilitating payments, the deposit account can be used as security for a loan or other financial transaction. In Canada, secured transactions involving deposit accounts as collateral are commonplace.[4] My thesis explores this thin, yet important, slice of the law of secured transactions. The focus is on those commercial transactions in which a customer of a depository institution

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[1] "Deposit account" is the preferred term in academic writing, so it will generally be used throughout.
[2] Clayton Bangsund, "The Deposit Account & Chose in Action at Common Law & Under the PPSA: A Historical Review" (2014) 30(1) B.F.L.R. 1 ("*Historical Review*") at 37.
[3] Bruce A. Markell, "From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9" (1999) 74 Chi.-Kent L. Rev. 963 at 968.
[4] Jacob S. Ziegel, "Canadian Perspectives on the Law Lords' Rejection of the Objection to Chargebacks" (1998-1999) 14 B.F.L.R. 131 at 141-42.

(generically referred to as a "bank"[5]) grants, to a third party or to the bank itself, an interest in the customer's deposit account to secure payment or performance of an obligation; in other words, posts collateral in the form of a bank account. The colloquial term "cash collateral"[6] is instructive. It reflects the highly liquid nature of the deposit account. It is precisely this liquidity which makes the deposit account an appealing,[7] yet simultaneously illusive,[8] form of personal property security for banks and other commercial lenders.

B. REGISTRATION V. CONTROL

My thesis pits two paradigms against each other in an evaluative exercise: the *registration* paradigm in effect in common law Canada under the *Personal*

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[5] In Canadian commercial academic writing, the term "bank" is often restricted to mean "a chartered bank under the *Bank Act*, S.C. 1991, c. 46" because the technical restrictive meaning avoids confusion. However, in this thesis, for ease of reference, the term "bank" is frequently used in the more colloquial sense of "depository institution" or "deposit-taking institution", whether a (i) chartered bank under the *Bank Act*, (ii) credit union, (iii) *caisse populaire*, (iv) etc. Use of the term "bank", in this more general sense, does no violence in the context of this thesis.

[6] As a financial industry colloquialism, "cash collateral" is a reference to the posting of collateral in the form of a deposit account. I tend to avoid using the term because it misleadingly suggests that cash, which has a tangible existence (as opposed to a deposit account, which does not), is involved in the transaction. Still, there are times when the term "cash collateral" fits nicely into the structure of a sentence, so on occasion I succumb to temptation and use it, but only where appropriate. See Benjamin Geva, "Security Interests in Bank Deposits Under UCC article 9: A Perspective" (2013) Universidad Nacional Autónoma de México, Instituto de Investigaciones Juridicas 31 at 32: "Funds deposited to secure an obligation are known to constitute 'cash collateral.' The latter term is a misnomer; the 'deposit' is a debt owed by the depositary, whether or not it is a bank. It neither consists of 'cash', in the sense of coins and banknotes, nor is the 'cash' truly segregated."

[7] See Dwight L. Greene, "Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection – The Common Law is Alive and Well" (1989-1990) 39(2) Drake L. Rev. 259 at 261, n. 2: "... deposit accounts should be even more valuable as collateral than inventory and accounts. Both of these frequently-relied-upon assets derive their value largely from the ease with which they can be converted into cash or its equivalent. A deposit account is already a cash equivalent."

[8] See Ingrid M. Hillinger, David L. Batty & Richard K. Brown, "Deposit Accounts Under the New World Order" (2002) 6 N.C. Banking Inst. 1 at 54.

Property Security Act[9] ("PPSA"), versus several variations of the *control* paradigm in effect in the United States (under Article 9 of the Uniform Commercial Code ("UCC")) and Australia (under the *Personal Property Securities Act*[10] ("AUSPPSA")), and proposed for adoption in Ontario by the Personal Property Security Law Subcommittee of the Ontario Bar Association ("OBA PPSL Subcommittee").[11] Technical details of this exercise are furnished later in this chapter. For now, I aim to orient the reader to the issue at hand by recounting the recent history of the deposit account control initiative in Canada.

C. Recent History of the Deposit Account Control Initiative

I begin[12] this account with a brief summary of the Supreme Court of Canada decision in *Caisse populaire Desjardins de l'Est de Drummond v. Canada*.[13] Originating

[9] "PPSA" means, and is a generic reference to, the Canadian PPSA. Citations for the PPSA are as follows: *Personal Property Security Act*, R.S.A. 2000, c. P-7 (Alberta, "APPSA"); R.S.B.C. 1996, c. 359 (British Columbia, "BCPPSA"); C.C.S.M. c. P35 (Manitoba, "MPPSA"); S.N.B. 1993, c. P-7.1 (New Brunswick, "NBPPSA"); S.N.L. 1998, c. P-7.1 (Newfoundland, "NFPPSA"); S.N.W.T. 1994, c. 8 (Northwest Territories, "NWTPPSA"); S.N.S. 1995-96, c. 13 (Nova Scotia, "NSPPSA"); S.N.W.T. 1994, c. 8 (Nunavut, "NPPSA"); R.S.O. 1990, c. P.10 (Ontario, "OPPSA"); R.S.P.E.I. 1988, c. P-3.1 (Prince Edward Island, "PEIPPSA"); S.S. 1993, c. P-6.2 (Saskatchewan, "SPPSA"); R.S.Y. 2002, c. 169 (Yukon, "YPPSA"). Unless otherwise specified in this thesis, the APPSA serves as a proxy for the PPSA. In other words, all statutory references to the PPSA are to the provisions of the APPSA, unless otherwise specified.

[10] Act. No. 130 of 2009 ("AUSPPSA").

[11] See Ontario Bar Association, Personal Property Security Law Subcommittee, *Perfecting Security Interests in Cash Collateral* (February 6, 2012) ("*OBA Proposal*"), online: <http://www.oba.org/Advocacy/Submissions>. The "OBAPPSA" is the personal property security regime that would be brought about by the adoption of the *OBA Proposal*.

[12] The push for control was already on before the *Drummond* decision was released. In June 2009, International Swaps and Derivatives Association Inc. ("ISDA") delivered a letter to provincial government officials in both Ontario and Alberta urging the adoption of a control paradigm for deposit accounts. See, for example, Letter from Francois Bourassa (ISDA) to Allen Doppelt (Ontario Government) and Doug Morrison (Alberta Government) (June 8, 2009) ("*2009 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.

[13] [2009] 2 S.C.R. 94 ("*Drummond*").

in Quebec, the dispute in *Drummond* concerned a term deposit maintained at a bank (a *caisse populaire*, the functional equivalent of a credit union) by Camvrac. The priority competition was between the bank and a federal Crown tax agency asserting a deemed trust in respect of unremitted source deductions owed by Camvrac. The federal Crown tax agency prevailed in a majority decision penned by Rothstein J. (Deschamps and LeBel JJ. dissenting). The outcome hinged on Justice Rothstein's conclusion that, pursuant to the relevant transaction documentation between the bank and Camvrac, a "security interest" – as that term is defined in the *Income Tax Act*[14] – in the term deposit had been created in favour of the bank. Accordingly, since the bank had a security interest in the term deposit, the term deposit fell subject to the Crown tax agency's trust-based claim under federal legislation, the *Income Tax Act*[15] and *Employment Insurance Act*.[16]

In *Drummond's* aftermath, the financial industry, troubled by the decision's PPSA implications,[17] reasserted its demands for Canadian provinces and territories to (i) abandon the PPSA's registration paradigm for deposit account perfection and priority ordering in secured transactions, and (ii) adopt a control paradigm in its stead.[18] The financial industry's demands are backed by the threat that, if Canadian

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[14] R.S.C. 1985, c. 1 (5th Supp.), s. 224(1.3).
[15] *Income Tax Act,* s. 227(4.1).
[16] *Employment Insurance Act*, S.C. 1996, c. 23, s. 86(2.1).
[17] See, for example, Margaret Grottenthaler, "Supreme Court of Canada Decision reveals risk of characterization of cash collateral arrangements as creating security interests", Structured Finance Update (September 24, 2009), online: <http://www.stikeman.com/cps/rde/xchg/se-en/hs.xsl/13044.htm>; Ian J. Binnie, "Comment on *Caisse populaire Desjardins de l'Est de Drummond v. Canada*" (2011) 26 B.F.L.R. 327.
[18] Letter from Francois Bourassa (ISDA) to Allen Doppelt (Ontario Government) and Doug Morrison (Alberta Government) (April 13, 2010) ("*2010 ISDA Letter*"), online: ISDA

jurisdictions do not adopt the control paradigm, major financial industry players will move their derivatives business to friendlier jurisdictions like New York or Illinois.[19] Of Canada's common law jurisdictions, the financial industry initially focused its lobbying efforts in the provinces of Ontario and Alberta,[20] but has since expanded its efforts to other jurisdictions.[21]

In Ontario, the Business Law Section of the Ontario Bar Association tasked the OBA PPSL Subcommittee with considering the merits and demerits of the PPSA reform sought by the financial industry. The OBA PPSL Subcommittee investigated the matter and submitted its final report to Ontario's Ministry of Consumer Services and Ministry of Finance in February 2012, recommending adoption of a control

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<http://www2.isda.org/regions/canada/>; also see Robert M. Scavone, "Cash Collateral Under the PPSA: The Case for Control" (2012) 53 Can. Bus. L.J. 263; see, more recently, Margaret Grottenthaler, "Cash collateral amendments for Ontario recommended by expert panel", Canadian Structured Finance Law (August 4, 2015), online: <www.canadianstructuredfinancelaw.com>.

[19] Bourassa, *2010 ISDA Letter*, *ibid.* at 2 and 4; Letter from Canadian Market Infrastructure Committee (CMIA) to Alberta Securities Commission, Autorite des marches financiers, British Columbia Securities Commission, Financial and Consumer Services Commission (New Brunswick), Financial and Consumer Affairs Authority of Saskatchewan, Manitoba Securities Commission, Nova Scotia Securities Commission, Nunavut Securities Commission, Ontario Securities Commission, Office of the Superintendent of Securities, Newfoundland and Labrador, Office of the Superintendent of Securities (Northwest Territories), Office of the Yukon Superintendent of Securities, Superintendent of Securities, Department of Justice and Public Safety (Prince Edward Island) (collectively, the "Securities and Financial Commissions") (May 13, 2015) ("*2015 CMIA Letter*") at 5.

[20] See note 18; Letter from Katherine Darras (ISDA) to Robin Edger (Ontario Government) (May 7, 2012) ("*2012 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.

[21] See, for example, the *2015 CMIA Letter*, *supra* note 19. The CMIA is an industry group. The following membership issued the *2015 CMIA Letter*: Bank of America Merrill Lynch, Bank of Montreal, Bank of Tokyo-Mitsubishi UFJ (Canada), Caisse de depot et placement du Quebec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Deutsche Bank A.G. (Canada Branch), Federation des Caisses Desjardins du Quebec, Healthcare of Ontario Pension Plan, HSBC Bank Canada, JPMorgan Chase Bank, N.A. (Toronto Branch), Manulife Financial Corporation, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers' Pension Plan Board, Public Sector Pension Investment Board, Royal Bank of Canada, Sun Life Financial, The Bank of Nova Scotia and the Toronto-Dominion Bank.

paradigm for "financial accounts."[22] The proposed OBAPPSA, outlined and detailed in a series of brief memos, is representative of a hybrid bank-directed control model since, under its edict, registration would remain an available albeit inferior method of perfecting a security interest and attaining some measure of priority status.

Initially, the Government of Ontario responded favourably to the OBA PPSL Subcommittee's proposal for adoption of a deposit account control paradigm. In 2013, it declared its intention to adopt a control paradigm.[23] Despite this declaration, however, reform efforts in Ontario stalled, ostensibly for political reasons.[24] The registration paradigm thus remains in effect in Ontario for the time being (as of March 2017). However, pressure continues to mount. In June 2015, an expert panel[25] called for adoption of a deposit account control paradigm in its report

[22] OBA PPSA Subcommittee, *OBA Proposal*, *supra* note 11.

[23] See Government of Ontario, *2013 Ontario Budget: A Prosperous and Fair Ontario* (Toronto: Queen's Printer for Ontario, 2013), online: <www.ontario.ca/budget> at 289.

[24] See Anthony Duggan, "Set-off, flawed assets and security interests in cash deposits" (April 2016) Butterworths Journal of International Banking and Financial Law 201 at 203; also see Jennifer Babe et al., *Business Law Agenda: Priority Findings & Recommendations Report* (June 2015) at 9: "The panel agreed that the PPSA should be amended to facilitate the use of cash collateral. The panel recognized that discussions among stakeholders, including pension experts, will assist in determining the best way to achieve this outcome." As suggested in the above quote, the delay appears to be due in part to political fallout – concerning Ontario pensioners – from the Supreme Court of Canada's decision in *Sun Indalex Finance LLC v. United Steelworkers*, 2013 SCC 6 ("*Indalex*"). For a concise account of the decision and its connection to the cash collateral debate, see Margaret Grottenthaler, "SCC Decision in Re Indalex not good news for cash collateral arrangements", Canadian Structured Finance Law (February 8, 2013), online: <www.canadianstructuredfinancelaw.com>.

[25] The membership of the expert panel is as follows: Jennifer Babe (Partner – Miller Thomson LLP), Terry Burgoyne (Partner, Osler – Hoskin & Harcourt LLP), Gordon Davies (General Counsel – OpenText Corporation), Doug Downey (Partner – Lewis, Downey, Tornosky, Lassaline & Timpano), Anthony Duggan (Professor – University of Toronto, Faculty of Law), Kenneth Fredeen (General Counsel – Deloitte LLP), Carol Hansell (Founder/Sr. Partner – Hansell LLP), Sheila Murray (General Counsel – CI Financial Corp.), Christopher Nicholls (Professor – Western University Law School), J.A. Prestage (Partner – Blake, Cassels & Graydon LLP), David Stevens (Partner – Gowlings, Lafleur Henderson LLP), Patrice Walch-Watson (Partner – Torys LLP) & Cynthia Williams (Professor –

to Ontario's Minister of Government and Consumer Services.[26] In the fall of 2016, the Business Law Advisory Council (composed of many of the same members as the expert panel), established by the Government of Ontario to review Ontario's corporate and commercial legislation, issued a further call for adoption of a control paradigm for deposit accounts.[27] Meanwhile, in Quebec, Canada's lone civil law jurisdiction, legislators have ceded to the financial industry's demands, recently adopting, under the *Civil Code of Quebec*, a control model not unlike that adopted by the United States of America under UCC Article 9. Quebec's control-based regime took effect on January 1, 2016.[28]

Despite continuing pressure,[29] no other Canadian provincial or territorial government, outside of Ontario and Quebec, has, to my knowledge, announced definitive plans to abandon the registration paradigm in favour of the control paradigm. Instead, while ruminations continue, these other jurisdictions seem

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Osgoode Hall Law School). The expert panel also consulted external experts including Professors Roderick J. Wood and Tamara M. Buckwold.

[26] Babe, Burgoyne, et al., *supra* note 24.

[27] Business Law Advisory Council, *Report to Minister of Government and Consumer Services* (Fall 2016) at 2, 9-11. The Business Law Advisory Council is comprised of three working groups: Commercial Law Working Group: Chairperson Jennifer Babe, Doug Downey, Patrick Shea, Rob Scavone; Entity Law Working Group: Chairperson Carol Hansell, Andy Chan, Jack Ground, Andrea Johnson, Sheila Murray, Arlene O'Neill; Franchise Working Group: Chairperson Peter Viitre, Patrick Shea. In preparing its report, the Business Law Advisory Council consulted with the following organizations: Canadian Bankers Association, Canadian Coalition of Good Governance, Canadian Finance and Leasing Association, Canadian Investor Relations Institute, Canadian Market Infrastructure Committee, C.D. Howe Institute, Institute of Corporate Directors, LawPRO, Ontario Chamber of Commerce, Ontario Securities Commission, PPSA Committee of the Ontario Bar Association, Standing Committee of the Ontario Bar Association, Toronto Opinions Group.

[28] Michel Deschamps, Mathieu Dubord & Mary Jeanne Phelan, "New Regime in Quebec for Security on Bank Deposits and Other Monetary Claims", McCarthy Tetrault (May 15, 2015), online: <www.mccarthy.ca>.

[29] See, for example, *2015 CMIA Letter*, *supra* note 19.

content to take a "wait-and-see" approach.[30] The future of Canadian personal property security law, as it pertains to deposit accounts, is at a critical crossroads. Which road will be taken? More importantly, which road *should* be taken?

II. TECHNICAL LANGUAGE

At this juncture, I must define several key technical terms that are used extensively throughout this chapter, and the thesis generally. As a preliminary matter, I assume that the reader has a basic understanding of personal property security law and is acquainted with common personal property security terms such as "attachment", "perfection" and "priority." It is also imperative that the reader understand three technical terms to which I have assigned special meaning: "regime", "model" and "paradigm."

I use the term "regime" in a broad generic sense; included, within its meaning, is a jurisdiction's existing (or proposed) integrated system of legislative rules and regulations governing security interests in deposits accounts, as affected by set-off principles and other principles of law and equity. In contrast, "model" is typically used as a characterization reference. Each deposit account regime under investigation falls under one of three general model-types: 1. Pure registration model; 2. Hybrid model; and 3. Pure control model. Finally, "paradigm," in respect of any given model or regime, refers to the *highest order* method of perfection

[30] See Letter from Professors Roderick J. Wood (University of Alberta) and Tamara M. Buckwold (University of Alberta) to Sandra Petersson (Alberta Law Reform Institute) (December 17, 2015), in which the professors propose a project that would subject various aspects of the PPSA to review including the perfection and priority rules for deposit accounts.

available[31] – the ideal method of perfection that optimally assures a secured party of priority to the deposit account balance.

To demonstrate usage of the above technical language, the PPSA (an existing regime) is a pure registration model with a registration paradigm, while UCC Article 9 (also an existing regime) is a pure bank-directed control model with a control paradigm. Meanwhile, both Australia's AUSPPSA (an existing regime) and the OBAPPSA (a proposed regime) are hybrid models with control paradigms, though each exhibits slightly different characteristics. While the proposed OBAPPSA is a hybrid *bank-directed* control model (meaning that the depository bank enjoys unfettered discretion regarding whether another secured party can perfect a security interest in the customer's deposit account by control), the AUSPPSA is a hybrid *bank-only* control model (meaning that only the depository bank may perfect a security interest in its customer's deposit account by control).

III. PRINCIPAL & DERIVATIVE QUESTIONS

I am interested in answering a number of questions as part of this research project. The principal question (answer(s) in italics[32]) can be posed as follows:

- To what extent, if at all, should Canadian common law jurisdictions amend the PPSA in a manner that permits or mandates a security interest

[31] See Randal C. Picker, "Perfection Hierarchies and Nontemporal Priority Rules" (1998-2000) 74 Chi.-Kent L. Rev. 1157 at 1158, where the author describes the notion of "perfection hierarchy."
[32] Abbreviated answers to the questions are set out in italics. The accompanying footnotes pinpoint the locations of the more detailed answers set out in the body of the thesis.

in a deposit account to be perfected by control? *Canadian common law jurisdictions should not amend the PPSA in such a manner.*[33]

In the process of answering this principal question, I also answer a series of derivative questions, and subquestions, that flow therefrom. These include:

- Should Canadian PPSA jurisdictions replace the registration paradigm with a control paradigm? *Canadian PPSA jurisdictions should not replace the registration paradigm with a control paradigm.*[34]
- If the control paradigm is adopted, which model-type is more desirable: a pure control model or a hybrid control model? *A hybrid control model is preferable to a pure control model.*[35]
- If a pure control model is desirable, to what extent should it be harmonized with UCC Article 9? *Given my conclusion that a pure control model is undesirable, this question is not answered.*
- If a hybrid control model is desirable, which is to be preferred: a hybrid bank-only control model such as Australia's AUSPPSA, or a hybrid bank-directed control model such as the OBAPPSA proposed by the OBA PPSL Subcommittee? *The AUSPPSA's hybrid bank-only control model is preferable to the OBAPPSA's hybrid bank-directed control model.*[36]

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[33] This question is answered, in detail, in Chapter 9 ~ Thesis.
[34] This question is answered in Chapter 9 ~ Thesis. There is a great deal of nuance in this question, part of which is addressed near the end of Chapter 8, namely, that a jurisdiction might adopt a hybrid control model without embracing a control paradigm.
[35] This derivative question is answered in Chapter 8 ~ Scrutiny.
[36] This derivative question is answered in Chapter 8 ~ Scrutiny.

- What characteristics are exhibited in an optimal system of integrated legislative rules and regulations governing security interests in deposit account balances that interact with set-off principles and other principles of law and equity? *A detailed answer to this question is furnished in Chapter 9 ~ Thesis.*[37]

IV. METHODOLOGY & THESIS OVERVIEW

BOOK I ~ INTRODUCTION

In Book I, comprised of the Prologue and this Chapter 1, I introduce the subject matter of the thesis and pose a central question. In subsequent chapters, I use a variety of research strategies and methodologies to answer this question and its derivatives. My research approach is mostly traditional in that it focuses on the specific language contained in various legislative provisions across numerous jurisdictions, deliberates on how those legislative provisions interact and apply in various factual settings, and reviews and critiques academic and judicial interpretations of and opinions on these subjects. In this Part IV of the chapter, I furnish details about my research strategies and methodologies, and describe how and when they are employed throughout. The reader is concomitantly furnished with a structural overview of the thesis.

BOOK II ~ PREPARATION

[37] This question is answered in Chapter 9 ~ Thesis.

The object of Book II – comprising Chapters 2 and 3 – is to prepare the reader for the technical analyses undertaken in Book III. Chapter 2 is a foundational chapter in a number of respects. The chapter begins by concisely describing the juridical and practical nature of the deposit account, an important preliminary task. Next, the chapter explores the philosophical underpinnings of personal property security law and establishes a standardized evaluative framework. Recognized within the personal property security law literature are a series of *values* (the "PPSL values"[38]) that, taken together, inform the design of a legal framework aimed generally at the promotion of commercial development.[39] In Chapter 2, I examine these PPSL values and derive from them a series of evaluative criteria against which the regimes, model-types and paradigms are measured.[40] The evaluative criteria are tailored to the specific context of deposit account perfection and priority ordering.

The evaluative criteria developed in Chapter 2 are valuable in two distinct but related ways. First, they assist in identifying which personal property security regimes and model-types contain attributes (i.e. frameworks, directives and

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[38] See Clayton Bangsund, "PPSL Values" (2015) 57(2) Can. Bus. L.J. 184.

[39] Roderick J. Wood, "Circular Priorities in Secured Transactions Law" (2010) 47 Alta. L. Rev. 823 ("*Circular Priorities*") at 825: "In Part V, I will provide an assessment of these approaches by identifying a set of criteria that promote the general values and goals of commercial law."; Ewan McKendrick, ed., *Goode on Commercial Law*, 4th ed. (London: Penguin Books, 2010) at 1347: "This, then, is the essence of commercial law – the accommodation of rules, usages and documents fashioned by the world of business; the facilitation, rather than the obstruction, of legitimate commercial development."

[40] See Law Commission of Canada, *Modernizing Canada's Secured Transactions Law: The Bank Act Security Provisions* (Ottawa: Law Commission of Canada, 2004), where the Law Commission adopts a similar approach when examining potential solutions that would address the incompatibilities between PPSA security and s. 427 *Bank Act* security; Also see R. Wood, *Circular Priorities*, *ibid.* at 845, where the author identifies five criteria for use in evaluating the various circularity resolution approaches: 1. Simplicity; 2. Predictability; 3. Universality; 4. Incentive effect; and 5. Congruence with commercial expectations.

features pertaining to deposit accounts) most consonant with the PPSL values. Second, the evaluative criteria are used in conjunction with standardized fact patterns to assess outcomes and the legal mechanics that produce those outcomes; this idea is elucidated below in my description of Book III. Before turning to that exercise, however, I must outline the balance of the preparatory work undertaken in Book II.

Chapter 3 introduces the basic principles of set-off – legal, equitable and contractual – and explores and articulates the principles that govern when a deposit account balance is claimed by an assignee asserting a proprietary right under the PPSA, on one hand, and by the depository bank asserting a right of deposit account set-off, on the other. This task directly assists in analyzing and assessing the various regimes and paradigms in Book III. Since set-off principles, and account debtor rights generally, affect priority outcomes, they must be considered in any analysis of the statutory models and regimes that produce such outcomes.

BOOK III ~ EXAMINATION

Book II's preparatory tasks having been completed, examination begins in Book III, comprising Chapters 4 through 8. In these chapters, I subject control, as a paradigm for perfection and priority ordering of security interests in deposit accounts, to a critical examination with reference to the five evaluative criteria developed in Chapter 2. Since registration – the current *status quo* in Canadian common law jurisdictions – is control's logical counterpoint, it too is subjected to scrutiny with reference to the evaluative criteria.[41] Indeed, each of the impugned regimes – Article 9, the PPSA, AUSPPSA and OBAPPSA, representing a unique blend of paradigm and model-type – receives standardized scrutiny. The comparative performances of the various regimes and model-types, measured with reference to the evaluative criteria, help guide my conclusions.[42]

Chapter 4 opens Book III with a concise general description, including a brief historical developmental account, of the treatment afforded to the deposit account as an item of personal property security under each of the regimes being investigated. Chapter 5 then develops three standardized fact patterns – Patterns β (*beta*), Ω (*omega*) and Ψ (*psi*) – each describing a distinct series of events that might realistically unfold in connection with a commercial debtor's borrowing arrangements. The standardized fact patterns all involve debtor default and a resulting priority dispute over the debtor's deposit account balance or the proceeds thereof. They are used as tools in evaluating the personal property security regimes, furnishing illustrative assistance as I identify which regimes (and model-types and paradigms) best adhere to the evaluative criteria and the PPSL values underlying them.

[41] Ironically, registration will act as a "control" in the technical analytical sense described by Robert Nozick, *The Nature of Rationality* (Princeton: Princeton University Press, 1993) at 183, n. 5: "I have not checked to see what empirical studies of people's decisions exist to support this *empirical* claim by the legal theorists (i.e. the claim that *stare decisis* enables people to accurately predict consequences and therefore plan their actions with confidence in future outcomes), what alternative legal structure functioned as the control, and so on." (underlined portion added)

[42] For examples of this methodology at play, see, for example, Michele Garziadei, Ugo Mattei & Lionel Smith, *Commercial Trusts in European Private Law* (Cambridge Books Online, 2013); Roderick J. Wood, "Acquisition Financing of Inventory: Explaining the Diversity" (2014) 13(1) O.U.C.L.J. 49 ("*Acquisition Financing*"); Clayton Bangsund, "'But I Didn't Mean To': The Role of Intent in U.S. and Canadian Anti-Preference Law" (2013) 50(4) Alta. L. Rev. 815.

In each standardized fact pattern, a different set of players is introduced in an effort to capture a wide array of potential conflicts arising in various unique contexts, involving an assortment of claimants. In Pattern β, the depository bank, with which the subject deposit account is maintained, is pitted against a purchase money inventory supplier in pursuit of the proceeds of its original collateral. In Pattern Ω, a non-depository accounts financer competes with a purchase money inventory supplier proceeds claimant. Meanwhile, in Pattern Ψ, a debtor's general lender (a bank itself) clashes with the depository bank (and financial derivatives counterparty of the debtor) over the debtor's deposit account balance.

It is worth observing, at this stage, that all comparative analytical evaluations are conducted with reference to the evaluative criteria, but not all evaluations draw upon the standardized fact patterns. Identifying similarities and differences in the features of the various regimes (i.e., wording, phrasing and structuring of the legislative provisions) does not always require the illustrative assistance of a standardized fact pattern. Nonetheless, the standardized fact patterns are commonly employed, and in Chapter 6, the various regimes under investigation are subjected to each of Patterns β, Ω and Ψ. The application of the various regimes' directives to the standardized fact patterns may (or may not) produce varying outcomes respecting which party, in any particular pattern, has priority to (or in some cases, a *superior right to*[43]) the disputed deposit account balance.[44] In such an

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[43] This distinction relates to the technical conceptualization of set-off as a "non-proprietary" right. See Ronald C.C. Cuming, "Security Interests in Accounts and the Right of Set-Off" (1991) 6 B.F.L.R. 299 at 301, n. 4, where the author notes this subtle distinction: "In this article, the term 'priority' is used

instance, the evaluative criteria may assist in identifying which outcome is more desirable or commercially reasonable. Because the evaluative criteria are derived from the PPSL values, an outcome inconsistent with, or unfulfilling, the evaluative criteria (or any of them) is undesirable.

In some instances, two regimes subjected to the same fact pattern may produce identical outcomes, but for different reasons. Here the standardized fact patterns help highlight key differences in the regimes' rules, procedures, analytical structures or general features. For example, a standardized fact pattern may simply aid in demonstrating how the specific procedural steps a particular creditor must take to ensure itself of priority to the collateral under one regime differ from the procedural steps mandated under another regime.

In Chapter 7, the various regimes, model-types and paradigms are comparatively evaluated with reference to the evaluative criteria.[45] The results of the comparative analytical evaluations are recorded, numerically, on a cumulative adherence table.

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to refer to 'a prior right' to the money. It is not used to indicate a ranking of two proprietary interests in the money."

[44] See Garziadei, Mattei & Smith, *supra* note 42 at 33-34, where this methodology is described by the authors as part of what they refer to as the "common core methodology" (i.e. the common core of the substantive and procedural law of trusts (using the term "trusts" loosely) in various common law and civil law jurisdictions): "The method adopted to treat our subject is thus new in its application to trusts. The contributions collected in the second part of this volume focus on fact situations as a starting point for comparative enquiry. The factual patterns featuring as cases in this book were designed to bring on stage the various legal techniques employed across Europe in our field of study, as well as to obtain answers about the probable outcomes of the cases in each national jurisdiction."

[45] For a similar approach, see World Bank Group, *Doing Business 2015: Going Beyond Efficiency* (Washington: International Bank for Reconstruction and Development, 2014), online: <http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB15-Chapters/DB15-Report-Overview.pdf>.

TABLE 1.1 **SPECIMEN CUMULATIVE ADHERENCE TABLE**						
Evaluative Criteria → **Regimes**	**Criterion A** *Creation & Perfection*	**Criterion B** *Risk Assessment*	**Criterion C** *Dispute Resolution*	**Criterion D** *Competitive Market*	**Criterion E** *Proceeds*	**Cumulative Adherence Score** **/5**
Hypothetical Regime	*0.750*	*0.750*	*0.500*	*0.750*	*0.250*	*3.000*
Article 9 *Control ~ Pure*						
PPSA *Registration ~ Pure*						
AUSPPSA *Control ~ Hybrid*						
OBAPPSA *Control ~ Hybrid*						
Performance Legend ~ Adherence Grade 0.000 = No adherence 0.250 = Weak adherence 0.500 = Average adherence 0.750 = Strong adherence 1.000 = Optimal adherence						

This tabulation technique aids in synthesizing data, identifying patterns, making comparisons, conducting aggregate assessments, drawing conclusions, and developing recommendations.[46] Variable weighting of the evaluative criteria is explored as I attempt to calibrate the aggregate assessment of the regimes. Variable

[46] See, for example, World Bank Group, *ibid.* at vi; Edward S. Herman and Noam Chomsky, *Manufacturing Consent: The Political Economy of the Mass Media* (London: Vintage Books, 1994) at 91-106 (Part 3.2, Basic Electoral Conditions in El Salvador, Guatemala, and Nicaragua, 1982-85), where the authors evaluate, with reference to five criteria, the "freeness" of elections held in El Salvador, Guatemala and Nicaragua during the 1980s. Although the authors did not adopt a strict tallying method, they did aggregate performance criteria in aid of their conclusion that Nicaragua's election was "freer" than either of El Salvador's or Guatemala's. See 106: "…our overall finding is that neither El Salvador nor Guatemala met *any* of the five basic conditions of a free election, whereas Nicaragua met some of them well, others to a lesser extent."

cumulative adherence tables are produced to reveal how conclusions might differ based on one's philosophical orientation and corresponding acceptance and/or rejection of a series of "amplification" and "deamplification" arguments.[47] The regimes are evaluated according to various philosophies, and an enhanced version of the PPSA is pondered as I formulate my answer to the central question. Finally, I identify and describe the regime and model-type that, in my view, best adheres to the evaluative criteria and the PPSL values underlying them. In the Appendix, I offer my suggestions for PPSA reform.

It is important to note, at this early stage, that while I do rely on the cumulative adherence tables and, to a certain extent, the cumulative adherence scores they produce and record, the tables and scores are first and foremost a means of managing information and collating data. In this regard, they are very useful tools. They are not, however, hard forms of empirical measurement, nor do I purport them to be. For instance, I do not place great significance on minor numerical differences in the regimes' cumulative adherence scores. I am not engaging in a scientific exercise, but rather more of a gestalt. The cumulative adherence score earned by each regime gives one, at best, a general sense of the regime's overall adherence to the evaluative criteria and the PPSL values underlying

[47] Robin J. Schwill, "Policy Choices in Insolvency: A Decision Framework" IIC-ART Vol. 2-2: "A basic decision matrix consists of establishing a set of criteria options which are scored and summed to gain a total score which can then be ranked. Taking this one step further would involve assigning weights to the criteria in order of their relative importance: the more important the criteria, the higher the weighting. One advantage of the decision matrix is that subjective opinions about alternatives are forced to become more objective (and potentially subject to evidence gathering). Another advantage is that sensitivity analysis can be performed to determine how much relative weighting and scoring would have to change in order to come up with an alternative option ranking as the highest."

them, along with a sense of that regime's relative adherence in comparison with the other regimes. In this spirit, the variable weighting exercises described in the last paragraph are designed to emphasize the strengths and weaknesses of the various regimes under investigation.

Even if my tally method can be criticized, on mathematical grounds, this does not diminish the value or importance of my discussion and analysis. At the very least, my approach, of amplifying and deamplifying various evaluative criteria and pondering the relative overall effect in terms of comparative evaluation, furnishes a logical and coherent framework for comprehensible discussion of a complex and multi-faceted subject. In short, my arguments are reinforced by the numerical grades but not exclusively derived from them. In Chapter 7, the cumulative adherence tables, and the cumulative adherence scores they produce and record, furnish an organizational structure within which my analysis and discussion unfolds.

With the initial evaluation complete in Chapter 7, Chapter 8 interrogates the case for control, again falling back on the PPSL values for foundational support. Specifically, I critically examine the principal arguments that have been advanced in favour of adoption of the control paradigm and a bank-directed control model like Article 9 or the OBAPPSA. I close the chapter by identifying, having regard for the PPSL values, which of the various control models I think is most deserving of consideration by Canadian provinces and territories intent on moving away from the registration paradigm.

BOOK IV ~ CONCLUSION

Book IV is comprised of Chapter 9 alone, in which I present my answer to the central question of whether Canadian PPSA jurisdictions ought to amend the PPSA in a manner that permits or mandates a security interest in a deposit account to be perfected by control, thereby replacing the registration paradigm for deposit account perfection and priority ordering with a control paradigm.

V. ASSUMPTIONS & LIMITATIONS

My research project is premised on a number of foundational assumptions that are articulated and justified, in Chapters 2 and 3, as they become relevant. I have limited my detailed substantive statutory reviews to four distinctive regimes: Article 9, PPSA, AUSPPSA and OBAPPSA. Each of these regimes – whether existing or proposed – emanates from a common law jurisdiction which enacts English language statutes. I chose these regimes because they exhibit distinctive characteristics, yet are very closely linked in terms of lineage and statutory object.

My common law statutory review, however, is by no means exhaustive. For instance, I do not furnish a separate and independent review of New Zealand's *Personal Property Securities Act 1999* ("NZPPSA"). This is because the NZPPSA is essentially a replica of Saskatchewan's SPPSA, which itself closely resembles Alberta's APPSA (my chosen proxy statute for Canada's PPSA in this thesis). Due to the NZPPSA's general concordance with the PPSA, a separate review of the NZPPSA would have been of limited value. Nonetheless, details of its concordance are furnished in the footnotes throughout Chapter 4 ~ Description.

To recap, the regimes under investigation capture a variety of distinctive common law statutory systems that govern deposit account perfection and priority ordering. For reasons of political history and/or geographic proximity, these regimes have the real potential to materially influence the ongoing development and reform of personal property security legislation in Canada.

VI. CONCLUSION

As noted above, the colloquial term "cash collateral" is instructive. It reflects the highly liquid nature of the deposit account. It is precisely this liquidity which makes the deposit account an appealing, yet simultaneously illusive, form of personal property security for banks and other commercial lenders, thus underscoring the importance of furnishing a "carefully thought-out legal framework"[48] for the governance of deposit accounts as items of commerce and personal property security. Any proposal for PPSA reform in respect of deposit accounts ought to be grounded in sound policy, and vetted thoroughly. In the ensuing chapters, I take up this important task as I explore and interrogate the

[48] The phrase "carefully thought-out legal framework" is borrowed from Friedrich A. Hayek, *The Road to Serfdom* (London: The Institute of Economic Affairs, 2005) at 45: "The liberal argument does not advocate leaving things just as they are; it favours making the best possible use of the forces of competition as a means of coordinating human efforts. It is based on the conviction that, where effective competition can be created, it is a better way of guiding individual efforts than any other. It emphasizes that in order to make competition work beneficially a carefully thought-out legal framework is required, and that neither the past nor the existing legal rules are free from grave defects."

control paradigm – and its logical counterpoint, the registration paradigm – in the context of deposit account perfection and priority ordering. My thesis contributes to the literature on this important and timely subject through its detailed comparative accounts of the various distinctive deposit account regimes and model-types, and its assessment of those regimes and model-types in accordance with traditional values of personal property security law.

BOOK II ~ PREPARATION

CHAPTER 2 ~ FOUNDATION

I. CHAPTER OVERVIEW

In this chapter, a variety of foundational tasks are attended to. In Part II, I furnish a concise description of the juridical nature of the deposit account. Part III identifies and expounds upon two assumptions that underlie the research project; an abbreviated account of the institution of secured credit is furnished in an effort to demonstrate that my foundational assumptions are not unwarranted. In Part IV, my evaluative framework is developed; I identify and discuss the *values* of personal property security law, and derive from these values *evaluative criteria* (*cum* principles) that assist in examining the control and registration paradigms (and the various model-types and regimes) in later chapters. The control and registration paradigms are measured and compared pursuant to these standard evaluative criteria.

II. JURIDICAL NATURE OF THE DEPOSIT ACCOUNT

At this early stage, it is worthwhile considering the juridical nature of the deposit account. Despite the prevalence of its existence and use, the deposit account is a widely misunderstood item of personal property. In legal terms,[1] the deposit

[1] Originating in Antiquity, the deposit account predates English common law. See Benjamin Geva, *The Payment Order of Antiquity and the Middle Ages: A Legal History* (Oxford: Hart Publishing, 2011) ("*Payment Order of Antiquity*") at 115. For a detailed review of the deposit account, see Clayton Bangsund, "The Deposit Account & Chose in Action at Common Law & Under the PPSA: A Historical Review" (2014) 30(1) B.F.L.R. 1 ("*Historical Review*") at 29.

account is best understood as a loan from the depositor to the bank[2] – a "legal chose in action."[3] The average individual might find this surprising. Intuitively, such individual might not regard himself as the bank's creditor, but instead have some vague notion that, in a deposit account, he "owns" funds in the bank's safekeeping. This lay conceptualization, while perhaps appealing, is problematic. After all, particular funds deposited into a bank account are not specifically set aside for the depositor's exclusive re-access.[4] Rather, they become property of the bank, and may be used to make additional loans to the bank's other customers. A depositor has a right to demand funds representing some or all of his account balance, and to sue the bank if it fails to meet his demand.[5] In short, the deposit account is a form of intangible property, representing a simple right to payment on demand.

III. PERSONAL PROPERTY SECURITY FOUNDATIONS

A. FOUNDATIONAL PREMISES

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[2] *Foley v. Hill* (1848) 9 E.R. 1002 (H.L.) at 1005: "The money paid into the banker's, is money known by the principal to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself, paying back only the principal, according to the custom of bankers in some places, or the principal and a small rate of interest, according to the custom of bankers in other places. The money placed in the custody of the banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous speculation; he is not bound to keep it or deal with it as the property of his principal, but he is of course answerable for the amount, because he has contracted, having received that money, to repay to the principal, when demanded, a sum equivalent to that paid into his hands."; Also see, generally, *Joachimson v. Swiss Bank Corp.*, [1921] 3 K.B. 110 (C.A.).

[3] *Re A.G. Ontario and Royal Bank*, [1970] 2 O.R. 467 (C.A.) at para. 6.

[4] See Geva, *Payment Order of Antiquity, supra* note 1 at 597.

[5] M.H. Ogilvie, *Bank and Customer Law in Canada* (Toronto: Irwin Law, 2007) at 227; James Penner, *The Idea of Property in Law* (London: Oxford University Press, 2000) at 129.

As articulated by the United Nations Commission on International Trade Law, "[t]he fundamental justification for secured transactions law lies in the premise that the total net wealth of an economy will increase if more secured credit is available as a complement to unsecured credit."[6] The statement presupposes that credit availability advances our societal quest for optimal social welfare.[7] It further presupposes that secured credit, as an institution, offers something distinguishable from unsecured credit; something worthwhile. Both presuppositions require at least cursory examination.

1. CREDIT

Scarcity drives the demand for credit. The commercial reality is that businesses commonly experience resource scarcity including, without limitation, monetary scarcity.[8] The stark necessity of credit, as an institution promoting the survival of commercial enterprise (and by extension, presumably, the general citizenry), is thus established.[9] In a world of resource scarcity and monetary credit

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[6] United Nations Commission on International Trade Law (UNCITRAL), *UNCITRAL Legislative Guide on Secured Transactions* (New York: United Nations, 2010) at Intro para. 46.

[7] Lynn M. LoPucki, "The Unsecured Creditor's Bargain" (1994) 80 Va. L. Rev. 1887 at 1947: "For several decades, scholars have treated expanded credit as patently desirable and security as the preferred mechanism for expanding it."

[8] See UNCITRAL, *supra* note 6 at Intro para. 46; Steven H. Harris and Charles W. Mooney, Jr., *Security Interests in Personal Property: Cases, Problems and Materials,* 4th ed. (New York: Foundation Press, 2006) ("*SIPP*") at 1, 71. Businesses commonly opt for credit even when possessed of sufficient cash (i.e. liquid resources) to satisfy their outstanding debt obligations and contemplated asset acquisitions. They do so when their calculus predicts that they will be better off, on a net basis, (i) borrowing money and paying the agreed rate of interest, and (ii) allocating available liquid assets to higher yielding investments.

[9] But we should always be mindful of the possibility, however slight, that our entire credit/monetary system is flawed and in need of reform or a total revamp. See John Stuart Mill, *On Liberty* (New York:

demand, society collectively benefits when producers, manufacturers, distributors, retailers and other commercial players are able to "bridge the gap" between their front-end expenditures and back-end revenues with affordable credit.[10]

2. Secured Credit

What of the second presupposition? Does *secured credit*, as an alternative or complement to unsecured credit, confer net social benefits? For instance, does security make credit more plentiful, or more affordable, for debtors? If so, how? These remain burning questions – presently smouldering, perhaps – for which I offer no definitive answers. For the purposes of this thesis, I must proceed on the assumption that secured credit is a worthwhile institution; one worth preserving. I therefore proceed on the assumption that secured credit serves a useful societal purpose; that the PPSA ought to facilitate secured transactions under which debtors grant, and secured creditors acquire, proprietary interests in debtors' personal property.[11] Next I furnish (a) a basic account of the conventional explanation for secured credit,[12] and (b) a synopsis of the academic discourse pertaining to the

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Barnes & Noble, 2007) at 24: "The beliefs which we have most warrant for, have no safeguard to rest on, but a standing invitation to the whole world to prove them unfounded."

[10] Homer Kripke, "Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact" (1985) 133 U. Pa. L. Rev. 929 at 941-942.

[11] See, for example, Steven L. Harris and Charles W. Mooney, Jr., "A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously" (1994) 80 Va. L. Rev. 2021 ("*Property Based Theory*") at 2021: "In embarking upon the revision of what many consider the most successful commercial statute ever, we take as our 'first principle' that Uniform Commercial Code Article 9 should facilitate the creation of security interests."

[12] Such an account, of course, is necessarily built upon the more basic assumption, earlier articulated, respecting credit availability.

occurrence, utility,[13] and indeed, legitimacy, of secured credit as a state-sanctioned social institution.

Recall the basic underlying notion, stated above, that society collectively benefits when commercial enterprise is better able to bridge the gap between its front-end expenditures and back-end revenues with affordable credit.[14] Secured credit, as an institution, supposedly advances the cause of affordable credit.[15] Here is how. Imagine that a debtor ("D") wishes to borrow money from a creditor ("C"). In comparison with lending on unsecured terms, acquiring a security interest in D's personal property (the "collateral") diminishes C's risk of investment loss by enabling C to look directly[16] to the collateral for recourse in the event of default in priority to D's other creditors, including if D is insolvent and/or becomes bankrupt.[17] This reduction in C's risk is accompanied, theoretically,[18] by a reduction

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[13] I generally prefer the term "utility" to "efficiency." See Richard A. Epstein, *Simple Rules for a Complex World* (Cambridge: Harvard University Press, 1995) at 30: "Within professional philosophical and economic circles, 'utility' has become the all-purpose placeholder for those goods and consequences that are desired, either by individuals or by collectives. Accordingly the maximization of social utility becomes the objective of a sound system of legal rules."

[14] Whether credit is considered affordable, in any given instance, is assessed from the debtor's perspective. A debtor will consider credit affordable if it can yield, from the borrowed principal, revenue sufficient to repay the principal and interest. See David Gray Carlson, "On the Efficiency of Secured Lending" (1994) 80 Va. L. Rev. 2179 at 2193.

[15] UNCITRAL, *supra* note 6 at Intro para. 46.

[16] Without requiring a judgment, and without, or with very limited, court process and oversight.

[17] This statement obviously assumes that C holds the highest ranking priority position with respect to the collateral. *Priority* and *efficient enforcement* are two commonly cited benefits (from the secured creditor's perspective) of secured credit. See John Armour and Sandra Frisby, "Rethinking Receivership" (2001) 21(1) Oxford J. of Legal Stud. 73 at 86. But there are also other oft-cited benefits including, for example, *enhanced monitoring*.

[18] But see Hugh Beale, Michael Bridge, Louise Gullifer & Eva Lomnicka, *The Law of Personal Property Security* (Oxford: Oxford University Press, 2007) at para. 1.06: "It is by no means certain that, in practice, a precisely calculable interest rate spread separates the cost of secured and unsecured credit."

in the rate of interest at which C is willing to lend to D.[19] In other words, security diminishes the amount of interest C will charge D on the outstanding principal.[20] Both C and D are better off for having entered into the secured transaction, each gaining a benefit he would not have enjoyed in the absence of security;[21] C enjoys streamlined realization mechanisms and diminished risk of investment loss, while D enjoys reduced credit costs and, in most cases, retains possession and use of the subject collateral. The conventional explanation is intuitively appealing,[22] but is it sound?

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[19] John Armour, "The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking?" (2008) 2 European Company and Financial Law Review 3 ("*Debate About Secured Lending*") at 5; European Bank for Construction and Development (EBCD), *Model Law on Secured Transactions* (London: EBCD, 1994) at V.

[20] In commercial lending, credit interest rates are driven by perceived risk. A creditor, in determining the interest rate at which it will advance credit to a particular customer (or, indeed, whether it will advance credit at all), conducts due diligence in an effort to estimate its risk of loss. The lower the perceived risk, the lower the rate of interest offered to the customer. See, for example, Ronald J. Mann, "The First Shall Be Last: A Contextual Argument for Abandoning Temporal Rules of Lien Priority" (1996) 75 Tex. L. Rev. 11 at 32: "It is clear that lenders do not charge a single interest rate for all construction projects; rather, they charge different rates based on such things as the strength of the borrower and the general contractor, the lender's prior relationship with the borrower, and the perceived riskiness of the project."

[21] On this basic account, as between C and D, the secured transaction appears mutually beneficial, i.e., both are better, not worse, off. But see Richard A. Posner, *Economic Analysis of Law*, 5th ed. (New York: Aspen Law & Business, 1998) at 14; Michael J. Trebilcock, *The Limits of Freedom of Contract* (Cambridge: Harvard University Press, 1993) at 7 and 58: "Even if both parties to a particular exchange benefit from it, the exchange may entail the imposition of costs on non-consenting third parties. From both a welfare and an individual autonomy perspective, such exchanges are problematic. From a welfare perspective, the Pareto criterion will not be met if an exchange has made some better while making others worse off. In terms of Kaldor-Hicks efficiency, the welfare implications of the exchange would entail balancing the costs to third parties against the gains to the immediate parties to the exchange." Also see discussion at 244-245.

[22] For another conventional account of secured credit, see Anthony J. Duggan & Jacob S. Ziegel, *Secured Transactions in Personal Property: Cases, Text, and Materials*, 6th ed. (Toronto: Emond Montgomery Publications Limited, 2013) at 5: "(1) There is a risk that the debtor may go bankrupt. A recession sharply increases the risk of non-payment for both commercial and consumer debts. An unsecured creditor can expect to receive only a small dividend (on average five cents on the dollar) from the realization of the bankrupt's assets, and frequently will receive nothing at all. Even where a

Notice how the conventional account focuses on the positive features of security primarily from the perspective of the secured creditor, C, and, to a somewhat lesser extent, the debtor, D.[23] Take a broader view, however, and instead consider the effects of the secured transaction on D's other creditors – non-adjusting unsecured creditors,[24] whether voluntary, reluctant or involuntary – who may be injured by the depletion of the asset pool available for satisfaction of their claims.[25] Indeed, some observers regard security as a wealth redistribution

secured creditor's recovery is limited to the value of the collateral, if the secured creditor is first in line, realization of 60 to 70 percent of the claim is quite common, and may be higher. (2) Even if the debtor does not become insolvent, having to sue the debtor to recover the amount owing and to levy execution on the debtor's property is time consuming and expensive. A secured creditor, on the other hand, is free in many of the provinces, and generally under federal law, to seize the collateral and dispose of it without needing prior judicial authorization. (3) If the creditor does not take security, there is always the danger that a subsequent creditor will demand it and, thereby, acquire priority in the event of non-payment of both debts. Again, the debtor may be tempted to sell some of its assets to generate cash. Obviously this will reduce the volume and value of assets available for distribution among the debtor's creditors. (4) A secured creditor is often given more power in the security agreement to monitor the debtor's affairs and such monitoring is more effective with the benefit of security than without it. The secured creditor can also threaten to seize the collateral if the debtor fails to make payment or otherwise fails to meet its obligations under the security agreement."

[23] See, for example, Robert E. Scott, "A Relational Theory of Secured Financing" (1986) 86 Colum. L. Rev. 901 ("*Relational Theory*") at 901: "The conventional justification for such preferential treatment is that security increases the aggregate amount of credit available to deserving debtors."

[24] LoPucki, *supra* note 7 at 1896; For a scheme of classification for D's unsecured creditors, see Lucian Ayre Bebchuk and Jesse M. Fried, "The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics" (1997) 82 Cornell L. Rev. 1279 ("*Further Thoughts*") at 1295-1304: (1) Adjusting creditors (i.e. those creditors capable of adjusting the terms of their credit arrangements with D in light of C's security interest); and (2) Non-adjusting creditors (i.e. those creditors incapable of adjusting credit terms in light of C's security interest), comprising (i) involuntary creditors (i.e. tort claimants), (ii) government tax and regulatory claimants, (iii) voluntary creditors with small claims (i.e. where it would be cost prohibitive to take security), and (iv) prior voluntary creditors.

[25] In law & economics literature, authors tend to engage in Kaldor-Hicks efficiency analysis. See Trebilcock, *supra* note 21 at 7: "In this context, two concepts of efficiency are of central importance: *Pareto efficiency* and *Kaldor-Hicks efficiency*. Pareto efficiency would ask of any transaction or policy or legal change, will this transaction or change make somebody better off while making no one worse off? Kaldor-Hicks efficiency, in contrast, would ask the question, would this collective decision (for example, a change in legal rules) generate sufficient gains to the beneficiaries of the change that they

mechanism by which the sophisticated and powerful (i.e. secured creditors) exploit the vulnerable and weak (i.e. non-adjusting unsecured creditors).[26] Accordingly there have been calls for a softening of the priority rules to allow certain non-adjusting unsecured creditors to share in the proceeds of liquidated encumbered collateral.[27]

Quite aside from security's potentially harmful impact on unsecured creditors, it is not entirely clear that the debtor actually benefits from granting security. Some predict that the lower interest rate offered by C will be fully offset by the higher interest rate D's other creditors will charge in light of their increased risk of loss.[28] If this is true, then why would D ever issue secured debt? Schwartz,

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could, *hypothetically*, compensate the losers from the change so as to render the latter fully indifferent to it but still have gains left over for themselves?"; Also see Posner, *supra* note 21 at 14.

[26] LoPucki, *supra* note 7; John Hudson, "The Case Against Secured Lending" (1995) 15 Int'l Rev. L. & Econ. 47.

[27] See, for example, Lucian Ayre Bebchuk and Jesse M. Fried, "The Uneasy Case for the Priority of Secured Claims in Bankruptcy" (1996) 105 Yale L.J. 857 ("*Uneasy Case*"), where the authors endorse a partial priority rule (as opposed to a full priority rule) under one of two methods: 1. Adjustable priority rule; or 2. Fixed-fraction priority rule; Also see LoPucki, *supra* note 7 at 1947, where the author proposes a system under which an unsecured creditor would only be subordinate to secured creditors if it agreed in fact (expressly or implicitly) to such subordination; Also see Alan Schwartz, "A Theory of Loan Priorities" (1989) 18 J. Legal Stud. 209 ("*Theory of Loan Priorities*") at 212, where the author proposes the following reform to the priority scheme: "…under the proposal made here, initial lenders that hold substantial debt commonly would take first; later creditors that took security would rank second to the initial lender but ahead of creditors that came after; and most other later creditors would continue to take pro rata." For a more detailed description of Schwartz's proposed priority scheme, see 248.

[28] Thomas H. Jackson and Anthony T. Kronman, "Secured Financing and Priorities Among Creditors" (1979) 88 Yale L.J. 1143; Alan Schwartz, "Security Interests and Bankruptcy Priorities: A Review of Current Theories" (1981) 10 J. Legal Stud. 1 ("*Current Theories*"); F.H. Buckley, "The Bankruptcy Priority Puzzle" (1986) 72 Va. L. Rev. 1393.

building upon ideas originated by Jackson & Kronman,[29] offers a concise account of the secured credit ubiquity puzzle.

> When a creditor becomes secured, however, certain (or all) assets of the debtor are set aside to help insure that this creditor is paid; in consequence, its chance of collecting its debt are much increased. And when these assets are removed from the general pool, the chance that the debtor's unsecured creditors will collect their debts correspondingly decreases. If all creditors are informed, the secured creditor will charge a lower interest rate because it is secured, whereas the unsecured creditors will charge higher interest rates because the pool of assets available to satisfy their claims has shrunk. The debtor's total interest bill is thus unaffected by the existence of security. Since the issuance of secured debt is itself costly, however, the debtor would be worse off with security than without it. Firms would never sell secured debt.[30]

On this theory, secured lending is a zero-sum game[31] in which lower rates charged by secured creditors are fully offset by the higher rates charged by unsecured creditors. Since the debtor is no better off, overall, for having granted a security interest, and since granting such security interest is itself costly,[32] Schwartz puzzles over the ubiquity of secured credit in the real world.[33]

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[29] Jackson & Kronman, *ibid.*

[30] Schwartz, *Current Theories, supra* note 28 at 7.

[31] See Duggan & Ziegel, *supra* note 22 at 4; Harris & Mooney, *Property Based Theory, supra* note 11 at 2027.

[32] See Ronald J. Mann, "Explaining the Pattern of Secured Credit" (1997) 110 Harv. L. Rev. 625 ("*Explaining the Pattern*") at 660, where the author cites observational data, in respect of a particular company, indicating that the transaction costs (including all professional fees) of producing a $10 Million unsecured loan were approximately 0.75% of principal, while the transaction costs of producing a secured loan of equivalent value were between 1.5% and 2.0% of principal. This observation tends to refute assertions made by James J. White, "Efficiency Justifications for Personal Property Security" (1984) 37 Vand. L. Rev. 473 at 490; Kripke, *supra* note 10 at 959; Paul M. Shupack, "Solving the Puzzle of Secured Transactions" (1989) 41 Rutgers L. Rev. 1067 ("*Solving the Puzzle*") at 1091; LoPucki, *supra* note 7 at 1942, n. 204.

[33] Alan Schwartz, "Taking the Analysis of Security Seriously" (1994) 80 Va. L. Rev. 2073 ("*Taking Analysis Seriously*") at 2079.

Schwartz's article, among others, drew strong reactions and prompted a lively academic debate.[34] From the ubiquity puzzle emerged a number of theories that attempt to justify[35] or explain[36] the occurrence of secured credit.[37] For example, law and economics efficiency explanations[38] are typically premised on theories of screening,[39] signalling,[40] monitoring,[41] controlling[42] and/or bonding.[43] The

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[34] See, for example, Kripke, *supra* note 10.

[35] See, for example, Harris & Mooney, *Property Based Theory, supra* note 11, where the authors promote a liberal theory of secured credit premised on the free alienability of private property. See 2024: "The well-accepted rights of property owners – to use and freely and effectively to alienate their property and to be secure in their ownership – form the basis of our normative theory of secured transactions. Like broader theories of property law, which generally validate the decisions of debtors to transfer their property outright, our theory generally validates the decisions of debtors to transfer their property for collateral purposes. And like the broader theories, our theory respects personal autonomy and freedom of contract." And 2048: "Our normative theory of security interests is grounded upon the normative theories that justify the institution of private property. The right to own private property is the bedrock of capitalism and an essential component of a market economy." And 2051: "We believe it follows that the law should honor the transfer or retention of security interests on the same normative grounds on which it respects the alienation of property generally."

[36] See, for example, Mann, *Explaining the Pattern, supra* note 32.

[37] For two reviews of the various theories, see Norman Siebrasse, "A Review of Secured Lending Theory" (1997) ResearchGate, online: <http://www.researchgate.net/profile/Norman_Siebrasse/publication/237830835_A_Review_of_Secured_Lending_Theory/links/543511af0cf2dc341daf683f.pdf>; Armour, *Debate About Secured Lending, supra* note 19.

[38] See, for example, White, *supra* note 32 at 479.

[39] See, for example, Buckley, *supra* note 28; George G. Triantis, "Secured Debt Under Conditions of Imperfect Information" (1992) 21 J. Legal Stud. 225.

[40] The signalling theory – the theory that a debtor's willingness to give security signals financial strength – has been debunked on the basis of empirical evidence. See Siebrasse, *supra* note 37 at 27; Armour, *Debate About Secured Lending, supra* note 19 at 7.

[41] See Jackson & Kronman, *supra* note 28 at 1143, n. 1; Schwartz, *Current Theories*, *supra* note 28 at 7; Kripke, *supra* note 10 at 966-969; LoPucki, *supra* note 7 at 1921; Mann, *Explaining the Pattern, supra* note 32 at 639.

[42] Armour & Frisby, *supra* note 17 at 75, where the authors focus on the benefits of security as a device for ensuring control (as opposed to ensuring priority): "This claim is distinct from much of law-and-economics literature about security interests, in that it focuses on the benefits which can be achieved through the allocation of rights to *control*, rather than priorities to payment of return." Note that this reference to "control" is intended in the general sense of "control over the PPSA enforcement process" (see John Armour, "The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking?" (2008) Social Science Research Network (posted April 9, 2008), online: SSRN <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1118030> ("*Lessons for*

literature has helped elucidate the benefits and problems associated with secured credit as an institution,[44] focusing the academic community's attention on the plight of involuntary, wholly non-adjusting, unsecured creditors. Indeed, legitimate fairness concerns have been raised about liquidation priority rules that place certain secured creditors – in particular, non-purchase money secured creditors[45] – ahead of innocent tort victims.[46] The theoretical literature has also prompted empirical research. According to Armour, for example, the empirical findings "tend to suggest that the legal institution of secured credit is, on the whole, socially beneficial, and

European Lawmaking") at 3 and 7), which is to be contrasted with the narrow technical sense of "control as a PPSA perfection step."; Also see Mann, *Explaining the Pattern, supra* note 32 at 683: "This Article, in contrast, presents a detailed analysis of the mechanisms by which secured credit provides borrowers with benefits that are wholly distinguishable from the cost-shifting benefits condemned in the existing scholarship. Specifically, secured credit lowers the costs of lending transactions not only by increasing the strength of the lender's legal right to force the borrower to pay, but also by enhancing the borrower's ability to give a credible commitment to refrain from excessive future borrowing and by limiting the borrower's ability to engage in conduct that lessens the likelihood of repayment."; Also see Jay Lawrence Westbrook, "The Control of Wealth in Bankruptcy" (2004) 82(4) Tex. L. Rev. 795.

[43] See, for example, Robert Scott, "The Truth About Secured Lending" (1997) 82 Cornell Law Rev. 1436 at 1448-52.

[44] See, for example, Scott, *Relational Theory, supra* note 23 at 969, where the author develops a relational theory of secured credit: "Relational theory shifts the focus from security's function as a postbankruptcy claim against specific assets to its role as prebankruptcy leverage that reduces the risk of misbehavior and business failure."; But also see Allen N. Berger and Gregory F. Udell, "Relationship Lending and Lines of Credit in Small Firm Finance" (1995) 68 J. Bus. 351; Siebrasse, *supra* note 37 at 52.

[45] I may have "missed the mark" in identifying "non-purchase money secured creditors," as opposed to "non-*new money* secured creditors" (i.e. creditors securing antecedent debt). My preference for a strong purchase money priority rule is anchored in a common sense belief which I can only articulate as follows: I think a purchase money lender ought to be entitled to "take back her stuff" in the event of debtor default.

[46] See Bebchuk & Fried, *Uneasy Case*, *supra* note 27 at 907, n. 163, where the authors furnish the following list of authors who have proposed bankruptcy superpriority for tort claimants over secured creditors: Adler, Leebron, LoPucki, Painter and Roe. For an insightful and critical discussion of this type of proposal, citing empirical data, see Armour, *Debate About Secured Lending*, *supra* note 19 at 22-25.

that such benefits are likely to outweigh the social costs of any transactions motivated by redistribution."[47]

In short, the utility of secured credit may not be as certain as we enamoured with the subject would like to believe.[48] Mann astutely observes that the institution of secured credit may not be explicable or justifiable under any "single unifying theory"[49] due to its multi-contextual nature. In any event, security's future,[50] as an institution, appears quite secure, for the moment at least. To my knowledge, no Canadian provincial or territorial government has plans to abandon the PPSA specifically, or secured transactions generally.[51] For this reason, my research project is meaningful and important, even if the theoretical underpinnings of secured credit remain speculative and/or unfounded.

B. STATEMENT OF ASSUMPTIONS

[47] Armour, *Lessons for European Lawmaking, supra* note 19 at 2.

[48] I wonder if part of the answer to the secured credit utility/legitimacy question can be found in Aristotle's observation: "And utility is not a permanent quality; it differs at different times." See Aristotle, *The Nicomachean Ethics*, trans. by Harris Rackham (Hare: Wordsworth, 1996) at 208, Book VIII, iii, 3.

[49] Mann, *Explaining the Pattern*, *supra* note 32 at 682: "Furthermore, this Article shows the importance of attention to context. Secured credit is an area in which broad conclusions are likely to be incorrect: suppliers do not always lend on an unsecured basis, and large companies do not always borrow unsecured. To make a serious effort to describe the richness of the real pattern, a theory must not only acknowledge, but embrace, the variety of circumstances in which parties make lending decisions. This conclusion may frustrate those who search for a single unifying theory for credit decisions. But a complicated theory with explanatory value is preferable to a simple and unitary theory that bears no relation to the actual world of lending."

[50] The institution has ancient origins; Goode traces security back at least 4,000 years to the Akkadians. See R.M. Goode, "Is the Law Too Favourable to Secured Creditors?" (1983-84) 8 Can. Bus. L.J. 53 ("*Law Too Favourable?*") at 53.

[51] The PPSA is enacted under the exclusive jurisdiction of the provincial legislatures to make laws in relation to matters of property and civil rights pursuant to section 92(13) of the *Constitution Act, 1867*.

As noted above, for the purposes of this thesis, I proceed on the assumption that credit – and more specifically, secured credit – serves a useful societal purpose; that the PPSA ought to facilitate secured transactions under which debtors grant, and secured creditors acquire, proprietary interests in debtors' personal property.[52] It is within the strictures of these basic premises that I articulate and explore the PPSL values in Part IV.[53]

IV. Evaluative Criteria

A. From Values to Evaluative Criteria

The literature reveals, disappointingly perhaps, that there exist no unifying principles[54] of either commercial law or its personal property security subgenre.[55]

[52] Armour, *Debate About Secured Lending, supra* note 19 at 29: "The starting point for discussion by lawmakers is therefore that security has the potential to generate social benefits, through reducing the default risk of marginal firms."

[53] Even if these basic premises are unsupported in *truth*, this does not alter the fact that secured credit is part of our *reality*, and has been, in varying degrees, for millennia. Moreover, the institution of secured credit shows no signs of decline.

[54] The veracity of this statement depends on how one defines the term 'principle'. By 'principle', I mean a generally applicable norm. A 'principle' is more concrete and robust than a mere 'value'. Terms of this nature are susceptible to different meanings and definitions. See, for example, Ronald Dworkin, *Taking Rights Seriously* (London: Duckworth, 1997) at 22: "I call a 'policy' that kind of standard that sets out a goal to be reached, generally an improvement in some economic, political, or social feature of the community (though some goals are negative, in that they stipulate that some present feature is to be protected from adverse change). I call a 'principle' a standard that is to be observed, not because it will advance or secure an economic, political, or social situation deemed desirable, but because it is a requirement of justice or fairness or some other dimension of morality." Dworkin describes principles as less absolute than rules, and subject to a relative weighting process, at 26: "Principles have a dimension that rules do not – the dimension of weight or importance." Dworkin further explains, at 217: "Every rule of law is supported, and presumably justified, by a set of policies it is supposed to advance and principles it is supposed to respect." I, too, conceptualize 'principles' as more abstract and less absolute than 'rules'. In the same vein, I conceptualize 'values' as more abstract and less absolute than 'principles'. A 'value', derivative of a 'policy', is an abstract ideal that informs the development and articulation of 'principles'. A 'principle' is a generally

Instead, recognized are a series of *values* that, taken together, inform the design of a legal framework aimed generally at the promotion of commercial development.[56] The values are derivative of a general policy[57] of secured credit facilitation.[58] Indeed, one might think of 'facility'[59] as the prime value.[60] In the following account, Nozick captures my intended meaning of the term 'value'[61] in its verb form.

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applicable norm and, subject to a relative weighting with other relevant principles, informs the development and articulation of 'rules'.

[55] Ewan McKendrick, ed., *Goode on Commercial Law*, 4th ed. (London: Penguin Books, 2010) at 1347: "Are there unifying principles which bind the almost infinite variety of transactions in which businessmen engage, marking these off from other types of contract? The absence of anything resembling a commercial code makes this question harder to answer than might be imagined. If by commercial law we mean a relatively self-contained, integrated body of principles and rules peculiar to commercial transactions, then we are constrained to say that this is not to be found in England."

[56] Roderick J. Wood, "Circular Priorities in Secured Transactions Law" (2010) 47 Alta. L. Rev. 823 ("*Circular Priorities*") at 825: "In Part V, I will provide an assessment of these approaches by identifying a set of criteria that promote the general values and goals of commercial law."; McKendrick, *Goode on Commercial Law, ibid.* at 1347: "This, then, is the essence of commercial law – the accommodation of rules, usages and documents fashioned by the world of business; the facilitation, rather than the obstruction, of legitimate commercial development."; Willard Z. Estey, "The Fluctuating Role of Contract Law in the Community" (1983-84) 8 Can. Bus. L.J. 272 at 272.

[57] I mean 'policy' in the sense described by Dworkin, *Taking Rights Seriously, supra* note 54 at 90: "Arguments of principle are arguments intended to establish an individual right; arguments of policy are arguments intended to establish a collective goal. Principles are propositions that describe rights; policies are propositions that describe goals."

[58] Roderick J. Wood, "Acquisition Financing of Inventory: Explaining the Diversity" (2014) 13(1) O.U.C.L.J. 49 ("*Acquisition Financing*") at 50: "The idea that the legislation creates an efficient, predictable and commercially sensible framework that facilitates secured financing is as close as one can possibly get to a central tenet of faith in this field."

[59] The value of being facilitative of personal property secured transactions.

[60] UNCITRAL, *supra* note 6 at Intro para. 49.

[61] In adopting the term 'value(s)' – a term with connotations of moral virtue – as descriptive of 'commercial ideals', I do not intend any Orwellian mischief - that is to say, transforming the meaning of a term into its opposite, in effect normalizing 'commercial ideals' as 'moral epitomes': see Edward S. Herman and Noam Chomsky, *Manufacturing Consent: The Political Economy of the Mass Media* (London: Vintage Books, 1994) at 333, n. 7. I do not believe that the PPSL values are or ought to be held in the same high esteem as moral virtues such as 'compassion', 'generosity' or 'love'. I choose the word 'value(s)' because I cannot discern a more suitable substitute. I toyed with various alternatives – 'qualities', 'ideals' and 'characteristics', for example – but none captures the essence of my intended meaning as intelligibly and succinctly as the term 'value(s)'. Again, I intend no Orwellian mischief, but I must confess that the PPSL values may be regarded as a form of 'goodthink' (i.e. orthodoxy) as that

> To value something is to stand in a particular close, positive psychological and attitudinal relation to it, a relation itself marked by high organic unity.[62]

In Part IV.B, I identify and expound upon the core commercial values of personal property security law (the "PPSL values"). In doing so, I present the PPSA, including the regulatory framework and infrastructure associated therewith, as a "ballpark prototype" of a system that embodies, more or less, the PPSL values. It is important to note, however, that the pertinent question, in some instances or settings, is *whether* the PPSA embodies the PPSL values. In other words, I do not suggest that the PPSA, *by definition*, optimally embodies the PPSL values.

The PPSL values informed the initial design and implementation of the PPSA, and they remain crucial in guiding its continuing development. For example, they assist in evaluating the PPSA, and any secured transactions regimes with shared philosophical bases, on a normative level; that is, critically examining any particular aspect of a secured transactions regime and adjudging it "good" or "bad" according to a set of internal standards. In Part IV.C, I draw from the PPSL values a series of *evaluative criteria* (*cum* principles) designed to assist in examining and evaluating the deposit account perfection and priority ordering structures of the broadly similar, yet distinct, statutory personal property security regimes (whether existing or proposed) of Canada, the United States and Australia.

B. PPSL VALUES

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term is introduced and detailed in the B Vocabulary of the language Newspeak: see George Orwell, *1984* (New York: Plume, 1983) at 271 (Appendix – Principles of Newspeak).

[62] Robert Nozick, *The Examined Life* (New York: Simon and Schuster, 1989) at 166.

1. *GENERAL ACCOUNTS*

Consider two leading accounts of the objectives of modern personal property security law.

> **UNCITRAL, identifying eleven objectives of a "workable secured transactions regime"[63]**
>
> (1) to promote low-cost credit by enhancing the availability of secured credit; (2) to allow debtors to use the full value inherent in their assets to support credit; (3) to enable parties to obtain security rights in a simple and efficient manner; (4) to provide for equal treatment of diverse sources of credit and of diverse forms of secured transaction; (5) to validate non-possessory security rights in all types of asset; (6) to enhance certainty and transparency by providing for registration of a notice in a general security rights registry; (7) to establish clear and predictable priority rules; (8) to facilitate efficient enforcement of a secured creditor's rights; (9) to allow parties maximum flexibility to negotiate the terms of their security agreement; (10) to balance the interests of persons affected by a secured transaction; (11) to harmonize secured transactions laws, including conflict-of-law rules.[64]
>
> **Cuming, Walsh & Wood, identifying the foundational objectives of the PPSA**
>
> 1. Comprehensiveness; 2. Flexibility 3. Fair and efficient enforcement; 4. Protection of information needs of third parties; 5. Efficient registration system; 6. Certainty and predictability in the ordering of priorities; and 7. Facilitation of interprovincial and international financing.[65]

As one might expect, the two accounts exhibit numerous commonalities in both substance and form. From these accounts, and others,[66] and having specific

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[63] UNCITRAL, *supra* note 6 at Intro para. 47.

[64] UNCITRAL, *ibid.* at Intro paras. 49-59.

[65] Ronald C.C. Cuming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law*, 2nd ed. (Toronto: Irwin Law, 2012) at 6-12.

[66] Duggan & Ziegel, *supra* note 22; Hugh Beale, Michael Bridge, Louise Gullifer & Eva Lomnicka, *The Law of Security and Title-Based Financing*, 2nd ed. (Oxford: Oxford University Press, 2012).

regard for the PPSA including the regulations promulgated thereunder and the supporting framework and infrastructure associated therewith (i.e. the personal property registry ("PPR")), a series of singular terms can be gleaned, each of which embodies a PPSL value.[67] In Part IV.B.3, I identify and describe thirteen oft-cited PPSL values. But before embarking on that principal task, some preliminary observations are in order.

2. REDUNDANCY & CONFLICT

Upon reviewing the list of PPSL values, one will immediately notice that several of the values, while presented discretely under their own headings, are inextricably linked to – and in some cases, virtually synonymous with – other similar value(s).[68] This may cause concerns about redundancy and/or overstatement, which the detailed discussion in Part IV.B.3 will alleviate.

Difficulties of the opposite nature also arise. In some instances of inter-PPSL value relationships, it may not be possible to simultaneously observe two (or more) PPSL values, thereby forcing lawmakers to choose, on some principled basis,[69] which PPSL value(s) to embrace and which to reject.[70] Indeed, the PPSL values,

[67] See Roy Goode, "The Codification of Commercial Law" (1988) 14 Monash U. L. Rev. 135 ("*Codification of Commercial Law*"), where the author undertakes a similar exercise while making his case for the codification of commercial law.

[68] The PPSL values often exhibit substantial conceptual overlap or are otherwise difficult to define, describe or explain without reference to each other.

[69] Presumably, the general import of each of the competing PPSL values, as measured against each other and the collective, dictates the outcome of this decision. See Robin J. Schwill, "Policy Choices in Insolvency: A Decision Framework" IIC-ART Vol. 2-2.

[70] See, for example, McKendrick, *Goode on Commercial Law*, *supra* note 55 at 1348: "Obviously, businessmen look to the law to produce results that in the typical case commend themselves as

viewed collectively, are rather amorphous. But these concerns, too, are alleviated; *context* is the assuaging ingredient. Chomsky's words are apposite.

> The values that we hold are not absolute. They are always contingent. They conflict. And life is made up of decisions and complicated situations and cases of conflicting values. If you listen to just one in isolation, yes, it may sound legitimate, and maybe is. But you have to ask what it means under particular conditions.[71]

In specific context, the PPSL values, when given appropriate weight – that is, considered in relation to each other and the collective – assist in articulating meaningful evaluative standards. Part IV.C furnishes demonstrative support. A discussion of the PPSL values, in the *generic* PPSA context in Part IV.B, leads to an articulation, in Part IV.C, of evaluative criteria tailored to the *specific context* of deposit account perfection and priority ordering.

3. Values

Before starting into the PPSL values, one final note of clarification is required. I do not claim the following list of PPSL values to be exhaustive;[72] there may be

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reasonable and as responsive to legitimate commercial needs and practices. What they also expect of the law is predictability in its application and thus in the outcome of disputes on legal issues. This, however, involves a paradox, for the higher the degree of predictability required, the greater the detail in which the principles and rules have to be expressed; yet businessmen also attach great importance to flexibility, to a legal environment which enables them to develop new commercial instruments, new business practices, confident in the knowledge that they will be upheld by the courts as producing their desired legal effects, and this militates in favour of broad principle and discretions and against a high degree of detail and the predictability that comes with it."

[71] "Noam Chomsky on Abortion and Conflicting Values", online: Youtube <http://youtu.be/_BN8COPwG1A> (clip taken from the Tony Kaye documentary *Lake of Fire*, (ThinkFilm, 2006)); Also see Dworkin, *Taking Rights Seriously, supra* note 54 at 26.

[72] This disclaimer echoes one furnished by Nozick, *supra* note 62 at 183: "The list of dimensions is exhausting. A long list cannot provide us with much understanding if it remains unordered, a jumble. We need to structure the list to gain some intellectual control. The list is not sacrosanct, though."

others. The PPSL values are introduced in their noun form. This placeholder behaves as a sort of shorthand allusion to the substantive ideal it embodies.

a. facility

First and foremost, the PPSA is facilitative; it aims to facilitate, rather than obstruct, secured transactions involving personal property.[73] Accordingly, 'facility' is the prime PPSL value.[74] The PPSA enables debtors to "use the full value inherent in their assets to support credit,"[75] thereby embracing the classical liberal philosophy that one ought to be free to deal with his property as he sees fit.[76]

The PPSA is also facilitative in that it accommodates, not just the *effectuation* of any particular secured transaction, but also effective *risk assessment* for all of the debtor's existing and potential future creditors on a reasonably simple,

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[73] See Wood, *Acquisition Financing, supra* note 58 at 65: "All of these statutes adopt as a fundamental premise the idea that the law should facilitate secured transactions, and should not impose legal barriers that will render the institution of secured credit more costly."

[74] See Harris & Mooney, *Property Based Theory, supra* note 11 at 2021; see, more generally, Goode, *Codification of Commercial Law, supra* note 67 at 148: "The primary function of commercial law, in the sense in which I use that term, is to accommodate the legitimate practices and expectations of the business community in relation to their commercial dealings."

[75] UNCITRAL, *supra* note 6 at Intro para. 50.

[76] See Harris & Mooney, *Property Based Theory*, *supra* note 11 at 2022: "The law should not impair the ability of debtors to secure as much or as little of their debts with as much or as little of their existing and future property as they deem appropriate."; Also see Friedrich A. Hayek, *The Road to Serfdom* (London: The Institute of Economic Affairs, 2005) at 41: "Our system has forgotten that the system of private property is the most important guarantee of freedom."; Also see, generally, Hayek's celebrated trinity – Friedrich A. Hayek, *Law, Legislation and Liberty, Volume 1: Rules and Order* (Chicago: The University of Chicago Press, 1973); *Law, Legislation and Liberty, Volume 2: The Mirage of Social Justice* (Chicago: The University of Chicago Press, 1976); *Law, Legislation and Liberty, Volume 3: The Political Order of a Free People* (Chicago: The University of Chicago Press, 1979).

inexpensive[77] and accurate basis. Risk assessment is discussed in more detail under "*transparency*" in Part IV.B.3.b.

Finally, the PPSA is facilitative in that it accommodates efficient dispute resolution if a priority dispute does arise. It encourages efficient dispute resolution through the imposition of bright-line priority rules that typically hinge on an easily ascertainable objective standard – time of registration.[78] Dispute avoidance is a vitally important, yet frequently overlooked, aspect of the PPSA's facility; one rarely focuses on those PPSA disputes that *do not materialize* into formal legal proceedings.[79]

Simply put, the PPSA embraces secured credit as a modern business financing technique.[80] The statute facilitates secured transactions. The prime PPSL value, 'facility', inspires and informs all others.

b. transparency

'Transparency' is allied with 'facility'. Indeed, in the PPSA context,

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[77] See Armour, *Debate About Secured Lending, supra* note 19 at 27.

[78] It is important to recognize that the special purchase money priority rules, though not necessarily of the "first in time" variety, are temporal in the sense that they are *pegged* to time of registration. See PPSA, ss. 34(2) (priority to purchase money equipment financier if registered within 15 days of debtor possession) and (3) (priority to purchase money inventory financier if, *inter alia*, registered prior to debtor acquiring possession).

[79] See M.D. Chalmers, "Codification of Mercantile Law" (1902) 25 Annual Report of the American Bar Association 282 at 288: "The object of the man of business is, not to get a scientific decision on a particular point, but to avoid litigation altogether. On the whole, he would rather have a somewhat inconvenient rule clearly stated than a more convenient rule worked out be a series of protracted and expensive litigations, pending which he does not know how to act."

[80] Duggan & Ziegel, *supra* note 22 at 22; Cuming, Walsh & Wood, *supra* note 65 at 11; UNCITRAL, *supra* note 6 at Intro paras. 49 and 70.

'transparency' facilitates risk assessment. The centerpiece of the PPSA's transparency, and the risk assessment it facilitates, is the PPR. Consider UNCITRAL's description of the importance of a public notice registry.

> In order for a secured transactions regime to function efficiently, it is important that all parties be able to determine with a reasonable degree of certainty the extent of the rights of a grantor and third parties in assets to be encumbered. The cornerstone for achieving this certainty, while at the same time respecting and addressing confidentiality concerns, is to establish a general security rights registry for recording notices about the possible existence of a security right.[81]

In Canadian jurisdictions, the PPR is easily accessible. Online users are able to conduct searches and effect registrations.[82] The PPR can be conceptualized as a public "bulletin board" on which diligent creditors post notice, discoverable by others, of their existing or potential proprietary interests in debtors' personal property.[83] All creditors, whether secured or unsecured, can gain access, either directly or through an agent (typically a law firm or registry business), to the PPR for assistance in informing their credit granting decisions;[84] an instantaneous online search reveals the existence and identity of the debtor's other secured creditors, and other potentially competing claims against the searching creditor's collateral.[85] Sophisticated credit granting institutions are intimately familiar with the workings

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81 UNCITRAL, *ibid.* at Intro para. 54.

82 Armour, *Debate About Secured Lending, supra* note 19 at 26: "..., the advent of the internet has greatly reduced the costs involved in updating and searching registers, giving this strategy [of informing others of an interest via general public registry] a clear advantage, at least in theory, over the others." [square bracketed text added]

83 The *in rem* nature of property rights, coupled with the fact that personal property is not government titled, necessitates the Personal Property Registry.

84 Cuming, Walsh & Wood, *supra* note 65 at 8; Duggan & Ziegel, *supra* note 22 at 22; UNCITRAL, *supra* note 6 at Intro para. 55.

85 Cuming, Walsh & Wood, *ibid*. at 326.

of the PPR and the PPSA. The registry system is central to the facilitation of non-possessory security interests under which debtors retain possession and use of their collateral.

'Transparency', as a PPSL value, embodies the ideal of efficient risk assessment,[86] and is supported and exemplified by the PPR.[87]

c. flexibility

'Flexibility', too, is tied to 'facility'. The PPSA exhibits flexibility by enabling debtors and secured creditors to tailor their financing arrangements to their specific needs.[88] Examples of the PPSA's flexibility, with specific reference to its registration rules, include (i) the advance registration rule (i.e. registration can be effected before or after a security agreement is signed, or a security interest attaches),[89] (ii) the omni-registration rule (i.e. one registration can be effective in perfecting security interests granted under multiple agreements and transactions, thereby assuring the secured party's priority),[90] and (iii) the registration error forgiveness

[86] EBCD, *supra* note 19.
[87] UNCITRAL, *supra* note 6 at Intro para. 66: "The *Guide* is premised on the view that efficiency will be enhanced if a State establishes a registry with the following central features: *(a)* it is a single general security rights registry; *(b)* it records notices relating to existing or potential security rights and not documents; *(c)* the registry files are made available for searching by any interested party; and *(d)* except in very limited cases (see chapter IX on acquisition financing), it provides that third-party effectiveness and priority are determined according to the time of registration."
[88] Cuming, Walsh & Wood, *supra* note 65 at 6; UNCITRAL, *ibid.* at Intro para. 57: "The secured transactions regime should provide maximum flexibility for parties to tailor their security agreements to meet their precise needs."; McKendrick, *Goode on Commercial Law, supra* note 55 at 1348; Armour, *Debate About Secured Lending, supra* note 19 at 27.
[89] PPSA, s. 43(4); Cuming, Walsh & Wood, *ibid.* at 327.
[90] PPSA, s. 43(5); Cuming, Walsh & Wood, *ibid.* at 329.

rule (i.e. a registration error is forgiven, and recognized as valid, provided the error is not seriously misleading).[91]

The PPSA enables debtors and creditors to implement credit arrangements with as much flexibility as possible. The PPSA's flexibility is borne out in its (i) general respect for freedom of contract (including, for example, recognition and enforceability of subordination agreements)[92], (ii) easily and inexpensively accessed PPR infrastructure, and (iii) default priority rules predominantly linked to or synchronized with such infrastructure.

d. simplicity

'Simplicity', as a legal value, has appeal across many genres.[93] Its counterpart is 'complexity', a characteristic to be avoided in commercial law to the extent possible.[94] Reminiscent of 'transparency' and 'flexibility', 'simplicity' too has facilitative undertones. In the personal property security law context, 'simplicity'

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[91] PPSA, s. 43(6); Cuming, Walsh & Wood, *ibid.* at 363-371.

[92] PPSA, s. 40; Cuming, Walsh & Wood, *ibid.* at 479.

[93] Epstein, *supra* note 13; Estey, *supra* note 56 at 287.

[94] Epstein, *ibid.* at 21; See Stephanie Ben-Ishai & David Percy, *Contracts: Cases and Commentaries*, 9th ed., (Toronto: Carswell, 2014) at 10: "The law and lawyers are supposed to be providing a service for consumers. If the law is too complex and unpredictable, as well as being destructive rather than supportive of continuing relationships, then it is surely not living up to the reasonable expectations of those consumers."; Also see Peter Schuck, "Legal Complexity: Some Causes, Consequences, and Cures" (1992) 42 Duke L.J. 1 at 3, where the author organizes complexity into four discrete categories: 1. Density; 2. Technicality; 3. Differentiation; 4. Indeterminacy or uncertainty; Finally, see Grant Gilmore, *Security Interests in Personal Property, Vol. I* (Boston: Little, Brown and Company, 1965) at 288, where the author describes the pendulum-like nature of the law as regards simplicity and complexity: "In the growth of the law there are periods of relative stability and periods of rapid change. The introduction of some radically new element into a stable situation leads to a pendulum-like swing from simplicity to complexity and then, as the new elements become assimilated, back towards simplicity."

refers to the relative ease with which parties are able to create and perfect a security interest.[95] UNCITRAL offers a concise description of this value.

> The *Guide* also takes the position that creation of a security right should be as simple as possible and that only minimal additional steps should be required to make the security right effective against third parties.[96]

UNCITRAL identifies two procedural aspects of 'simplicity' as a PPSL value; creation and perfection. The former – creating a security interest – is primarily a matter of basic contract law. In respect of the latter, the PPSA aims to impose "minimal additional steps" to perfect a security interest and establish third party effectiveness.

e. efficiency

The term 'efficient' exhibits elasticity; it has different meanings in different contexts.[97] Consider *Webster's New World Dictionary's* general definition of the term, from which my intended meaning of the PPSL value 'efficient' is derived.

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[95] UNCITRAL, *supra* note 6 at Intro para. 51.

[96] UNCITRAL, *ibid.* at Intro para. 65.

[97] In law and economics literature, for example, 'efficiency' is often used as a reference to "net wealth maximization" (see Posner, *supra* note 21 at 14) or "optimal social welfare" (see Dworkin, *Taking Rights Seriously*, *supra* note 54 at 91). In contrast, and adopting my intended meaning of the term 'efficiency', consider the following account of the efficiency of 15th century mercantile law, taken from McKendrick, *Goode on Commercial Law, supra* note 55 at 4, n. 6: "… Speedy trial was indeed the essence of disputes among merchants. Dr. Charles Gross gives a vivid illustration of the celerity of the procedure by reference to an action tried in the piepowder court of Colchester in 1458 (Gross, *Select Cases*, vol I, p xxvi): 'The plaintiff sued for the recovery of a debt at 8am and the defendant was summoned to appear at 9 o'clock. He did not come at that hour and the sergeant was ordered to distrain him to come at 10 o'clock, at which hour he made default. Similar defaults were recorded against him at 11 and 12 o'clock. At the latter session judgment was given in favour of the plaintiff, and appraisers were ordered to value the defendant's goods which had been attached. They made their report at 4 o'clock, and the goods were delivered to the plaintiff.'"

"efficient" - ... 2. producing a desired effect, product, etc. with a minimum of effort, expense, or waste.[98]

As a PPSL value, then, 'efficiency' refers to minimization of time, effort and expense in (i) conducting the due diligence necessary to inform a credit granting decision, (ii) creating and perfecting a security interest,[99] and (iii) enforcing a secured creditor's rights against personal property collateral in the event of debtor default.[100]

f. predictability

i. family values

It must be acknowledged, from the outset, that 'predictability', 'certainty' and 'clarity' convey similar meanings; they each carry connotations of 'definiteness', 'sureness' and/or 'confidence'. Collectively, therefore, 'predictability', 'certainty' and 'clarity' comprise the family of "PPSL definiteness values"; each, individually, is a "PPSL definiteness value". It is arguable that the PPSL definiteness values should be collapsed into a single PPSL value, but the regularity with which they are employed in the literature, sometimes in combination (as opposed to interchangeably), suggests that each deserves separate consideration.[101] Beyond their shared meanings, do the three PPSL definiteness values convey anything distinct? In the ensuing discussion, I attempt to describe how each member of the family may bear

[98] David B. Guralnik, ed., *Webster's New World Dictionary*, 2nd college ed. (Toronto: Nelson, Foster & Scott Ltd., 1970) at 445, *s.v.* "efficient".
[99] Cuming, Walsh & Wood, *supra* note 65 at 7 and 9.
[100] Cuming, Walsh & Wood, *ibid.* at 7; UNCITRAL, *supra* note 6 at Intro paras. 56 and 65.
[101] Cuming, Walsh & Wood, *ibid.* at 10.

its own mark, or exhibit unique connotations, in the PPSA context. But again, I reemphasize that the PPSL definiteness values' commonalities far exceed their dissimilarities.

ii. predictability – ex ante connotations

'Predictability' is a value of commercial law generally[102] and personal property security law specifically.[103] Consider the words of Duggan & Ziegel.

> The ability to predict accurately the relative priority position a credit grantor will occupy in the event it is required to rely on a security interest is often an important consideration in the initial decision to grant credit. The lack of a single, integrated system of priority rules that characterized prior law meant that a decision whether or not to grant credit often had to be made in the context of considerable legal uncertainty about the outcome of a priority dispute involving other claims to the collateral. The much more complete priority system of the PPSA not only ensures greater consistency in court decisions dealing with priority disputes, but also facilitates more accurate assessment of the legal risks involved in granting credit.[104]

The above account describes the unique *ex ante* perspective[105] (i.e., before the act of lending) 'predictability' brings to the family of PPSL definiteness values.[106] The PPSA facilitates risk assessment, and in doing so enables creditors to advance credit with relative confidence, *from the outset*, in a favourable (or unfavourable) outcome should a priority dispute arise.

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[102] McKendrick, *Goode on Commercial Law, supra* note 55 at 1348.

[103] Duggan & Ziegel, *supra* note 22 at 22.

[104] *Ibid*.

[105] See Posner, *supra* note 21 at 8.

[106] See Iain MacNeil, "Uncertainty in Commercial Law" (2009) 13 Ed. L. Rev. 68 at 69, where the author relates, yet distinguishes, the terms 'consistency' and 'predictability': "Consistency is closely related to predictability, but focuses less on the outcome of a particular adjudication by comparison with what the law is generally understood to be and more on the relative outcomes of different adjudications that apply the same law."

g. certainty

i. certainty – ex post connotations

Commercial parties "crave certainty."[107] Cuming, Walsh & Wood describe the benefits of certainty in the PPSA context.

> By establishing a single comprehensive registration system, the PPSA greatly enhanced <u>certainty</u> and <u>predictability</u> for secured parties. Under the Act, priority among security interests that have been perfected by registration generally is determined by the order of registration without regard to actual knowledge, and the holder of a registered or otherwise perfected security interest generally has priority against subsequent claimants.[108] (emphasis added)

Note how, in the above statement, the terms 'certainty' and 'predictability' are used in conjunction.[109] In what sense, if any, is 'certainty', as a PPSL definiteness value, distinct from 'predictability'?

In general usage, 'certainty' seems to have a broader, or more generic, meaning than 'predictability'. Whereas 'predictability' necessarily conveys an *ex ante* connotation (i.e., in 2017, I cannot predict which team will win the 2016 World Series), 'certainty' is more commonly employed from either or both *ex ante* (i.e., "I am certain that I will have priority if there is default in the future.") and *ex post* perspectives (i.e., after the act of lending – "Now that I have lent money and default

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[107] McKendrick, *Goode on Commercial Law, supra* note 55 at 8.

[108] Cuming, Walsh & Wood, *supra* note 65 at 11; Also see UNCITRAL, *supra* note 6 at Intro para. 54.

[109] For another example, see Goode, *Codification of Commercial Law, supra* note 67 at 150.

has occurred, I am certain I will have priority under the rules.").[110] Semantics perhaps, but in any event, it is worth acknowledging that, as a general matter, 'certainty' – unlike 'predictability' – can and commonly does carry both *ex ante* and *ex post* connotations. Another distinction lies in the terms' general usages, namely, the dichotomy, or causal connection, between "certain rules" and "predictable outcomes."

ii. interconnectedness

Perhaps the most important point to take from Cuming, Walsh & Wood's above excerpt, is that the PPSL definiteness values and the personal property registry are deeply interconnected.

h. clarity

i. clarity – connotations of simplicity and transparency

Is there any real difference between 'certain' and 'clear'?[111] If there is, I suggest that it is this. 'Clear', unlike 'certain', seems more closely connected to

[110] This may indeed be hairsplitting. For example, it would not be incorrect (though perhaps unusual) to make the following statement: "Now that default has occurred, I predict that I will have priority under the rules."

[111] Consider the following account by UNCITRAL, *supra* note 6 at Intro para. 55, which references both terms (and the term 'predictable') in the same paragraph: "*(g) To establish <u>clear</u> and <u>predictable</u> priority rules* – A prospective creditor must not only be able to ascertain the rights of the grantor and third parties in the assets to be encumbered, it must also be able to determine with <u>certainty</u>, at the time it agrees to extend credit, the priority that its security right in encumbered assets would enjoy relative to the rights of other creditors (including an insolvency representative in the grantor's insolvency). Thus, a modern secured transactions regime must provide <u>clear</u> rules that allow prospective creditors to determine the priority of their security rights at the outset of the transaction in a reliable, timely and cost-efficient manner." (underlined emphasis added)

‘simplicity’. A certain rule can be either simple or complex. But can a clear rule be complex? I suppose it can, but the term ‘clear’ conveys a sense of simplicity and effortlessness that the term ‘certain’ does not.

Ponder another natural, yet distinct, bond between the terms ‘clear’ and ‘transparent’. The terms ‘predictable’ and ‘certain’, though *somewhat* related to ‘transparency’, do not share the same intimate nexus with ‘transparent’ as ‘clear’ does (i.e., imagine looking through a window).

ii. closing remarks re: the family of PPSL definiteness values

My attempt to differentiate the three PPSL definiteness values may be unconvincing; perhaps the definiteness values should be consolidated. But the point remains that each of the PPSL definiteness values receives significant attention in the literature. Perhaps this merely reflects, or should be understood to reflect, the degree of importance assigned to the family of PPSL definiteness values as an undifferentiated whole. It might simply mean that the PPSL definiteness values carry, or should carry, more influence than some other PPSL value(s); that they play a key role in advancing the prime PPSL value, ‘facility’.[112]

i. equality

[112] *Vallejo v. Wheeler,* (1774) 1 Cowp. 143 (K.B.) at 153, per Lord Mansfield: “In all mercantile transactions the great object should be certainty: and therefore, it is of more consequence that a rule be certain, than whether the rule is established one way or the other. Because speculators in trade then know what ground to go upon.”

The term 'equality', as a PPSL value, has a narrow meaning[113] intimately tied to the free market economic ideal of effective competition.[114] The general idea is that a level playing field – a system of legal rules that places all participants, regardless of class or character, on an equal footing[115] – creates an optimally competitive secured credit marketplace. In the long-running discourse concerning federal *Bank Act* security, Cuming delivers an eloquent critique of the harmful impact of unequal treatment and artificial class differentiation on secured credit markets.

> A basic assumption is that the best system is one that facilitates the greatest amount of competition and efficiency in the market. When one applies a competitive market test, it is difficult to make a case for the type and degree of federal involvement suggested in the Paper. Why should two types of participants in the same market (eg. banks and credit unions) be subject to different legal regimes? Why should a debtor have different rights depending on whether he or she borrows from a bank or a credit union? How can credit users do any "comparison shopping" for a product (financing) when there is artificial product differentiation

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[113] As a PPSL value, 'equality' embraces the ideal of "equal opportunity and treatment", not "equal holdings."

[114] UNCITRAL makes repeated use of the phraseology "effective and efficient." See, for example, UNCITRAL, *ibid.* at Intro paras. 43 and 45. UNCITRAL embraces the ideal of "effective competition" as espoused by classical liberals. See Hayek, *The Road to Serfdom*, *supra* note 76 at 45: "The liberal argument does not advocate leaving things just as they are; it favours making the best possible use of the forces of competition as a means of coordinating human efforts. It is based on the conviction that, where effective competition can be created, it is a better way of guiding individual efforts than any other."

[115] See Ronald Dworkin, *Law's Empire* (London: Fontana Press, 1986) at 296: "Government makes decisions touching the production, distribution, and ownership of property and the uses people are entitled to make of property they own. These decisions together constitute a scheme of property, and the government's responsibility to treat people as equals in all decisions governs the property scheme it creates and enforces."

> resulting from differences in the legal regimes applicable to the various sources of financing?[116]

UNCITRAL echoes Cuming's sentiment, and highlights the importance of a level playing field in the secured credit marketplace.

> Open competition among all potential credit providers is an effective way of reducing the cost of credit. For this reason, an efficient secured transactions regime will be designed to apply equally to a wide range of credit providers: financial institutions and other lenders, manufacturers and suppliers and both domestic and non-domestic credit providers.[117]

As a general matter,[118] the PPSA aims to place all commercial entities, regardless of class or character, on an equal footing vis-à-vis the debtor and each other. In this narrow sense, the PPSA embraces the PPSL value of 'equality'.

j. balance

i. connotations of fairness

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[116] Ronald C.C. Cuming, "The Position Paper on Revised Bank Act Security: Rehabilitation of Canadian Personal Property Security Law or Curing the Illness by Killing the Patient" (1992) 20 Can. Bus. L.J. 336 at 346.

[117] UNCITRAL, *supra* note 6 at Intro para. 52. Also see Intro para. 50: "This means that the law should apply to all types of debtor (that is, legal or natural persons, including customers). … It also means permitting the granting of security rights in the same assets by the same grantor to different credit providers." Also see Intro para. 72, where UNCITRAL describes the aim of creating equality of treatment among purchase money sellers and purchase money lenders: "*(l) Equality of treatment of all creditors that provide credit to enable grantors to acquire tangible assets* – …The *Guide* takes the position that the secured transactions regime should treat sellers and lenders that provide credit to enable a buyer to acquire tangible assets in the same way."

[118] This general statement ignores inequalities in parties' negotiating leverage and financial clout. In addition, a notable exception (to the general statement) is the recently adopted control paradigm in respect of investment property (i.e. securities, whether certificated or uncertificated, security entitlements, securities accounts, futures contracts and futures accounts). By virtue of the enactment of the STA, and the resulting amendments to the PPSA, only securities intermediaries enjoy the benefit of the automatic control rule.

In commercial academic literature, as in other arenas,[119] the term 'balance' is virtually synonymous with 'fairness'.[120] UNCITRAL furnishes an account of 'balance' as a PPSL value.

> Security agreements are not just contractual undertakings between secured creditors and grantors. Their property effects also affect the rights of third parties such as other secured creditors, privileged and unsecured creditors, purchasers and other transferees of the encumbered assets, the insolvency representative and the State. An efficient and effective secured transactions regime must take into account the legitimate interests of all parties and aim to achieve each of the substantive objectives mentioned above, in a way that is balanced and consistent with relevant laws, including insolvency laws.[121]

ii. proceeds claims

The PPSL value of 'balance' is engaged in the structure and design of a secured transaction regime's rules governing proceeds.[122] UNCITRAL places great emphasis on the importance of extending a security interest in original collateral to the identifiable and traceable proceeds it generates.[123] Notions of fairness inform this basic position.[124] More explanation is required.

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[119] Consider, for instance, the Fox News motto, "Fair & Balanced", online: Fox News <http://www.foxnews.com/>.

[120] See Cuming, Walsh & Wood, *supra* note 65 at 7. Admittedly, the term 'fair' is rather nebulous, but most people would agree that we should aim to make our laws fair. Perhaps 'just' is an appropriate synonym; or 'equitable', or 'balanced'. The term 'just' may be appropriate in this context (of PPSA priority contests) given its naturally distributive connotation: see H.L.A. Hart, *The Concept of Law* (Oxford: Clarendon Press, 1961) at 153-154; Aristotle, *supra* note 48 at 118, Book V, ii, 13.

[121] UNCITRAL, *supra* note 6 at Intro para. 58.

[122] See, generally, Cuming, Walsh & Wood, *supra* note 65, Chapter 11 (Following and Tracing into New Forms of Collateral).

[123] UNCITRAL, *supra* note 6 at Chap I paras. 21-22.

[124] UNCITRAL, *ibid.* at Intro para. 64: "... The *Guide* characterizes such assets as proceeds and takes the position that, because the economic value of the encumbered asset is the creditor's ultimate

Imagine that a purchase money inventory financier supplies inventory to a debtor in the retail sector. When the inventory is sold in the ordinary course of the debtor's business, the financier's security interest in the inventory (its original collateral) terminates.[125] It is thus considered fair and just that the asset generated in exchange for the inventory (whether money, instrument, chattel paper, account, etc.) be treated as substitute collateral.[126] But the fairness considerations do not end there; a further balancing of legitimate interests is required for the fashioning of appropriate priority rules with respect to that substitute collateral. Consider the matter from the perspective of an accounts financier who eyes the retail debtor's accounts receivable as original collateral. As between the purchase money inventory financier and the accounts financier, who has (or should have) a better claim to the accounts? Cuming, Walsh & Wood explain how Canadian jurisdictions have adopted different priority rules where purchase money proceeds claimants butt heads with accounts financiers.

> The PPSA makes it clear that the priority of a purchase money security interest extends to any proceeds as well. Although this represents the general rule, PPSA jurisdictions take divergent approaches in the following scenario.
>
> *An accounts financier is given a security interest on all the debtor's accounts and it registers first-in-time. Later, an inventory financer is given a purchase money security interest on all inventory that it supplies to D. The inventory financer takes the necessary procedural steps to ensure that it obtains the purchase money security interest*

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source of payment, the security right should be extended into whatever proceeds are received upon the disposition of the encumbered asset."

[125] See, for example, PPSA, s. 30(2).

[126] UNCITRAL, *supra* note 6 at Chap I para. 17: "This principle of carrying the security right forward into proceeds is generally thought necessary to protect the rights of the secured creditor whenever a grantor sells or leases an encumbered asset."; Cuming, Walsh & Wood, *supra* note 65 at 552.

> *superpriority. Some of the inventory is then sold to customers giving rise to proceeds in the form of accounts owing to the debtor.*
>
> There are two distinct approaches that have been adopted in the various PPSA jurisdictions. In Ontario and the Atlantic provinces the inventory financer is given priority only if it gives advance notice to the accounts financer of its intention to take a purchase money security interest in the inventory.[127] In the Western provinces and the Territories,[128] the accounts financer is given priority over the inventory financer provided that the accounts financer claims the accounts as original collateral rather than as proceeds and has given new value for them.[129]

The above account nicely demonstrates that lawmakers with differing perspectives can undertake the same balancing exercise and arrive at divergent conclusions. In any case, it is clear that the PPSA, in the name of 'balance' and 'fairness', enables secured creditors to pursue proceeds of their original collateral. These same values – 'balance' and 'fairness' – also help delimit the extent of that power through the PPSA's special priority rules. As a PPSL value, then, 'balance' commands that lawmakers, in fashioning priority rules, weigh the legitimate interests of all affected parties.

k. comprehensiveness

UNCITRAL concisely describes the PPSL value of 'comprehensiveness'.

> The *Guide* is based on the premise that secured credit is promoted when restrictions concerning who may be a grantor or a secured creditor, what types of assets may be encumbered and what kinds of obligation may be secured are minimized. Thus, States should aim at enacting legislation that is comprehensive in scope and that, as far as possible, embraces all forms of secured transactions,

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[127] See, for example, OPPSA, s. 33(1).

[128] See, for example, SPPSA, s. 34(6).

[129] Cuming, Walsh & Wood, *supra* note 65 at 464; For another account of this distinction, see Wood, *Acquisition Financing*, *supra* note 58 at 58.

> all categories of grantors and secured creditors and all types of movable asset and secured obligation.[130]

The PPSA aims to furnish a comprehensive statutory framework governing "the creation, perfection, priority and enforcement of security interests in all types of personal property."[131] This point is axiomatic – particularly in the Canadian PPSA context, where substantial comprehensiveness has been reality for decades – and will thus be of limited assistance during the comparative analytical evaluation process. However, in contrast with the PPSA, consider the *Bank Act* security provisions, which do not embody the value of comprehensiveness.[132] With reference to *Bank Act* security, only chartered banks may take it, only certain classes of borrowers may grant it, and only enumerated types of personal property may be encumbered pursuant to it.[133] The *Bank Act* security provisions furnish a restricted system, and are unlike the PPSA, which applies, comprehensively, to all creditors, debtors and personal property varieties.

l. uniformity

'Uniformity', as a PPSL value, exhibits an inter-jurisdictional flavour.[134] The theory behind inter-jurisdictional uniformity is that commercial participants are

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[130] UNCITRAL, *supra* note 6 at Intro para. 61. See similar statements at Intro paras. 50, 53 and 62.

[131] Cuming, Walsh & Wood, *supra* note 65 at 6; Duggan & Ziegel, *supra* note 22 at 22.

[132] Clayton Bangsund, "A Critical Examination of Recently Proposed Amendments to the *Bank Act* Security Provisions" (2012) 75(2) Sask. L. Rev. 211 at 218.

[133] See Clayton Bangsund, "Another Appeal for Pragmatic Reform: The Future of Section 427 Bank Act Security and Canadian Personal Property Security Law", (2012) Social Science Research Network (posted January 31, 2012), online: SSRN <http://ssrn.com/abstract=1995572>, in which I propose the suspension and ultimate repeal of the *Bank Act* security provisions.

[134] For a historical account of the Canadian PPSA uniformity initiative, see Duggan & Ziegel, *supra* note 22 at 18-20.

better served if there is substantial standardization in personal property security legislation across provincial and state lines.[135] Canada and the United States both furnish examples of organizations devoted to achieving national inter-jurisdictional uniformity. In Canada, the Uniform Law Conference of Canada has, as its objective, the harmonization of laws from province to province and territory to territory.[136] In the United States, the foremost specimen of uniformity is the Uniform Commercial Code, a model code enacted uniformly, more or less, across all 50 American states.[137]

m. coherency

'Coherency', as a PPSL value, embodies the ideal of treating like property alike, in a conceptually consistent manner. The PPSA endeavours to subject different forms of personal property, which exhibit similar legal incidents, to a consistent set of legal directives and procedures. 'Coherency' rounds out the PPSL values.

C. EVALUATIVE CRITERIA (CUM PRINCIPLES)

1. ARTICULATION

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[135] See Wood, *Acquisition Financing*, *supra* note 58 at 51, n. 14.

[136] See Uniform Law Conference of Canada, online: ULCC <http://www.ulcc.ca/en/home/>; The Canadian Conference on Personal Property Security Law also aspires to the achievement of substantial uniformity across Canada.

[137] For more information on the UCC, and its co-sponsors, the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Law (NCCUSL), see, generally, Duke Law, online: Uniform Commercial Code <http://law.duke.edu/lib/researchguides/ucc/>.

Having (i) reviewed the PPSL values in the *generic* PPSA context in Part IV.B, I articulate, in Part IV.C, five evaluative criteria tailored to the *specific context* of deposit accounts. The evaluative criteria are divided along five lines, largely derived and adapted from the substantive structural design of Cuming, Walsh & Wood's seminal Canadian personal property security law treatise: 1. Creation & Perfection;[138] 2. Risk Assessment;[139] 3. Dispute Resolution;[140] 4. Competitive Market;[141] and 5. Proceeds.[142] In enunciating the evaluative criteria, I have considered all of the PPSL values to the fullest extent possible.[143] Each evaluative criterion is preceded with an explanation for its articulation, and followed by a listing of the PPSL values it engages and draws upon.

CREATION & PERFECTION

As detailed above in my discussion of the PPSL values, personal property security regimes aim to facilitate secured transactions in many different forms of personal property. A primary facet of this facilitation pertains to the initial creation

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[138] Cuming, Walsh & Wood, *supra* note 65, Chapter 4 (Creation of a PPSA Security Interest) & Chapter 5 (Perfection).

[139] *Ibid.,* Chapter 6 (The Registration System).

[140] *Ibid.*, Chapter 7 (Transferees of Collateral), Chapter 8 (Competitions Among Secured Parties), Chapter 9 (Competitions with Other Claimants) & Chapter 10 (The Effects of Bankruptcy and Insolvency Proceedings on Security Interests).

[141] "Competitive Market" is the lone orphan. Cuming, Walsh & Wood, *ibid.*, do not dedicate a chapter (or chapters) of their personal property security law treatise to the importance of maintaining effective competition in the secured credit marketplace because the point is trite, and thus rightly assumed. However, the authors do note the importance of open competition in the secured credit marketplace. See, for example, the authors' discussion at 709.

[142] *Ibid.,* Chapter 11 (Following and Tracing into New Forms of Collateral).

[143] UNCITRAL, *supra* note 6 at Intro para. 48: "Thus it is important for States not just to choose selectively among these objectives, but also to take all of them into account to the fullest extent possible."

and perfection of security interests by willing commercial participants. A secured creditor and its debtor ought to be able to achieve creation and perfection of a security interest in a deposit account at minimal expense and with sufficient ease and simplicity. Thus the first evaluative criterion concerns effectuation of secured transactions.

CRITERION A ~ CREATION & PERFECTION

An optimal deposit account regime will accommodate, in a simple and inexpensive manner, the creation and perfection of a security interest in a deposit account (either as original collateral or proceeds) as desired by the debtor and any prospective secured creditor.

FACILITY - FLEXIBILITY - SIMPLICITY - EFFICIENCY - EQUALITY - BALANCE

RISK ASSESSMENT

A second major dimension of secured transactions facilitation concerns effective risk assessment for all commercial creditors. At the outset of a commercial relationship, a prospective secured creditor ought to be in a position to reasonably accurately predict, with sufficient ease and at minimal expense, the probable outcome of a priority dispute concerning its original collateral and/or proceeds, or at the very least, reasonably foresee potential subordination risks. Thus the second evaluative criterion concerns the accommodation of risk assessment undertakings.

CRITERION B ~ RISK ASSESSMENT

An optimal deposit account regime will enable any creditor, with minimal effort and expense and prior to its extension of credit to the debtor, to reasonably accurately predict the probable outcome of a priority dispute in respect of the deposit account balance (whether original collateral or proceeds).

FACILITY - TRANSPARENCY - SIMPLICITY - EFFICIENCY - PREDICTABILITY - CERTAINTY - CLARITY - EQUALITY - BALANCE

DISPUTE RESOLUTION

Another key dimension of secured transactions facilitation pertains to the efficient resolution of priority disputes. Where disputes do arise, secured creditors should be able to turn to a statutory regime that furnishes, and to a court system that enforces, clear bright-line rules that hinge on easily and inexpensively ascertained objective evidence. Ideally, such a regime will enable commercial players to altogether avoid the time and expense associated with formal dispute resolution proceedings before the judiciary. Thus the third evaluative criterion concerns dispute resolution.

CRITERION C ~ DISPUTE RESOLUTION

An optimal deposit account regime will, in the event of a priority dispute in respect of the deposit account balance, furnish a clear and certain priority rule which hinges on easily and inexpensively ascertained objective criteria and evidence.

FACILITY - TRANSPARENCY - SIMPLICITY - EFFICIENCY - CERTAINTY – CLARITY - BALANCE

Competitive Market

Another critical dimension of a personal property security regime concerns its adherence to basic competitive market principles. To the extent possible, a secured transactions regime ought to embrace the principles of free market competition by placing all commercial players, regardless of their class or character, on a level playing field. Thus the fourth evaluative criterion pertains to the benefits of an optimally competitive marketplace in a capitalist system.

Criterion D ~ Competitive Market

An optimal deposit account regime will create an ideally competitive marketplace for security interests in deposit accounts by subjecting all prospective secured creditors to the same substantive and procedural rules.

FACILITY - FLEXIBILITY - SIMPLICITY - EQUALITY - BALANCE

Proceeds

A personal property security regime ought to protect, to some degree, a secured creditor's claim to the proceeds of its disposed-of original collateral. Where a debtor disposes of encumbered personal property, its secured creditor should receive a substitute security interest in the original collateral's identifiable and traceable proceeds; this is a litmus test of the proprietary strength of personal property security. Thus the fifth evaluative criterion pertains to a secured creditor's ability to pursue the proceeds of its original collateral.

CRITERION E ~ PROCEEDS

An optimal deposit account regime will simultaneously (a) enable a secured creditor, with minimal effort and expense, to claim (i) a deposit account balance as proceeds of its original collateral, and (ii) the proceeds of a deposit account balance either as first or subsequent generation proceeds, and (b) for both (i) and (ii), furnish a clear and certain priority rule that fairly balances the interests of the secured creditor and relevant third parties.

FACILITY - FLEXIBILITY - SIMPLICITY - EFFICIENCY - PREDICTABILITY - CERTAINTY - CLARITY - BALANCE

2. *ENGAGED, UNENGAGED, & EQUIVOCAL VALUES*

a. Engaged Values

Ten of the PPSL values – including the prime value[144] of 'facility' – are drawn upon and identified in support of the articulation of the evaluative criteria. Meanwhile, three PPSL values – 'comprehensiveness', 'uniformity' and 'coherency' – are noticeably absent. Explanation is required.

b. Comprehensiveness Unengaged

As noted above, the PPSA aims to furnish a comprehensive statutory framework governing the creation, perfection, priority and enforcement of security interests in all types of personal property. Again, this point is axiomatic, particularly

[144] policy: see note 54.

in the Canadian PPSA context where substantial comprehensiveness has been reality for decades. Thus, 'comprehensiveness', as a PPSL value, offers no guidance in the specific context of deposit account perfection and priority ordering, and is not drawn upon or named in support of the articulation of the evaluative criteria.

c. Uniformity Equivocal

'Uniformity' is certainly a worthwhile ideal,[145] but it does not, by itself, furnish any intellectual guidance[146] in the deposit account perfection and priority ordering debate.[147] Here is why. Control proponents argue that Canadian jurisdictions ought to adopt the deposit account control paradigm to, *inter alia,* bring Canadian law in line with American law.[148] But, of course, it can also be argued, with equally persuasive intellectual force, that American law should be

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[145] One might argue that the jurisdictionally monopolistic nature of legal practice dampens the benefits associated with uniformity. A significant credit transaction, exhibiting an inter-jurisdictional dimension, typically requires lawyer(s), within each relevant jurisdiction, to assist in effecting the transaction including but not limited to the rendering of a legal opinion. This reality tends to undercut arguments about the efficiency (or economy in terms of transaction expense) of inter-jurisdictional uniformity.

[146] At most, uniformity offers *practical guidance*. If, for example, it was known with certainty that the ALI and NCCUSL would *never* adopt a registration paradigm for UCC Article 9, but that Canadian PPSA jurisdictions *might* adopt a control paradigm, one could argue that the Canadian PPSA jurisdictions ought to transition to a control paradigm for purposes of uniformity.

Practical guidance would also issue in the following type of scenario. If, hypothetically, ninety-eight jurisdictions adopted the X paradigm, while only one adopted the Y paradigm, a hundredth jurisdiction contemplating which paradigm to adopt might rationally select paradigm X principally for reasons of uniformity.

[147] I make the same point in Clayton Bangsund "'But I Didn't Mean To': The Role of Intent in U.S. and Canadian Anti-Preference Law" (2013) 50(4) Alta. L. Rev. 815 at 839.

[148] Ontario Bar Association, Personal Property Security Law Subcommittee, "Perfecting Security Interests in Cash Collateral" (February 6, 2012) ("*OBA Proposal*"), online: <http://www.oba.org/Advocacy/Submissions> at 14 (Background Paper); Letter from Katherine Darras (ISDA) to Robin Edger (Ontario Government) (May 7, 2012), ("*2012 ISDA Letter*") online: ISDA <http://www2.isda.org/regions/canada/>.

brought in line with Canadian law via adoption of the registration paradigm. Either solution addresses the uniformity concern. Therefore, in this debate, 'uniformity' is equivocal as a PPSL value, and is not named in support of the articulation of the evaluative criteria.

Which paradigm and model-type, for deposit account perfection and priority ordering, best observes the values of personal property security law? Only once this question is answered, with reference to the remaining PPSL values, can inter-jurisdictional 'uniformity' offer any intellectual guidance in the debate surrounding deposit account perfection and priority ordering. As stated by Gullifer, "the question of what the law should be comes logically before the question of harmonization."[149]

d. Coherency Equivocal

Recall that 'coherency', as a PPSL value, embodies the ideal of treating like property alike. Indeed, this is one of the principal arguments advanced in support of the adoption of a control paradigm for deposit accounts:[150] Given the deposit account's likeness to investment property (which is subject to a control paradigm), the two types of property should be treated alike.[151] A detailed examination of this argument is outside the purview of this chapter, but an obvious flaw, or inconsistency, should be noted.

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[149] Louise Gullifer, "What Should We Do About Financial Collateral?" (2012) 65 Current Leg. Probs. 377 at 378.

[150] OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 148; Letter from Francois Bourassa (ISDA) to Allen Doppelt (Ontario Government) and Doug Morrison (Alberta Government) (June 8, 2009) ("*2009 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.

[151] OBA PPSL Subcommittee, *OBA Proposal*, *ibid.* at 14 (Background Paper).

One wonders why the 'coherency' argument advanced by control proponents is limited to deposit accounts, and not advanced in respect of other forms of intangible personal property such as general accounts receivable (of which deposit accounts are merely one unique subspecies[152]). After all, realizing conceptual coherency, as between deposit accounts and investment property, will *of necessity* create incoherency, as between those property types (i.e., deposit accounts and investment property, which would be subject to the control paradigm) and all other intangibles (which would remain subject to the registration paradigm). For this reason, 'coherency', as a PPSL value, also tends toward equivocality, and is not explicitly drawn on and named in support of the articulation of the evaluative criteria.[153] Additional questions are raised in relation to the 'coherency' argument, which will be pursued in detail in Chapter 8.

3. Conclusion

Each aspect of the evaluative exercise is important, and deserves its due consideration in plotting the overall design of a regime for deposit accounts. The matter can be summarized rather succinctly: Creating and perfecting a security interest in personal property, including a deposit account, should be easy and inexpensive for a prospective secured creditor and a willing debtor. The secured creditor should be able to reasonably predict the probable outcome of a priority

[152] The deposit account is a specific variety of account receivable owing from bank to customer. For a detailed historical review of the deposit account and the chose in action, see Bangsund, *Historical Review*, *supra* note 1.
[153] Gullifer, *supra* note 149 at 380.

dispute over the account and/or its proceeds, or at the very least, reasonably foresee potential subordination risks. Where a priority dispute does arise, the secured creditor should be able to turn to a statutory regime that furnishes, and to a court system that enforces, clear rules based on easily and inexpensively ascertained objective criteria and evidence. Where the debtor disposes of encumbered collateral, including a deposit account, the secured creditor should receive a substitute security interest in the collateral's identifiable and traceable proceeds. All of the foregoing should ideally occur within a competitive marketplace that places all prospective secured creditors on a level playing field.

The evaluative criteria (*cum* principles) articulated in this chapter – and by implication, the PPSL values underlying them – will help guide me on my quest to identify and expound upon an optimal, or at least improved, legal framework for the governance of perfection and priority ordering in respect of security interests in deposit accounts. The various existing and proposed deposit account regimes will be measured against such principles, and on such principles my theory will rest.

CHAPTER 3 ~ SET-OFF

I. INTRODUCTION

A. THE POWER OF SET-OFF

Set-off has inspired massive works,[1] in part because it raises interesting conceptual questions,[2] but also because it arises in innumerable contexts.[3] Set-off can be asserted in court as a procedural defence[4], and is often asserted, initially, as a self-help remedy.[5] In this latter context, set-off is especially powerful.[6] Banks

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[1] Philip R. Wood's text on the subject is 1,287 pages; Rory Derham's is 982. *Infra* note 2.

[2] For example, there is debate about whether set-off is procedural or substantive. See Kelly R. Palmer, *The Law of Set-Off in Canada* (Aurora: Canada Law Book, 1993) at 9-15. There is also ongoing debate about the proper conceptualization of current account set-off (i.e. account combination); see Philip R. Wood, *English and International Set-Off* (London: Sweet & Maxwell, 1989) ("*International Set-Off*") at paras. 1-19, 3-5 through 3-6; and Rory Derham, *Derham on the Law of Set-Off*, 4th ed. (Oxford: Oxford University Press, 2010) at paras. 15.03-15.17.

[3] Set-off issues arise in (i) bankruptcy and insolvency proceedings – see for example, *Cdn. Admiral Corp. v. L.F. Dommerich & Co.*, [1964] S.C.R. 238; *Coopers & Lybrand Ltd. v. Lumberland Building Materials Ltd.* (1983), 150 D.L.R. (3d) 411, 1983 CarswellBC 572 (S.C.); *Cam-Net Communications v. Vancouver Telephone Co.*, 1999 BCCA 751; *Caisse populaire Desjardins de l'Est de Drummond v. Canada*, [2009] 2 S.C.R. 94 ("*Drummond*"); (ii) judgment enforcement proceedings – see, for example, *McCready Co. v. Alberta Clothing Co.* (1910), 3 Alta. L.R. 67 (S.C.); *Burman v. Rosin* (1916), 26 D.L.R. 790 (Ont. S.C.); *Palmer v. Southwood*, (1976), 67 D.L.R. (3d) 327, [1976] 3 W.W.R. 556 (Alta. S.C); (iii) secured transactions and accounts factoring arrangements – see *Cdn. Admiral Corp. v. L.F. Dommerich & Co., supra*; *Atlantic Acceptance Corp. v. Burns & Dutton Construction (1962) Ltd.* (1970), [1971] 1 W.W.R. 84 (Alta. C.A.); *Telford v. Holt*, [1987] 2 S.C.R. 193 ("*Telford v. Holt*"); *Indian Head Credit Union v. Andrew,* 1992 CarswellSask 358 (C.A.) ("*Indian Head Credit Union*"); *Drummond*, *supra*; and (iv) trust arrangements – see *Daniels v. Imperial Bank* (1914), 19 D.L.R. 166 (Alta. S.C.); *Fonthill Lumber Ltd. v. Bank of Montreal*, [1959] O.R. 451 (C.A.).

[4] Ronald C.C. Cuming, "Security Interests in Accounts and the Right of Set-Off" (1991) 6 B.F.L.R. 299 ("*Security Interests and Set-Off*") at 304.

[5] P. Wood, *International Set-Off, supra* note 2 at para. 1-18.

[6] Set-off as a self-help remedy essentially embodies, in the "intangible world," the same idea captured in the "tangible-world" expression, "possession is nine-tenths of the law." Of course, a mere assertion of set-off is not dispositive of the matter. However, asserted as a self-help remedy, set-off forces the party against whom it is asserted to decide whether or not to challenge such assertion in court. An

routinely assert set-off against deposit account balances (generically referred to as "deposit account set-off") as a self-help remedy,[7] and therefore hold a powerful realization tool. This chapter investigates the limits of that power in common law Canada, an important preparatory task. Since set-off principles affect priority outcomes, they must be considered in any analysis of the statutory models and regimes that produce such outcomes.

B. THE BASIC CONCEPTUALIZATION OF SET-OFF

"Set-off" is broadly defined as the "discharge of reciprocal (monetary[8]) obligations to the extent of the smaller obligation."[9] Imagine that A owes B $100, and that B owes A $60 in a related or unrelated transaction. B's claim against A is property in the hands of B; an account (a species of intangible under the PPSA taxonomy) or a chose in action (under the common law taxonomy). So too is A's claim against B. Pursuant to set-off principles, B may be entitled to extinguish his indebtedness to A; he may do so by using his property (i.e. his monetary claim against A) to reduce or retire A's reciprocal monetary claim.[10] In technical set-off

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unchallenged assertion is necessarily resolved in favour of the asserter, regardless of what the outcome would have been had the assertion of set-off been challenged.

[7] P. Wood, *International Set-Off, supra* note 2 at paras. 3-11 through 3-14.

[8] *Ibid.* at para. 1-91.

[9] *Ibid.* at para. 1-1.

[10] *Ibid.* at para. 1-3, where P. Wood describes the proper conceptualization of set-off: "Note that the debtor uses his asset to pay his liability. He sets off the cross-claim owed to him to pay the creditor's claim. The debtor does not apply the creditor's claim to pay the cross-claim. It is vital at the very outset to get the property in the debts the right way round."

At para. 1-51, P. Wood notes that set-off can be conceptualized as a form of payment (or mutual cross-payment): "Set-off may be regarded as similar to payment. In setting off his cross-claim, the debtor 'pays' the creditor's primary claim *pro tanto* and obliges the creditor to 'pay' the cross-claim. There is therefore a *pro tanto* redemption, discharge, satisfaction, extinguishment or reduction of the reciprocal debts. Set-off pays them both. In formal terms, set-off is a form of discharge."

parlance, B may "*set off*[11] *his property against*" – or, worded alternatively, "*assert his right of set-off against*" – A's property.[12] This does not mean, however, that B has a *proprietary right* in A's property; instead, A's claim against B is merely reduced or retired by operation of law. In this sense, the right of set-off is distinguishable from a scenario in which A specifically grants B a security interest in A's property to secure repayment of A's indebtedness to B. This distinction, though subtle, is important because registration of a financing statement with the PPR is required under the latter scenario (if B wishes to optimize his position under the conventional PPSA priority rules), but not under the former.[13]

C. Chapter Overview

This chapter is comprised of four parts, inclusive of this introduction. Playing a foundational role, Part II sets out the basic Canadian principles of legal, equitable and contractual set-off. Specifically, Parts II.A and II.B examine legal set-off and equitable set-off respectively, while Part II.C examines contractual set-off as a

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P. Wood's most colourful account of the proper conceptualization of set-off in the banking context is furnished in Philip R. Wood, *Set-Off and Netting, Derivatives, Clearing Systems*, 2nd ed. (London: Sweet & Maxwell, 2007) ("*Set-Off & Netting*") at para. 1-022: "Set-off uses the loan to knock out the deposit, like skittles. Set-off is the discharge of both reciprocal claims. Thus a bank applies a loan owed to it to pay a deposit owed by it – its asset to pay its liability. The bank does not retain a deposit as a lien because it has no property over the deposit: the property of the deposit is held by the depositor. Note that in set-off the debtor uses its asset to pay its liability: it pays with its asset."

[11] The term "set off" (i.e. absent a hyphen) is used as a verb. See P. Wood, *International Set-Off*, *ibid.* at para. 1-4.

[12] There is a noticeable lack of strict adherence to P. Wood's technical conceptualization in both case law and academic commentary. P. Wood's "orders of operation" are regularly reversed, but outcomes are rarely affected, or in any way tainted, by virtue of their non-compliance with P. Wood's metaphysics. Nonetheless, I prefer his conceptualization, and endeavour to adhere to it consistently.

[13] In the context of contractual set-off, the distinction is more than subtle; it's tenuous, and vulnerable to challenge. See Clayton Bangsund "Set-Off & Security Interests" (2017) 50(1) UBC L. Rev. 1.

supplement to or variance of legal and equitable set-off rights, with a specific focus on the bank's right of account combination and the express contractual set-off clauses that govern deposit account balances.

Part III explores and articulates the principles that govern when a deposit account balance is claimed by an assignee (secured party or absolute transferee) asserting a proprietary right under the PPSA, on one hand, and by the bank (with which the deposit account balance is maintained) asserting a right of deposit account set-off, on the other. This task directly assists in analyzing and assessing the perfection paradigms – registration and control – in later chapters of this thesis.

The chapter closes, in Part IV, with some final words respecting (i) the power of deposit account set-off, (ii) deposit account set-off's relevance to and impact on PPSA security interests in deposit accounts, and (iii) the basic fact that deposit account set-off is inextricably linked to the PPSA's deposit account perfection and priority rules, and therefore must be measured, and possibly reformed itself, as part of any legislative reform effort respecting such rules.

II. CANADIAN PRINCIPLES OF LEGAL, EQUITABLE & CONTRACTUAL SET-OFF[14]

A. LEGAL SET-OFF

[14] In Canada, set-off has been divided into three general categories. See *Telford v. Holt*, *supra* note 3 at para. 22; Also see Benjamin Geva, "Rights in Bank Deposits and Account Balances in Common Law Canada" (2012) 28 B.F.L.R. 1 ("*Rights in Bank Deposits*") at 5.

Legal set-off traces back to two early eighteenth century English statutes.[15] In *Telford v. Holt,* the Supreme Court of Canada articulated the basic requirements for legal set-off, in the modern Canadian tradition, by quoting approvingly from the British Columbia Court of Appeal decision *Canadian Imperial Bank of Commerce v. Tuckerr Industries Inc.*[16]

> Statutory set-off (or set-off at law) "requires the fulfilment of two conditions. The first is that both obligations must be debts. The second is that both debts must be mutual cross-obligations."[17]

Thus, legal set-off requires (i) mutuality between the party asserting set-off and the party against whom set-off is asserted, and (ii) that the cross-obligations constitute debts both existing and payable at the time set-off is asserted.[18] It follows that legal set-off only arises between two parties holding mutual cross-debts, whether or not such debts arose under connected contracts.

B. EQUITABLE SET-OFF

1. GENERAL PRINCIPLES

Also in *Telford v. Holt*, the Supreme Court of Canada enunciated the principles of equitable set-off.

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[15] 1729, 2 Geo. II, c. 22; 1735, 8 Geo. II, c. 24. See *Telford v. Holt*, *ibid.* at para. 23. Interestingly, the first set-off statutes in the common law world were American, not English. See William H. Lloyd, "The Development of Set-off" (1916), 64 U. Pa. L. Rev. 541 at 553, where the author notes that the first set-off statute was enacted in Virginia in 1645.
[16] 1983 CarswellBC 552, [1983] 5 W.W.R. 602 (B.C.C.A.).
[17] *Telford v. Holt*, *supra* note 3 at para. 25.
[18] Geva, *Rights in Bank Deposits, supra* note 14 at 6 and 41.

> Equitable set-off is available where there is a claim for a money sum whether liquidated or unliquidated: see *Aboussafy v. Abacus Cities Ltd.* More importantly in the context of this case, it is available where there has been an assignment. There is no requirement of mutuality. The authorities to be reviewed indicate that courts of equity had two rules regarding the effect of a notice of assignment on the right to set-off. First, an individual may set off against the assignee a money sum which accrued and became due prior to the notice of assignment. And second, an individual may set off against the assignee a money sum which arose out of the same contract or series of events which gave rise to the assigned money sum or was closely connected with that contract or series of events.[19]

Equitable set-off can thus be conceptualized as a *relaxation* of the strict rules of legal set-off.[20] Unlike legal set-off, equitable set-off does not require mutuality,[21] but may require a close connection between the obligations being set off.[22] Additionally, equitable set-off does not necessarily require that the cross-obligations constitute liquidated debts; unliquidated claims may be the subject of equitable set-off.[23]

Where there has been assignment, either or both of two rules of equitable set-off may apply in favour of an account debtor who finds himself embroiled in a dispute with the assignee: the unconnected claims notification rule (referred to by

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[19] *Telford v. Holt*, *supra* note 3 at para. 27.

[20] Palmer, *supra* note 2 at 5 and 65; But consider the bizarre case of *Coffey Estate v. Coffey*, 2014 CarswellBC 184, 2014 BCSC 110 at paras. 42 and 45, where, quite remarkably, the court disallowed equitable set-off yet allowed legal set-off!

[21] In England, equitable set-off generally requires mutuality. See *Muscat v. Smith*, [2003] E.W.C.A. 962 at para. 50. Unlike Canadian courts, however, English courts do not view assignment of one of the mutual cross-claims as destroying mutuality, instead regarding this as an "exception" to the general mutuality requirement. See Richard Calnan, *Taking Security: Law and Practice*, 2nd ed. (Bristol: Jordan Publishing, 2011) at 468; Also see Rory Derham, "Equitable Set-Off: A Critique of *Muscat v. Smith*" (2006) 122 L.Q.R. 469 at 484.

[22] *A. & E. Capital Funding Inc. v. Maplex General Insurance Co.*, 1999 CarswellOnt 1884, (1999) 10 C.B.R. (4th) 225 (C.A.); Also see *Cam-Net Communications v. Vancouver Telephone Co.*, *supra* note 3 at para. 30: "The interrelatedness of the obligations giving rise to the two claims may give rise to the possibility of unfairness to the appellant if set-off is not allowed."

[23] See, for example, *Coopers & Lybrand Ltd. v. Lumberland Building Materials Ltd.*, *supra* note 3 at paras. 16-17.

Wilson J., in *Telford v. Holt*, as the "general rule") and/or the close connection rule (referred to by Wilson J. as the "exceptional rule").[24]

2. *UNCONNECTED CLAIMS NOTIFICATION RULE*

Pursuant to the unconnected claims notification rule, an account debtor can set off against the assignee a money sum which accrued and became due[25] (i.e. was existing and payable) prior to the notice of assignment.[26] In other words, under the unconnected claims notification rule, an account debtor is entitled to assert equitable set-off against an assignee to the same extent that it would have been able to assert legal set-off against the assignor immediately prior to receipt of notice of the assignment.[27]

3. *CLOSE CONNECTION RULE*

The close connection rule is more liberal than the unconnected claims notification rule. Under the close connection rule, debts accrued but not due at the

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[24] For a detailed account of the strictures of equitable set-off, see Clayton Bangsund & Jasmine Lothian "Inequity in Equitable Set-Off: Telford v Holt Revisited" (2016) 94(1) Can. Bar Rev. 149.

[25] Master Funduk offers a characteristically concise description of the distinction between "due" and "accruing due" in *Macdonald & Macdonald Outdoor Advertising Inc. v. Edmonton Centre Elks Lodge No. 552*, (1997) 49 Alta. L.R. (3d) 192 at para. 18: "A debt which is due is a debt whose time for payment has arrived. A debt which is accruing due is a debt whose time for payment has not yet arrived, that is, a debt which is to be paid at a future date but which cannot be sued for before that date: Dunlop, p. 377. Most debts which are "accruing due" depend only on the effluxion of time to become due." In this chapter, I tend to use the terms "existing" and "payable", as they are less ambiguous than the terms "accruing due" and "due".

[26] *Telford v. Holt, supra* note 3 at paras. 27 and 33.

[27] *Ibid.* at para. 33; Also see Geva, *Rights in Bank Deposits, supra* note 14 at 39: "Possibly with the view of protecting the account debtor's reasonable expectations, it has been persistently held, that an assignee takes a debt subject to legal (i.e. statutory) set-off, namely, subject to the debtor's right to set off a liquidated amount owing from the assignor under a separate transaction."

time of notice of the assignment (i.e. debts existing but not payable) can nonetheless be set off by the account debtor against the assignee if the contracts to which the debts relate are closely connected and it would be manifestly unjust to refuse set-off in the circumstances.[28] Thus, unlike the unconnected claims notification rule, the close connection rule incorporates the *debitum in praesenti solvendum in futuro* principle (i.e. immediate set-off of an existing debt that becomes payable at a future date due to the effluxion of time). Additionally, the close connection rule may apply, not only where the account debtor's claim is for a liquidated debt, but also where the account debtor's claim is unliquidated.[29] This demonstrates that there are also non-temporal reasons why one might assert the close connection rule of equitable set-off. The close connection rule – restated – provides that debts (and unliquidated claims) in existence but not payable at the time of notice of the assignment can nonetheless be set off by the account debtor against an assignee if (i) the cross-claims are closely connected, and (ii) it would be manifestly unjust to refuse set-off in the circumstances.[30]

C. CONTRACTUAL SET-OFF

1. EXPANSION & CONTRACTION

[28] *Telford v. Holt*, *ibid.* at paras. 34 and 39.
[29] *Telford v. Holt, ibid*. at para. 27; Also see Geva, *Rights in Bank Deposits*, *supra* note 14 at 11.
[30] *Telford v. Holt*, *ibid.* at paras. 34 and 39.

The principles of legal and equitable set-off may be varied under contract.[31] In addition to any legal or equitable set-off rights that may exist in favour of the account debtor, a party may bargain with his contractual counterparty for, or against, set-off rights, in which case the extent of such rights can be tailored to the parties' specifications. The purpose of such contractual clauses is usually to expand, not narrow or eliminate,[32] set-off rights.[33]

2. *Account Combination: Implied Contractual Term*

In the banking industry, the unique relationship between a bank and its customer gives the bank an implied contractual right of "account combination."[34]

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[31] *Telford v. Holt*, *ibid.* at para. 22; *Teneycke v. Saskatchewan Wheat Pool*, 2000 SKQB 191; *Drummond*, *supra* note 3 at para. 22.

[32] M.H. Ogilvie, *Bank and Customer Law in Canada* (Toronto: Irwin Law, 2007) at 249: "Finally, there can be no exercise of the right of set-off where it has been expressly excluded by agreement or by a course of dealings between the bank and the customer."; Also see *National Westminster Bank Ltd. v. Halesowen Presswork and Assemblies Ltd.* [1972] A.C. 785; *New Brunswick (Minister of Commerce & Development) v. Bank of N.S.* (1988), 95 N.B.R. (2d) 330.

[33] See Ewan McKendrick, ed., *Goode on Commercial Law*, 4th ed. (London: Penguin Books, 2010) at 650; Also see Louise Gullifer, ed., *Goode on Legal Problems of Credit and Security*, 4th ed. (London: Sweet & Maxwell, 2009) at para. 7.26, for an account of the effect of contractual modification of set-off rights on an assignee: "In general an assignee of a debt takes subject to equities, including the debtor's right of contractual set-off as regards cross-claims on another account for advances made to the creditor prior to the debtor's receipt of notice of assignment. Where the terms of the set-off extend to contingent liabilities of the creditor to the debtor it would seem that the assignee takes subject to those contingent liabilities. But the debtor cannot assert a contractual set-off in respect of claims arising from new dealings with the creditor after the debtor has received notice of assignment."

[34] Ogilvie, *supra* note 32 at 247: "A bank's right to combine accounts in order to discharge an overdraft is based on the fundamental bank and customer contractual relationship entered into when the first account is opened."; Also see Geva, *Rights in Bank Deposits, supra* note 14 at 16: "It is noteworthy that the existence of the common law right to combine accounts presupposes that the mere existence of separate accounts does not amount to an agreement precluding the combination. Rather, as indicated, 'as between banker and customer, whatever number of accounts are kept in the [banker's] books, the whole is really but one account.' While contractual set-off is premised on the existence of an agreement permitting it, a banker's set-off is premised on the lack of an agreement precluding it."; Also see Gullifer, *supra* note 33 at para. 7-01.

Account combination[35] gives a depository bank the implied contractual right to set off, with or without advance notice, the customer's current debt balances against reciprocal deposit account balances.[36] P. Wood concisely describes the basic elements of account combination.

> The classic example is a bank current account. The chief characteristics of reciprocal claims on current account available for blending appear to include the following:
>
> > (a) There is a continuous relationship between the parties, notably the relationship between banker and customer.
> > (b) Both debit and credit balances are currently payable, in the sense that each must be paid on reasonable notice.
> > (c) Both claims are liquidated.[37]

Account combination can be conceptualized as a *reaffirmation* of existing legal set-off principles, with a self-help component.[38] As noted above, account combination can also be understood as an implied contractual term pursuant to which the bank is entitled to set off its customer's current debit balances against reciprocal deposit account balances.[39] In any event, as noted by P. Wood in the

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[35] This form of set-off takes a variety of names: "combining accounts", "account consolidation", "consolidation of accounts", "netting" and "blending". See N.W. Caldwell, "Security Interests in Proceeds: Account Consolidation and the PPSA" (1995) 59(1) Sask. L. Rev. 165 at 172.

[36] See Geva, *Rights in Bank Deposits*, *supra* note 14.

[37] P. Wood, *International Set-Off*, *supra* note 2 at para. 3-2.

[38] See Geva, *Rights in Bank Deposits, supra* note 14 at 14-16, where the author describes account combination as having all the features of legal set-off asserted against the depositor. Also consider the following excerpt at 16: "Possibly, however, an implied agreement with the customer precludes a bank from combining current and loan accounts so that 'sums paid into [a] current account … cannot be used by the bank in discharge of [a] loan account without the consent of the customer. At the same time, combination with the current account is permissible, where the customer is in default on the loan, so that the loan is 'presently payable' and not only 'owing or accruing.' Prior to that default, '[i]t is the implied agreement [between the bank and its customer] which results in [the] … separation [between the current and loan accounts], as opposed to a view that the different nature of the accounts precludes combination."

[39] Geva, *Rights in Bank Deposits, ibid.* at 19: "Rather, in my view, the bank's right to combine accounts is an implied term in the overarching banking as well as in each account contract. Under that

following two excerpts, account combination is a powerful tool in the hands of banks.

> As against interveners, such as assignees, the bank can treat the accounts as one so that an assignee takes subject to the set-off, but even here the fact than an assignee is subject to the set-off is explicable on the ordinary ground than an assignee usually takes subject to a liquidated cross-claim which the debtor has against the assignor, incurred before notice of the assignment and maturing before or at the same time as the assigned claim or (in the case of an independent set-off) before the assignee commences action for the assigned claim.[40]
>
> It is probably true to say that in no case can an intervener defeat a debtor's current account set-off. For example, an assignee of an assigned claim takes subject to an independent cross-claim owing by the assignor to the debtor which was incurred before the notice of assignment to the debtor if the cross-claim is a simple debt (not contingencies or future rent) and is due and payable before the assignee commences his action for the assigned claim.[41]

A notable qualification to P. Wood's broad statement respecting the power of account combination presents itself where the bank receives actual notice of an intervener's interest in specific funds[42] prior to their deposit in the customer's deposit account. In such an instance, the bank's right of account combination is

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contractual term, the bank is allowed to transfer to an overdrawn account, or in fact any account in a debit position which is in breach of the banking contract, funds available to the credit of the customer in another account. The bank may do so for its own protection as well as for the protection of the customer."; Also see Bradley Crawford, *The Law of Banking and Payment in Canada*, vol. 2 (Toronto: Canada Law Book, Looseleaf updated to November 2008), §9:60.20(3)(b): "It thus appears that the bank's right to combine accounts, while perhaps similar to the more general statutory right of set-off, is distinguishable by reason of having had its origin in the common law and the contractual relationship of banker and customer, rather than statute or the conscience of the Court of Equity."; Gullifer, *supra* note 33 at para. 7-01.

[40] P. Wood, *International Set-Off*, *supra* note 2 at para. 3-7.

[41] *Ibid.* at para. 3-28.

[42] Such funds must be "identifiable" and "traceable," and the intervener's claim to them is subject to the lowest intermediate balance rule. In other words, the intervener's proprietary claim in the deposit account balance may dissipate. For detailed discussion of tracing principles, see Ronald C.C. Cuming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law*, 2nd ed. (Toronto: Irwin Law, 2012) at 567-573.

defeated by the intervener's proprietary interest in the funds.[43] To suggest otherwise is to assert that banks have a license to knowingly convert others' property, which clearly cannot be the case.[44]

3. *SET-OFF CLAUSES IN CUSTOMER ACCOUNT AGREEMENTS: EXPRESS CONTRACTUAL TERMS*

Beyond account combination, express set-off clauses are commonplace in banks' customer account agreements.[45] Consider the following sample set-off clauses, drawn from three major banks' standardized customer account agreements, each available on the internet.

> **Bank of Montreal, Agreement for Business Banking**
>
> Section 5 – ... We may set off or apply funds available in your Account(s) to the amount of any indebtedness or liability you may have to us, in any manner we consider necessary and without prior notice to you, unless we have specifically agreed otherwise.[46]
>
> **RBC Royal Bank, Master Client Agreement**
>
> Section 1.8 – Set-off. Royal Bank may, at any time, and without notice, apply any credit balance (whether due or not) in any Account, or in any other account in the Customer's name or to which the Customer is beneficially entitled, maintained at any branch or agency of Royal Bank inside or outside

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[43] For application of this principle in the context of trust property, see *Fonthill Lumber Ltd. v. Bank of Montreal*, *supra* note 3 at para. 17.

[44] See Cuming, *Security Interests and Set-Off*, *supra* note 4 at 309; Caldwell, *supra* note 35 at 176: "There is, however, a further condition on the exercise of the right to consolidate accounts: the account debtor must lack knowledge of the security interest before the right to consolidate accounts exists."

[45] Ogilvie, *supra* note 32 at 247; McKendrick, *supra* note 33 at 650; Colin Bamford, *Principles of International Financial Law* (New York: Oxford University Press, 2011) at para. 3.26: "... It is common now for banks to include an explicit right of set-off in their standard forms of contract. In conformity with the normal caution of lawyers, the drafting often begins with the words 'in addition to any other rights the bank may have', in order to preserve the implied right of consolidation."

[46] http://www.bmo.com/pdf/Banking_Agreements.pdf.

> Canada, towards the payment of any obligation (including any contingent obligation) of the Customer to Royal Bank whether in the same or other currency. Royal Bank may use all or any part of any such credit balance to buy any currencies that may be necessary to effect that application. This right of set-off is in addition to, and in no way derogates from, Royal Bank's rights of consolidation and set-off under Applicable Laws.[47]
>
> **TD Canada Trust, Financial Services Terms**
>
> Section 4 – Set off debts against your accounts. We can apply a positive (credit) balance in any of your accounts with us against any debt, obligation or liability you may owe to us. We can set off these balances in any manner we consider necessary (unless we have specifically agreed not to do so), and we are not required to first give you any notice.[48]

Interestingly, two[49] of the three sample set-off clauses do not expand the right of set-off to any significant degree.[50] One might have expected, for example, that the typical customer account agreement would provide a bank with the right to set off any debit balances owing by the customer or its affiliates against any deposit account credit balances of the customer or such affiliates (i.e. relax legal set-off's mutuality requirement).[51]

4. Contractual Set-Off: Statement of Assumption re Account Combination

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[47] http://www.rbcroyalbank.com/business/pdf/Master-Client-Agreement_EN.pdf.

[48] http://www.tdcanadatrust.com/document/PDF/accounts/tdct-accounts-fst.pdf.

[49] The RBC Royal Bank clause includes the phrase "including any contingent obligation," ostensibly giving the bank the right to set off a contingent term debt against a deposit account balance. See P. Wood, *International Set-Off*, *supra* note 2 at paras. 5-10(b) and 5-50.

[50] One could also advance the argument that the TD Canada Trust clause should be interpreted to permit set-off of an unmatured term debt against a deposit account balance. But this interpretation should likely be rejected, particularly in light of the operative words "unless we have specifically agreed not to do so." See *Tilford Property Co. Ltd. v. Cannon Street Acceptance*, May 22, 1975, unreported, but described by P. Wood, *International Set-Off, ibid.* at para. 3-23; Also see *Williams & Glyn's Bank Ltd. v. Barnes* [1981] Com. L.R., also described by P. Wood at para. 3-23.

[51] P. Wood, *International Set-Off*, *ibid.* at para. 1-27; Gullifer, *supra* note 33 at paras. 7-21 and 7-27.

Based on the substance of the sample set-off clauses, my analysis in later chapters will proceed on the assumption, in respect of any particular deposit account balance, that the standardized customer account agreement governing such deposit account neither expands nor contracts the basic principles of account combination, but rather adopts those basic principles.[52] Thus, in the deposit account set-off context, the principles of contractual set-off are treated as synonymous with, or equivalent to, account combination.

III. SET-OFF & THE PERSONAL PROPERTY SECURITY ACT

A. INTRODUCTORY REMARKS

Any discussion of PPSA priority disputes[53] involving deposit accounts would be incomplete absent consideration of the principles of set-off, since the application of these principles may impact the outcomes of such disputes.[54] Between a secured party asserting priority to a deposit account on the basis of a PPSA security interest, and a bank asserting a superior claim to the deposit account on the basis of set-off, who prevails? And on what analytical grounds?

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[52] This assumption may not accurately reflect reality. For example, some banks may use more elaborate customer account agreements for "corporate families" where a multitude of distinct legal entities are under common control. See Gullifer, *ibid.* at para. 7-27.

[53] The better term may be "superiority dispute" when the competition is between a secured party asserting a proprietary claim in a deposit account and the bank asserting set-off against such account. See Cuming, *Security Interests and Set-Off, supra* note 4 at 301, n. 4, where the author, mindful of this distinction, describes the manner in which he uses the term "priority": "In this article, the term 'priority' is used to refer to 'a prior right' to the money. It is not used to indicate a ranking of two proprietary interests in the money."

[54] P. Wood, *Set-Off & Netting, supra* note 10 at para. 5-001; Cuming, *Security Interests and Set-Off, ibid.*

B. SUBSECTION 66(3)

1. THE STARTING POINT

A natural starting point for an analysis of the interplay between set-off principles and secured transactions principles is PPSA s. 66(3), reproduced below.

> The principles of the common law, equity and the law merchant, except insofar as they are inconsistent with the express provisions of this Act, supplement this Act and continue to apply.

2. PRINCIPLES OF THE COMMON LAW, EQUITY & THE LAW MERCHANT

As a preliminary note, the principles of legal, equitable and contractual set-off collectively constitute "principles of the common law, equity and the law merchant." For example, equitable set-off clearly constitutes a "principle of equity;" it actually identifies itself as such. Equitable set-off belongs to that "body of rules or principles which form an appendage to the general rules of law, or a gloss upon them."[55] Snell elaborates.

> In order to ensure the smooth running of society it is necessary to formulate general rules which work well enough in the majority of cases. Sooner or later, however, cases arise in which, in some unforeseen set of facts, the general rules produce substantial unfairness. When this occurs, justice requires either an amendment of the rule or, if (as in England some five or six centuries ago) the rule is not freely changeable, a further rule or body of rules to mitigate the severity of the rules of law.[56]

Telford v. Holt is a textbook example of equity in action. While legal set-off was unavailable to Telford, the Supreme Court of Canada, on grounds of fairness and

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[55] John McGhee, ed., *Snell's Equity*, 30th ed. (London: Sweet & Maxwell, 2000) at para. 1-03.
[56] *Ibid.* at para. 1-03.

to mitigate the perceived severity of the strict legal rule, allowed Telford an equitable set-off against Holt.

3. Deposit Account Set-Off & Subsection 66(3)

In the specific context of deposit account set-off, subsection 66(3) therefore provides that the principles of legal, equitable and contractual set-off, "except insofar as they are inconsistent with the express provisions" of the PPSA, supplement the PPSA and continue to apply.[57] To what extent, if at all, are the principles of set-off inconsistent with the express provisions of the PPSA? To what extent are set-off principles *embodied* in, or *statutorily recognized* by, the PPSA? Subsection 41(2) is clearly implicated. A series of illustrative scenarios help elucidate this provision and the PPSA framework for governance of deposit account set-off rights.

C. Deposit Account Set-Off v. True Security Interest

1. Deposit Account Set-Off v. Security Interest in Deposit Account as Original Collateral

a. C, D & Bank: Scenario 1

[57] This "PPSA paramountcy" is consistent with s. 74(2): "Except as otherwise provided in this or any other Act, if there is a conflict between this Act and any Act other than those referred to in subsection (1), this Act prevails."

Imagine a simple scenario.[58] In Scenario 1, C opens a deposit account with the Bank on day 1; $100 is deposited into the account. On day 2, the Bank grants C an unsecured revolving operating line of credit, payable on demand, with a borrowing limit of $100. C immediately draws down the operating line to the $100 limit, spending the borrowed funds on ephemeral luxuries. On day 3, C grants D a security interest in his deposit account to secure payment of a $100 debt obligation. D immediately perfects his security interest by registering a financing statement. On day 4, D notifies the Bank of his security interest in C's deposit account.[59] On day 5, C defaults on his payment obligation to D; consequently, D serves written notice on the Bank demanding that the Bank make payment of the $100 deposit account balance to him.[60]

In a subsequent dispute over the deposit account balance, how do the principles of legal, equitable and contractual set-off interact with the PPSA's rules governing conventional security? Between D and the Bank, who holds the superior position?

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[58] Admittedly, this simple scenario is contrived and, in the real world, is unlikely to occur in this specific fashion. A secured party is more likely to take a security interest in a commercial debtor's inventory (see Scenario 2) or general accounts receivable, both forms of collateral which generate proceeds that ultimately get deposited into the debtor's deposit account. However, to clarify, it is not unusual for a secured party to acquire a security interest in a deposit account as original collateral. Indeed, a standard general security agreement provides for such a security interest. See Jacob S. Ziegel, "Canadian Perspectives on the Law Lords' Rejection of the Objection to Chargebacks" (1998-1999) 14 B.F.L.R. 131 ("*Canadian Perspectives*") at 141. What is unusual about Scenario 1 is that the secured party is acquiring an isolated security interest in *only* the deposit account. See Roderick J. Wood, "Acquisition Financing of Inventory: Explaining the Diversity" (2014) 13(1) O.U.C.L.J. 49 ("*Acquisition Financing*") at 69.

[59] Note that D's previous registration of a financing statement with the Personal Property Registry does not constitute constructive notice to the Bank: PPSA, s. 47. The applicable knowledge requirements are set out in PPSA, s. 1(2).

[60] PPSA, s. 57(1)(a).

b. Outcome in the absence of the PPSA

Before engaging in statutory analysis, first consider the outcome of such a dispute in the absence of a statutory framework – that is, on the assumption that D received an assignment of C's deposit account at common law. On this assumption, the Bank is entitled to set off the operating line balance against the deposit account balance by virtue of both equitable set-off and contractual set-off principles.

Pursuant to the unconnected claims notification rule, the Bank is entitled to assert equitable set-off against D to the same extent that it would have been entitled to assert legal set-off against C prior to receiving notice of D's interest. On day 4, at the moment before the Bank was notified of D's interest, the Bank was entitled to assert legal set-off against C based on the presence of the dual elements of "mutuality" and "current liquidated debts". It follows that the Bank is entitled to assert equitable set-off against D under the unconnected claims notification rule. Moreover, the close connection rule may be satisfied if it is determined that the contracts to which the cross-debts relate are closely connected and that it would be manifestly unjust to refuse the Bank set-off. Finally, the Bank is entitled to set-off under contractual principles, including its implied contractual right of account combination, since the deposit account and the operating line are both "current accounts."

In short, absent a statutory framework, the Bank would be successful in a Scenario 1 dispute with D.

c. Outcome under the PPSA

i. PPSA s. 41

Now consider the outcome under PPSA governance. Subsections 41(1) and (2) are reproduced below.

> (1) In this section, "account debtor" means a person who is obligated under an intangible or chattel paper.
>
> (2) The rights of an assignee of collateral that is either an intangible or chattel paper are subject to
>
> > (a) the terms of the contract between the account debtor and the assignor and any defence or claim arising out of the contract or a closely connected contract, and
> >
> > (b) any other defence or claim of the account debtor against the assignor that accrues before the account debtor has knowledge of the assignment,
>
> unless the account debtor has made an enforceable agreement not to assert defences or claims arising out of the contract.

Subsection 41(1) clarifies the scope of section 41 and its various subsections. For the purposes of section 41, the Bank constitutes an "account debtor."[61] In Saskatchewan, the concordant provision (specifically, subsection 41(1)) further clarifies that D, a "secured party,"[62] constitutes an "assignee" for the purposes of section 41.[63] With reference to Scenario 1, PPSA s. 41(2) therefore provides that D's rights in C's deposit account (an "account"[64] and an "intangible"[65] under the PPSA[66]) are subject to (a) the Bank's contractual rights under the customer account

[61] PPSA, s. 41(1)(a), "account debtor".
[62] SPPSA, s. 2(1)(nn), "secured party".
[63] SPPSA, s. 41(1)(b): "In this section, ... (b) "assignee" includes a secured party and a receiver."
[64] PPSA, s. 1(1)(b), "account".
[65] PPSA, s. 1(1)(x), "intangible".
[66] For a detailed account of the PPSA taxonomy, see Clayton Bangsund, "The Deposit Account & Chose in Action at Common Law & Under the PPSA: A Historical Review" (2014) 30(1) B.F.L.R. 1.

agreement or a closely connected contract, and (b) any other defence or claim the Bank has against C that accrues before the Bank acquires knowledge of the assignment to D. In short, PPSA s. 41(2) *recognizes* the Bank's contractual and equitable set-off rights against the deposit account balance, and affords them superiority over competing PPSA security.

ii. PPSA s. 41(2)(a)

Pursuant to PPSA s. 41(2)(a), the Bank is entitled to set off the operating line balance against the deposit account balance because D takes his assignment subject to the Bank's contractual rights. The Bank's implied contractual right of account combination entitles it to set off because the accounts are both current; thus, pursuant to s. 41(2)(a), D's claim to C's deposit account balance is subject to the Bank's contractual right to set off the operating line balance against the deposit account balance.[67]

Additionally, the Bank may assert the close connection rule of equitable set-off, which, like account combination, is embodied in the statutory language of PPSA s. 41(2)(a).[68] A revolving line of credit commonly operates in close connection with a deposit account balance, thus suggesting that the Bank is entitled to assert the close connection rule of equitable set-off in priority to D's security interest.[69]

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[67] See Geva, *Rights in Bank Deposits*, *supra* note 14.

[68] See Cuming, *Security Interests and Set-Off, supra* note 4.

[69] A current account and a revolving operating line are inextricably linked; they typically work in conjunction with each other. For two concise descriptions of the daily interaction between a current account and a revolving operating line, see *Agricultural Credit Corp. of Saskatchewan v. Pettyjohn,* [1991] 3 W.W.R. 689 (Sask. C.A.) ("*Pettyjohn*") at para. 22, per Sherstibitoff J.A.; *Flexi-Coil Ltd. v.*

iii. PPSA s. 41(2)(b)

Under PPSA s. 41(2)(b), D takes his security interest subject to "any other defence or claim" that the Bank has against C that accrues before the Bank acquired knowledge of the assignment. The Bank's "defences and claims" against C include, at a minimum, legal set-off since the dual elements of "mutuality" and "current liquidated debt" were present, as between the Bank and C, immediately prior to the Bank receiving notice of D's security interest.[70] Consequently, the Bank is entitled to assert equitable set-off – pursuant to the unconnected claims notification rule – against D under PPSA s. 41(2)(b).[71] In summary, the PPSA and the common law produce the same favourable outcome in favour of the Bank.

2. Deposit Account Set-Off v. Security Interest in Deposit Account as Proceeds

a. E, F & Bank: Scenario 2

Kindersley District Credit Union Ltd. (1993) 1993 CarswellSask 365 (C.A.) ("*Flexi-Coil*") at para. 47, per Jackson J.A.

[70] One might criticize this assertion on the basis that it assumes, without grounds, that set-off principles are among the "defences or claims" available to an account debtor under PPSA s. 41(2)(b). I recognize the circularity, but suggest that this is the very nature of the interplay between PPSA ss. 66(3) and 41(2)(b). Subsection 66(3) provides that set-off principles continue to apply to the extent not inconsistent with the express provisions of the PPSA. In turn, s. 41(2)(b), an express provision, makes generic reference to the availability of an account debtor's "defences and claims." Set-off principles certainly constitute "defences and claims." If one contends that they do not, then he must furnish a plausible alternative interpretation of the subsection. What else could be intended under s. 41(2)(b) that would be exclusive of set-off principles?

[71] This interpretive approach does not apply in Ontario, Manitoba, Northwest Territories and Nunavut, where equitable set-off is specifically identified in the concordant provision to SPPSA s. 41(2). See OPPSA s. 40(1.1)(a), MPPSA s. 41(2)(a)(ii), NWTPPSA s. 41(2)(a)(ii).

In Scenario 2, F asserts a security interest in E's deposit account balance as proceeds of her original collateral. On day 1, E opens a deposit account with the Bank; no initial deposit is made. On day 2, the Bank grants E an unsecured revolving operating line of credit (payable on demand), with a borrowing limit of $100. E immediately draws down the operating line to the $100 limit, spending the funds on evanescence. On day 3, E purchases $100 worth of inventory on credit terms from one of her suppliers, F, and grants F a purchase money security interest in the inventory to secure payment of the purchase price. F immediately perfects her security interest by registering a financing statement. On day 4, E sells the inventory to customers, and deposits sale proceeds of $100 into the deposit account. On day 5, E defaults on her obligations to F. F notifies the Bank of her proceeds security interest in E's deposit account, and demands that the Bank make payment to F of the $100 balance. The Bank refuses to comply with this demand. Between F and the Bank, who prevails in a dispute over the deposit account balance?

b. Outcome under the PPSA

i. Narrow Interpretive Approach: Non-Assignee

PPSA s. 41(2) applies to resolve the dispute in Scenario 2 only if F constitutes an "assignee" for the purposes of section 41. In my view, F constitutes an "assignee" given that she is a "secured party" in relation to the deposit account balance. On this reasoning, PPSA s. 41(2) applies to resolve the dispute in favour of the Bank. But according to Cuming, Walsh & Wood, PPSA s. 41(2) does not apply because F's rights arise, not by assignment, but automatically by operation of statute.[72]

> The PPSA provides a statutory right of set-off in relation to assignments of intangibles and chattel paper. However, this provision only applies where these rights have been transferred through an assignment of the intangible or chattel paper. The inventory financer's right to the account as proceeds does not arise by virtue of an assignment between the debtor and the inventory financer. Rather, the right arises automatically by virtue of its statutory right to the proceeds.[73]

The professors' stance rests on a narrow, technical interpretation of the term "assignee". Their logic is as follows: The term "assignee" typically refers to a person who has received a transfer of rights or property – that is, a *first-order* recipient of an "assignment".[74] Since F, a proceeds claimant, is not a first-order recipient of a deposit account assignment, she does not constitute an "assignee" for the purposes of section 41. Accordingly, PPSA s. 41(2) does not apply to resolve the dispute. On this view, only a first-order assignee is subject to the account debtor's equitable and contractual set-off rights pursuant to PPSA s. 41(2). One must turn to some other authority or line of analysis to resolve the priority dispute between F and the Bank. I will return, below, to the narrow interpretive approach, and how it affects the analysis in Scenario 2. While it is coherent and palatable, I prefer an alternate interpretive approach, which I will explain next.

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[72] PPSA, s. 28(1)(b).

[73] Cuming, Walsh & Wood, *supra* note 42 at 668; Also see Cuming, *Security Interests and Set-Off, supra* note 4 at 315: "A literal interpretation of section 41 of the Alberta Act and its equivalent leads to the conclusion that these provisions do not apply to such situations since the interest of the secured party in the proceeds does not arise out of a contractual or voluntary assignment by the assignor, but arises by operation of the Act."

[74] *Black's Law Dictionary*, 7th ed. (Bryan A. Garner, ed.) (St. Paul, West Group, 1999) at 115, *s.v.* "assignment": "The transfer of rights or property."

ii. Broad Interpretive Approach: Assignee

Under the broad interpretive approach, F's rights, as assignee, are subject to the Bank's deposit account set-off rights pursuant to PPSA s. 41(2) for precisely the same reasons as D's rights were subject to the Bank's deposit account set-off rights in Scenario 1. PPSA s. 41(2) directly applies to resolve the dispute because F is an "assignee." With reference to Saskatchewan's legislation, for example, F is a "secured party" with respect to the deposit account pursuant to SPPSA s. 28(1)(b), and thus an "assignee" (pursuant to SPPSA s. 41(1)(b)) of the deposit account for the purposes of section 41. The argument for the broad interpretive approach is strong in all PPSA jurisdictions, and is nearly incontestable in Manitoba, New Brunswick, Newfoundland, Nova Scotia, Northwest Territories, Nunavut, Prince Edward Island and Saskatchewan.[75] I prefer the broad interpretive approach because it is coherent and renders unnecessary a separate branch of parallel analysis in Scenario 2.

In contrast, further analysis is required in order to resolve Scenario 2 according to the narrow interpretive approach. I do not lightly dismiss this possibility. Suppose that Cuming, Walsh & Wood are correct in concluding that PPSA s. 41(2) is not squarely engaged in Scenario 2 on the basis that F is not an "assignee" of the deposit account. What, then, is the analytical path?

iii. Analytical Subtheories under the Narrow Interpretive Approach

[75] Manitoba (MPPSA, s. 41(1)), New Brunswick (NBPPSA, s. 41(1)), Newfoundland (NFPPSA, s. 42(1)(b)), Nova Scotia (NSPPSA, s. 42(1)), Northwest Territories (NWTPPSA, s. 41(1)), Nunavut (NPPSA, s. 41(1)), Prince Edward Island (PEIPPSA, s. 41(1)(b)), Saskatchewan (SPPSA, s. 41(1)(b)).

PROFESSOR CUMING'S CONSIDERATION OF TWO COMPETING INTERPRETIVE THEORIES

If PPSA s. 41(2) is inapplicable to Scenario 2, how is the matter resolved? In 1990, Cuming examined this question in considerable detail.[76] In so doing, he identified and assessed two divergent interpretive theories.[77] Keep in mind that Cuming offered his analysis in respect of the predecessor to the SPPSA, which did not then contain a concordant provision to SPPSA s. 41(1). Also keep in mind that, at present day, none of Alberta's APPSA (our proxy regime), British Columbia's BCPPSA, Ontario's OPPSA, or Yukon's YPPSA, contain a concordant provision to Saskatchewan's PPSA s. 41(1)(b).

IMPLICIT PRIORITY RULE THEORY

Under the first theory, PPSA s. 28(1) embodies an implicit priority rule in favour of the proceeds claimant over the set-off claimant (the "implicit priority rule theory").[78] Cuming articulates the implicit priority rule theory in simple terms (for ease of reference, I have identified the Scenario 2 parties in square brackets):

> The secured party [F] has a perfected security interest in the proceeds [E's deposit account balance] and this is sufficient to defeat the unsecured claim of the depositary institution [the Bank].[79]

Cuming dismisses the implicit priority rule theory on several grounds. First, PPSA s. 28, on its face, does not speak to priority, but "merely provides for the

[76] Cuming, *Security Interests and Set-Off, supra* note 4.
[77] *Ibid.* at 318.
[78] *Ibid.* at 316.
[79] *Ibid.* at 316.

creation and perfection of a statutory security interest in proceeds."[80] Secondly, to interpret section 28 in such a fashion disregards the fundamental nature of the deposit account as part of a larger contractual relationship between the assignor and the Bank.[81] Finally, the implicit priority rule theory creates *asymmetry* in the rules of deposit account set-off. Whereas deposit account set-off is available to the Bank (pursuant to PPSA s. 41(2)) where D claims the deposit account as original collateral, it is unavailable (pursuant to the implicit priority rule theory) where F claims the deposit account as proceeds. "Why the distinction?", Cuming asks. On what grounds can this interpretation, which artificially bifurcates the rules of deposit account set-off, be rationalized? Isn't it more sensible to adopt the same sort of analytical approach as that set out in PPSA s. 41(2)? Why should the Bank's power to assert deposit account set-off hinge on whether its competitor stakes its claim to the balance as original collateral or proceeds? Shouldn't the PPSA produce consistent outcomes in both cases? In any case, despite serious questions about its sensibility, application of the implicit priority rule theory, in Scenario 2, gives F priority over the Bank in relation to E's deposit account balance.

Uniform Equitable Set-Off Theory

Cuming rejects the implicit priority rule theory. He instead embraces a purposive interpretive theory under which the principles of equitable set-off apply

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[80] *Ibid.* at 316.

[81] *Ibid.* at 316-317, where Cuming acknowledges the bank's inherent rights: "The effect of section 28 is to create a statutory charge (a security interest) against that account. It does not change the underlying relationship between the account debtor and the assignor that is endemic to any debtor/creditor relationship."

in Scenario 2, just as they applied in Scenario 1 (the "uniform equitable set-off theory"). Cuming reasons, as per PPSA s. 66(3), that the principles of equitable set-off are "not inconsistent" with the express provisions of the PPSA.[82] Indeed, as demonstrated above, the principles of equitable set-off are embodied in PPSA s. 41(2). Additionally, Cuming asserts that the uniform equitable set-off theory creates *symmetry* in the rules of deposit account set-off, which is preferable to the asymmetrical bifurcation created by the adoption of the implicit priority rule theory.[83] So, while Cuming recognizes the distinction between an assignee (like D) and a non-assignee (like F), he nonetheless favours an analytical approach under which D and F are afforded equivalent treatment vis-à-vis the Bank.

Cuming's logic is persuasive. In my view, the uniform equitable set-off theory is preferable to the implicit priority rule theory because it makes the PPSA more coherent. In Scenario 2 – under the narrow interpretive approach – application of the uniform equitable set-off theory gives the Bank a superior claim to F with respect to E's deposit account balance, thereby mirroring the outcome of Scenario 1 through an analogous analytical framework involving the conjunctive operation and purposive interpretation of PPSA ss. 66(3) and 41(2).

PROFESSOR GEVA'S PERSPECTIVE

ACCOUNT COMBINATION THEORY

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[82] *Ibid.* at 321.
[83] *Ibid*.

In his article, Cuming focused on deposit account set-off through an equitable set-off lens, and favoured an interpretation of the PPSA that recognizes the supremacy of equitable set-off rights vis-à-vis competing PPSA security, whether original collateral or proceeds. In 2011, Geva also examined deposit account set-off.[84] Near the end of his article, Geva outlined his view of the appropriate analytical approach (the "account combination theory").

> I thus argue that as long as it is treated as a *right of set-off operating like a legal set-off*, and other than where it could benefit from the authority given by the secured party to the customer to dispose of the collateral free of the security interest, *the bank's right to combine accounts* is defeated by a security interest. At the same time, where it is characterized as a *current account set-off*, the banker's *right to combine accounts* defeats a competing security interest. I suppose that the result does not depend on whether the security interest is perfected. It is only as a *current account set-off* the right to combine accounts is "inherent in the banker-customer relation" so as to prevail over all adverse claims.[85]

Geva's account combination theory appears sound. It is consistent with the express language of the PPSA, and produces outcomes similar to that of the uniform equitable set-off theory. In Scenario 2, for example, the account combination theory, like the uniform equitable set-off theory, provides that the Bank's implied right of contractual set-off defeats F's security interest.[86]

iv. Synopsis

[84] Geva, *Rights in Bank Deposits, supra* note 14.

[85] *Ibid.* at 44.

[86] Geva appears to draw a distinction between (i) a scenario in which the deposit account and current credit account(s) operate in conjunction, and (ii) one in which the deposit account and current credit account operate independently (i.e. are treated as completely separate items of intangible personal property). In the former scenario, account combination is automatic and self-asserting, and trumps a competing security interest; in the latter, the bank must positively assert set-off in order to claim priority over the secured party, and may be thwarted if this assertion comes too late. The former state of affairs is presumed: Geva, *Rights in Bank Deposits, ibid.* at 16. Neither Scenario 1 nor Scenario 2 present facts that tend to rebut this presumptive state of affairs.

I will briefly recount the analytical framework for Scenario 2. If the broad interpretive approach is adopted, then the Bank is entitled to assert its right of deposit account set-off in priority to F pursuant to PPSA s. 41(2). Yet even if the broad interpretive approach is rejected, and the narrow interpretive approach is adopted in its stead, the prevailing view is that the Bank is nevertheless entitled, under a purposive reading of PPSA ss. 66(3) and 41(2), and analogous application thereof, to assert deposit account set-off in priority to F pursuant to equitable set-off and/or account combination. In other words, irrespective of one's preferred interpretive approach, the operative analysis in Scenario 2 is either identical to, or wholly analogous with, that in Scenario 1. In Scenario 2, the Bank's deposit account set-off rights, constitutive of contractual and equitable set-off principles, once again reign supreme vis-à-vis competing PPSA security.

3. Deposit Account Set-Off vis-à-vis Term Loan v. Security Interest

a. G, H & Bank: Scenario 3

In Scenario 3, G opens a deposit account with the Bank and makes an initial $100 deposit. The Bank then advances $100 of credit to G pursuant to an unsecured term loan, maturing three years into the future. G spends the funds on extravagances, and then grants H a security interest in his deposit account to secure payment of another $100 debt obligation. H registers notice of his security interest. G later defaults vis-à-vis H, who notifies the Bank of his security interest in G's deposit account, and demands that the Bank make payment of the $100 deposit account balance to him. The Bank refuses to comply with H's demand. Between H and the Bank, who prevails in a subsequent dispute over the deposit account balance? In Scenario 3, how do the principles of contractual set-off and equitable set-off interact with conventional PPSA security?

b. Outcome under the PPSA

In Scenario 3, the Bank is disentitled to account combination under PPSA s. 41(2)(a) because the amount payable under G's term loan is not presently payable; it does not constitute a "current account."[87] The Bank is also disentitled to set-off under PPSA s. 41(2)(b) – the unconnected claims notification rule – because the Bank did not have a right of legal set-off against G at the time it acquired knowledge of H's security interest. However, pursuant to the operative language of PPSA s. 41(2)(a) referable to the close connection rule, the Bank is possibly entitled to equitable set-off if the court concludes that there was a close connection between the term loan and reciprocal deposit account balance, and that it would be manifestly unjust to refuse the Bank set-off in the circumstances.

D. Deposit Account Set-Off v. Deemed Security Interest

1. Deposit Account Set-Off v. Absolute Transfer

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[87] But what if contractual documentation governing the term loan contains a carefully drafted clause providing that J is in default upon the Bank's receipt of notice of assignment of the deposit account, and that the Bank is entitled to accelerate and demand payment immediately upon receipt of notice? Would such a clause make the term loan account "current" for the purposes of account combination, and thus entitle the Bank to set off the term loan against the deposit account? For discussion of this issue in the U.S. context, see Barkley Clark, "Bank Exercise of Set-off: Avoiding the Pitfalls" (1981) 98 Banking L.J. 196 at 207-208. In the Canadian context, where a promissory note is involved, see *Belows v. Dalmyn,* [1978] 4 W.W.R. 630 (Man. Q.B.).

a. J, K & Bank: Scenario 4

Consider a final variation on the facts. In Scenario 4, J opens a deposit account with the Bank, and initially deposits $100 into the account. The Bank subsequently grants J an unsecured revolving operating line of credit (payable on demand), with a borrowing limit of $100. J immediately draws down the operating line entirely, and squanders the borrowed funds. J then effects, or purports to effect, an absolute transfer of her deposit account to K. K registers her interest at the PPR, then furnishes the Bank with notice demanding that the Bank pay the deposit account balance to her. The Bank refuses to comply with K's demand. Between K and the Bank, who prevails in a dispute over the deposit account balance?

b. Outcome under the PPSA

Again, the first threshold issue is whether PPSA s. 41(2) applies to resolve the dispute between K and the Bank. The clear answer is yes. K, an absolute transferee, constitutes an "assignee" for the purposes of section 41. Indeed, the term "assignee", in its colloquial usage, ordinarily refers to an absolute transferee.[88] With reference to Scenario 4, PPSA s. 41(2) provides that the Bank prevails over K in Scenario 4, again under precisely the same analysis that applied in Scenario 1.

c. Differentiation Between Absolute Transfer and Actual Transfer

[88] See UCC §9-102, Comment 26: "This Article generally follows common usage by using terms "assignment" and "assign" to refer to transfers of rights to payment, claims, and liens and other security interests. It generally uses the term "transfer" to refer to other transfers of interests in property. … Depending on the context, each term may refer to the assignment or transfer of an outright ownership interest or to the assignment or transfer of a limited interest, such as a security interest."

It is important to note that the absolute transfer described in Scenario 4 is quite different from a circumstance in which funds from J's deposit account are transferred to K's deposit account via electronic funds transfer, or some other similar method of funds transfer. Upon effectuation of the latter type of transaction, the disputed funds become K's, and J's deposit account balance is no longer available to be set off against by the Bank. The difference can be articulated as follows: In Scenario 4 – an absolute transfer scenario – there is an absolute transfer *of* a deposit account from J to K. Meanwhile, in an actual transfer scenario, the transfer of funds is actually effectuated *from* the deposit account of one (J) *to* the deposit account of another (K). In the latter scenario, the Bank has no right of set-off against J's deposit account because the account balance has been depleted. The funds are now constitutive of K's deposit account, whether maintained at the Bank or at some other depository institution, and the Bank's deposit account set-off rights do not extend to that account balance.

E. Closing Remarks & Statements of Assumption

Later chapters of this thesis proceed on the safe assumption that section 41 of the PPSA governs a dispute between a secured party or absolute transferee asserting priority to a deposit account as original collateral, and a bank asserting set-off against the deposit account.[89] Moreover, in respect of disputes in which a secured party asserts priority to a deposit account as proceeds, I proceed on the

[89] There is a dearth of case law interpreting or applying PPSA s. 41, but fleeting mention of s. 41(2) of the NBPPSA is made in *Western Surety v. National Bank*, 2001 NBCA 15 at para. 74. Similarly, in *Scanwood Canada Ltd. (Re)*, 2011 NSSC 468 at para. 83, passing mention is made of s. 42 of the NSPPSA. Neither of these decisions shed any light on deposit account set-off specifically.

further, but perhaps less safe, assumption that PPSA s. 41 applies just the same, or at the very least, that a purposive reading of PPSA ss. 66(3) and 41 entitles the bank to assert set-off under either the account combination approach or the uniform equitable set-off approach.

IV. UTILITY & CONCLUSION

In this chapter, I have described the basic Canadian principles of legal, equitable and contractual set-off, and the manner in which these principles interact with the statute under investigation, the PPSA. The analytical framework developed in this chapter, including its various built-in assumptions, is utilized in the analyses and assessments undertaken in later chapters.

Though the basic *idea* of set-off may be simple, the same cannot be said of its *application*. As demonstrated, the interaction between set-off principles and secured transactions principles is "colossally complicated."[90] However, a careful review of this interplay reveals that banks hold an extraordinarily powerful realization tool in deposit account set-off. When a deposit account balance is claimed by a secured party asserting a proprietary right under the PPSA, on one hand, and by the depository bank (with which the deposit account balance is maintained) asserting a right of set-off, on the other, the contest is often resolved in favour of the depository bank. Bear this in mind as I proceed with an examination of the perfection paradigms – registration and control – in subsequent chapters.

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[90] P. Wood, *Set-Off & Netting*, *supra* note 10 at para. 5-003.

Book III ~ Examination

CHAPTER 4 ~ DESCRIPTION

I. PROXIES

In Part II of this chapter, I furnish a concise general description, including a brief historical developmental account, of the treatment afforded to the deposit account as an item of personal property security under three[1] unique regimes (each representative of, or proxy for, a distinct combination of model-type and paradigm): (i) UCC Article 9, a U.S. model state statute representative of a pure bank-directed control model with a control paradigm, (ii) Alberta's APPSA, a Canadian provincial statute representative of a pure registration model with a registration paradigm (i.e., our proxy PPSA),[2] and (iii) the AUSPPSA, an Australian federal statute representative of a hybrid bank-only control model with a control paradigm.

Part III describes the treatment to be afforded to the deposit account under Ontario's PPSA pursuant to a proposal – the OBA Proposal – set forth by the OBA PPSL Subcommittee.[3] Although both the AUSPPSA and the proposed OBAPPSA are hybrid models with control paradigms, each exhibits distinctive features which merit separate discussion. While the AUSPPSA is representative of a hybrid bank-only control model, the OBAPPSA is representative of a hybrid bank-directed

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[1] Technically, four. See note 98.

[2] The account of the APPSA includes, in footnotes, statutory citations of concordance to New Zealand's NZPPSA.

[3] Ontario Bar Association, Personal Property Security Law Subcommittee, *Perfecting Security Interests in Cash Collateral* (February 6, 2012) ("*OBA Proposal*"), online: <http://www.oba.org/Advocacy/Submissions>.

control model. The basic descriptive accounts furnished in this chapter will facilitate the comparative analytical evaluations undertaken in later chapters.

II. EXISTING REGIME ACCOUNTS

A. UCC ARTICLE 9, UNITED STATES OF AMERICA ~ PURE BANK-DIRECTED CONTROL MODEL & CONTROL PARADIGM

1. HISTORICAL BACKGROUND

a. Former Article 9 ~ Deposit Account Exclusion

It is interesting and worthwhile to review the history of UCC Article 9,[4] which was introduced in 1950[5] as "an attempt at synthesis"[6] of a fragmented system of American personal property security law; the model code was soon adopted by all 50 states. Article 9, preferring function to form, concomitantly (i) embraced a unitary concept of "security interest," (ii) unified the previously independent and uncoordinated chattel security filing systems, and (iii) established substantially uniform state personal property security law.[7] However, its reach was not

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[4] For a current and concise evolutionary account of Article 9, see Roderick J. Wood, "Acquisition Financing of Inventory: Explaining the Diversity" (2014) 13(1) O.U.C.L.J. 49 ("*Acquisition Financing*") at 49, n. 1: "The UCC was first promulgated under the joint sponsorship of the American Law Institute and the National Conference of Commissioners on Uniform State Laws in 1952. It has since been revised several times and has been adopted by every state of the United States. It was substantially revised in 1998, and most recently revised in 2010, primarily in relation to registration issues."

[5] Grant Gilmore, *Security Interests in Personal Property,* vol. I (Boston: Little, Brown and Company, 1965) at 288.

[6] *Ibid.* at 288.

[7] Gilmore, *ibid.* at 296, notes that Article 9 was designed to end a "long history of the proliferation of independent security devices." He continues: "Whatever else counsel confronted by a novel situation

unlimited. For instance, Former Article 9[8] did not govern or facilitate a security interest in a deposit account as original collateral;[9] instead, it only governed a security interest in a deposit account as proceeds. As a result, security interests in deposit accounts as original collateral continued to be governed by a variety of non-uniform state statutes and the common law.[10]

Official Comment 7 to §9-104 of Former Article 9 sets out the rationale for the Former Article's exclusion of deposit accounts as original collateral.

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may do, he may not, under Article 9, invent a new device which, if eventually it wins judicial recognition, will develop its own set of rules, its own metaphysical structure, and, in time, its own filing system. However counsel may solve his novel situation, whatever name he may give to the documents he drafts, he will end up, if the 'transaction' is one 'intended to create a security interest,' with an Article 9 security interest, subject to the Article 9 rules, the Article 9 metaphysics and, most importantly, the Article 9 filing system."

[8] The Article 9 in existence prior to 1998 (whether the original 1950 version, or the subsequent 1972 version) is referred to herein as "Former Article 9." As discussed in further detail below, Article 9 underwent substantial amendments in 1998. The revised Article 9 (reflected in the 1998 version of the statute, as amended since) is referred to herein as "Revised Article 9" or simply "Article 9", as the context requires or permits. Unless otherwise specified, statutory provision references are to Revised Article 9.

[9] UCC Former Article 9, §9-104(l).

[10] See Jason M. Ban, "Deposit Accounts: An Article 9 Security Interest" (1998) 17 Ann. Rev. Banking L. 493 at 501. The U.S. common law of secured transactions in deposit accounts suffered from uncertainty, and interestingly, required a higher standard of control than Revised Article 9; see Stephen L. Sepinuck, *A Defense of Extending Article 9 to Cover Security Interests in Deposit Accounts as Original Collateral*, online: <https://www.law.gonzaga.edu/files/DefenseofExtendingArticle9.pdf> at 18.

Consider the following account of the U.S. common law regime, furnished by Willa E. Gibson, "Banks Reign Supreme Under Revised Article 9 Deposit Account Rules" (2005) 30 Del. J. Corp. L. 819 at 838: "By characterizing the depositor's interest as intangible personal property, common law requires that a creditor take possession of an indispensable instrument embodying the depositor's intangible property right to the funds in the account. Possession of such an instrument satisfies both evidentiary issues and policy concerns regarding public notice of the creditor's interest as achieved when creditors take possession of tangible property. The indispensable instrument requirement is necessary to insure that assignee or 'pledgee of the deposit account have exclusive control and irrevocable authority over the account' to achieve the type of control that a pledgee would have over collateral that was tangible in nature."

> Such transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law.[11]

Gibson observes that "[n]o additional reasoning was provided for the exclusion."[12] Some assert that the bank lobby influenced the decision to exclude deposit accounts as original collateral from Former Article 9,[13] but authority on the point is scant and vague.[14] The theory, however, makes intuitive sense since there is no other reason (that I can think of) why a model code, designed to comprehensively unify and create uniformity in U.S. personal property security law,

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[11] UCC Former Article 9, §9-104, Comment 7; See Bruce A. Markell, "From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9" (1999) 74 Chi.-Kent L. Rev. 963 at 970; Also see Ingrid M. Hillinger, David L. Batty & Richard K. Brown, "Deposit Accounts Under the New World Order" (2002) 6 N.C. Banking Inst. 1 at 5.

[12] Gibson, *supra* note 10 at 835; Also see Sepinuck, *supra* note 10 at 5: "To the extent that the original exclusion was motivated by concerns for the payment system – hence the designation of transactions involving deposit accounts as "special" – the 1972 amendments made no effort either to accommodate that concern or to explain why that concern was misplaced with respect to security interests in deposit accounts as proceeds."; Also see Steven L. Harris, "Non-Negotiable Certificates of Deposit: An Article 9 Problem" (1981-1982) 29 U.C.L.A. L. Rev. 330 at 361.

[13] On this theory, the exclusion was presumably aimed at *preventing* certainty and uniformity in the law, thereby discouraging non-depository secured creditors from honing in on deposit accounts as original collateral. See, for example, UCC, §9-109, Comment 16: "Under former Section 9-104(l), deposit accounts were excluded as original collateral, leaving security interests in deposit accounts to be governed by the common law. The common law is nonuniform, often difficult to discover and comprehend, and frequently costly to implement. As a consequence, debtors who wished to use deposit accounts as collateral sometimes were precluded from doing so as a practical matter."
For allusions to this theory, see Peter F. Coogan, Homer Kripke and Fredric Weiss, "The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements" (1965) 79(2) Harv. L. Rev. 229 at 230; Gilmore, *supra* note 5 at 312 and 316; Dwight L. Greene, "Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection – The Common Law is Alive and Well" (1989-1990) 39(2) Drake L. Rev. 259 at 261, n. 4: "The official explanation of the exclusion of deposit accounts leaves much to be desired. Unfortunately, there is no complete published authoritative historical source providing that rationale. What materials there are suggest that deposit accounts were excluded largely for political reasons in light of the vociferous opposition to the U.C.C. on the part of banks and their counsel."; Harris, *supra* note 12 at 362; Sepinuck, *supra* note 10 at 4.

[14] Markell, *supra* note 11 at 970, n. 23: "Although authority is scarce, some sources suggest that the drafters excluded deposit accounts largely for political reasons due to strong opposition by banking interests."

would intentionally and explicitly omit such a significant, and commonly used, item of personal property.[15]

b. *Rogue States & Non-Uniformity*

In the 1980s and 90s, a number of "rogue states" – among them, California, Hawaii, Idaho, Illinois, Louisiana and Oklahoma [16] – enacted non-uniform amendments to their versions of Former Article 9; such amended versions permitted the creation of security interests in deposit accounts as original collateral. Uniformity proponents were troubled, reflexively, by the resulting non-uniformity, but their interest was piqued upon learning that the rogue states' lending and banking systems did not falter or collapse, as forecasted by some, upon enactment of the non-uniform amendments.[17] The deposit account was thus pegged for potential inclusion under the Revised Article 9 reform process.

c. *Revised Article 9 ~ Deposit Account Inclusion*

i. *Legislative Reform Process*

In a process that formally commenced in 1990 with the Permanent Editorial Board's establishment of the Study Committee,[18] Former Article 9 underwent substantial change as American lawmakers sought to further enhance facilitation of

[15] On one theory, Original Article 9's exclusion of the deposit account was based on the idea that a deposit account free from security interests could cover administrative costs in restructuring. The same kind of logic can be applied to Revised Article 9's inclusion initiative, which limits secured parties to those few who dedicate substantial time, effort and expense acquiring control.
[16] Markell, *supra* note 11 at 973; Also see Sepinuck, *supra* note 10 at 2.
[17] Markell, *ibid.* at 973.
[18] Markell, *ibid.* at 969, n. 16.

the extension of secured credit and re-establish uniformity across state lines.[19] Among the most prominent and controversial of the Revised Article 9 reform initiatives was the inclusion of deposit accounts as original collateral. Harris & Mooney explain how, leading up to Revised Article 9's promulgation in 1998, Drafting Committee[20] members disagreed on a plethora of issues concerning the treatment of deposit accounts as original collateral.

> They argued that if a debtor enjoys unfettered access to the funds, then when the time comes to enforce its security interest, the secured party is likely to find that the deposit account has been depleted and the collateral is worthless. The Drafting Committee disagreed over whether, given this risk, lenders actually would extend additional credit in reliance on a deposit account to which the debtor had access.
>
> The Drafting Committee also disagreed over whether obtaining a perfected security interest in all deposit accounts of a debtor would become the routine result in the vast run of secured transactions. It disagreed over the appropriate priority rule for resolving a conflict between a security interest in a deposit account as original collateral and a security interest in the deposit account claimed as proceeds of inventory, accounts, or other original collateral; it disagreed over the appropriate priority rule for bank's right of setoff; and it disagreed over whether the benefits of including deposit accounts as original collateral justified the many special provisions required to accomplish the task. The Federal Reserve Bank of New York expressed concerns that security interests in deposit accounts would impede the free flow of funds through the payment system. Consumer-advocacy groups feared that individuals would inadvertently or unwisely encumber their bank accounts.[21]

Prior to (i) the decision being taken to include deposit accounts as original collateral under Revised Article 9, and (ii) the Drafting Committee's undertaking of

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[19] Steven L. Harris and Charles W. Mooney, Jr., "How Successful Was the Revision of UCC Article 9?: Reflections of the Reporters" (1998-2000) 74 Chi.-Kent L. Rev. 1357 ("*Reflections*") at 1359.

[20] See Alan Schwartz and Robert E. Scott, "The Political Economy of Private Legislatures" (1994-1995) 143(3) U. Pa. L. Rev. 595 ("*Political Economy of Private Legislatures*") at 600-603, for an in-depth discussion and analysis of the ALI and NCCUSL, and their composition and decision-making processes.

[21] Steven H. Harris and Charles W. Mooney, Jr., *Security Interests in Personal Property: Cases, Problems and Materials,* 4th ed. (New York: Foundation Press, 2006) ("*SIPP*") at 440.

the Revised Article 9 legislative drafting process, the Study Committee appointed an expert Advisory Committee[22] whose task it was, *inter alia*, "to evaluate whether the application of Article 9 should be expanded to include deposit accounts as original collateral."[23] The Study Committee explained the Advisory Committee's processes.

> In the course of preparing its report, the advisory group reviewed reported cases, scholarly literature, legislation and regulations relating to security interests in deposit accounts and consulted extensively with bar committees, representatives of the banking industry, and representatives of the Federal Reserve System.[24]

ii. Recommendations of the Advisory Committee

In its report, the Advisory Committee recommended inclusion of the deposit account as original collateral under Revised Article 9. It also furnished a number of specific recommendations regarding the technical details of the prospective inclusion.

The Advisory Committee recommended that a depository bank enjoy automatic perfection in respect of its customer's deposit account(s). Influencing this recommendation was the Advisory Committee's anticipation that, in the wake of Revised Article 9's deposit account inclusion, depository banks would modify their standardized deposit account agreements to include a grant of security from depositor to bank in the normal course. Automatic perfection for depository banks

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[22] For some basic information about the Advisory Committee's membership, see *Advisory Committee Report, infra* note 25**,** Tab 2. The Advisory Committee is also commonly referred to as the "Subcommittee on the Use of Deposit Accounts as Original Collateral" or the "Advisory Group", while the Study Committee is commonly referred to as the "Study Group."
[23] Permanent Editorial Board for the Uniform Commercial Code, "Article 9 Study Group Report" (December 1, 1992) ("PEB, *Study Committee Report*") at 69.
[24] *Ibid*.

would avoid the inundation of state filing offices with bank filings, and consequently avoid the passing on of fees associated with these filings to depositor customers.[25]

The Advisory Committee also recommended that a "non-depository secured creditor" – that is, a secured creditor other than the bank with which the deposit account is maintained – be permitted to perfect its security interest in a deposit account by filing/registration.

> …, we conclude that perfection of a nondepositary's security interest in a deposit account a (sic) original collateral should be effected merely by filing.[26]

Additionally, the Advisory Committee unequivocally recommended against adoption of a set of rules under which a depository bank could deny its depositor the ability to grant, to a non-depository secured creditor, an effective security interest in the depositor's deposit account balance(s).

> Moreover, allowing depositary institutions to have this kind of veto on security interests would be contrary to existing Code policy. Article 9 already declares ineffective all contractual provisions which prohibit the granting of a security interest in an account or general intangible. …
>
> Deposit accounts are essentially another type of general intangible on which money is owed. We do not believe that a departure from the policy expressed in §9-318(4) is warranted; depositary institutions should not be granted the ability to deny their depositors the right to grant an effective security interest in their deposit accounts.[27]

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[25] Subcommittee on the Use of Deposit Accounts as Original Collateral, "Report of the Subcommittee on the Use of Deposit Accounts as Original Collateral" (June 5, 1992), Working Document No. M6-44 ("*Advisory Committee Report*") at 16.

[26] *Advisory Committee Report, ibid.* at 20. See PEB, *Study Committee Report*, *supra* note 23 at 70, Advisory Group Recommendation (iv): "A security interest taken by a depositary institution at which the deposit account is maintained should be perfected upon attachment. A security interest taken by other creditors should be perfected by filing."

[27] *Advisory Committee Report, ibid.* at 13-14.

iii. Recommendations of the Study Committee

In June 1991, Kroener and Sepinuck – the Advisory Committee's chairperson and reporter, respectively – met with the Study Committee to report on the Advisory Committee's progress to date. Consider their account, in a subsequent memorandum of that meeting, of the views expressed by the Study Committee on deposit account priority ordering.

> Starting with 'easy' priority issues first, there was widespread agreement among the Study Committee members that if a secured creditor's collateral is sold and the proceeds placed in a deposit account, the creditor's interest should have priority over any 'security interest' in the deposit account later acquired by the depository institution.
>
> …
>
> As to priority disputes between the depository institution and a creditor secured in the deposit account as original collateral, the Study Committee, by a narrow margin, rejected a rule which would have the depository always win. Instead, they believed a traditional first-in-time priority rule should apply. …[28]

At one stage, then, the Study Committee apparently viewed it as trite that, in a priority dispute between a proceeds claimant and the depository bank, the proceeds claimant ought to prevail; that a proceeds claimant ought not to be divested of its proceeds simply because they were directed/diverted into a deposit account. Outside the proceeds context, where both competing claims were in respect of the deposit account as original collateral, the Study Committee preferred a traditional first-in-time priority rule to one that automatically granted priority to

[28] Memorandum (on Davis Polk & Wardwell letterhead) from Bill Kroener and Stephen Sepinuck to "Persons on the Attached List" (list unattached) (August 6, 1991), Tab 3 Exhibit D in *Advisory Committee Report*, *ibid.*

the depository bank. These predilections respecting priority, however, were not set out in the Study Committee's final report to the Permanent Editorial Board.

In its final report, the Study Committee recommended the inclusion of deposit accounts as original collateral under Revised Article 9. Although it recommended that "serious consideration" be given to the Advisory Committee's various recommendations respecting the deposit account inclusion, the Study Committee itself explicitly rejected – with very little explanation – the Advisory Group's recommendation against the granting of veto power to depository banks. The recommendations issued by the Study Committee to the Permanent Editorial Board are reproduced below.

> A. Article 9 should be revised to include deposit accounts within its scope as original collateral.
>
> B. Article 9 should be revised to provide that a depositary institution owes no duties to a secured party claiming a security interest in a deposit account maintained with that institution unless, and then only to the extent that, the institution agrees to assume such duties or is served with legal process concerning the deposit account.
>
> C. The Drafting Committee should give serious consideration to the recommendations contained in the Report of the Subcommittee on the Use of Deposit Accounts as Original Collateral.[29]

iv. Rejection of Recommendations & Resulting Scepticism

Ultimately, the Drafting Committee, after engaging in its own internal debate respecting the deposit account inclusion, drafted Revised Article 9 as a pure bank-directed control model under which only the depository bank enjoys automatic perfection of a security interest in a deposit account, while prospective non-

[29] PEB, *Study Committee Report*, *supra* note 23 at 68.

depository secured creditors require the cooperation and consent of the depository bank in order to acquire an effective security interest in a deposit account as original collateral. In other words, the Advisory Committee's recommendation against the granting of veto power to depository banks was altogether rejected.

Revised Article 9's "control only" feature was credited with facilitating the free flow of funds, and thus maintaining the integrity of the bank payment system, thereby appeasing the Federal Reserve Bank of New York.[30] And though – in direct contravention of the lawmakers' express mandate of better facilitating personal property secured transactions[31] – the pure control model adopted under Revised Article 9 actually made it more difficult for non-depository secured creditors to acquire a meaningful security interest[32] in a deposit account balance,[33] the Revised Article 9 regime was lauded for its congruity with the "reliance creditor theory" (explicated and critically examined in Chapter 8).[34]

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[30] See Harris & Mooney, *SIPP*, *supra* note 21 at 440; But also see Sepinuck, *supra* note 10 at 28: "The representatives of the New York Fed are quite proper in their concern with protecting the payment system. Yet in two years – with two of its attorneys serving on the Subcommittee – they were never able to offer one credible explanation of how the Subcommittee's recommendations could 'screw up' the payment system."

[31] Harris & Mooney, *Reflections, supra* note 19 at 1359.

[32] Gibson, *supra* note 10 at 825, describes what is meant by a "meaningful security interest": "However, a meaningful conveyance requires that creditors not only attach, but also perfect their security interests."

[33] See Gibson, *ibid.* at 823: "Based on these comments, one could reasonably assume that the revised deposit account rules are meant to encourage and promote deposit account financing. The revised deposit account rules achieve a different result: unless the secured party is a depositary bank maintaining the account, they (*sic*) will likely have difficulty perfecting its security interest."

[34] Harris & Mooney, *Reflections, supra* note 19 at 1366: "Revised Article 9's control-only perfection rule is in part a response to those who argued that it should not be 'too easy' to take a deposit account as original collateral." The merits of the reliance creditor theory will be examined in detail in

The American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL), co-sponsors of the model code, formally approved Revised Article 9 in 1998.[35] It came into force in 2001,[36] and remains largely unaltered to this day. Scepticism remains respecting the real object of the deposit account inclusion under Revised Article 9. Consider, for instance, Gibson's words on the subject.

> The favorable treatment provided to banks by Revised Article 9 suggests that the drafter's decision to include deposit accounts as original collateral was motivated by a desire to provide banks greater sovereignty, rather than to increase financing opportunities for their depositors.[37]

2. *REVISED ARTICLE 9*

Equipped with an understanding of the evolution of Revised Article 9's treatment of deposit accounts, let us now turn to the technical workings of the current regime.

a. Taxonomy & Creation

Chapter 8 ~ Scrutiny. See, generally, Randal C. Picker, "Perfection Hierarchies and Nontemporal Priority Rules" (1998-2000) 74 Chi.-Kent L. Rev. 1157.

[35] Markell, *supra* note 11 at 969.

[36] Wood, *Acquisition Financing, supra* note 4 at 60, n. 55.

[37] Gibson, *supra* note 10 at 825. Also see Gibson's comments at 847: "It seems unlikely that banks will grant control to lenders if they view them as competitors. In light of the financial interests that banks have in the accounts they maintain, their willingness to grant control to other creditors is at best questionable, especially the kind of control that would subordinate their security interests." And 853: "Conversely, Revised Article 9 has imposed the framework to restrain, rather than facilitate, voluntary and involuntary transfers of deposit accounts. The restraints are necessary to protect payment integrity, to a point. … Only naivety could lead one to assume that banks would only exercise their veto power to protect the payment system."

Outside the consumer context,[38] Article 9 allows a secured party to acquire a security interest in a deposit account as original collateral.[39] Under the Article 9 taxonomy, the deposit account constitutes a discrete category of personal property, defined as follows:

> "deposit account" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.[40]

Figure 4.1: Article 9 Taxonomy (2017)

PERSONAL PROPERTY											
goods	account	instrument	chattel paper	commercial tort claim	***deposit account***	document	investment property	letter-of-credit right	letter of credit	money	general intangible

Pursuant to UCC Article 1, the term "bank" means "a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company."[41] Article 9 imports the term "bank" into the term "deposit account."[42]

b. Attachment

i. Attachment Requirements

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[38] UCC, §9-109(d)(13); See Harris & Mooney, *Reflections, supra* note 19 at 1366: "Perhaps because they made a political judgment that opposition to the proposed inclusion of deposit accounts in consumer transactions might have resulted in excluding deposit accounts as original collateral in commercial transactions as well, the Drafting Committee agreed to exclude from Revised Article 9 assignments of deposit accounts in consumer transactions."

[39] UCC, §9-109(a)(1); Also see Markell, *supra* note 11 at 984.

[40] UCC, §9-102(a)(29).

[41] UCC, §1-201(b)(4).

[42] UCC, §9-102(c).

Under Article 9, a security interest in a deposit account generally attaches when it becomes enforceable against the depositor.[43] It becomes enforceable, against the depositor and third parties, when (1) value has been given,[44] (2) the depositor has rights in the deposit account,[45] and (3) either (A) the depositor authenticates[46] a security agreement that provides a description of the deposit account,[47] or (B) the secured party acquires control of the deposit account.[48]

ii. *Evidentiary Chasm*

The third requirement of enforceability – satisfied in either or both of the two aforementioned ways, (A) and/or (B) – is evidential in nature and object; it is concerned with establishing, as a matter of fact, that the depositor actually granted a security interest in the deposit account to the secured party. Official Comment 4 to §9-203 of Article 9 explains that acquiring control of the deposit account eliminates the need, which would otherwise exist, for the secured party to produce a debtor-authenticated security agreement describing the deposit account.

> The other alternatives in subsection (b)(3) dispense with the requirement of an authenticated security agreement and provide alternative evidentiary tests. … Similarly, under subsection (b)(3)(D), control of … a deposit account … satisfies the evidentiary test if control is pursuant to the debtor's security agreement.

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43 UCC, §9-203(a).
44 UCC, §9-203(b)(1).
45 UCC, §9-203(b)(2).
46 UCC, §9-102(a)(7): "'authenticate' means: (A) to sign; or (B) with present intent to adopt or accept a record, to attach to or logically associate with the record an electronic sound, symbol, or process."
47 UCC, §9-203(b)(3)(A).
48 UCC, §9-203(b)(3)(D).

This rationale is deficient in one glaring respect. First, in respect of non-depository secured creditors, the rationale is defensible since a non-depository secured creditor, in order to acquire control of the deposit account, must either procure a tripartite control agreement (among itself, the depositor and depository bank) or itself become the depository bank's customer of record. Both of these methods of control tend to positively establish that a security interest was *in fact* granted by the depositor to the non-depository secured creditor.

But the same line of reasoning does not hold for the depository bank, which acquires control of its customer's deposit account automatically, simply by virtue of being the depository bank (the "automatic control method", described below). How does the depository bank's identity establish that its depositor *in fact* granted a security interest to it? Simply put, it does not. The gap in this reasoning is obvious. Recognizing the identity of the depository bank as "the depository bank maintaining the deposit account" is thoroughly unhelpful in answering the question of whether the depositor, as a matter of fact, granted a security interest in the deposit account to the depository bank. This anomaly leaves open the possibility of a depository bank successfully establishing attachment (and perfection) based on a mere assertion that the depositor verbally agreed to grant a security interest. As noted by Markell, this flawed reasoning has disturbing consequences for third parties including non-depository secured creditors and unsecured creditors.

> Control will be examined later, but it is interesting to note that the incorporated definition – security agreement – does not require a writing. A security agreement is simply "an agreement that creates or provides for a security interest." The definition of "agreement" in Article 1 – applicable to

> Revised Article 9 – simply refers to "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance." Thus, attachment (at least with respect to deposit accounts) has no signed writing requirement. As a consequence, a security interest in favor of a bank in a deposit account can arise by implication as well as by express oral agreement – a fact that third party creditors will have to face each time they seek to garnish a deposit account.[49]

c. Perfection

Control is also the exclusive method of perfecting a security interest in a deposit account as original collateral.[50] A secured party has control of a deposit account (and thus gains perfected status in respect of the deposit account) if:

> (1) the secured party is the bank with which the deposit account is maintained [the "automatic control method"];
>
> (2) the depositor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the depositor [i.e. the parties execute a tri-partite control agreement – the "control agreement method"]; or
>
> (3) the secured party becomes the bank's customer with respect to the deposit account [the "customer method"].[51]

The automatic control method is available only to the depository bank. The second method of acquiring control of a deposit account – the control agreement method – is available only if the depository bank agrees to enter into a tripartite control agreement with the depositor and non-depository secured creditor, which it

[49] Markell, *supra* note 11 at 982.
[50] UCC, §§9-312(b)(1) and 9-314(a).
[51] UCC, §9-104(a). Bracketed labels are added; note that these labels do not form part of the statute or Article 9's official vernacular.

is under no obligation to do.[52] This particular feature of Article 9 has drawn sharp criticism because it gives depository banks unfettered veto power over depositors and their other (prospective) secured creditors,[53] rendering security interests unapproved by the bank "unperfectible."[54] This veto power, coupled with the automatic control method of perfection (which solely benefits banks) and favourable priority rules for depository banks, makes the Article 9 approach decidedly "bank friendly."[55] Hillinger, Batty & Brown elaborate on this friendliness.

> The Article 9 priority rules regarding interests in deposit accounts favor the depositary bank. The depositary bank's security interest prevails over the interest of everyone other than the secured creditor who becomes the depositary bank's customer. The risk to other secured creditors is obvious. Whether another creditor takes a security interest in a deposit account as original collateral or enjoys a security interest in the deposit account as identifiable cash proceeds, the creditor takes its interest knowing it will be subordinate to the interest of the depositary bank unless the creditor becomes the depositary bank's customer. A debtor could convert all its collateral into cash. The cash has to go somewhere. That 'somewhere' is likely to be a bank account. If the debtor deposits the cash into the deposit account, all claimants will be subordinate to the depositary bank unless a competing creditor is the bank's customer regarding the deposit account.[56]

Hillinger, Batty & Brown further explain that, under Article 9, banks negotiate from a position of greater leverage with respect to their depositors and non-depository secured creditors.

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[52] UCC, §9-342. Pursuant to the same section, the bank has no obligation to disclose the existence of a control agreement it enters into with the depositor and secured party, unless requested to do so by the depositor. See Hillinger, Batty & Brown, *supra* note 11 at 23.
[53] See Gibson, *supra* note 10.
[54] William D. Warren and Steven D. Walt, *Secured Transactions in Personal Property*, 7th ed. (New York: Foundation Press, 2007) at 203.
[55] See Hillinger, Batty & Brown, *supra* note 11 at 17, where the authors suggest that, as a matter of standard practice, depository banks will place granting language in their deposit account agreements, and consequently enjoy immediate perfection via the automatic control method.
[56] Hillinger, Batty & Brown, *ibid.* at 29.

> Because depositary banks will negotiate from a position of strength under the new Article 9, secured parties are going to find it more difficult to obtain the depositary bank's consent to a control agreement. A balanced control agreement that benefits the depositary bank as well as the secured party is the secured creditor's only hope. Otherwise, its request for a control agreement is doomed.[57]

A non-depository secured creditor maintains control of a deposit account, under the control agreement method, even if the depositor retains the right to direct disposition of funds from the deposit account.[58] This means that, with the depository bank's cooperation, it is possible for the parties to structure an arrangement under which both the non-depository secured creditor and the depositor are entitled to issue directions to the depository bank respecting disposition of deposit account funds.

The third method of acquiring control of a deposit account – the customer method – also requires cooperation from the depository bank. Under this method of control,[59] the non-depository secured creditor gains direct contractual privity with the depository bank. But Official Comment 3 to §9-104 clarifies that the non-depository secured creditor need not become the depository bank's *sole customer* in relation to the deposit account balance.

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[57] Hillinger, Batty & Brown, *ibid.* at 50 and 52. The authors elaborate on the depository bank's leverage, at 23: "A depositary bank has no duty to enter into a control agreement or to disclose its existence. This means the depositary bank has the potential to extract 'concessions' from the creditor who wants a control agreement."; Also see Gibson, *supra* note 10 at 847: "It seems unlikely that banks will grant control to lenders if they view them as competitors. In light of the financial interests that banks have in the accounts they maintain, their willingness to grant control to other creditors is at best questionable, especially the kind of control that would subordinate their security interests."

[58] UCC, §9-104(b).

[59] See Markell, *supra* note 11 at 987, where the author describes the limited use of the customer method of control: "This method of control, which has significant benefits in priority contests, will likely not be used for operating accounts, but rather for blocked accounts containing funds the debtor does not intend to use in its everyday business affairs." Empirical data on this point, if available, would be interesting to review.

> Under subsection (a)(3), a secured party may obtain control by becoming the bank's "customer," as defined in Section 4-104. As the customer, the secured party would enjoy the right (but not necessarily the exclusive right) to withdraw funds from, or close, the deposit account.[60]

d. Proceeds

Given the inherent reservoir function[61] served by deposit accounts, they often constitute proceeds of original collateral; thus deposit account balances as proceeds fall under Article 9's special definition of "cash proceeds."[62] Provided the security interest in the original collateral (whatever its form) was perfected, so too is a security interest in a deposit account as cash proceeds.[63] Intermingling of cash proceeds is commonplace; Article 9 clarifies that the lowest intermediate balance rule applies in determining whether any particular deposit remains, after a subsequent series of transactions, constitutive of the deposit account corpus.[64] Special rules, described below, govern priority rights to (i) deposit account balances *as proceeds*, and (ii) *proceeds of* deposit account balances (i.e. those items of

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[60] UCC, §9-104, Official Comment 3.

[61] See Hillinger, Batty & Brown excerpt above in the body text associated with note 57.

[62] UCC, §9-102(a)(9): "Cash proceeds" means proceeds that are money, checks, deposit accounts, or the like. The general definition of "proceeds" is set out in §9-102(a)(64).

[63] UCC, §§9-315(c) and 9-315(d)(2). §9-315(a)(2) clarifies that "a security interest attaches to any identifiable proceeds of collateral." See §9-315, Official Comment 7: "... Under subsection (d)(2), if the security interest in the original collateral was perfected, a security interest in identifiable cash proceeds will remain perfected indefinitely, regardless of whether the security interest in the original collateral remains perfected. In many cases, however, a purchaser or other transferee of the cash proceeds will take free of the perfected security interest. See, e.g., Sections 9-330(d) (purchaser of check), 9-331 (holder in due course of check), 9-332 (transferee of money or funds from a deposit account)."

[64] UCC, §9-315(b).

personal property which are purchased or paid for with funds transferred from deposit accounts).[65]

e. Priority to Deposit Account Balance

i. Priority Contests Involving the Depository Bank ~ Twofold Bank Supremacy

VIA SECURITY INTEREST

Under Article 9, all creditors are effectively on notice that the depository bank likely has a priority interest in the deposit account.[66] A depository bank's security interest in the deposit account has priority over a conflicting security interest held by a non-depository secured creditor unless the non-depository secured creditor can avail itself of the customer method of control (which the depository bank may, at its unfettered discretion, agree to and facilitate).[67] Aside

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[65] See Markell, *supra* note 11 at 991-1000.

[66] Hillinger, Batty & Brown, *supra* note 11 at 25; Also see Jean Wegman Burns, "New Article 9 of the UCC: The Good, the Bad, and the Ugly" (2002) U. Ill. L. Rev. 30 at 58: "Assuming the deposit account does not fall within the 'consumer transaction' exclusion, new Article 9 sends the secured creditor to another section to find out how to perfect the account. The short answer is that the creditor must control the account. Not surprisingly, the drafters define 'control' for a deposit account in yet another section (which provides three methods of control). Then, under the every-move-deserves-its-own-provision approach, the drafters require the creditor to go to still another section to find the rules for priority disputes in deposit accounts. This time the section can be subtitled: the bank holding the account always wins."; Also see Robert M. Scavone, "Cash Collateral Under the PPSA: The Case for Control" (2012) 53 C.B.L.J. 263 at 285: "First, if banks routinely require depositors to grant them a security interest in deposit accounts to secure overdraft facilities or other obligations, third-party creditors contemplating advancing against the security of a deposit account would be on constructive notice that the bank probably has already been granted such a security interest and can govern themselves accordingly, for example, by having the debtor request subordination or by excluding the credit balance of the account from the borrowing base."

[67] UCC, §§9-327(3) and (4). See UCC, §9-327, Official Comment 4: "Under paragraph (3), the security interest of the bank with which the deposit account is maintained normally takes priority over all other conflicting security interests in the deposit account, regardless of whether the deposit account constitutes the competing secured party's original collateral or its proceeds. A rule of this kind

from this narrow exception,[68] the depository bank, if involved in a priority dispute involving a deposit account balance, prevails[69] either by virtue of (i) its status as depository bank,[70] or (ii) its powerful right of set-off and/or recoupment.[71]

VIA SET-OFF AND/OR RECOUPMENT

Under Article 9, a depository bank's powerful priority right qua secured creditor is supplemented by, or held concurrently with, its rights of set-off and/or recoupment.[72] Geva succinctly describes the nature of recoupment (a distinct "set-offesque" term of American law), comparing it with roughly equivalent Canadian doctrine.

> 'Recoupment' is (sic) American law term meaning the right of a defendant in a lawsuit to demand deduction from the amount awarded to plaintiff of a sum due the defendant from the plaintiff in the transaction which was the subject of the lawsuit. See e. g. Black's Law Dictionary s. v. 'recoupment' and s. v. 'equitable recoupment'. It roughly covers 'abatement' and 'equitable set-off' in Anglo-Canadian law. In the common law, under the doctrine of abatement, damages resulting in the diminution of the value of the subject

enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account. …"

68 The customer method of control also gives the non-depository secured creditor priority over a bank's right of set-off. See UCC, §9-340(c), discussed below.

69 See Markell, *supra* note 11 at 1027: "While bringing almost excruciating clarity to the subject, Revised Article 9's provisions on deposit accounts do have complexities that bear more than one reading. The more one reads, the more one confirms that these complexities do indeed fit together, and snugly. More often than not, however, the result of these re-readings will confirm what one initially suspected: the depository bank always wins, or at least starts out the game far ahead. This can be seen not only in rules respecting perfection by, and only by, control, but also in the reversal of current law regarding the victor in contests between proceeds claims and offset rights."

70 UCC, §9-327(3).

71 UCC, §9-340(a).

72 UCC, §9-340.

> matter may be 'set up' as a defence, and not as a matter of set-off, against an action for the payment of the value of that subject matter.[73]

For ease of reference, I generically identify a depository bank's combined right of set-off and/or recoupment as its "rights of set-off" or "set-off rights" or some variation thereof, but specifically note where the doctrinal distinction becomes material.

As noted above, the depository bank's set-off priority[74] augments its priority entitlement via security interest (i.e. in the "pure secured transactions" context).[75] Revised Article 9 radically strengthens, in relative comparison with Former Article 9, the depository bank's rights of set-off. Whereas under Former Article 9, a depository bank's set-off rights were defeated by a proceeds claimant, the outcome of such a contest is reversed in favour of the depository bank under Revised Article 9.[76] Again, the only exception to the supremacy of the depository bank's right of set-off arises where a non-depository secured creditor perfects its security interest in the deposit account via the customer method of control.[77] But, as reflected in the operative language of UCC §9-340, and described in Official Comment 2 to that

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[73] Benjamin Geva, "Security Interests in Bank Deposits Under UCC article 9: A Perspective" (2013) Universidad Nacional Autónoma de México, Instituto de Investigaciones Jurídicas 31, online www.juridcas.unam.mx ("*A Perspective*") at 52, n. 136.

[74] UCC, §9-340(a).

[75] UCC, §9-340(b); See Markell, *supra* note 11 at 1006.

[76] See Markell, *ibid.* at 972 and 1006: "Under current law, a secured party with a perfected proceeds interest in a deposit account generally defeats a depositary bank's setoff rights. Revised Article 9 changes this dramatically. Under section 9-340, the depositary bank's setoff rights are superior to the secured party's security interest."; Also see Warren & Walt, *supra* note 54 at 202: "The lender can protect itself only by proceeding under 9-104(a)(3) and becoming the customer of the account, a step that presumably must be approved by the bank. 9-327(4). Non-bank lenders must value their rights in cash proceeds in light of this severe limitation, which reverses most of the pre-revision law on the subject."

[77] UCC, §9-340(c).

section, even this limited exception does not override the depository bank's right of recoupment.

> Subsection (c) contains an exception: if the secured party has control under Section 9-104(a)(3) (i.e., if it has become the bank's customer), then any set-off exercised by the bank against a debt owed by the debtor (as opposed to a debt owed to the bank by the secured party) is ineffective. The bank may, however, exercise its recoupment rights effectively.[78]

ii. Priority Contests Not Involving the Depository Bank

ORIGINAL COLLATERAL OR PROCEEDS ~ CONTROL SUPREMACY

Recall that a non-depository secured creditor can only perfect a security interest in a deposit account as original collateral by acquiring control. Also recall that, to the extent it claims a deposit account balance as proceeds of its original collateral, a non-depository secured creditor may perfect its security interest in the deposit account via control *or* filing (against the original collateral).

Where a priority dispute does not involve the depository bank, the non-depository secured creditor who first acquires control of the deposit account enjoys priority to its balance, regardless of whether competing claims to the deposit account are "original collateral claims" or "proceeds claims."[79] Given the more

[78] UCC, §9-340, Official Comment 2.

[79] UCC, §9-327(2). Pursuant to §9-327(1), a party with control of a deposit account has priority over a party without control. Markell, *supra* note 11 at 989, explains that, where neither secured party advances a proceeds claim, the same result follows as a matter of general principles (i.e. governing the relationship between perfected and non-perfected security interests) under §9-322(a)(2): "Under Revised Article 9, this is explicit by statute, although the same result would be obtained under the general principle that a perfected security interest – the one held by the secured party in control – has priority over an unperfected security interest – the one held by the secured party who is not in control."

onerous procedural hurdles for perfecting a security interest in a deposit account by control, it is rare, though theoretically possible, for more than two parties (e.g. the depository bank via the automatic control method, and more than one other party via either the control agreement method or customer method) to simultaneously acquire control of the same deposit account.[80] Thus, where the depository bank is uninvolved in the contest, priority is usually determined, non-temporally, with simple reference to which non-depository secured party has control.[81]

NON-CONTROL PROCEEDS CLAIMS ~ FIRST-IN-TIME SUPREMACY

Where no non-depository secured creditor acquires control of the deposit account – that is, where all non-depository secured creditors pursue the deposit account balance as proceeds of their original collateral – priority is generally determined pursuant to the first-in-time rule.[82] Markell furnishes an illustration.

> As an example, as between an inventory financier and a factor financing accounts arising from such inventory, the secured party who (sic – "first") filed its financing statement (as to inventory or accounts) will have priority over proceeds existing in the deposit account.[83]

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[80] See Hillinger, Batty & Brown, *supra* note 11 at 51, where the authors describe the typical restrictive covenant sought by a "lead secured creditor" procuring a control agreement: "A well-drafted control agreement will also require the depositary bank to confirm that no prior control agreement exists regarding the applicable deposit account. In addition, the depositary bank should covenant that it will not enter into any other subsequent control agreement. The provisions will ensure that no competing secured party does or will hold a secret lien on the deposit account."

[81] For proceeds, the time of perfection in respect of the original collateral is also the time of perfection in respect of the deposit account proceeds: §9-322(b)(1). But UCC, §§9-322(c)(2) and (f)(1) clarify that §9-327 priority supersedes a proceeds claim to a deposit account balance. Thus, a party with control will always prevail over a proceeds claimant lacking control.

[82] UCC, §9-322(a)(1).

[83] Markell, *supra* note 11 at 990. At first glance, it is tempting to assert that, even if the accounts financier filed first, §9-324(b) nonetheless gives superpriority to the inventory financier. However, a careful reading of the provision reveals that this is highly unlikely. Provided certain procedural

f. Priority to Proceeds Of Deposit Account Balance

i. Preliminary Note ~ Transferee of Funds From a Deposit Account Balance

A security interest continues in collateral notwithstanding that is has been sold, leased, exchanged, transferred or otherwise disposed of, unless Article 9 specifically provides otherwise.[84] Transfers of deposit account balances (and cash equivalents generally) present an exception to the general rule; funds transferred from a deposit account are lost to the transferee (i.e. the transferee takes the funds free and clear of security interests) unless she acted in collusion with the depositor in violating the rights of the secured creditor(s).[85] As explained in Official Comment

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requirements are satisfied, §9-324(b) extends the inventory financier's priority to "identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are <u>received on or before the delivery of the inventory to the buyer.</u>" (emphasis added) The services of an accounts factor are generally unnecessary where the debtor receives cash proceeds (which include money, cheques, deposit account balances, and the like) prior to or simultaneous with delivery of the inventory to the buyer; a commercial seller seeks the services of an accounts factor, *inter alia*, for an immediate cash infusion to enable it to meet its other financial obligations (i.e. pay employees, purchase supplies and inventory, etc.). In theory, at least, it seems that §9-324(b) could operate in favour of the inventory financier, but only under a contrived and unrealistic fact pattern. See Hillinger, Batty & Brown, *supra* note 11 at 27, n. 108.
An inventory financier's purchase money superpriority generally does not extend to accounts. See, generally, UCC, §9-324, Official Comment 8: "… As a general matter, also like former Section 9-312(3), the purchase-money priority in inventory does not carry over into proceeds consisting of accounts or chattel paper. Many parties financing inventory are quite content to protect their first-priority security interest in the inventory itself. They realize that when the inventory is sold, someone else will be financing the resulting receivables (accounts or chattel paper), and the priority for inventory will not run forward to the receivables constituting the proceeds. Indeed, the cash supplied by the receivables financer often will be used to pay the inventory financing. In some situations, the party financing the inventory on a purchase-money basis makes contractual arrangements that the proceeds of receivables financing by another be devoted to paying off the inventory security interest. … When the proceeds of original collateral (goods or software) consist of a deposit account, Section 9-327 governs priority to the extent it conflicts with the priority rules of this section."

[84] UCC, §9-315(a)(1).

[85] UCC, §9-332(b).

3 to §9-332, this rule helps "ensure that security interests in deposit accounts do not impair the free flow of funds."[86]

ii. Priority to Proceeds Of

A collection of particularly byzantine rules, even by Article 9 standards, govern priority contests involving competing security interests in *proceeds of* a deposit account; that is, those items of personal property that are acquired in exchange for funds transferred from a deposit account balance.[87] Priority depends on a number of factors, most notably – the form such proceeds take.

First, to the extent that deposit account proceeds eventually end up back in the debtor's deposit account, the general priority rules for deposit accounts, set out in §9-327 (described above), continue to apply.[88] This bodes well for a depository bank with a security interest in its depositor's account, or a non-depository secured creditor with control of the deposit account under the control agreement method or customer method of perfection. However, to the extent that the proceeds, or subsequent generations thereof, do not wind up back in the deposit account, priority rights may vary.

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[86] UCC, §9-332, Official Comment 3.

[87] UCC, §9-327, Official Comment 5: "The priority afforded by this section does not extend to proceeds of a deposit account. Rather, Section 9-322(c) through (e) and the provisions referred to in Section 9-322(f) govern priorities in proceeds of a deposit account. Section 9-315(d) addresses continuation of perfection in proceeds of deposit accounts. As to funds transferred from a deposit account that serves as collateral, see Section 9-332."

[88] UCC, §§9-322(c), (d) and (f)(1).

Where a secured creditor – whether the depository bank or otherwise – qualifies for priority to the deposit account by virtue of control, it also enjoys priority over a conflicting security interest in identifiable proceeds of the deposit account if (A) the security interest in the proceeds is perfected,[89] (B) the proceeds are cash proceeds (that is, money, cheques, deposit account balances, or the like), and (C) in the case of proceeds of proceeds, all intervening generations of proceeds are themselves cash proceeds or accounts relating to the deposit account.[90] This means that a depository bank who enjoys priority to its depositor's account will also enjoy priority with respect to a certificate of deposit purchased with funds from the deposit account.[91] However, the bank will not retain priority over a conflicting security interest in non-cash proceeds – like, for example, a television – purchased with funds from the deposit account, unless it is also the first to file a financing statement covering such non-cash proceeds.[92]

g. Enforcement

In the event of default by the depositor debtor, a depository bank perfected under the automatic control method may apply the balance of the deposit account to

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[89] See UCC, §9-315(c) and (d).
[90] UCC, §9-322(c).
[91] See Markell, *supra* note 11 at 994.
[92] UCC, §9-322(d); see UCC, §9-322, Official Comment 9, Example 12; Also see Markell, *ibid.* at 995; Also consider an account of the rationalization of the section by Hillinger, Batty & Brown, *supra* note 11 at 38: "Seemingly, subsection (d)'s rule is intended to protect those Article 9 parties who rely on the UCC files to chart their future course of conduct. SP-2, an equipment financer, would not expect its interest in the debtor's equipment to be primed by a non-filing creditor claiming the equipment as proceeds of its non-filed (hidden) lien."

the obligation secured.[93] In contrast, a non-depository secured creditor holding a perfected security interest under the control agreement method or customer method may instruct the depository bank to pay the deposit account balance to or for the benefit of the non-depository secured creditor.[94]

Where a non-depository secured creditor holds a security interest in a deposit account balance under a proceeds claim, and such interest is either unperfected or perfected by mere filing, it must resort to judicial process[95] to liquidate the account unless it receives cooperation from the debtor depositor. Official Comment 7 to §9-607 explains.

> If a security interest in a deposit account is unperfected, or is perfected by filing by virtue of the proceeds rules of Section 9-315, the depositary institution ordinarily owes no obligation to obey the secured party's instructions. See Section 9-341. To reach the funds without the debtor's cooperation, the secured party must use an available judicial procedure.[96]

A secured party, whether the depository bank or non-depository secured creditor, must proceed in a commercially reasonable manner during realization proceedings.[97]

B. PERSONAL PROPERTY SECURITY ACT, CANADA (& NEW ZEALAND[98]) ~ PURE REGISTRATION MODEL & REGISTRATION PARADIGM

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[93] UCC, §9-607(a)(4).
[94] UCC, §9-607(a)(5).
[95] UCC, §9-601(a)(1).
[96] UCC, §9-607, Official Comment 7.
[97] UCC, §9-607(c); see Markell, *supra* note 11 at 1005.
[98] The NZPPSA, which came into force on May 1, 2002, is substantially similar to the western Canadian PPSA prototype. Consequently, a separate descriptive account of the NZPPSA is

1. *HISTORICAL BACKGROUND*

The PPSA is the Canadian provincial/territorial statute primarily responsible for governing the creation of consensual security interests, their enforcement, and priority ordering.[99] The PPSA is derived and adapted from UCC Original Article 9,[100] sharing a vision and mandate of modernizing, rationalizing and consolidating Canadian personal property security law.[101] The PPSA, like its Article 9 counterpart, has undergone successive generations of significant revisions since its original enactment.[102] Consequently, the Canadian and U.S. personal property security regimes, though similar in many respects (e.g. both embrace the unitary concept of security[103]), have evolved separately and followed unique paths.[104]

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unnecessary. However, in my basic account of the APPSA (the Canadian PPSA proxy representative of the pure registration model and registration paradigm), corresponding statutory citations to the NZPPSA are furnished, and material distinctions are noted.

[99] The *Bank Act*, S.C. 1991, c. 46, also governs certain classes of secured transactions. Although s. 427 *Bank Act* security can extend to deposit accounts as proceeds, the principal focus of the thesis is on the PPSA's perfection and priority rules.

[100] Clayton Bangsund, "A Critical Examination of Recently Proposed Amendments to the *Bank Act* Security Provisions" (2012) 75(2) Sask. L. Rev. 211 at 214.

[101] Ronald C.C. Cuming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law*, 2nd ed. (Toronto: Irwin Law, 2012) at 5.

[102] For a historical evolutionary account of the Canadian provinces' and territories' enactment of PPSA legislation, see Cuming, Walsh & Wood, *ibid.* at 64-70; Also see Jacob S. Ziegel, "The New Provincial Chattel Security Law Regimes" (1991) 70 Can. Bar. Rev. 681; Jacob S. Ziegel, Ronald C.C. Cuming & Anthony J. Duggan, *Secured Transactions in Personal Property and Suretyships: Cases, Text and Materials*, 4th ed. (Toronto: Emond Montgomery Publications Limited, 2003) at 19-21.

[103] Michael G. Bridge, Roderick A. Macdonald, Ralph L. Simmonds & Catherine Walsh, "Formalism, Functionalism, and Understanding the Law of Secured Transactions" (1998-1999) 44 McGill L. J. 567 at 572.

[104] See Oona Hathaway, "Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System" (2001) 86 Iowa Law Rev. 601 at 604, where the author describes "path dependence" as the "idea that an outcome or decision is shaped in specific ways by the historical path leading to it."; Also see Wood, *Acquisition Financing, supra* note 4 at 50, where the author identifies

In 1976, Ontario was the first Canadian province to proclaim the PPSA in force.[105] Since then, and by 2001, each other common law province and territory enacted its own version of the PPSA.[106] The Canadian PPSA statutes are substantially similar from jurisdiction to jurisdiction, although the OPPSA bucks uniformity to some degree.[107]

2. PPSA

a. Taxonomy & Creation

In Canada, the PPSA defines seven distinct, and mutually exclusive, categories of personal property: 1) goods, 2) chattel paper, 3) investment property, 4) documents of title, 5) instruments, 6) money, and 7) intangibles.[108] Every conceivable item of personal property can be classified under one, and only one, of these seven categories.

Whereas the first six categories of personal property are defined by description,[109] the term "intangible" is negatively defined as "personal property other than goods, chattel paper, investment property, a document of title, an instrument and money."[110] Thus, if an item cannot be classified under one of the six

path dependence as one theory which potentially explains the diversity in the various common law jurisdictions' inventory acquisition financing rules.

[105] See Cuming, Walsh & Wood, *supra* note 101 at 1 and 6.

[106] *Ibid.* at 1 and 65.

[107] *Ibid.* at 64-70.

[108] APPSA, s. 1(1)(gg), "personal property".

[109] It is unnecessary to closely examine the descriptive definitions of each of the six categories. This thesis is chiefly concerned with the residual category of "intangible."

[110] APPSA, s. 1(1)(x), "intangible"; NZPPSA, s. 16(1), "intangible".

descriptively defined categories of personal property, it must be classified under the residual category of "intangible."[111] Intangibles can be *described* as all those items of personal property that (a) cannot be physically possessed, and (b) do not fall under any of the other six descriptive categories of personal property. But this descriptive account of the intangible is secondary to the precise definitional account set out in the PPSA.

Under the PPSA taxonomy, the deposit account is an intangible because it does not fit within any of the six descriptively defined categories of personal property. One might also observe that the deposit account is properly described (not merely defined) as an intangible because it has no tangible existence. But again, as noted above, this descriptive account is of secondary importance to the PPSA's definitional account. Within the definition of "intangible", the deposit account also falls under the narrower definition of "account", defined as "… a monetary obligation not evidenced by chattel paper, an instrument or a security, whether or not it has been earned by performance, but does not include investment property."[112]

In contrast with Former Article 9, the PPSA permits, and has always permitted, a secured party to acquire a security interest in a debtor's deposit

[111] Cuming, Walsh & Wood, *supra* note 101 at 21.
[112] APPSA, s. 1(1)(b); NZPPSA, s. 16(1), "account receivable".

account.[113] Indeed, in Canada, secured transactions involving deposit accounts as original collateral are commonplace.[114]

Figure 4.2: PPSA Taxonomy (2017)

PERSONAL PROPERTY						
goods	chattel paper	investment property	document of title	instrument	money	intangible Examples: - ***deposit account*** - license - intellectual property

b. Attachment

A PPSA security interest in a deposit account generally attaches when (1) value is given,[115] (2) the depositor has rights in the deposit account or power to transfer rights in the deposit account to a secured party,[116] and (3) the security interest becomes enforceable.[117] A security interest in a deposit account becomes enforceable when the depositor has signed a security agreement containing an adequate description of the collateral.[118]

c. Perfection

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113 Benjamin Geva, "Rights in Bank Deposits and Account Balances in Common Law Canada" (2012) 28 B.F.L.R. 1 ("*Rights in Bank Deposits*") at 20.
114 Jacob S. Ziegel, "Canadian Perspectives on the Law Lords' Rejection of the Objection to Chargebacks" (1998-1999) 14 B.F.L.R. 131 at 141-142.
115 APPSA, s. 12(1)(a); NZPPSA, s. 40(1)(a).
116 APPSA, s. 12(1)(b); NZPPSA, s. 40(1)(b).
117 APPSA, s. 12(1)(c); NZPPSA, s. 40(1)(c).
118 APPSA, s. 10(1)(d); NZPPSA, s. 36(1)(b).

A security interest in a deposit account is perfected when it has attached and all steps required for perfection under the PPSA have been completed.[119] In order to perfect its security interest in a deposit account, a secured party must register a financing statement with the PPR.[120] Thus the PPSA is representative of a pure registration model with a registration paradigm.

d. Proceeds

Unlike Revised Article 9, the PPSA does not designate a deposit account balance as a special form of proceeds;[121] instead, the general proceeds rules apply. A security interest in original collateral automatically extends to proceeds in the form of a deposit account.[122] A security interest in a deposit account is continuously perfected if the security interest in the original collateral is perfected by registration of a financing statement covering that collateral,[123] whether or not the financing statement includes a description of the account.

e. Priority to Deposit Account Balance

[119] APPSA, s. 19; NZPPSA, s. 41(1).
[120] APPSA, s. 25; NZPPSA, s. 41(1)(b)(i).
[121] This is untrue in New Zealand. See NZPPSA, s. 16(1): "*cash proceeds* means proceeds in the form of money, cheques, drafts, or deposit accounts in banks or similar institutions." The term "cash proceeds" is referenced in NZPPSA, s. 46(b)(ii), cited below.
[122] APPSA, s. 28(1)(b); NZPPSA, s. 45(1)(b).
[123] APPSA, s. 28(2)(c); NZPPSA, s. 46(b)(ii).

Note, from the outset, that each of the PPSA priority rules described below is potentially subject to the depository bank's deposit account set-off rights.[124] Such rights were explored in detail in Chapter 3, and will not be extensively rehashed here. Instead I will focus on the "pure secured transaction" rules embodied in the PPSA.

i. Original Collateral

The first secured party to register a financing statement describing the deposit account generally enjoys priority to its balance.[125] Failure to register a financing statement leaves a secured party unperfected and vulnerable to competing claims.[126]

ii. Non-Purchase Money Proceeds

Where a secured party claims a deposit account balance as proceeds of its original collateral, the time of registration, possession or perfection in relation to the original collateral is also the time that determines priority to the deposit account balance; the relevant "temporal peg" for determining priority to the deposit account balance vis-à-vis competing secured party claims.[127] Thus, in a priority contest, a secured party claiming a deposit account as proceeds of its non-purchase money

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[124] Under s. 41(2) of the APPSA, or its analogue. NZPPSA, s. 102. See, generally, Chapter 3 ~ Set-Off. Research has not been undertaken in respect of the extent of a depository bank's deposit account set-off rights in New Zealand.
[125] APPSA, s. 35(1); NZPPSA, s. 66(a).
[126] See, for example, APPSA, ss. 20(a) and 35(1)(b).
[127] APPSA, s. 35(3); NZPPSA, s. 68.

original collateral will prevail if its registration in relation to the original collateral pre-dates the competing secured party's registration.[128]

iii. Purchase Money Proceeds

PROCEEDS OF COLLATERAL OTHER THAN INVENTORY OR INTANGIBLES

Where a purchase money secured party claims a deposit account balance as identifiable proceeds of original collateral other than inventory or an intangible, it will enjoy priority to the deposit account balance – over any other security interest in the deposit account balance given by the depositor – if, not later than 15 days after the debtor (or another person at the depositor's request) obtained possession of the original collateral, the purchase money secured party perfected its security interest in the original collateral.[129]

PROCEEDS OF INTANGIBLES

Where a purchase money secured party claims a deposit account balance as identifiable proceeds of an intangible, it will enjoy priority to the deposit account balance – over any other security interest given by the depositor – if, not later than

[128] APPSA, s. 35(1); NZPPSA, s. 66.
[129] APPSA, s. 34(2)(a); NZPPSA, s. 73(1). The grace period under s. 73(1) of the NZPPSA is 10 days, rather than 15. Also note that, pursuant to s. 73(2), s. 103 of the NZPPSA overrides s. 73. Section 103 sets out special rules for transactions involving New Zealand's central bank clearing and settlement system.

15 days after the security interest in the intangible attaches, the purchase money secured party perfected its security interest in the intangible.[130]

PROCEEDS OF INVENTORY

Where a purchase money inventory financier claims a deposit account balance as identifiable proceeds of its original collateral, it will enjoy priority to the deposit account balance – over any other security interest in the deposit account balance given by the depositor – if, prior to the depositor (or another person at the depositor's request) obtaining possession of the inventory, the purchase money inventory financier (i) perfected its security interest in the inventory, and (ii) gave notice, stating that it expected to acquire a purchase money security interest in the inventory, to any other secured party who had, prior to registration of the purchase money security interest, registered a financing statement containing a description covering the inventory.[131]

ACCOUNTS FINANCING RULE AND ITS NON-APPLICATION: CANADIAN NON-UNIFORMITY

Western & Northern Canada

The PPSA in several provinces and territories – namely, Alberta,[132] British Columbia,[133] Manitoba,[134] Northwest Territories,[135] Nunavut,[136] Saskatchewan,[137]

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[130] APPSA, s. 34(2)(b); NZPPSA, s. 75. Again, the grace period under s. 75 of the NZPPSA is 10 days, not 15.
[131] APPSA, s. 34(3); NZPPSA, s. 74.
[132] APPSA, s. 34(6).
[133] BCPPSA, s. 34(5).
[134] MPPSA, s. 34(6).

and Yukon[138] – contains a provision which, on its face, appears to alter or overrule the priority rule described in the preceding section, under specified conditions. The system is designed to create new financing opportunities for debtors by giving them the ability to liquidate their accounts for immediate cash flow. Instead of waiting for a 60-day account to mature into payment, a debtor may sell that account to a factoring company at a slight discount, or, alternatively, use the account as collateral in support of its general operating line with the bank. This collection of PPSAs facilitates accounts financing activity by affording a first registered accounts financier, who gives new value for an account, priority over a purchase money inventory supplier's proceeds claim to that account. Under the operative provision, a non-proceeds security interest in an "account" given for new value has priority over a purchase money security interest in the account as proceeds of inventory if a financing statement relating to the security interest in the account is registered before the purchase money security interest is perfected or a financing statement relating to it is registered (the "accounts financing rule").[139]

Northwest Territories, Nunavut & Saskatchewan

[135] NWTPPSA, s. 34(6).
[136] NPPSA, s. 34(6).
[137] SPPSA, s. 34(6).
[138] YPPSA, s. 33(4).
[139] APPSA, s. 34(6); Interestingly, New Zealand also adopted this provision – see NZPPSA, s. 75A; See Cuming, Walsh & Wood, *supra* note 101 at 464: "In the Western provinces and Territories, the accounts financer is given priority over the inventory financer provided that the accounts financer claims the accounts as original collateral rather than as proceeds and has given new value for them."

Of the seven jurisdictions that have adopted the accounts financing rule, three – Northwest Territories,[140] Nunavut[141] and Saskatchewan[142] – have enacted an additional PPSA provision excepting deposit accounts from the rule. Specifically, the provision clarifies that the special accounts financing priority rule does not apply to deposit accounts. This makes sense since deposit accounts are liquid in the purest sense, and are thus never in need of factoring. The provision was introduced in Northwest Territories, Nunavut and Saskatchewan to give the *Transamerica* decision (discussed below) explicit statutory effect.

Alberta, British Columbia, Manitoba & Yukon

Meanwhile, the PPSAs of Alberta, British Columbia, Manitoba and Yukon do not contain a concordant provision to SPPSA s. 34(7), leaving open the possibility that deposit accounts are indeed subject to the accounts financing rule. It is arguable that this discrepancy is inconsequential in light of the decision of the Saskatchewan Court of Appeal in *Transamerica Commercial Finance Corp., Canada v. Royal Bank*,[143] where it was held that a depository institution was not entitled to benefit from the accounts financing priority rule (as it then was, consonant with the language of present-day APPSA s. 34(6)) with respect to a deposit account on which it was liable. Consider Vancise J.A.'s purposive interpretation of the SPPSA's concordant provision.

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[140] NWTPPSA, s. 34(6.1).
[141] NPPSA, s. 34(6.1).
[142] SPPSA, s. 34(7).
[143] [1990] 4 W.W.R. 673 (Sask. C.A.) ("*Transamerica*").

> In my opinion, s. 34(4) is intended to preserve the priority of an account financer over that of a purchase money financer. The rationale is that accounts financing ought not to be jeopardized by the creation of purchase money financing. The purchase money priority set out in subs. (2) is not applicable in the circumstances described in subs. (4). The bank is asserting a priority with respect to a deposit account in its bank which is not an account given to secure the financing provided by the bank. In this case, the money from the sale of the goods subject to the purchase money security interest was "identifiable or traceable personal property ... derived directly from any dealing with the collateral" which includes a deposit account in a bank which is in turn defined as a cash proceed. Thus it is a "cash proceed" and not an "account" as defined in the Act, given for new value. There is no evidence that the moneys were deposited in the bank in other than the ordinary course of business. There was no "new value" given to the debtor in relation to the deposits and s. 34(4) does not take away the priority of the purchase money security interest of Transamerica to the proceeds realizable from the sale of the inventory.[144]

There is no good reason, so far as I am aware, why one would ever factor a deposit account. Because a deposit account balance is liquid (i.e. a cash equivalent), a depositor has no reason to "liquidate it" through an accounts factoring arrangement. As such, although I may have points of disagreement with the Saskatchewan Court of Appeal,[145] the *Transamerica* decision is sensible. Indeed, the provision seems clearly aimed at facilitating accounts factoring arrangements, which are never utilized for the liquidation of deposit account balances.

On one hand, no court has rejected *Transamerica*, and if the decision is followed in Alberta, British Columbia, Manitoba and Yukon, this will bring about substantive harmony across the western and northern Canadian jurisdictions despite formal non-uniformity in the text of their PPSAs. On the other hand, the express language of the accounts financing priority rule is inconsistent with the

[144] *Ibid.* at para. 34.

[145] Vancise J.A.'s conclusion that a deposit account is not an "account," as defined in the SPPSA, is incorrect.

decision in *Transamerica*, and it is plausible that a future court could decline to follow it. Even if *Transamerica* is followed in these jurisdictions, the decision, interpreted narrowly, does not preclude a party other than the depository institution from asserting the accounts financing priority rule in respect of a deposit account balance. Meanwhile, this possibility is expressly precluded under the Acts of Northwest Territories, Nunavut and Saskatchewan. In these jurisdictions, a purchase money financer of original collateral will have priority with respect to proceeds in the form of a deposit account as against a non-purchase money security interest held by the depositary bank or another secured party.

Eastern Canada: Ontario, New Brunswick, Newfoundland, Nova Scotia & Prince Edward Island

In eastern Canadian jurisdictions – Ontario,[146] New Brunswick,[147] Newfoundland,[148] Nova Scotia[149] and Prince Edward Island[150] – an inventory supplier enjoys priority to an account as proceeds of its original collateral provided it furnishes advance notice to a previously registered accounts financier of its intention to take a purchase money security interest in the inventory. Failing provision of notice, the inventory supplier is not entitled to the purchase money superpriority, and a first registered accounts financier (whether secured party or absolute transferee) prevails over the inventory supplier. The PPSAs of Ontario,

146 OPPSA, s. 33(1)(b)(iii).
147 NBPPSA, s. 34(2)(b).
148 NFPPSA, s. 35(2)(b).
149 NSPPSA, s. 35(2)(b).
150 PEIPPSA, s. 34(2)(b).

New Brunswick, Newfoundland, Nova Scotia and Prince Edward Island aim to give maximal protection to diligent purchase money financiers, enabling them to claim superpriority to account proceeds. This protection, however, is not absolute. For example, a purchase money financier's proceeds interest remains subject to the account debtor's contractual and equitable rights to the extent they are not affected by the notice given.

f. Priority to Proceeds Of Deposit Account Balance

The same general priority rules that apply to a deposit account balance *as proceeds* also apply to the *proceeds of* a deposit account balance. In this sense, the PPSA is far less complex than Article 9, which must manage proceeds priority claims having regard for the delicate interplay of temporal (i.e. filing-based) and non-temporal (i.e. control-based) priority rules.[151]

g. Enforcement

In the event of debtor default, a party with a security interest in a deposit account may enforce its interest by collecting the balance from the depository

[151] But see Cuming, Walsh & Wood, *supra* note 101 at 583, where the authors, using an illustrative example (italicized), discuss the cut-off of a non-temporal priority rule (i.e. premised on control) in the context of proceeds of investment property: "*SP1 takes and registers a security interest in all present and after-acquired personal property. SP2 takes a security interest in investment property and perfects it through control. SP2 also registers in respect of proceeds. The investment property is disposed of and the debtor acquires proceeds collateral.* SP1 has priority to the proceeds despite the fact that SP2 had priority to the original collateral. The operative provision of the PPSA states that the time of registration, possession or perfection of the original security interest is also the time of registration, possession or perfection of its proceeds security interest. SP1 registered before SP2 perfected, therefore SP1 wins. The non-temporal priority rules therefore afford a priority in respect of the original collateral, but not in respect of the proceeds if the security interest was not the first to be registered or perfected."

bank;[152] it may do so by notifying the depository bank that it is to make payment of the deposit account balance to the secured party,[153] and applying such payment to the satisfaction of the obligation secured by the security interest.[154] The secured party may deduct its reasonable collection expenses from the amount collected.[155] As noted above, a non-depository secured creditor's entitlement to the deposit account balance may be subject to the depository bank's deposit account set-off rights, which as we have seen, are quite powerful.[156] A secured party who engages in realization proceedings is subject to a duty to act in good faith and in a commercially reasonable manner.[157]

C. PERSONAL PROPERTY SECURITIES ACT 2009, AUSTRALIA ~ HYBRID BANK-ONLY CONTROL MODEL & CONTROL PARADIGM

1. HISTORICAL BACKGROUND

Reminiscent of the personal property security statutes introduced in the United States and Canada, Australia's AUSPPSA was a legislative response to a "patchwork system of statutory initiatives supplemented by the common law and equitable principles."[158] Like New Zealand's version of the statute, adopted in 1999,

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[152] APPSA, s. 57; See, generally, Cuming, Walsh & Wood, *ibid.* at 662.
[153] APPSA, s. 57(1)(a).
[154] APPSA, s. 57(1)(b).
[155] APPSA, s. 57(2)(b)(i); NZPPSA, s. 108.
[156] See, generally, Chapter 3 ~ Set-Off.
[157] APPSA, s. 66(1).
[158] Anthony Duggan and David Brown, *Australian Personal Property Securities Law* (Australia: LexisNexis, 2012) at para. 1.37.

Australia's was drafted using Saskatchewan's SPPSA as its inspiration.[159] However, as noted by Goode, the AUSPPSA is significantly lengthier than its North American counterparts.

> If Article 9 is unrivalled for its complexity, the Australian PPSA is unmatched for its length, running to an amazing 343 sections, incorporating numerous amendments since it was first enacted.[160]

The AUSPPSA was enacted in December 2009, and became operative on January 30, 2012.[161] It is a federal statute brought about by state cooperation and coordination,[162] leaving Australia – like New Zealand, which enjoys the natural "uniformity" advantage of being a unitary state – with one statute, and perhaps more importantly, one registry. These features alone place the Australian and New Zealand systems well ahead of both the American and Canadian systems on a uniformity metric.[163]

2. AUSPPSA

a. Taxonomy & Creation

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[159] Duggan & Brown, *ibid.* at paras. 1.41 (n. 46) and 1.50.
[160] Duggan & Brown, *ibid.* at v (Foreword by Roy Goode).
[161] Duggan & Brown, *ibid.* at para. 1.49; Wood, *Acquisition Financing, supra* note 4 at 49, n. 4.
[162] Duggan & Brown, *ibid.* para. 1.51, n. 67: "The scheme is supported by an agreement entered into between the Commonwealth and State governments: Inter-Governmental Personal Property Securities Law Agreement (2 October, 2008). The inter-governmental agreement is reflected in PPSA Pt. 7.3, Div 2, which deals with the constitutional basis of the statute. Acting pursuant to the inter-governmental agreement, each state has passed legislation referring its jurisdiction over PPSA matters to the Commonwealth. See, for example: Personal Property Securities (Commonwealth Powers) Act 2009 (NSW); Personal Property Securities (Commonwealth Powers) Act 2009 (Qld), Personal Property Securities (Commonwealth Powers) Act (SA), Personal Property Securities (Commonwealth Powers) Act 2010 (Tas), Personal Property Securities (Commonwealth Powers) Act 2009 (Vic)."
[163] Duggan & Brown, *ibid.* at para. 1.51.

In Australia, under the AUSPPSA, the residual category of personal property is "intangible property," defined as "personal property (including a license) that is not any of the following: (a) financial property; (b) goods; (c) an intermediated security."[164] The "ADI account" (i.e. deposit account) is a species of intangible property, and thus falls within the AUSPPSA's residual category of personalty. The term "ADI account" is defined as follows:

> *ADI account* means an account, within the ordinary meaning of that term, kept by a person (whether alone or jointly with one or more other person) with an ADI that is payable on demand or at some time in the future (as agreed between the ADI and the person or persons).[165]

Consider, also, the definition of "ADI" (i.e. bank).

> *ADI* (short for authorised deposit-taking institution) has the same meaning as in the *Banking Act 1959*.[166]

An ADI account is thus, for all intents and purposes, a deposit account maintained with an Australian bank. The AUSPPSA permits a secured party to acquire a security interest in a debtor's ADI account; this entitlement extends to the ADI itself.[167] An "account"[168] maintained with an institution other than an ADI also falls under the residual definition of intangible property, but does not constitute an ADI account. It therefore falls subject to the general rules applicable to intangible property.

[164] AUSPPSA, s. 10, "intangible property".
[165] AUSPPSA, s. 10, "ADI account".
[166] AUSPPSA, s. 10, "ADI". Curiously, neither "ADI" nor "authorized deposit-taking institution" appear to be defined in the *Banking Act 1959* or, so far as I can tell, any of its amending acts.
[167] AUSPPSA, s. 12(4)(b).
[168] AUSPPSA, s. 10, "account".

Figure 4.3: AUSPPSA Taxonomy (2017)

PERSONAL PROPERTY							
goods	financial property					intermediated security	intangible property
	chattel paper	currency	document of title	investment instrument	negotiable instrument		Examples: ***- *ADI account*** - license - intellectual property

b. Attachment & Enforceability

i. Requirements for Attachment & Enforceability

A security interest in an ADI account is enforceable against the debtor[169] only if it has attached to the ADI account;[170] a security interest attaches when (a) the depositor has rights in the ADI account or the power to transfer rights in it to the secured party,[171] and (b) either (i) value is given,[172] or (ii) the depositor does an act by which the security interest arises.[173] A security interest in an ADI account is enforceable against a third party if (a) the security interest has attached to the deposit account,[174] and (b) either (i) the security interest in the ADI account is

[169] AUSPPSA uses the term "grantor" rather than "debtor."
[170] AUSPPSA, s. 19(1).
[171] AUSPPSA, s. 19(2)(a).
[172] AUSPPSA, s. 19(2)(b)(i).
[173] AUSPPSA, s. 19(2)(b)(ii).
[174] AUSPPSA, s. 20(1)(a).

perfected by control,[175] or (ii) a security agreement adequately describing the deposit account as collateral is signed, adopted or accepted by the depositor.[176]

ii. Another Evidentiary Chasm

The AUSPPSA suffers from the same deficiency as Article 9. As discussed in further detail below, a depository ADI acquires automatic control of a deposit account simply by virtue of being the depository ADI. Of course, this fact alone does not establish that the depositor actually granted the depository ADI a security interest in the ADI account. As under Article 9, the AUSPPSA's deposit account directive leaves open the possibility of a depository ADI successfully establishing third party enforceability and perfection without reliance on a written and signed security agreement.

c. Perfection

A security interest in an ADI account is perfected if (i) the security interest is attached,[177] (ii) the security interest is enforceable against third parties,[178] and (iii) the secured party takes an available perfection step.[179] A security interest in an ADI account may be perfected by effective registration[180] or control.[181] The AUSPPSA

[175] AUSPPSA, s. 20(1)(b)(ii).
[176] AUSPPSA, ss. 20(1)(b)(iii) and (2).
[177] AUSPPSA, s. 21(1)(b)(i).
[178] AUSPPSA, s. 21(1)(b)(ii).
[179] AUSPPSA, s. 21(1)(b)(iii).
[180] AUSPPSA, s. 21(2)(a). See Part 5.4, ss. 159-168 for "effective registration" requirements.
[181] AUSPPSA, s. 21(2)(c)(i).

regime is thus representative of a hybrid (bank-only control) model with a control paradigm.

Only the "depository ADI" – the ADI with which the ADI account is maintained – enjoys the privilege of automatic control.[182] All other parties, including other ADIs – all ADIs other than the depository ADI ("non-depository ADIs") – must perfect a security interest in an ADI account by registration.[183]

d. Proceeds

A security interest in original collateral automatically attaches to identifiable proceeds thereof, including an ADI account.[184] The time of registration or possession or perfection in relation to the original collateral is also the time of registration, possession or perfection in relation to the ADI account.[185] A security interest in an ADI account as proceeds is perfected if the security interest in the original collateral was perfected by a registration that describes the ADI account[186] or the original collateral.[187]

e. Priority to Deposit Account Balance

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[182] AUSPPSA, s. 25: "A secured party has *control* of an ADI account for the purposes of section 21 (perfection – main rule) if, and only if, the secured party is the ADI."; Also see AUSPPSA, ss. 12(3A) and (4)(b).
[183] Wood, *Acquisition Financing, supra* note 4 at 61.
[184] AUSPPSA, s. 32(1)(b).
[185] AUSPPSA, s. 32(5).
[186] AUSPPSA, s. 33(1)(a).
[187] AUSPPSA, s. 33(1)(c). A proceeds claimant has a five-day grace period of temporary perfection for otherwise unperfected proceeds; failure to comply leaves the security interest unperfected. See ss. 33(2) and (3).

i. *Priority Contests Involving the Depository ADI ~ Control Supremacy*

The Guide to Part 2.6 of the AUSPPSA concisely describes the priority rules pertaining to ADI accounts.

> For example, a security interest held by an ADI in an ADI account with the ADI has priority over any other security interest in the ADI account. An ADI has control over an ADI account held with the ADI (see section 25). Only the ADI with which an ADI account is held may perfect a security interest in the ADI account by control (see section 21). A security interest perfected by control has priority over any other security interest in the same collateral (see section 57).[188]

Depository ADIs thus enjoy an "especially privileged position" with respect to ADI account balances under the AUSPPSA.[189] As noted by Duggan & Brown, the combined effect of sections 57 and 75 of the AUSPPSA constitutes "a generous concession in favour of the banking industry."[190] The authors candidly explain, "[t]his is a risk that inventory financiers and others will have to take into account when deciding whether to do business with the grantor and if so, on what terms."[191] The omnipotence of a depository ADI's claim to its depositor's ADI account balance, on the basis of control, obviates the depository ADI's need to rely on set-off rights.[192]

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[188] AUSPPSA, s. 54.

[189] John G.H. Stumbles, "Personal Property Security Law in Australia and Canada: A Comparison" (2011) 51 C.B.L.J. 425 at 436; This "especially privileged position" is reinforced in a later section of the AUSPPSA, s. 75: "To avoid doubt, a perfected security interest, held by an ADI, in an ADI account with the ADI has priority over any other perfected security interest in the ADI account."

[190] Duggan & Brown, *supra* note 159 at para. 5.24.

[191] Duggan & Brown, *ibid.* at para. 2.32.

[192] The specialized provisions dealing with set-off do not apply to ADI accounts. Instead they only apply to accounts and chattel paper, which are distinct items of personal property: see AUSPPSA, s. 80. This is curious. Does a depository ADI, who does not have a security interest in its depositor's ADI account, have a set-off right equivalent or analogous to that provided in s. 80 of the AUSPPSA? In reality, the issue is moot, since control is, essentially, a proxy for set-off under this bank-only control model.

ii. Priority Contests Not Involving the Depository ADI

ORIGINAL COLLATERAL

Where a priority dispute arises not involving the depository ADI as a contestant, the first secured party to effect registration covering the ADI account generally enjoys priority.[193] For each secured party other than the depository ADI, failure to register leaves it unperfected and vulnerable to competing claims.[194]

NON-PURCHASE MONEY PROCEEDS

Where an ADI account balance is claimed as proceeds of a secured party's original collateral, the time of registration or possession or perfection in relation to the original collateral is also the time of registration, possession or perfection in relation to the ADI account.[195] Thus, in a priority contest, a secured party claiming an ADI account balance as proceeds of its original collateral will prevail if its registration in relation to the original collateral pre-dates the competing secured party's registration in relation to the ADI account.[196]

PURCHASE MONEY PROCEEDS

[193] AUSPPSA, s. 55(4) and (5).
[194] See, for example, AUSPPSA, s. 55(3).
[195] AUSPPSA, s. 32(5).
[196] AUSPPSA, ss. 32(5), 33(1)(c) and 55. To the extent that two parties each claim an ADI account balance as proceeds of their original collateral, it is not necessarily a matter of determining who has priority to the "same collateral," but rather a matter of determining, using tracing principles, the extent to which the ADI account balance remains constitutive of their respective proceeds claims.

Where a secured party (a "purchase money proceeds claimant") claims an ADI account balance as proceeds of its purchase money collateral, whether inventory or non-inventory, it will enjoy priority to the ADI account balance if the purchase money security interest was perfected by a prescribed registration[197] (i.e. a purchase money designated registration) within the statutorily prescribed timeframe.[198] With respect to proceeds of inventory, the purchase money proceeds claimant's registration must be effected at or before (i) the time the depositor obtained possession, if the inventory is goods,[199] or (ii) the time of attachment, if the inventory is other than goods.[200] With respect to non-inventory, the purchase money proceeds claimant's registration must be effected within 15 days of (i) the depositor taking possession, if the non-inventory is goods,[201] or (ii) the day the interest attached, if the non-inventory is other than goods.[202]

f. Priority to Proceeds Of Deposit Account Balance

i. Priority Contests Involving the Depository ADI

Earlier, it was noted that the AUSPPSA places the depository ADI in an especially privileged position in relation to ADI account balances. The AUSPPSA takes this privileged position one step further, under s. 57(2A), to *proceeds of* ADI

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[197] AUSPPSA, s. 153(1), Table Item 7.
[198] AUSPPSA, 33(1)(c) and 62.
[199] AUSPPSA, s. 62(2)(b)(i).
[200] AUSPPSA, s. 62(2)(b)(ii).
[201] AUSPPSA, s. 62(3)(b)(i).
[202] AUSPPSA, s. 62(3)(b)(ii).

account balances.[203] Duggan & Brown furnish an illustrative example of the inordinate strength – even in comparison with Revised Article 9 – of an ADI's ability to claim proceeds of an ADI account balance.

> Example 20. SP supplies Grantor with inventory on conditional sale terms and registers a financing statement which perfects Grantor's security interest in both the inventory and its proceeds. Grantor holds a deposit account with Bank. Bank makes a loan to Grantor and takes a security interest in the deposit account to secure repayment. Grantor sells inventory and deposits the sale proceeds in the deposit account. There are no other funds in the account. Grantor later makes a withdrawal from the account and uses the money to purchase new inventory. Grantor defaults against SP and Bank and they both claim the new inventory.
>
> Under Article 9, Bank's priority extends to the withdrawal as proceeds of the deposit, but not to the new inventory purchased with the withdrawal. There is no corresponding limitation in the Australian PPSA. In Example 20, PPSA subs 57(2A) is the governing provision and the result appears to be that Bank has priority over SP with respect to the new inventory. It follows that the risk to inventory suppliers flowing from the super-priority rule in favour of banks is greater than in the United States.[204]

ii. Priority Contests Not Involving the Depository ADI

Where the depository ADI is not a contestant in a priority dispute respecting an ADI account balance, the same general priority rules that apply to an ADI account balance *as proceeds* (again, where the depository ADI is uninvolved in the priority contest) also apply in respect of *proceeds of* the ADI account balance.

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[203] AUSPPSA, s. 57(2A).

[204] Duggan & Brown, *supra* note 159 at para. 11.50; Also see Wood, *Acquisition Financing, supra* note 4 at 64, where the author makes a similar comparison to the *OBA Proposal*: "In Australia, there is no similar restriction. The bank is able to assert priority over the supplier in respect of the new inventory so long as it can demonstrate that funds in the deposit account were used to acquire it. Not only will its claim to the deposit account be defeated by the bank, the bank will be able to assert a higher ranking claim to any new inventory that is acquired with those funds. This places the supplier in an almost impossible position. The supplier will never have an assurance that it will be enjoy a higher-ranking claim to the inventory that it supplies."

g. *Enforcement*

Curiously, no section of the AUSPPSA provides explicit guidance on the enforcement of a security interest in an ADI account.[205] This appears to be a legislative drafting oversight.[206] The AUSPPSA does, however, furnish express guidance respecting enforcement of a security interest in an "account," which is an analogous form of personal property to the ADI account.[207] Assuming this section applies to enforcement of a security interest in an ADI account, a secured party who is not the depository ADI (the "non-depository ADI secured party") may, on depositor default, serve written notice on the depository ADI directing the depository ADI to pay the non-depository ADI secured party the amount owing to the depositor within five business days from the date of notice.[208] The non-depository ADI secured party must apply the amount it receives in payment from the depository ADI toward the secured obligation.[209]

A different process is engaged where the enforcing secured party is the depository ADI itself. Duggan & Brown explain how the depository ADI enforces a security interest in the ADI account in the event of debtor default.

> The ADI will enforce its security interest by taking money from the disputed account and applying it in satisfaction of the outstanding loan obligation.

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[205] See Duggan & Brown, *ibid.* at para. 12.64, n. 97.
[206] This is not the AUSPPSA's only drafting slip. See, for example, Duggan & Brown, *ibid*. at para. 11.48.
[207] AUSPPSA, s. 120(1)(a)(i).
[208] AUSPPSA, ss. 120(2) and (3).
[209] AUSPPSA, s. 120(4).

> This remedy is functionally equivalent to the banker's right of set-off or combination of accounts.[210]

A general standard of honesty and commercial reasonableness applies to enforcement actions under the AUSPPSA.[211] A secured party, whether the depository ADI or a non-depository ADI secured party, is subject to this general standard.

3. *STATUTORY REVIEW*

The AUSPPSA recently underwent a statutorily prescribed review.[212] Whitaker, a banking and finance partner with the Ashurst law firm, was assigned to lead the review,[213] and furnished a comprehensive final report on February 27, 2015.[214] Among his 394 recommendations for improvement to the AUSPPSA, the following are of particular relevance to this thesis.

> Recommendation 73: That the Act not be amended to allow a secured party other than the ADI itself to perfect by control over an ADI account.[215]

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210 Duggan & Brown, *supra* note 159 at para. 2.33.

211 AUSPPSA, s. 108.

212 AUSPPSA, s. 343(1). The review was to be completed by January 31, 2015.

213 Attorney-General of Australia, News Release, "Statutory Review of the Personal Property Securities Act" (April 4, 2014), online http://www.attorneygeneral.gov.au/Mediareleases/Pages/2014/SecondQuarter/4April2014StatutoryreviewofthePersonalPropertySecuritiesAct.aspx.

214 Bruce Whitaker, *Review of the Personal Property Securities Act 2009: Final Report* (Commonwealth of Australia, 2015) ("*Statutory Review*").

215 *Ibid.* at 142. At the outset of his review, Whitaker anticipated calls for the creation of control interests of non-depository secured parties, and was surprised that none were initially forthcoming. Nonetheless, he raised the issue with stakeholders. Among respondents, a small number suggested permitting control interests in favour of non-depository secured parties, while the great majority did not. One respondent made an odd suggestion that only the ADI and its wholly-owned subsidiaries be permitted control interests. At 142, Whitaker rejected this suggestion with delicate language: "That may be advantageous for the ADI, but would not reflect the reasons why it may be thought

> Recommendation 74: That a security interest held by an ADI in an ADI account with it continue to be automatically perfected by control.[216]
>
> Recommendation 223: That Government consider, as part of the further consultations referred to in Recommendations 64 to 76, whether it is appropriate for a security interest that is perfected by control to be entitled to a super-priority for each of the types of collateral listed in s 21(2)(c).[217]
>
> Recommendation 225: That s 57(2A) be deleted.[218]

III. PROPOSED REGIME ACCOUNT

A. OBA PPSL SUBCOMMITTEE'S PROPOSED OBAPPSA ~ HYBRID BANK-DIRECTED CONTROL MODEL & CONTROL PARADIGM

1. HISTORICAL BACKGROUND

a. Initial Rejection of Article 9 Deposit Account Initiative & Control Paradigm

In the 1990s, several prominent Canadian commercial academics, observing the unfolding of Revised Article 9's deposit account reform initiative, expressed serious reservations about the adoption of a control paradigm for deposit accounts

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appropriate from a policy perspective to allow perfection by control by the ADI itself (particularly if that perfection is automatic, as I discuss below)."

216 *Ibid.* at 143.

217 *Ibid.* at 311.

218 *Ibid.* at 312. Whitaker recommended deletion of s. 57(2A): "This seems to be a very generous concession, and the policy behind it is not clear. In the case of an ADI that has a security interest over an ADI account with it, for example, the effect of the section seems to be that the ADI would have a super-superior priority claim to any property that was acquired using funds from the ADI account. It is hard to understand why this should be so. … A small number of respondents argued that s 57(2A) is appropriate, and should be retained. The great majority of respondents were of the view, however, that the section should be deleted. That is my view as well."

under the Canadian PPSA, preferring retention of the registration paradigm instead.[219] Consider Ziegel's words on the matter.

> My own undogmatic view is that intangibles of all types are such an important and growing form of collateral that we should be slow to dispense with registration requirements in the absence of more compelling arguments than the ones that have been advanced to date.[220]

Meanwhile, Cuming & Walsh described the discretionary bank-approval feature of the control agreement method as permitting a depository bank to "play 'dog-in-the-manger' if it wishes."[221] Perhaps due in part to public dissent by prominent academics, a parallel reform initiative calling for a PPSA control paradigm for deposit accounts, did not gain any traction in Canada at the time. Academic commentators continue to express serious reservations about adoption of a control paradigm for deposit accounts. Wood identifies some of the basic concerns.

> In any event, there is considerable controversy in Canada over the appropriateness of the revised Article 9 approach to deposit accounts. It heavily stacks the deck in favour of the bank and gives it a veto right over the creation of any security interest in a deposit account.[222]

b. Pressure from ISDA

In June 2009, the International Swaps and Derivatives Association Inc. ("ISDA") delivered a letter to provincial government officials in both Ontario and

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[219] Jacob S. Ziegel, "Canadian Perspectives on the Law Lords' Rejection of the Objection to Chargebacks" (1998-1999) 14 B.F.L.R. 131 at 145; Also see R.C.C. Cuming and C. Walsh, "Possible Implications of Revised UCC Article 9 for Canadian Personal Property Security Acts", online Uniform Law Conference of Canada http://www.ulcc.ca/en/poam2/index.cfm?sec=1999&sub=1999jk ("*ULCC Report*").
[220] Ziegel, *ibid.* at 145.
[221] Cuming & Walsh, *ULCC Report*, *supra* note 219 at para. 27.
[222] Roderick J. Wood, "Journey to the Outer Limits of Secured Transactions Law: Caisse Populaire Desjardins de l'est de Drummond" (2010) 48 Can. Bus. L.J. 482 ("*Journey to the Outer Limits*") at 497.

Alberta urging the adoption of a control paradigm for deposit accounts.[223] ISDA promoted abandonment of the PPSA's registration paradigm and adoption of a control paradigm similar to that of Article 9. Various reasons were proffered including (i) the deposit account's similarity to investment property, which had recently been subjected to the control paradigm, (ii) the fact that Article 9 subjects deposit accounts to the control paradigm, (iii) the difficulty and expense, under the existing regime, of assuring a secured party of priority (i.e. eliminating all risk) to a deposit account balance in sophisticated financial transactions like, for example, derivatives transactions, and (iv) the unclear usage and realization rights provided for under the existing regime.

In April 2010, ISDA issued a second letter to the same government officials in both provinces.[224] The second letter was prompted, in part, by the recent Supreme Court of Canada decision *Caisse populaire Desjardins de l'Est de Drummond v. Canada*,[225] in which doubt was cast on the efficacy of financial industry "triple cocktails"; that is, secured transactions simultaneously providing for a chargeback, a contractual set-off right and a flawed asset arrangement. ISDA asserted that Canadian derivatives industry participants were at a competitive disadvantage in the post-*Drummond* world, and again asked the government for swift legislative reform.

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223 Letter from Francois Bourassa (ISDA) to Allen Doppelt (Ontario Government) and Doug Morrison (Alberta Government) (June 8, 2009) ("*2009 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.

224 Letter from Francois Bourassa (ISDA) to Allen Doppelt (Ontario Government) and Doug Morrison (Alberta Government) (April 13, 2010) ("*2010 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.

225 [2009] 2 S.C.R. 94 ("*Drummond*").

> As awareness of the implications of the *Caisse Drummond* decision increases, Canadian participants and global participants that deal with Canadian entities are becoming reluctant to accept cash collateral from Canadian participants.[226]
>
> …
>
> There is a significant risk that credit support in the form of cash will no longer be acceptable to many international entities that participate in this market. This is, in fact, already happening. Cash collateral is the least costly form of collateral for most Canadian parties, which means that continued uncertainty in this area will lead to increased costs and risks for Canadian market participants.[227]

ISDA's second letter included specific proposals – this time for both the OPPSA and APPSA – for the adoption of a control paradigm for deposit accounts. Additional amendments, reinforcing and clarifying account debtor set-off rights, were also proposed.[228]

c. OBA Proposal

i. OBA PPSL Subcommittee Recommendation

Meanwhile, also in 2010, the Business Law Section of the Ontario Bar Association tasked the OBA PPSL Subcommittee with examining the merits or demerits of implementing deposit account reform along the lines proposed by ISDA. The OBA PPSL Subcommittee investigated the matter and submitted its final report to Ontario's Ministry of Consumer Services and Ministry of Finance on February 6, 2012.[229] The OBA PPSL Subcommittee recommended adoption of a control

[226] Bourassa, *2010 ISDA Letter*, *supra* note 224 at 2.
[227] *Ibid.* at 4.
[228] *Ibid.* at 15-16.
[229] OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 3.

paradigm for "financial accounts."[230] The proposed OBAPPSA, which adopts the control paradigm, can be characterized as a hybrid bank-directed control model since registration remains an available, albeit inferior, method of perfecting a security interest and attaining some measure of priority status.

ii. ISDA Support

ISDA publicly expressed support for the OBA PPSL Subcommittee's recommendations in a third letter to the Ontario government.[231] In that correspondence, it also responded to several government questions and reiterated the urgency of reform.

> As we noted in both 2009 and 2010, Canadian market participants are already competitively disadvantaged by Ontario's current law. ... It is not only important that the Ontario government indicate its intention to move forward with reform, but that it actually implements reform, preferably in 2012.[232]

iii. Ontario Government Response & Inaction

Despite opposition from several prominent academics,[233] the government of Ontario responded favourably to the OBA PPSL Subcommittee's proposal for adoption of a deposit account control paradigm, and to pressure from ISDA. In 2013, the Ontario government declared its intention to adopt a deposit account control paradigm, presumably along the lines recommended by the OBA PPSL

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[230] *Ibid*.
[231] Letter from Katherine Darras (ISDA) to Robin Edger (Ontario Government) (May 7, 2012) ("*2012 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.
[232] Darras, *2012 ISDA Letter*, *ibid*. at 4.
[233] Cuming, Walsh & Wood, *PPSL, supra* note 101 at 74.

Subcommittee.[234] Despite this positive declaration, however, reform efforts in Ontario stalled, ostensibly for political reasons.[235] Thus the registration paradigm remains extant in Ontario for the time being (as of March 2017).

Pressure continues to mount, however. In June 2015, for instance, an expert panel – of thirteen academics and practitioners – renewed calls for adoption of a deposit account control paradigm in a report to Ontario's Minister of Government and Consumer Services.[236] In the fall of 2016, the Business Law Advisory Council, established by the Government of Ontario to review Ontario's corporate and commercial legislation, issued a further call for adoption of a control paradigm for deposit accounts.[237]

2. OBAPPSA

What follows is a brief descriptive account of the "OBAPPSA" – the regime that would be brought about by the adoption of the OBA Proposal. It is more

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[234] See Government of Ontario, *2013 Ontario Budget: A Prosperous and Fair Ontario* (Toronto: Queen's Printer for Ontario, 2013), online: <www.ontario.ca/budget> at 289.

[235] See Jennifer Babe et al., *Business Law Agenda: Priority Findings & Recommendations Report* (June 2015) at 9: "The panel agreed that the PPSA should be amended to facilitate the use of cash collateral. The panel recognized that discussions among stakeholders, including pension experts, will assist in determining the best way to achieve this outcome." As suggested in the above quote, the delay appears to be due in part to political fallout – concerning Ontario pensioners – from the Supreme Court of Canada decision in *Sun Indalex Finance LLC v. United Steelworkers*, 2013 SCC 6 ("*Indalex*"). For a concise account of the decision and its relation to the cash collateral debate, see Margaret Grottenthaler, "SCC Decision in Re Indalex not good news for cash collateral arrangements", Canadian Structured Finance Law (February 8, 2013), online: <www.canadianstructuredfinancelaw.com>.

[236] Babe et al., *ibid.*; also see Geva, *A Perspective, supra* note 73.

[237] Business Law Advisory Council, *Report to Minister of Government and Consumer Services* (Fall 2016) at 2, 9-11.

pleasant reading an active voice, so I will present my discussion of the OBAPPSA as if it were currently in effect.

a. Terminological & Taxonomic Modification

The OBAPPSA introduces several important new categories of personal property. Indeed, the PPSA taxonomy is modified under the OBAPPSA. First consider the definition of "deposit account."

> "deposit account" means an account maintained by a financial institution for a person identified in the records of the financial institution as its customer to which deposits to, or funds received or held by, that financial institution are or may be credited, including a deposit account in any form (whether demand, term, cash, chequing or savings, and whether or not evidenced by a certificate of deposit, account agreement, passbook or other document), an investment account, a custody account and a clearing or settlement account, but does not include investment property and a monetary obligation evidenced by chattel paper or an instrument;[238]

The definitions of "consumer account" and "financial account" are also reproduced.

> "consumer account" means a deposit account that is maintained for a natural person and is used by the natural person primarily for personal, family or household purposes;[239]
>
> "financial account" means:
>
> (a) a deposit account other than a consumer account; and
>
> (b) a monetary obligation owed by a financial institution to any person in respect of funds received or held by that financial institution for the purpose of securing an obligation to that financial institution or to another person, but does not include investment property,

[238] OBAPPSA, s. 1(1), "deposit account".
[239] OBAPPSA, s. 1(1), "consumer account".

> consumer accounts and any monetary obligation evidenced by chattel paper or by an instrument;[240]

A consumer account is a special subspecies of deposit account that is maintained for a natural person for personal, family or household purposes. The financial account, in contrast, is the residual subcategory of deposit account, comprised of all other types of deposit account (including, notably, where there is no deposit account *per se*[241]). A noteworthy term, referenced in each of the above definitions, is "financial institution" (i.e. an institution which maintains a deposit account, whether consumer or financial). The OBAPPSA furnishes a broad definition of the term "financial institution"; included in the enumerated list of qualifying entities are banks, credit unions, insurance companies, trust companies and broker dealers.[242] With respect to any particular deposit account, I will refer to the financial institution maintaining it as the "depository bank."

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[240] OBAPPSA, s. 1(1), "financial account".

[241] OBA PPSL Subcommittee, *OBA Proposal, supra* note 3 at 25 (Details of Proposal): "The second branch of the definition ensures that all cash collateral arrangements in which a financial institution receives or holds cash can be perfected by control, even if the financial institution does not formally maintain a deposit account and even if the funds received or held by the financial institution are used by it in its business."

[242] See OBAPPSA, s. 1(1), "financial institution". Entities that qualify as a financial institution include a bank, savings bank, loan company, savings and loan association, treasury branch, trust company, caisse populaire, credit union, cooperative credit society or association of credit unions, caisses populaires or cooperative credit societies, insurance company, clearing or settlement agency or central counterparty, central bank, entity engaged in brokering, dealing in, executing, clearing or settling securities, futures, opinions on futures or derivatives on behalf of others, etc.

Figure 4.4: OBAPPSA Taxonomy (2012)

PERSONAL PROPERTY								
goods	chattel paper	investment property	document of title	instrument	money	***deposit account***		intangible
						consumer account	***financial account***	

b. Control Paradigm ~ Financial Accounts Only

The OBAPPSA, like its OPPSA predecessor, continues to permit a secured party to acquire a security interest in a debtor's deposit account. The OBAPPSA's control paradigm applies only to financial accounts.[243] Consumer accounts remain under the registration paradigm. The OBA PPSL Subcommittee explains that consumer accounts are excluded from the control paradigm, not necessarily for good reason, but rather to "allay fears" and "minimize controversy" surrounding the control initiative generally.

> Consumer accounts are excluded partly because the deposit account control regime in Article 9 of the UCC does not apply to consumer accounts and partly to allay some commentators' fears that financial institutions would exploit their dominant position at the expense of consumers. We believe that consumers and financial institutions would actually both benefit if consumer accounts were included within the definition of financial account, and subject to the control regime; but we are concerned that critics of the Proposal may view consumers differently. Therefore, with a view to minimizing controversy, consumer accounts are excluded. But for those concerns (which we do not believe would be justified), we would have included consumer accounts in the control regime.[244]

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[243] OBAPPSA, s. 1(2)(f).

[244] OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 3 at 2 (Details of Proposal).

Elsewhere, the OBA PPSL Subcommittee describes the consumer account exclusion as a consumer protection measure designed to ensure that consumers are not exploited by the powerful bank sector.

> This exclusion will ensure that power imbalances between individual consumers and their financial institutions do not become a factor in the new regime and mitigates the perceived risk that banks might regard the new priority regime as an opportunity to further enhance their position in the consumer credit market.[245]

c. Attachment & Enforceability

Under the OBAPPSA, a security interest in a financial account is not enforceable against a third party unless it has attached.[246] The security interest attaches only when (1) value is given,[247] (2) the debtor has rights in the financial account or the power to transfer rights to a secured party,[248] and (3) either (a) the debtor has signed a security agreement containing a description of the financial account sufficient to enable it to be identified,[249] or (b)(X) the debtor has signed a security agreement, (Y) the secured party has control under subsection (1)(2) pursuant to that security agreement, and (Z) the security agreement contains a description of the financial account sufficient to enable it to be identified, or a description of the financial account that describes it as such.[250]

d. Perfection

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[245] *Ibid.* at 7.
[246] OBAPPSA, s. 11(1).
[247] OBAPPSA, s. 11(2).
[248] OBAPPSA, s. 11(2).
[249] OBAPPSA, s. 11(2)(a)(i).
[250] OBAPPSA, s. 11(2)(e).

A secured party may perfect a security interest in a financial account by registration[251] or control.[252] Since registration is inferior to control as a method of perfection, the OBAPPSA regime is representative of a hybrid bank-directed model with a control paradigm.[253] Subsection 1(2)(f) of the OBAPPSA limits the scope of the control paradigm to financial accounts. Thus, the remaining analysis will focus on the treatment of financial accounts.

> For the purposes of this Act
>
> … (f) a secured party has control of a financial account if:
>
>> (i) the secured party is the financial institution that is obligated to the customer under the financial account [the "automatic control method"];
>>
>> (ii) the customer, the secured party and the financial institution that is obligated to the customer under the financial account have agreed in writing that the financial institution will comply with instructions originated by the secured party directing disposition of funds from the financial account without further consent by the customer [the "control agreement method"]; or
>>
>> (iii) the secured party is the customer with respect to the financial account [the "customer method"].[254] [square bracketed text added]

The OBAPPSA furnishes an automatic control method in favour of the depository bank. The second method of acquiring control of a financial account – the control agreement method – is available only if the depository bank agrees to enter into a tripartite control agreement with the depositor and secured party, which it is

[251] OBAPPSA, s. 23.
[252] OBAPPSA, s. 22.1(3).
[253] OBAPPSA, s. 30.1(8).
[254] OBAPPSA, s. 1(2)(f). Bracketed labels are added; note that these labels do not form part of the OBAPPSA's official language.

under no obligation to do, even if the depositor so requests or directs.[255] The third method – the customer method – similarly requires cooperation from the depository bank. A secured party maintains control of a financial account even if the depositor, a debtor or any other person retains the right to direct the disposition of the funds.[256] The above-described features of control essentially mirror those of Article 9.

The OBAPPSA's deposit account regime is bank-friendly but, unlike Article 9, it does not grant the depository bank the power to render a security interest in its depositor's financial account unperfectible; registration remains an available, albeit vastly inferior, method of perfection for all secured parties.[257]

e. Proceeds

A security interest in original collateral automatically extends to identifiable proceeds taking the form of a deposit account balance.[258] Where the security interest was perfected by registration when the proceeds arose, the security interest in the proceeds remains continuously perfected (i) as long as the registration remains effective, or (ii) where the security interest was perfected with respect to the proceeds by any other method permitted, for so long as the conditions of such perfection remain satisfied.[259]

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[255] OBAPPSA, s. 17.2(2).
[256] OBAPPSA, s. 1(2)(g).
[257] OBAPPSA, s. 23.
[258] OBAPPSA, s. 25(1)(b).
[259] OBAPPSA, s. 25(2).

f. ***Priority to Financial Account Balance***

i. *Starting Principle ~ Control Supremacy*

Section 30.1 of the OBPPSA contains the priority rules governing conflicting security interests in the same financial account. A starting principle is that the security interest of a secured party having control of a financial account has priority over a security interest held by a secured party lacking control of the financial account.[260]

ii. *Priority Contests Involving the Depository Bank ~ Twofold Bank Supremacy*

VIA SECURITY INTEREST

Subject to one exception, a depository bank's security interest in a financial account, which is automatically perfected via the automatic control method, has priority over any competing security interest.[261] The lone exception is where a competing secured party has control of the financial account via the customer method of perfection. In this circumstance – one that requires the initial cooperation of the depository bank in order to come to fruition – the competing secured party retains priority to the financial account.[262]

VIA SET-OFF

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[260] OBAPPSA, s. 30.1(2).
[261] OBAPPSA, s. 30.1(6.1).
[262] OBAPPSA, s. 30.1(6.2).

The OBA PPSL Subcommittee's proposed legislative amendments clarify, and likely enhance, the depository bank's rights of deposit account set-off vis-à-vis competing secured party claims.[263] For example, subsection 40(1.2) of the OBAPPSA provides that the priority rules in sections 20 and 30 do not affect the defences set out in subsection 40(1.1);[264] these defences include the depository bank's deposit account set-off rights. An interesting question arises in reference to subsection 40(1.2): Does the absence of mention of section 30.1 in subsection 40(1.2) suggest that section 30.1 *does affect* the defences set out in subsection 40(1.1)? No clear answer emerges. On one hand, the language of subsection 40(1.2) does appear to imply section 30.1 paramountcy. On the other hand, subsection 40(1.1), conventionally interpreted (i.e. absent subsection 40(1.2)), operates to supersede the priority rules set out in earlier sections of the statute.

Under the OBA Proposal, the language contained in subsection 40(1.1) is clarified, or beefed up, to include explicit reference to "contractual rights of set-off."[265] The OBAPPSA is also amended to clarify that section 40 applies in respect of both "security interests" and absolute "assignments."[266] Finally, subsection 61(1.1) of the OBAPPSA reinforces the sovereignty of deposit account set-off rights, providing that such rights stand separate and apart from (i.e. are held concurrently with) any security interest the depository bank may have in the financial account.

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[263] See Chapter 3 ~ Set-Off.
[264] OBAPPSA, s. 40(1.2).
[265] OBAPPSA, s. 40(1.1).
[266] OBAPPSA, s. 40(1).

> Unless otherwise agreed by the parties, a secured party may exercise a right of recoupment, compensation, set-off or consolidation against an account or a financial account to satisfy an obligation owed to the secured party whether or not the security interest in that collateral has been perfected by control.[267]

To briefly recap, a depository bank retains, under the OBAPPSA, an immensely powerful right of deposit account set-off that may be set up against secured parties who advance competing claims to the deposit account balance.

iii. Priority Contests Not Involving the Depository Bank ~ Control Supremacy

To the extent that the depository bank is not involved in a priority contest over a financial account balance, the OBAPPSA gives priority to the first party to acquire control of the financial account via either the customer method or control agreement method.[268] Where the OBAPPSA's control-based priority rules do not apply, the residual registration-based priority rules govern.[269] As a practical matter, this means that, under the OBAPPSA, the special purchase money superpriority rules,[270] which would otherwise apply in respect of proceeds, do not extend to proceeds in the form of a financial account balance.

g. Priority to Proceeds Of Deposit Account Balance

Unlike Article 9 and the AUSPPSA, the OBAPPSA does not contain special priority rules governing rights to proceeds of a deposit account balance; instead, the

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[267] OBAPPSA, s. 61(1.1).
[268] OBAPPSA, s. 30.1(4)(d).
[269] OBAPPSA, s. 30.1(8).
[270] Contained in OBAPPSA, s. 33.

general rules apply.[271] Accordingly, acquiring control of a financial account does not furnish a control-party with special priority privileges beyond the financial account itself.

h. Enforcement

In the event of depositor default, a party with a security interest in a financial account is entitled (i) to notify the depository bank to make payment to the party whether or not the depositor was theretofore making collections on the financial account,[272] and (ii) to apply the balance of the financial account to the obligation secured.[273] As noted above, the OBAPPSA also authorizes the depository bank to exercise its deposit account set-off rights against a financial account irrespective of its control rights in such financial account.[274] A secured party, whether the depository bank or otherwise, must proceed in a commercially reasonable manner during realization proceedings.[275]

IV. SEGUE

Having furnished basic descriptive accounts of three existing, distinctive, regimes and model-types, and another basic descriptive account of a proposed regime with distinctive features, I next turn my attention to development of three

[271] See, for example, OBAPPSA, ss. 25, 30 and 33.
[272] OBAPPSA, s. 61(1)(a). A slightly strained interpretation of clause 61(1)(a) permits the depository bank self-notification.
[273] OBAPPSA, s. 61(1)(c).
[274] OBAPPSA, s. 61(1.1).
[275] OBAPPSA, s. 61(2).

standardized fact patterns – Patterns β (*beta*), Ω (*omega*) and Ψ (*psi*) – that will aid in evaluating the various regimes and model-types.

CHAPTER 5 ~ STANDARDIZATION

STANDARDIZED FACT PATTERNS

I now set out three standardized fact patterns that will be employed in the comparative analytical exercise carried out in later chapters. Each describes a distinct series of events that could realistically unfold in connection with a commercial debtor's borrowing arrangements.[1] In each fact pattern, a different set of players is introduced. This is done in an effort to capture as many possibilities and potentialities as possible in the standardized analysis that ensues in later chapters. The patterns are identified with reference to Greek letters; Patterns β (*beta*), Ω (*omega*) and Ψ (*psi*).

PATTERN β (*BETA*) ~ BANK VERSUS PURCHASE MONEY INVENTORY SUPPLIER

On day 1, Retailer opens a non-interest bearing deposit account with Bank; no initial deposit is made. On day 2, Bank grants Retailer an operating line of credit,

[1] In Patterns β, Ω and Ψ, various types of credit transactions are effected; most such transactions generate interest in favour of creditors at specified rates. However, for simplicity's sake (i.e., to keep values "round"), interest charges will be disregarded (i.e., treated as *de minimis*) when debtors make their scheduled payments. Using Pattern β as an example, Debtor purchases inventory worth $100 from Supplier on 60 day credit terms bearing interest at 4% per annum; at the time of the scheduled payment, Debtor will pay Supplier $100 (as opposed to $100 plus accrued interest). Disregarding accrued interest amounts will not materially affect analyses or distort outcomes. Interest rates are specified (but not accounted for) to (i) give the standardized fact patterns a realistic air, and (ii) depict the interrelationship between the credit interest rates a rational business debtor might agree to pay, on one hand, and charge, on the other.

bearing interest at 3% per annum,[2] payable on demand, with a borrowing limit of $100;[3] the line of credit is secured by all of Retailer's present and after-acquired personal property. Also on day 2, Bank takes all required procedural measures[4] to perfect its security interest in the deposit account and Retailer's other personal property. On day 3, Retailer draws on the operating line to the $100 borrowing limit and immediately transfers such funds to its employees on account of wages.

On day 4, Retailer purchases $100 worth of inventory (the "Inventory") from Supplier on credit terms, and grants Supplier a purchase money security interest in the Inventory to secure payment of the purchase price.[5] Each credit purchase bears interest at 4% per annum and becomes payable to Supplier on the 60th day after Retailer acquires possession of the Inventory.[6] The Inventory constitutes original collateral from the perspective of Supplier. Also on day 4, Supplier takes (or has previously taken) all required steps to perfect its security interest in the Inventory

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[2] See note 1.

[3] In practice, operating line credit limits often float based on the value of the debtor's inventory and current accounts receivable. See Roderick J. Wood, "Acquisition Financing of Inventory: Explaining the Diversity" (2014) 13(1) O.U.C.L.J. 49 ("*Acquisition Financing*") at 53.

[4] These required procedural measures differ from jurisdiction to jurisdiction.

[5] See Wood, *Acquisition Financing*, *supra* note 3 at 52, where the author describes the exceptional nature of the purchase money security interest: "Priority competitions among secured parties are generally determined in accordance with a first to register or perfect rule of priority. A major exception to this rule is created in respect of acquisition financing. All of the statutes accommodate acquisition financing through the concept of the purchase money security interest (hereafter "PMSI"). If the security interest falls within the definition of a PMSI, and if certain conditions are satisfied, the acquisition financier will enjoy priority even though it is not the first in time. The priority competitions over inventory will therefore typically involve two issues. The first is whether the proper procedural steps have been satisfied. The second is whether the security interest falls within the definition of a PMSI."

[6] It is common, in these types of purchase money inventory arrangements, for the terms to provide that interest does not begin to accrue until after a specified date, e.g., 30 days after delivery. The abeyance period is designed to incentivize the debtor to make prompt payment and avoid incurring interest charges.

and any proceeds generated therefrom in whatever form they may take; all required procedural measures are taken to ensure that Supplier enjoys superpriority with respect to the Inventory.

On day 5, Retailer sells the Inventory, in the ordinary course of business, to ten different buyers (collectively, the "Buyers", and each a "Buyer") on unsecured credit terms; each credit sale bears interest at 5% per annum and becomes payable to Retailer on the 30th day after Buyer takes possession of the Inventory. All Buyers take possession of their items of Inventory on day 5. Each account receivable generated from a credit sale from Retailer to Buyer constitutes original collateral from the perspective of Bank, and first generation proceeds from the perspective of Supplier.[7]

On day 34, each of the ten Buyers submits money (i.e., government issued paper currency) in full payment of the purchase price for the Inventory;[8] from Supplier's perspective, the money constitutes second generation proceeds of its Inventory. Retailer immediately deposits (also on day 34) the money into its deposit account at Bank. The resulting $100 deposit account balance constitutes third

[7] Each account receivable constitutes both an "account" and an "intangible" under the PPSA taxonomy. The term "account" is defined as "a monetary obligation not evidenced by chattel paper, an instrument or a security, whether or not it has been earned by performance, but does not include investment property." An account is a subspecies of "intangible," which itself comprises one of the seven categories of personal property. Intangibles are a "residual" category of personal property, as reflected in the negative definition of the term: "personal property other than goods, chattel paper, investment property, a document of title, an instrument and money." The deposit account similarly falls within both definitions of "account" and "intangible" under the PPSA taxonomy.

[8] In reality, these payments would rarely be made with money (i.e., paper currency). In modern commercial practice, they are typically effectuated electronically or via cheque (in which case, they must clear the Buyers' accounts). I use money in the example because it is simplest.

generation proceeds from Supplier's perspective, and original collateral from Bank's perspective.

On day 64, Retailer fails to make the scheduled payment due to Supplier; Supplier declares default, immediately notifies Bank of its security interest in Retailer's deposit account balance as third generation proceeds, and serves written notice on Bank requesting that Bank make immediate payment of the $100 deposit account balance to Supplier. In response (also on day 64), Bank immediately declares default on the operating line of credit, and demands payment of the outstanding balance.

Bank refuses to make payment to Supplier and asserts, as a self-help remedy, a superior right to the deposit account balance either by virtue of (i) itself having a prioritized security interest in the deposit account balance, or (ii) set-off principles. Supplier asserts priority to the deposit account balance on the basis that it is comprised of the identifiable and traceable proceeds of Supplier's purchase money collateral, namely, the Inventory. Litigation ensues.

PATTERN Ω (*OMEGA*) ~ ACCOUNTS FINANCIER VERSUS PURCHASE MONEY INVENTORY SUPPLIER

On day 1, Wholesaler opens a non-interest bearing deposit account with Corrigan Bank; no initial deposit is made. No other credit arrangements exist between Corrigan Bank and Wholesaler. On day 2, Accounts Financier grants Wholesaler an operating line of credit, bearing interest at 3% per annum, payable on demand, with a borrowing limit of $100; the line of credit is secured by all of Wholesaler's present and after-acquired accounts. Also on day 2, Accounts Financier takes all required procedural measures to perfect its security interest in its collateral including the deposit account. On day 3, Wholesaler draws on the operating line to the $100 borrowing limit and immediately transfers such funds to its employees on account of wages.

On day 4, Wholesaler purchases $100 worth of inventory (the "Inventory") from Supplyco on credit terms, and grants Supplyco a purchase money security interest in the Inventory to secure payment of the purchase price. Each credit purchase bears interest at 4% per annum and becomes payable to Supplyco on the 60th day after Wholesaler acquires possession of the Inventory. The Inventory constitutes original collateral from the perspective of Supplyco. Also on day 4, Supplyco takes (or has previously taken) all required steps to perfect its security interest in the Inventory and any proceeds generated therefrom in whatever form they may take; all required procedural measures are taken to ensure that Supplyco enjoys superpriority with respect to the Inventory.

On day 5, Wholesaler sells the Inventory, in the ordinary course of business, to ten different purchasers (collectively, the "Purchasers", and each a "Purchaser") on unsecured credit terms; each credit sale bears interest at 5% per annum and becomes payable to Wholesaler on the 30th day after Purchaser takes possession of the Inventory. All Purchasers take possession of their items of the Inventory on day 5. Each account receivable generated from the credit sale from Wholesaler to

Purchaser constitutes original collateral from the perspective of Accounts Financier, and first generation proceeds from the perspective of Supplyco.

On day 34, each of the ten Purchasers submits to Wholesaler full payment in the form of money. From Accounts Financier's perspective, such money constitutes first generation proceeds, while from Supplyco's perspective, the money constitutes second generation proceeds. Wholesaler immediately deposits (also on day 34) the money into its deposit account at Corrigan Bank. The resulting $100 deposit account balance constitutes both original collateral and second generation proceeds from Accounts Financier's perspective, and third generation proceeds from Supplyco's perspective.

On day 64, Wholesaler fails to make the scheduled payment due to Supplyco; Supplyco declares default, immediately notifies Corrigan Bank of its security interest in Wholesaler's deposit account balance as third generation proceeds, and serves written notice on Corrigan Bank requesting that Corrigan Bank make immediate payment of the $100 deposit account balance to Supplyco. Accounts Financier promptly discovers Supplyco's actions, and consequently declares default on the operating line of credit, demanding that Corrigan Bank make immediate payment to Accounts Financier of the outstanding deposit account balance.

Unsure of and disinterested in which claimant – Accounts Financier or Supplyco – holds a superior claim to the deposit account balance, Corrigan Bank refuses to make payment to either party, and instead pays the deposit account balance into court on an interpleader basis. Litigation ensues. Accounts Financier asserts priority to the funds representing the deposit account balance both as original collateral (i.e., the deposit account balance is an "account") and as second generation proceeds of its original collateral (i.e., the original collateral being the accounts generated from the sale of Inventory from Wholesaler to Purchasers on unsecured credit terms).[9] Supplyco asserts priority to the deposit account balance on the basis that it is comprised of the identifiable and traceable proceeds of Supplyco's purchase money collateral.

PATTERN Ψ (*PSI*) ~ LENDING BANK VERSUS FINANCIAL DERIVATIVES[10] COUNTERPARTY (DEPOSITORY BANK)

On day 1, Opco opens a non-interest bearing deposit account with Derivative Bank, and makes an initial deposit of $10.

On day 2, Lending Bank grants Opco a $100 term loan (the "Loan") bearing interest at a variable floating rate of prime (where the then-current prime rate is 5% per annum) plus 3% per annum (the "Variable Rate"). The Loan's term is 60

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[9] For a discussion of this "dual-capacity approach" in a slightly different context under Australian law, see R. Wood, *Acquisition Financing*, *supra* note 3 at 59, n. 51.

[10] For a basic description of financial derivatives, see Philip R. Wood, *Set-Off and Netting, Derivatives, Clearing Systems*, 2nd ed. (London: Sweet & Maxwell, 2007) ("*Set-Off & Netting*") at para. 10-001: "'Derivatives' is a generic term used to describe futures, options, swaps and various other similar transactions. They are 'derived' from underlying assets, eg an option to buy a share in the future is a contract derived from the share (the 'underlying'). Most derivative contracts are contracts for differences – the difference between the agreed future price of an asset on a future date and the actual market price on that date." At para. 10-005, P. Wood identifies the main users of derivatives: "The main users of derivatives are sophisticated investors, especially banks, insurers, pension funds, mutual funds, corporates and hedge funds. These are all sophisticated investors who hold large pools of intangible financial assets (loans, bonds, shares) whose value they wish to protect, in the same way that the rest of the world protects their buildings, their houses, their manufactures, their oil, their other tangible possessions, and also hope to make a profit out of them."

months; simple interest-only payments become payable on the first day of each month during the term, and the Loan's principal becomes payable via balloon payment at the expiry of the term. The Loan provides that, under any event of default (including Opco's failure to make any scheduled payment), Lending Bank may accelerate the Loan and immediately demand, from Opco, repayment of the principal and any outstanding interest. The Loan is secured by all of Opco's present and after-acquired personal property. Lending Bank takes all required procedural measures to perfect its security interest in Opco's personal property including its deposit account at Derivative Bank. Opco transfers the borrowed funds to a variety of creditors and suppliers.

On day 3, Opco enters into an over-the-counter[11] interest rate swap[12] (the "Swap") with Derivative Bank pursuant to which, on the first day of each month during the term of the Loan, Derivative Bank must pay to Opco an amount equal to the monthly interest payment payable under the Loan (i.e., pay Opco monthly interest on the Loan's principal at the Variable Rate), and Opco must pay to Derivative Bank a monthly amount equal to 8%[13] per annum (the "Fixed Rate") (i.e.,

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[11] P. Wood, *Set-Off & Netting*, *ibid.* at para. 11-001: "OTC – The "over-the-counter" markets are private transactions. The term probably originally derives from buying groceries in the corner shop over the counter and was used in the US in the 1870s to describe the practice of buying shares over bank counters. These deals are usually sold by banks. The OTC markets are much bigger than exchange-traded markets – maybe five times as big."

[12] P. Wood, *Set-Off & Netting*, *ibid.* at para. 10-001: "'If you pay me amounts equal to the variable floating rate of interest on the loan I owe to my bank, I will pay you amounts equal to a fixed rate of 5 per cent on a loan of the same amount.' This is an interest rate swap. The effect is that I have made my interest obligation fixed and certain rather than floating and unpredictable."

[13] 8% represents the *initial* fixed-rate equivalent of the variable rate (prime [5%] + 3%) negotiated between Opco and Lending Bank.

pay Derivative Bank monthly interest on the Loan's principal at the Fixed Rate).[14] The Swap prescribes settlement netting.[15] On the first day of each month during the term, the party "out-of-the-money" must pay to the party "in-the-money" the positive difference between the scheduled reciprocal monthly payments. The Swap also provides, in the event of default by either Opco or Derivative Bank, an immediate right of close-out netting[16] (i.e., cancellation of the Swap and set-off of outstanding reciprocal payments) to the non-defaulting party; the enumerated events of default include, *inter alia*, "any act of default by Opco under the terms of its Loan with Lending Bank." Additionally, pursuant to the Swap, Opco grants to Derivative Bank a security interest in the deposit account balance to secure any net amounts payable by Opco to Derivative Bank over the term of the Swap.

On day 4, the prevailing prime rate of interest is reduced from 5% per annum to 2% per annum, thereby putting Derivative Bank "in-the-money" in respect of the

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[14] P. Wood, *Set-Off & Netting*, *ibid.* at para. 10-007: "The reciprocal payments are not actual interest, but amounts equal to interest calculated on the same notional principal amount. The lenders to Float Co and Fixed Co are not affected. Float Co and Fixed Co must pay the lenders actual interest on their respective loans, regardless of whether the other party makes its swap payments. Thus if Float Co becomes insolvent, Fixed Co must still pay its bondholders 10 per cent, even though Fixed Co is no longer receiving swap payments from Float Co."

[15] P. Wood, *Set-Off & Netting, ibid.* at para. 1-006: "Settlement netting is the advance set-off by contract of equivalent fungible claims under executory contracts, eg for commodities or foreign exchange, where the mutual deliveries fall due for payment or delivery on the *same day*. The object is to reduce exposures in relation to reciprocal deliveries due on the same day where often the deliveries are commodities or foreign exchange deliverable under executory contracts so that set-off of debts is not available."

[16] P. Wood, *Set-Off & Netting, ibid.* at para. 1-005: "Close-out netting is the cancellation of a series of open executory contracts between two parties, eg for a sale of goods or foreign exchange or investments, on the default of the counterparty and the set-off of the resulting gains and losses. Close-out netting requires two steps on a counterparty default: *cancellation* of the unperformed contracts, and then *set-off* of the gains and losses on each contract, so as to produce a single net balance owing one way or the other. Strictly, three steps are required – cancellation, calculation of losses and gains, then set-off. Cancel, calculate, set-off"

first scheduled Swap payments and potentially triggering margin call requirements.[17]

On day 31 (the first day of the second month, and consequently the date for the first scheduled payments under both the Loan and the Swap), Opco fails to make its first scheduled interest payment to Lending Bank under the Loan; Lending Bank declares default and serves written notice on Derivative Bank requesting that Derivative Bank make immediate payment of the deposit account balance to Lending Bank. Derivative Bank refuses to make full payment to Lending Bank. Instead, it immediately declares default under the terms of the Swap and seeks to perform a close-out netting; that is, Derivative Bank purports to cancel the Swap, calculates that it is "in-the-money" to the extent of $0.25[18] (the "Net Payment"), and sets off the Net Payment against Opco's deposit account balance prior to transferring the balance of $9.75 to Lending Bank. As a self-help remedy, Derivative Bank asserts a superior right to the Net Payment either by virtue of (i) itself having a prioritized security interest in the deposit account balance, or (ii) set-off principles. Lending Bank asserts priority to the deposit account balance as its original collateral. Litigation ensues between Derivative Bank and Lending Bank in respect of entitlement to the Net Payment.

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[17] Office of the Superintendent of Financial Institutions (OSFI), *Guideline E-22 re: Margin Requirements for Non-Centrally Cleared Derivatives* (September 2016).

[18] Close-out netting calculation: ($100*0.08/12) – ($100*(0.02+0.03)/12) = $0.25. For the sake of simplicity, this figure assumes no margin call requirements were triggered during the month. See, generally, OSFI, *Guideline E-22, ibid.*

CHAPTER 6 ~ SUBJECTION

I. PATTERNS, REGIMES & EVALUATIVE CRITERIA

In Chapter 5, I developed three standardized fact patterns that might realistically unfold in connection with a commercial debtor's borrowing arrangements and its operating deposit account. The patterns are identified with reference to the Greek letters β, Ω and Ψ. Pattern β (*beta*) involves a priority dispute, in respect of a deposit account balance, between the depository bank and a purchase money inventory supplier pursuing proceeds of its disposed-of inventory. Pattern Ω (*omega*) involves a priority dispute, in respect of a deposit account balance, between a non-bank accounts financier and a purchase money inventory supplier proceeds claimant. Pattern Ψ (*psi*) involves a priority dispute, in respect of a portion of a deposit account balance, between a depository bank (& financial derivatives counterparty) and a lending bank.

In Part II of this chapter, (i) Article 9 – representative of a pure bank-directed control model with a control paradigm, (ii) the PPSA – representative of a pure registration model with a registration paradigm, (iii) the AUSPPSA – representative of a hybrid bank-only control model with a control paradigm, and (iv) the OBA PPSL Subcommittee's proposed OBAPPSA for the Province of Ontario – a distinctive hybrid bank-directed control model with a control paradigm, are each subjected to Patterns β, Ω and Ψ. These analyses set the stage and furnish examples for Chapter

7, in which the various regimes will undergo comparative analytical evaluation having regard for the five evaluative criteria developed in Chapter 2.

II. SUBJECTING THE PROXY REGIMES TO THE STANDARDIZED FACT PATTERNS

A. PATTERN β (*BETA*) ~ DEPOSITORY BANK VERSUS PURCHASE MONEY INVENTORY SUPPLIER

The Pattern β players are Retailer (depositor), Bank (depository bank), Supplier (purchase money inventory supplier) and Buyers (retail purchasers). Sequential details of Pattern β are set out in Chapter 5; an abbreviated account is set out below.

Pattern β ~ Abbreviated Account
• Day 1 – Retailer opens a deposit account at Bank. • Day 2 – Bank grants Retailer \$100 operating line secured by all of Retailer's present and after-acquired personal property, including the deposit account. Bank takes required procedural measures to perfect its security interest in its collateral including the deposit account. • Day 3 – Retailer draws down operating line to the \$100 limit, and uses the proceeds to pay its employees. • Day 4 – Retailer purchases \$100 of Inventory from Supplier on 60 day credit terms. Supplier acquires (or retains) a purchase money security interest in the Inventory, and takes all required procedural measures to perfect its security interest in both the Inventory and the deposit account as the probable destination of its disposed-of Inventory. Additionally, Supplier takes all required procedural measures to ensure, to the extent possible, that it will have purchase money superpriority with respect to the Inventory and its proceeds including the deposit account. • Day 5 – Retailer sells the Inventory to Buyers on 30 day unsecured credit terms. • Day 34 – Buyers pay Retailer for the Inventory, and Retailer deposits \$100

proceeds (in the form of cash) in the deposit account.

- Day 64 – Retailer fails to make the scheduled payment due to Supplier. Supplier declares default, and demands payment of the deposit account balance from Bank. Bank asserts, as a self-help remedy, a superior right to the deposit account balance. Litigation ensues.

1. ARTICLE 9 ~ UNITED STATES OF AMERICA

a. Pertinent Procedural Background

Under Article 9, Bank fulfilled the requirements for perfection of its security interest in Retailer's deposit account on Day 2 pursuant to the automatic control method;[1] attachment was also automatic,[2] but may just as well have been achieved through Bank's procurement of a Retailer-authenticated security agreement.[3]

On Day 4, Supplier obtained a purchase money security interest in the Inventory it supplied to Retailer.[4] To perfect its security interest in the Inventory, Supplier filed a financing statement describing the Inventory.[5] To qualify for superpriority with respect to the Inventory, Supplier ensured (i) that its filing was effected prior to Retailer receiving possession of the Inventory,[6] and (ii) that any holder of a conflicting security interest in the Inventory – including, notably, Bank –

[1] UCC, §§9-104(a)(1) and 9-314(a).
[2] UCC, §9-203(b)(3)(D). A debtor-authenticated security agreement is not required under this clause. See Chapter 4 ~ Description.
[3] UCC, §9-203(b)(3)(A).
[4] UCC, §9-103(b).
[5] UCC, §9-310(a).
[6] UCC, §9-324(b)(1).

was furnished with a prior authenticated notification stating that Supplier expected to acquire a purchase money security interest in the Inventory.[7]

Since Supplier attached and perfected its security interest in the Inventory, it automatically and continuously obtained – on Day 34, i.e., upon Retailer's $100 deposit – equivalent status with respect to the deposit account as identifiable third generation[8] "cash proceeds" of the Inventory.[9] Supplier thus acquired some degree of automatic protection with respect to Retailer's deposit account balance as proceeds of the Inventory. Also on Day 34, the $100 deposit automatically became subject to Bank's attached and perfected security interest in the deposit account as original collateral.[10]

b. Possibilities

At this stage, it is necessary to discuss a number of possibilities because Pattern β stipulates, not only that Supplier perfected its security interest in the deposit account (as noted in the preceding paragraph), but that, on Day 4, Supplier took *all required procedural measures* to ensure, to the extent possible, priority to the deposit account as proceeds of the Inventory. The discussion that ensues thus focuses on the adequacy or inadequacy of various potential measures that Supplier may take. The operative question is: What measures, under Article 9, could Supplier have taken to ensure priority over Bank in respect of the deposit account balance?

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[7] UCC, §§9-324(b)(2), (3) and (4).

[8] I spare the reader technical details of Supplier's first and second generation proceeds, to wit, the 60 day accounts receivable owing from Buyers, and money, respectively.

[9] UCC, §§9-315(a)(2), (c) and (d)(2).

[10] UCC, §§9-104(a)(1), 9-203(b)(3)(D) and 9-314(a).

i. Control Agreement Method

First, consider the outcome of a priority dispute in Pattern β if Supplier had perfected its security interest in Retailer's deposit account pursuant to the control agreement method. Assuming that, on Day 4, Supplier was able to negotiate a tripartite control agreement with Bank and Retailer[11] – a process requiring significant effort and expense, with no guarantee of success, even if at Retailer's request[12] – it still does not assure itself of priority with respect to the deposit account. Article 9 provides that Bank prevails even where Supplier took the extraordinary measure of procuring a tripartite control agreement with Bank and Retailer; this outcome is the product of Bank's (i) prioritized security interest,[13] and (ii) superior set-off rights.[14]

ii. Subordination Agreement

To prevail over Bank under the terms of a control agreement, or some other form of standalone agreement, Supplier must have incorporated an explicit subordination clause under which Bank agreed to subordination of both (i) its

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[11] UCC, §9-104(a)(2).

[12] UCC, §9-342; see Ingrid M. Hillinger, David L. Batty & Richard K. Brown, "Deposit Accounts Under the New World Order" (2002) 6 N.C. Banking Inst. 1 at 30: "Collateral-specific creditors could also request a control agreement, but it will probably not work. In all likelihood, the depositary bank has already entered into a control agreement with the debtor's senior lender and promised not to enter into a control agreement with any other party. Lenders, such as equipment vendors, will also likely lack the clout to force a relocation of the debtor's deposit accounts. In fact, the deposit account might be maintained by the debtor's senior lender."

[13] UCC, §9-327(3).

[14] UCC, §9-340(a).

security interest in Retailer's deposit account, and (ii) its set-off rights.[15] It is unclear why Bank, or any similarly situated depository bank, would ever agree to such subordination. Simply put, Bank has little incentive, in a Pattern β scenario, to subordinate its priority status to an inventory supplier.

iii. Customer Method

Next, consider the outcome if Supplier acquired control of Retailer's deposit account pursuant to the customer method; that is, from Day 4 forward, became recognized by Bank as *the customer*, or *a co-customer*, in respect of Retailer's deposit account.[16] Assuming that Supplier perfected through the customer method of control, it does assure itself of priority to the deposit account balance. To the extent available, the customer method of control provides a safe harbour for Supplier insofar as Retailer's deposit account balance is concerned.[17] The problem is availability. While it is theoretically possible for Supplier to acquire control under the customer method, such a scenario is unlikely to occur. First, Bank is under no obligation to facilitate Supplier's acquisition of control of the deposit account.[18] Moreover, Official Comment 8 of §9-324 explains that an inventory supplier does not typically take this extraordinary measure of acquiring control – either becoming customer on the deposit account or procuring a tripartite control agreement – but

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[15] UCC, §9-339; see William D. Warren and Steven D. Walt, *Secured Transactions in Personal Property*, 7th Ed. (New York: Foundation Press, 2007) at 144, pt. 4; Hillinger, Batty & Brown, *supra* note 12 at 27.
[16] UCC, §9-104(a)(3).
[17] UCC, §§9-327(4) and 9-340(c).
[18] UCC, §9-342.

instead contents itself with inventory as its primary source of payment in the event of debtor default.[19]

Even if an inventory supplier desires control of a retailer's deposit account pursuant to the customer method, and even if Bank is willing to facilitate this transaction, the retailer will understandably be extremely hesitant to grant, to a *lucky one* of its inventory suppliers, such extraordinary power.[20] A rare exception might present itself where the ongoing existence of a retailer's business hinges on a continued relationship with a particular inventory supplier who is unwilling to continue doing business with the retailer without the privilege of the customer method of control (i.e., where the retailer is desperate to "hold on" to one particular supplier). But as a practical matter, the customer method of deposit account control may not be available for Supplier's benefit in this instance.[21]

iv. Lockbox Payment Arrangement

Finally, consider a sequence of events that diverges from the basic Pattern β scenario outlined above. Suppose Supplier implemented a lockbox[22] payment arrangement to protect its claim to the proceeds of the Inventory. Specifically,

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[19] UCC, §9-324, Official Comment 8.

[20] But perhaps no more hesitant than a depositor contemplating granting control via the control agreement method, which similarly authorizes the secured party to give directions respecting deposit account funds without the prior approval of depositor.

[21] Hillinger, Batty & Brown, *supra* note 12 at 30: "Even though the depositary bank may lose its top priority position when funds leave the account and become proceeds of it, still, much can be said about having priority to all funds in the deposit account unless the creditor becomes the bank's customer, an unpractical scenario in many cases."

[22] For an illustrative example of a lockbox payment arrangement, see Hillinger, Batty & Brown, *ibid.* at 44-45.

imagine that, on Day 5, Buyers were instructed by Retailer (or Supplier) to direct account payments to Supplier, not Retailer.[23] Assuming such an arrangement was implemented, Supplier enjoys priority.

Depending on how the lockbox arrangement is structured, it may simply amount to another instantiation of Supplier satisfying the customer method of control. If, on Day 34, for example, Supplier deposited the diverted funds into a separate deposit account maintained with Bank under Supplier's name, it satisfied the customer method of control, and thus enjoys priority over Bank.[24]

In a different scenario, Supplier might direct the $100 of diverted lockbox funds into a deposit account maintained with another depository bank, effectively preventing Bank from poaching its proceeds. In such instance, Supplier *avoids* a deposit account priority dispute altogether, and prevails accordingly.

But lockbox arrangements, while possible to implement, are rarely employed by inventory suppliers. Inventory suppliers tend to focus on manufacturing and/or collecting inventory for subsequent sale to multitudes of customers. They typically have neither the dedicated resources nor the sophistication to implement effective lockbox payment arrangements with their *customers' customers*.[25] Rather, lockbox payment arrangements are more commonly employed by accounts financiers in the specialty business of acquiring, and collecting on, accounts in bulk.

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[23] Hillinger, Batty & Brown, *ibid.* at 56: "Lockboxes and concentration accounts are necessary to maintain priority with respect to proceeds of inventory and accounts."
[24] UCC, §9-104(a)(3).
[25] An inventory supplier who sells relatively few high-value items might realistically consider implementing a lockbox payment arrangement.

c. *Priority Recap*

To recap, unless Supplier took one of three extraordinary measures at significant effort, expense and risk of failure, Bank is likely to prevail in a Pattern β priority dispute,[26] thereby entitling Bank to apply the deposit account balance against the outstanding operating line.[27] One measure Supplier could have taken to ensure itself priority was to procure, from Bank and Retailer, a tripartite control agreement, or any type of agreement, containing a subordination clause in favour of Supplier.[28] Another measure Supplier could have taken to ensure itself priority was to perfect its security interest in the deposit account pursuant to the customer method of control.[29] A third, distinct measure Supplier could have taken to protect its proceeds claim was to implement a lockbox payment arrangement with Retailer's customers, thereby diverting funds away from Bank and altogether averting a deposit account priority dispute. Supplier would have required cooperation from Bank and/or Retailer to successfully implement any of these extraordinary measures.

2. *PPSA ~ Canada*

a. *Pertinent Procedural Background*

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[26] UCC, §§9-327(3) and 9-340(a).
[27] UCC, §9-607(a)(4).
[28] UCC, §9-339.
[29] UCC, §9-327(4) and §9-340(c).

Under the PPSA, Bank fulfilled the requirements for attachment[30] and perfection[31] (by registering a financing statement with the PPR) of its security interest in Retailer's deposit account on Day 2.

On Day 4, Supplier took a purchase money security interest in Inventory it supplied to Retailer on credit.[32] To perfect its security interest in the Inventory, Supplier registered a financing statement covering the Inventory.[33] To qualify for purchase money superpriority with respect to the Inventory, it ensured (i) that its registration was effected prior to Retailer receiving possession of the Inventory,[34] and (ii) that any secured party who had, before Supplier's registration, registered a financing statement containing a description covering the Inventory, was furnished with notice – prior to Retailer obtaining possession of the Inventory – stating that Supplier expected to acquire a purchase money security interest in the Inventory.[35]

Supplier also took steps to protect its right to proceeds of the Inventory, including the deposit account. In this instance, since Supplier's registration adequately described the Inventory, its perfected status extended to proceeds deposited into the deposit account on Day 34.[36] Thus Supplier retained a measure of automatic protection in respect of deposit account proceeds of the Inventory (its original collateral). Also on Day 34, the $100 deposit became subject to Bank's

[30] APPSA, s. 12.
[31] APPSA, ss. 19 and 25.
[32] APPSA, s. 1(1)(ll)(i).
[33] APPSA, ss. 19 and 25.
[34] APPSA, s. 34(3)(a).
[35] APPSA, ss. 34(3)(b)(c) and (d).
[36] APPSA, ss. 28(1)(b) and (2)(c).

security interest in the deposit account as original collateral[37] (and, at the same time, as second generation proceeds[38]).

b. Priority

In a priority competition, Bank will prevail pursuant to its right of deposit account set-off[39] unless it agreed to waive or subordinate that right to Supplier pursuant to a subordination agreement.[40] The fact that Bank received a purchase money notification, in connection with the Inventory, is insufficient to cut off Bank's deposit account set-off right. Instead, to preclude deposit account set-off, Supplier must have advised Bank of its interest in each specific deposit before it was deposited into the deposit account; this represents a narrow limitation on Bank's otherwise powerful deposit account set-off right.[41]

Absent Bank's overriding right of deposit account set-off, Supplier would prevail under the PPSA's purchase money inventory priority rule.[42] Additionally, Supplier could have implemented a lockbox payment arrangement to overcome Bank's powerful deposit account set-off right, though this occurrence would be unlikely, as a practical matter, for the same reasons described above in the Article 9 analysis.

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[37] APPSA, ss. 13(1), 19 and 25.
[38] APPSA, ss. 28(1)(b) and (2)(c).
[39] APPSA, s. 41(2), or the analogue thereof. See Chapter 3 ~ Set-Off.
[40] APPSA, s. 40.
[41] See Chapter 3 ~ Set-Off, footnote 44 and surrounding body text.
[42] APPSA, s. 34(3).

3. AUSPPSA ~ *Australia*

a. *Pertinent Procedural Background*

Under the AUSPPSA, Bank fulfilled the requirements for attachment and enforceability of its security interest in Retailer's ADI account, on Day 2.[43] Also on Day 2, Bank acquired automatic perfection of the ADI account by virtue of its status as the depository ADI.[44]

On Day 4, Supplier took a purchase money security interest in Inventory it supplied to Retailer on credit. To perfect its security interest in the Inventory, Supplier registered a financing statement adequately describing the Inventory.[45] To qualify for purchase money superpriority with respect to the Inventory, and its proceeds, Supplier ensured that registration was effected prior to Retailer obtaining possession of the Inventory.[46] Since Supplier's registration adequately described the Inventory, its perfected status automatically extended to the $100 deposited into Retailer's ADI account on Day 34.[47] Also on Day 34, the $100 deposit became subject to Bank's attached and perfected security interest in the deposit account.[48]

b. *Priority*

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[43] AUSPPSA, ss. 19 and 20.
[44] AUSPPSA, s. 25.
[45] AUSPPSA, ss. 21(1)(b)(iii) and (2)(a).
[46] AUSPPSA, s. 62(2)(b)(i).
[47] AUSPPSA, s. 33(1)(c).
[48] AUSPPSA, ss. 19, 20 and 25.

In a priority dispute, Bank will prevail[49] unless Supplier was able to procure a subordination agreement pursuant to which Bank specifically yielded priority to the ADI account balance to Supplier.[50] Barring unique circumstances, there is little incentive for an ADI in Bank's position to subordinate its interest to a supplier. Note, however, that Supplier could have implemented a lockbox payment arrangement if it were insistent on maintaining a priority claim to the proceeds of its Inventory.

4. OBAPPSA ~ PROPOSED ONTARIO REGIME

a. Pertinent Procedural Background

As a preliminary note, under the OBAPPSA, Retailer's deposit account constitutes a "financial account,"[51] and thus falls under the control paradigm.[52] "Consumer accounts,"[53] in contrast, remain under the registration paradigm.

On Day 2, Bank fulfilled the requirements for attachment and enforceability of its security interest in Retailer's deposit account by acquiring a signed security agreement.[54] Also on Day 2, Bank gained automatic perfection of its security interest in the deposit account under the automatic control method, i.e., by virtue of its status as the depository bank.[55]

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[49] AUSPPSA, ss. 54, 57(1) and 75.
[50] AUSPPSA, s. 61.
[51] OBAPPSA, s. 1(1), "financial account".
[52] OBAPPSA, s. 1(2)(f).
[53] OBAPPSA, s. 1(1), "consumer account".
[54] OBAPPSA, ss. 11(2)(a)(i) and (e).
[55] OBAPPSA, ss. 1(2)(f)(i) and 22.1(3).

On Day 4, Supplier acquired a purchase money security interest in Inventory it supplied to Retailer on credit. To perfect its security interest in the Inventory, Supplier effected registration describing the Inventory.[56] To qualify for purchase money superpriority with respect to the Inventory, Supplier ensured (i) that its registration was effected prior to Retailer receiving possession of the Inventory,[57] and (ii) that any secured party who had, before Supplier's registration, registered a financing statement containing a description covering the Inventory, was furnished with notice – prior to Retailer obtaining possession of the Inventory – stating that Supplier expected to acquire a purchase money security interest in the Inventory.[58]

Since Supplier attached and perfected its security interest in the Inventory, it automatically acquired, on Day 34, equivalent status with respect to the deposit account as identifiable proceeds of the Inventory.[59] Supplier thus retained a degree of automatic protection in respect of Retailer's deposit account as proceeds. A separate registration with the PPR, describing intangibles generally or Retailer's deposit account specifically, would have similarly sufficed to establish Supplier's "lower order" method of perfection. Also on Day 34, the $100 deposit automatically became subject to Bank's attached and perfected[60] security interest in the deposit account as original collateral.[61]

b. Possibilities

[56] OBAPPSA, ss. 19 and 23.
[57] OBAPPSA, s. 33(1)(a).
[58] OBAPPSA, ss. 33(1)(b) and (c).
[59] OBAPPSA, ss. 25(1)(b) and (2).
[60] by control.
[61] OBAPPSA, ss. 1(2)(f)(i), 11(2)(a)(i) and (e), and 22.1(3).

Since Pattern β's stipulates that, on Day 4, Supplier took *all required procedural measures* to ensure, to the extent possible, priority to the deposit account as proceeds of the Inventory, it again becomes necessary, at this stage, to discuss a number of possibilities. The ensuing discussion focuses on the measures Supplier could have taken to assure itself of priority to deposit account proceeds under the OBAPPSA.

i. Control Agreement Method

First, consider the outcome of a priority dispute in Pattern β if Supplier had perfected its security interest in Retailer's deposit account pursuant to the control agreement method. Assuming that, on Day 4, Supplier was able to negotiate a tripartite control agreement with Bank and Retailer[62] – a process requiring significant effort and expense, with no guarantee of success, even if at Retailer's request[63] – , Supplier does not assure itself of priority over Bank with respect to the deposit account. The OBAPPSA, like Article 9, provides that Bank prevails in such circumstances notwithstanding the extraordinary perfection measure taken by Supplier; this outcome is the product of Bank's (i) prioritized security interest,[64] and (ii) superior deposit account set-off rights.[65]

ii. Subordination Agreement

[62] OBAPPSA, s. 1(2)(f)(ii).
[63] OBAPPSA, s. 17.2(2).
[64] OBAPPSA, s. 30.1(6.1).
[65] OBAPPSA, s. 40(1.1).

To prevail over Bank under the terms of a control agreement, or some other form of standalone agreement, Supplier must have obtained the benefit of an explicit subordination clause under which Bank agreed to subordination of both (i) its security interest in Retailer's deposit account, and (ii) its deposit account set-off rights.[66] In the real world, an inventory supplier's prospects of procuring such a clause from a bank are slight. In fact, it may be more probable for the bank to procure an explicit agreement from the inventory supplier that it will not pursue its proceeds into the debtor's deposit account balance.

iii. Customer Method

Next, consider the outcome if, on Day 4, Supplier acquired control of Retailer's deposit account pursuant to the customer method, becoming recognized by Bank as the customer, or a co-customer, in respect of Retailer's deposit account.[67] Even assuming that Supplier availed itself of the customer method of control, it is not entirely clear whether it prevails over Bank's deposit account set-off rights, which, under the OBAPPSA (unlike under Article 9), are not explicitly subject to a "customer method of control" override.[68] Supplier prevails over Bank in Pattern β

[66] OBAPPSA, s. 38.

[67] OBAPPSA, s. 1(2)(f)(iii).

[68] OBAPPSA, s. 40(1.1). Subsection 40(1.2) provides, "for greater certainty," that "the priority rules in sections 20 and 30 do not affect" set-off rights referred to in s. 40(1.1). One might argue that s. 40(1.2) implies that the priority rules in s. 30.1 *do affect* such set-off rights. Supporting this assertion is a view of the customer method of control as creating a "silo" around the disputed funds, arguably destroying the mutuality generally required for set-off. But militating against this argument is the conventional interpretation of s. 40(1.1) (and its concordant provisions in other provinces' and territories' PPSAs) as superseding the secured transactions priority rules set out earlier in the statute. For a detailed discussion of the interpretation of s. 40(1.1), and its concordants, see (i) Chapter 3 ~ Set-Off, and (ii) Chapter 4 ~ Description.

by virtue of the customer method only (i) if Bank is deprived of its right of deposit account set-off either by agreement or by circumstance, or (ii) if OBAPPSA subsections 40(1.1) and (1.2) are interpreted so as not to affect the operation of section 30.1.[69]

iv. Lockbox Payment Arrangement

Finally, consider a sequence of events that diverges from the basic Pattern β scenario outlined above. Suppose Supplier implemented a lockbox payment arrangement with Retailer's customers; on Day 5, Buyers were instructed by Retailer (or Supplier) to direct account payments to Supplier, not Retailer. If such an arrangement were implemented, Supplier would be assured of priority.

Depending on how the lockbox arrangement was structured, it may simply amount to another instance of Supplier invoking the customer method of control. For example, if, on Day 34, Supplier deposited the diverted funds into a separate deposit account maintained with Bank under Supplier's name, it satisfied the customer method of control, and thus establishes priority over the Bank. This tactic probably results in Supplier defeating Bank's right of deposit account set-off.[70]

Under a varied set of facts, Supplier might have directed the diverted lockbox funds into a deposit account maintained with another depository bank, effectively

[69] OBAPPSA, s. 30.1(6.2).

[70] OBAPPSA, ss. 1(2)(f)(iii) and 30.1(6.2). Under the OBAPPSA, could Bank potentially extend its right of deposit account set-off to *this* separate deposit account? Likely not, especially if Supplier is the "sole customer" on the new account. But this answer might be different if Retailer remains a co-customer on the new account.

preventing Bank from capturing proceeds of the Inventory, Supplier's original collateral. Here, Supplier avoids a deposit account priority dispute altogether, and accordingly prevails.

c. Priority Recap

Unless Supplier took extraordinary measures at significant effort, expense and risk of failure, Bank is likely to prevail in a Pattern β priority dispute, and will therefore be entitled to apply the deposit account balance against Retailer's delinquent operating line balance.[71] The OBAPPSA offers Supplier even less refuge than Article 9 in Pattern β since even the customer method of perfection (i.e., not merely the control agreement method, as under Article 9) is potentially vulnerable to Bank's right of deposit account set-off.[72] One measure Supplier could have taken to ensure itself priority was to procure, from Bank and Retailer, an agreement containing a subordination clause in favour of Supplier.[73] Another distinct measure Supplier could have taken to protect its proceeds claim was to implement a lockbox payment arrangement with Retailer's customers, thereby diverting funds away from Bank and averting a priority dispute. In order to successfully implement either of these extraordinary measures, Supplier would have required active cooperation from Retailer and/or Bank.

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[71] OBAPPSA, ss. 61(1)(a) and (c), and 61(1.1).
[72] OBAPPSA, s. 40(1.1).
[73] OBAPPSA, s. 38.

B. PATTERN Ω (*OMEGA*) ~ NON-BANK ACCOUNTS FINANCIER VERSUS PURCHASE MONEY INVENTORY SUPPLIER

The Pattern Ω players are Wholesaler (depositor), Corrigan Bank (depository bank), Accounts Financier (non-bank accounts financier), Supplyco (inventory supplier) and Purchasers (retail business purchasers). Sequential details of Pattern Ω are set out in Chapter 5; an abbreviated account is set out below.

Pattern Ω ~ Abbreviated Account
• Day 1 – Wholesaler opens a deposit account at Corrigan Bank. • Day 2 – Accounts Financier grants Wholesaler $100 operating line secured by all of Wholesaler's present and after-acquired accounts, including the deposit account. Accounts Financier takes all required procedural measures to perfect its security interest in its collateral including the deposit account at Corrigan Bank. • Day 3 – Wholesaler draws down the operating line to the $100 limit, and uses the proceeds to pay its employees. • Day 4 – Wholesaler purchases $100 of Inventory from Supplyco on 60 day credit terms. Supplyco acquires (or retains) a purchase money security interest in the Inventory, and takes all required procedural measures to perfect its security interest in the Inventory and the deposit account as the probable destination for its disposed-of Inventory. Additionally, Supplyco takes all required procedural measures to ensure, to the extent possible, that it will have superpriority with respect to the Inventory and its proceeds including the deposit account. • Day 5 – Wholesaler sells the Inventory to Purchasers on 30 day unsecured credit terms. • Day 34 – Purchasers pay Wholesaler for the Inventory, and Wholesaler deposits $100 proceeds (in the form of cash) in the deposit account at Corrigan Bank. • Day 64 – Wholesaler fails to make the scheduled payment due to Supplyco. Supplyco declares default, and demands payment of the deposit account balance from Corrigan Bank. Accounts Financier discovers Supplyco's actions, and consequently declares default, demanding payment of the deposit account balance from Corrigan Bank. Unsure of who holds a superior claim to the deposit account balance, Corrigan Bank refuses to make payment to either Supplyco or Accounts Financier, but instead pays the funds into court on an interpleader basis. Litigation ensues between Supplyco and

Accounts Financier respecting entitlement to the interpleaded funds.

1. ARTICLE 9 ~ UNITED STATES OF AMERICA

a. Pertinent Procedural Background

On Day 2, Accounts Financier perfected its security interest in Wholesaler's (i) general accounts by filing a financing statement,[74] and (ii) deposit account held at Corrigan Bank by acquiring control.[75] Accounts Financier acquired control of the deposit account either by (i) procuring a tripartite control agreement with Wholesaler and Corrigan Bank (i.e., the control agreement method),[76] or (ii) becoming a named customer on Wholesaler's deposit account with Corrigan Bank (i.e., the customer method of control).[77] Contrast this with an alternative scenario in which Accounts Financier simply relied on its less potent statutory right to pursue proceeds of its original collateral into Wholesaler's deposit account balance.[78] According to the facts of Pattern Ω, Accounts Financier took additional precautions.

On Day 4, Supplyco obtained a purchase money security interest in the Inventory it supplied to Wholesaler.[79] To perfect its security interest in the Inventory, Supplyco filed a financing statement describing the Inventory.[80] To

[74] UCC, §9-310(a).
[75] UCC, §§9-104(a), 9-312(b)(1) and 9-314(a). Note that no debt obligation was created until the operating line was drawn down on Day 3. But I will not dwell on this technical point since it is ultimately of little or no import in relation to the task at hand.
[76] UCC, §9-104(a)(2).
[77] UCC, §9-104(a)(3).
[78] UCC, §9-315(d).
[79] UCC, §9-103(b).
[80] UCC, §9-310(a).

qualify for superpriority with respect to the Inventory, Supplyco ensured (i) that its filing was effected prior to Wholesaler receiving possession of the Inventory,[81] and (ii) that any holder of a conflicting security interest in the Inventory was furnished with a prior authenticated notification stating that Supplyco expected to acquire a purchase money security interest in the Inventory.[82]

In these circumstances, it is highly unlikely that Supplyco would have taken additional steps to acquire control of Wholesaler's deposit account. Instead, since Accounts Financier already obtained control of the deposit account, Supplyco was more likely to rely on its statutory right to pursue proceeds of the Inventory into accounts receivable (which simply required a proper filing)[83] and ultimately into Wholesaler's deposit account.[84]

Since Supplyco attached and perfected its security interest in the Inventory, it automatically and continuously obtained – on Day 34, i.e., upon Wholesaler's $100 deposit – equivalent status with respect to the deposit account as identifiable "cash proceeds" of the Inventory.[85] Supplyco thus acquired some degree of automatic protection with respect to Wholesaler's deposit account balance as proceeds of the Inventory. Also on Day 34, the $100 deposit became subject to Accounts Financier's attached and perfected security interest in the deposit account.

b. Priority

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[81] UCC, §9-324(b)(1).
[82] UCC, §§9-324(b)(2), (3) and (4).
[83] UCC, §§9-315(a)(2), (c), (d)(1) and (3).
[84] UCC, §§9-315(a)(2), (c) and (d)(2).
[85] UCC, §§9-315(a)(2), (c) and (d)(2).

In a priority dispute, Accounts Financier will prevail since it acquired control of Wholesaler's deposit account while Supplyco did not.[86] The reverse would be true if, for instance, Supplyco (rather than Accounts Financier) took the necessary procedural steps to perfect its security interest in the deposit account by control. And if, by some chance, Accounts Financier and Supplyco both acquired control of Wholesaler's deposit account, priority would be awarded to the first to do so.[87]

In reality, it is far more plausible, in a scenario of this nature, for neither Accounts Financier nor Supplyco to have taken the required steps to acquire control of Wholesaler's deposit account. In such circumstances, since the deposit account infusion (cash proceeds), representing third generation proceeds vis-à-vis Supplyco, and second generation proceeds vis-à-vis Accounts Financier, were received *after* delivery of the Inventory to the Purchasers, UCC §9-322(a)(1) applies in favour of Accounts Financier under this factual subvariant.[88] But if the facts were again altered such that the cash proceeds were received *on* or *before* delivery of the Inventory to the Purchasers, Supplyco prevails pursuant to an extension of its purchase money superpriority to the identifiable cash proceeds of the Inventory.[89]

2. PPSA ~ CANADA

a. Pertinent Procedural Background

[86] UCC, §9-327(1).

[87] UCC, §9-327(2). Given the practical and procedural constraints associated with acquiring control of a deposit account, this possibility is highly unlikely to occur in the real world. This is especially so in light of §9-342, which gives Corrigan Bank unfettered discretion to refuse entering into a control agreement, even if at Wholesaler's request.

[88] UCC, §§9-322(a)(1) and (b)(1).

[89] UCC, §9-324(b).

On Day 2, Accounts Financier attached its security interest in Wholesaler's accounts receivable and deposit account,[90] and also perfected its security interest by registering a financing statement with the PPR.[91]

On Day 4, Supplyco took a purchase money security interest in Inventory it supplied to Wholesaler on credit. To perfect its security interest in the Inventory, Supplyco registered a financing statement covering the Inventory.[92] To qualify for purchase money superpriority with respect to the Inventory, it ensured (i) that its registration was effected prior to Wholesaler receiving possession of the Inventory,[93] and (ii) that any secured party who had, before Supplyco's registration, registered a financing statement containing a description covering the Inventory, was furnished with notice – prior to Wholesaler obtaining possession of the Inventory – stating that Supplyco expected to acquire a purchase money security interest in the Inventory.[94]

Supplyco also took steps to protect its right to proceeds of the Inventory, including the deposit account. Since Supplyco's registration adequately described the Inventory, its perfected status extended to proceeds deposited into the deposit account on Day 34.[95] Thus, Supplyco retained a measure of automatic protection in respect of deposit account proceeds of the Inventory. Also on Day 34, the $100

[90] APPSA, s. 12.
[91] APPSA, ss. 19 and 25.
[92] APPSA, ss. 19 and 25.
[93] APPSA, s. 34(3)(a).
[94] APPSA, ss. 34(3)(b)(c) and (d).
[95] APPSA, ss. 28(1)(b) and (2)(c).

deposit became subject to Accounts Financier's attached and perfected security interest in the deposit account.[96]

b. Priority

In an APPSA-governed priority dispute, Accounts Financier will prevail over Supplyco if an Alberta court rejects the principle in *Transamerica*[97] or adopts a narrow interpretation of its scope which only prevents Corrigan Bank (not Accounts Financier) from asserting the accounts financing rule, against the deposit account balance, in priority to Supplyco. Under this narrow interpretation of the *Transamerica* principle, Accounts Financier remains entitled to assert the accounts financing rule against the deposit account balance in priority over Supplyco. In contrast, under a broader interpretation of the principle in *Transamerica,* no person, including Accounts Financier, is entitled to assert the accounts financing rule over Supplyco's purchase money proceeds interest. On this purposive reading of *Transamerica*, Supplyco prevails pursuant to the PPSA purchase money superpriority rule. The above analysis pertaining to the APPSA, applies, *mutatis mutandis*, in British Columbia (BCPPSA[98]), Manitoba (MPPSA[99]) and Yukon (YPPSA[100]).

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[96] APPSA, ss. 12, 19 and 25.
[97] APPSA, ss. 28(2) and 34(3)(a).
[98] BCPPSA, s. 34(5).
[99] MPPSA, s. 34(6).
[100] YPPSA, s. 33(4).

In Saskatchewan (SPPSA[101]), Northwest Territories (NWTPPSA[102]) and Nunavut (NPPSA[103]), Supplyco unquestionably prevails over Accounts Financier due to the inclusion, in those jurisdictions' statutes, of a special provision excluding deposit accounts from the accounts financing rule.

None of Ontario (OPPSA[104]), New Brunswick (NBPPSA[105]), Newfoundland (NFPPSA[106]), Nova Scotia (NSPPSA[107]) and Prince Edward Island (PEIPPSA[108]) contain a special accounts financing rule. Instead, under such statutes, provided appropriate notice is furnished to Accounts Financier, Supplyco prevails pursuant to the carry-over of its purchase money superpriority into Wholesaler's deposit account balance.[109]

3. AUSPPSA ~ AUSTRALIA

a. Pertinent Procedural Background

On Day 2, Accounts Financier attached, and rendered enforceable against third parties, its security interest in Wholesaler's accounts receivable and the ADI

[101] Pursuant to SPPSA, s. 34(7), the priority rule in s. 34(6) does not apply to a deposit account. As such, s. 34(3) applies in favour of Supplyco.
[102] NWTPPSA, s. 34(6.1).
[103] NPPSA, s. 34(6.1).
[104] OPPSA, s. 33(1).
[105] NBPPSA, s. 34(2).
[106] NFPPSA, s. 35(2).
[107] NSPPSA, s. 35(2).
[108] PEIPPSA, s. 34(2).
[109] See Ronald C.C. Cuming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law*, 2nd ed. (Toronto: Irwin Law, 2012) at 464.

account.[110] It also perfected its security interest in the accounts receivable and the ADI account on Day 2 by registering a financing statement.[111]

On Day 4, Supplyco took a purchase money security interest in Inventory it supplied to Wholesaler on credit. To perfect its security interest in the Inventory, Supplyco registered a financing statement adequately describing the Inventory.[112] To qualify for purchase money superpriority with respect to the Inventory, and its proceeds, Supplyco ensured that registration was effected prior to Wholesaler obtaining possession of the Inventory;[113] since Supplyco's registration adequately described the Inventory, its perfected status automatically extended to the $100 of proceeds deposited into Wholesaler's ADI account on Day 34.[114] Also on Day 34, the $100 deposit became subject to Accounts Financier's attached and perfected security interest in the ADI account.[115]

b. Priority

In a priority dispute, Supplyco prevails pursuant to subsection 62(2) of the AUSPPSA. Subsection 64(1), which would otherwise override subsection 62(2), does not apply in favour of Accounts Financier in this instance because the definition of "account" does not include, within its meaning, "ADI account". If it did, Accounts

[110] AUSPPSA, ss. 19 and 20.
[111] AUSPPSA, ss. 21(1)(b)(iii) and (2)(a).
[112] AUSPPSA, ss. 21(1)(b)(iii) and (2)(a).
[113] AUSPPSA, s. 62(2)(b)(i).
[114] AUSPPSA, ss. 32 and 33(1)(a) and (c).
[115] AUSPPSA, ss. 19, 20, 21(1)(b)(iii) and (2)(a).

Financier would enjoy priority over Supplyco under subsection 64(1). But since it does not, subsection 62(2) applies in favour of Supplyco.

4. *OBAPPSA ~ PROPOSED ONTARIO REGIME*

a. Pertinent Procedural Background

On Day 2, Accounts Financier perfected its security interest in Wholesaler's (i) general accounts receivable by effecting registration,[116] and (ii) deposit account held at Corrigan Bank by control.[117] It acquired control of the deposit account either by (i) procuring a tripartite control agreement with Wholesaler and Corrigan Bank (i.e., the control agreement method),[118] or (ii) becoming a named customer on Wholesaler's deposit account with Corrigan Bank (i.e., the customer method of control).[119] Contrast this with an alternative scenario in which Accounts Financier simply relied on its statutory right to pursue proceeds of its original collateral into Wholesaler's deposit account balance.[120]

On Day 4, Supplyco acquired a purchase money security interest in Inventory it supplied to Wholesaler on credit. To perfect its security interest in the Inventory, Supplyco registered a financing statement describing the Inventory.[121] To qualify for purchase money superpriority with respect to the Inventory, Supplyco ensured (i)

116 OBAPPSA, ss. 19 and 23.
117 OBAPPSA, ss. 1(2)(f), 19 and 22.1(3).
118 OBAPPSA, s. 1(2)(f)(ii).
119 OBAPPSA, s. 1(2)(f)(iii).
120 OBAPPSA, ss. 25(1)(b) and (2).
121 OBAPPSA, ss. 19 and 23.

that its registration was effected prior to Wholesaler receiving possession of the Inventory,[122] and (ii) that any secured party who had, prior to Supplyco effecting registration, registered a financing statement containing a description covering the Inventory, was furnished with notice – prior to Wholesaler obtaining possession of the Inventory – stating that Supplyco expected to acquire a purchase money security interest in the Inventory.[123]

It is highly implausible that Supplyco would have taken additional steps to acquire control of Wholesaler's deposit account in these circumstances. Instead, since Accounts Financier already acquired control of the deposit account, Supplyco is more apt to perfect by registration[124] or rely on its statutory right to pursue proceeds of the Inventory into accounts receivable and ultimately into Wholesaler's deposit account balance.[125]

Since Supplyco attached and perfected its security interest in the Inventory, it automatically acquired, on Day 34, equivalent status with respect to the deposit account as identifiable proceeds of the Inventory.[126] Supplyco thus retained a degree of automatic protection in respect of Wholesaler's deposit account as proceeds. A separate registration with the PPR, describing intangibles generally or Wholesaler's deposit account specifically, would have similarly sufficed to establish Supplyco's "lower order" method of perfection in the deposit account. Also on Day

[122] OBAPPSA, s. 33(1)(a).
[123] OBAPPSA, ss. 33(1)(b) and (c).
[124] OBAPPSA, ss. 19 and 23. As a practical matter, Supplyco would have effected registration in respect of the deposit account, on Day 2, in the same financing statement covering the Inventory.
[125] OBAPPSA, ss. 25(1)(b) and (2), and 33(1).
[126] *Ibid.*

34, the $100 deposit became subject to Accounts Financier's attached and perfected[127] security interest in the deposit account.[128]

b. Priority

In a priority dispute, Accounts Financier will prevail because it acquired control of the deposit account while Supplyco did not.[129] The reverse would be true if Supplyco (rather than Accounts Financier) took the necessary procedural steps to perfect its security interest in the deposit account by control. And if, by chance, Accounts Financier and Supplyco both acquired control of the deposit account, priority would be awarded to the first to do so.[130]

Again, it is far more plausible, in a scenario of this nature, for neither Accounts Financier nor Supplyco to take the required steps to acquire control of Wholesaler's deposit account. On these varied facts, Supplyco would prevail over Accounts Financier pursuant to the carry-over of its purchase money superpriority into Wholesaler's deposit account balance.[131]

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[127] by control.
[128] OBAPPSA, ss. 1(2)(f)(ii) and (iii), 11(2)(a)(i) and (e), 19 and 22.1(3).
[129] OBAPPSA, s. 30.1(2).
[130] OBAPPSA, s. 30.1(4)(d).
[131] OBAPPSA, s. 33(1).

C. PATTERN Ψ (*PSI*) ~ LENDING BANK VERSUS DEPOSITORY FINANCIAL DERIVATIVES COUNTERPARTY

The Pattern Ψ players are Opco (depositor), Derivative Bank (depository bank & financial derivatives counterparty) and Lending Bank (non-depository bank). Sequential details of Pattern Ψ are set out in Chapter 5; an abbreviated account is set out below.

Pattern Ψ ~ Abbreviated Account
• Day 1 – Opco opens a deposit account at Derivative Bank, and makes an initial deposit of $10. • Day 2 – Lending Bank lends $100 to Opco as a term loan (the "Loan") secured by all of Opco's present and after-acquired personal property, including the deposit account at Derivative Bank. Lending Bank takes all required procedural measures to perfect its security interest in its collateral including the deposit account. Opco uses the borrowed funds to pay a variety of creditors and suppliers. • Day 3 – Opco enters into an interest rate swap (the "Swap") with Derivative Bank (precise details of the Swap are furnished in Chapter 5). The Swap prescribes settlement netting and, upon default, an immediate right of close-out netting. Events of default under the Swap include "any act of default by Opco under the terms of its Loan with Lending Bank." Additionally, pursuant to the Swap, Opco grants Derivative Bank a security interest in the deposit account balance to secure any net amounts payable by Opco to Derivative Bank over the term of the Swap. Derivative Bank takes all required procedural measures to perfect its security interest in the deposit account. • Day 4 – The prevailing prime rate of interest is reduced from 5% to 2%, thereby putting Derivative Bank "in-the-money" in respect of the first scheduled Swap payments. • Day 31 – Opco fails to make its first scheduled Loan payment to Lending Bank. Lending Bank declares default and serves written notice on Derivative Bank requesting immediate payment of the deposit account balance. Derivative Bank refuses to make immediate payment of the deposit account balance to Lending Bank; Derivative Bank instead declares default under the terms of the Swap, calculates it is "in-the-money" to the extent of $0.25 (the "Net Payment"), and sets off the Net Payment amount against Opco's deposit account balance prior to transferring the remainder of the deposit account balance ($9.75) to Lending Bank. Litigation ensues in respect of legal

entitlement to the Net Payment retained by Derivative Bank.

1. *ARTICLE 9 ~ UNITED STATES OF AMERICA*

a. Pertinent Procedural Background

On Day 2, Lending Bank perfected its security interest in Opco's deposit account held at Derivative Bank by acquiring control;[132] it acquired control of the deposit account either by (i) procuring a tripartite control agreement with Opco and Derivative Bank (i.e., the control agreement method),[133] or (ii) becoming a named customer on Opco's deposit account with Derivative Bank (i.e., the customer method of control).[134] On Day 3, Derivative Bank perfected its security interest in Opco's deposit account pursuant to the automatic control method.[135]

b. Priority

Resolution of the priority dispute between Lending Bank and Derivative Bank will depend on the method used by Lending Bank to acquire control of Opco's deposit account. If Lending Bank acquired control using the control agreement method, then Derivative Bank will prevail.[136] If, however, Lending Bank perfected via the customer method of control, it will prevail over Derivative Bank.[137] Finally, Lending Bank will prevail if it procured a subordination agreement from Derivative

[132] UCC, §§9-104(a), 9-312(b)(1) and 9-314(a).
[133] UCC, §9-104(a)(2).
[134] UCC, §9-104(a)(3).
[135] UCC, §§9-104(a)(1), 9-312(b)(1) and 9-314(a).
[136] UCC, §§9-327(3) and 340(a).
[137] UCC, §§9-327(4) and 9-340(c).

Bank, perhaps incorporated into the tripartite control agreement described above.[138] In reality, it will be very difficult for Lending Bank to procure such a favourable agreement from Derivative Bank given that it is Opco's derivatives counterparty.

2. *PPSA ~ Canada*

a. Pertinent Procedural Background

On Day 2, Lending Bank perfected its security interest in Opco's deposit account by registering a financing statement with the PPR.[139] On Day 3, Derivative Bank similarly perfected its security interest in Opco's deposit account by effecting registration.[140]

b. Priority

In a priority dispute between Lending Bank and Derivative Bank, Derivative Bank will prevail pursuant to its right of deposit account set-off.[141] In the absence of Derivative Bank's right of deposit account set-off, Lending Bank will prevail since it was the first party to effect registration in respect of the deposit account balance.[142] But as a practical matter, given the potency of Derivative Bank's deposit account set-

[138] UCC, §9-339.
[139] APPSA, ss. 19 and 25.
[140] APPSA, ss. 19 and 25.
[141] APPSA, s. 41(2).
[142] APPSA, s. 35(1).

off right, Lending Bank must procure a subordination agreement from Derivative Bank in order to ensure itself of priority in Pattern Ψ.[143]

3. AUSPPSA ~ Australia

a. Pertinent Procedural Background

On Day 2, Lending Bank attached, and rendered enforceable against third parties, its security interest in Opco's deposit account (i.e., ADI account).[144] It also perfected its security interest on Day 2 by registering a financing statement.[145] On Day 3, Derivative Bank automatically perfected its security interest in Opco's deposit account.[146]

b. Priority

Unless Lending Bank procures a subordination agreement under which Derivative Bank subordinates its security and set-off rights to Lending Bank,[147] Derivative Bank will enjoy priority over Lending Bank in a Pattern Ψ priority contest governed by the AUSPPSA.[148]

4. OBAPPSA ~ Proposed Ontario Regime

a. Pertinent Procedural Background

[143] APPSA, s. 40.
[144] AUSPPSA, ss. 19 and 20.
[145] AUSPPSA, ss. 21(1)(b)(iii) and (2)(a).
[146] AUSPPSA, s. 25.
[147] AUSPPSA, s. 61.
[148] AUSPPSA, ss. 54, 57(1), 75 and 80.

On Day 2, Lending Bank perfected its security interest in Opco's deposit account held at Derivative Bank by acquiring control;[149] it acquired control of the deposit account either by (i) procuring a tripartite control agreement with Opco and Derivative Bank (i.e., the control agreement method),[150] or (ii) becoming a named customer on Opco's deposit account with Derivative Bank (i.e., the customer method of control).[151] On Day 3, Derivative Bank perfected its security interest in Opco's deposit account pursuant to the automatic control method.[152]

b. Priority

Resolution of the priority dispute between Lending Bank and Derivative Bank will depend on the method used by Lending Bank to acquire control. If Lending Bank acquired control using the control agreement method, then Derivative Bank will prevail.[153] If, however, Lending Bank perfected via the customer method of control, the conclusion then depends on the interpretation of subsections 30.1(6.2), 40(1.1) and (1.2) of the OBAPPSA.[154] If Derivative Bank's deposit account set-off right, under subsection 40(1.1), is *not subject to* subsection 30.1(6.2), then Derivative Bank will prevail over Lending Bank.[155] But if Derivative Bank's deposit account set-off right is subject to subsection 30.1(6.2), then Lending Bank will

[149] OBAPPSA, ss. 1(2)(f), 19 and 22.1(3).
[150] OBAPPSA, s. 1(2)(f)(ii).
[151] OBAPPSA, s. 1(2)(f)(iii).
[152] OBAPPSA, ss. 1(2)(f)(i), 19 and 22.1(3).
[153] OBAPPSA, s. 30.1(6.1).
[154] See the detailed discussion of this issue in note 68 and in Chapter 4 ~ Description.
[155] OBAPPSA, s. 40(1.1).

prevail over Derivative Bank.[156] Additionally, Lending Bank would prevail if it procured a subordination agreement from Derivative Bank overruling the powerful right of set-off.[157]

III. SEGUE

Each proxy regime has now been subjected to Patterns β, Ω and Ψ. The stage is set for comparative analytical evaluation of the proxy regimes in Chapter 7 ~ Evaluation.

[156] OBAPPSA, s. 30.1(6.2).
[157] OBAPPSA, s. 38.

Chapter 7 ~ Evaluation

I. Chapter Overview

In Chapter 4, I furnished descriptive accounts of the deposit account regimes under investigation. In Chapter 6, I subjected each regime to the three standardized fact patterns introduced in Chapter 5. In this chapter, I subject the regimes to a comparative analytical evaluation having regard for the five evaluative criteria developed and articulated in Chapter 2. Discussion from earlier chapters is periodically drawn upon in support of this evaluation.

In Part II of this chapter, the five evaluative criteria are each restated, and the regimes are then assessed having regard for their adherence to such criteria. Each regime is assigned an adherence grade under each of the evaluative criteria. In Part III, the regimes undergo comparative aggregate assessment; that is, the adherence grades produced by each regime, under each evaluative criterion, are recorded in a cumulative adherence table. Relative weighting of the evaluative criteria is then varied and additional cumulative adherence tables are produced to, *inter alia*, demonstrate how one's philosophical convictions might impact his conclusions about the regimes' relative adherence levels. The existing and proposed regimes are loosely ranked, and the chapter concludes with my views on the regimes' relative adherence to the PPSL values and some general observations and suggestions for how the PPSA might be amended to enhance its adherence to the evaluative criteria and the PPSL values underlying them.

TABLE 7.1 **SPECIMEN CUMULATIVE ADHERENCE TABLE**						
Evaluative Criteria ➔ **Regimes ⬇**	**Criterion A** *Creation & Perfection*	**Criterion B** *Risk Assessment*	**Criterion C** *Dispute Resolution*	**Criterion D** *Competitive Market*	**Criterion E** *Proceeds*	**Cumulative Adherence Score** **/5**
Hypothetical Regime	*0.750*	*0.750*	*0.500*	*0.750*	*0.250*	*3.000*
Article 9 *Control ~ Pure*						
PPSA *Registration ~ Pure*						
AUSPPSA *Control ~ Hybrid*						
OBAPPSA *Control ~ Hybrid*						
Performance Legend ~ Adherence Grade 0.000 = No adherence 0.250 = Weak adherence 0.500 = Average adherence 0.750 = Strong adherence 1.000 = Optimal adherence						

II. COMPARATIVE ANALYTICAL EVALUATION

<u>CRITERION A - CREATION & PERFECTION</u>

An optimal deposit account regime will accommodate, in a simple and inexpensive manner, the creation and perfection of a security interest in a deposit account (either as original collateral or proceeds) as desired by the debtor and any prospective secured creditor.

<u>*FACILITY - FLEXIBILITY - SIMPLICITY - EFFICIENCY - EQUALITY - BALANCE*</u>

ANALYSIS & ADHERENCE GRADES

While each of the PPSA, AUSPPSA and OBAPPSA renders creation and perfection of a security interest, whether as original collateral or proceeds, a matter of relative ease and economy for *any secured party*, Article 9 poses obstacles for a prospective non-depository secured party who wishes to perfect a security interest in a deposit account balance as original collateral.

Under Article 9, the depository bank, itself enjoying automatic perfection by control, retains veto power over the debtor's capacity to facilitate perfection of a security interest in its deposit account balance as original collateral in favour of a non-depository secured party. Non-depository secured parties must, in the usual case, undertake the time-consuming and costly task of negotiating a tripartite control agreement with the debtor and the depository bank – a process that may ultimately prove unsuccessful if the depository bank exercises its veto power. Cuming & Walsh criticize this feature of Article 9 on the ground that it permits a depository bank to "play 'dog-in-the-manger' if it wishes."[1] Indeed, of the regimes under investigation, Article 9 alone grants the depository bank the power of rendering competing security interests in its customer's deposit account, as original collateral, unperfectible. In light of this deficiency, and given the significant time, effort and expense required to acquire control of the deposit account (assuming the depository bank is willing to cooperate and facilitate such a secured transaction), Article 9, representative of a pure bank-directed control model with a control paradigm, has been assigned a weak Criterion A adherence grade of 0.250.

Unlike Article 9, each of the PPSA, AUSPPSA and OBAPPSA makes the creation and perfection of a security interest in a deposit account a matter of relative ease and economy for any party. Both the AUSPPSA and OBAPPSA feature the automatic control method of perfection in favour of the depository bank. However, neither imposes obstacles on a prospective non-depository secured party desirous of creating and perfecting a security interest in a deposit account. Under both regimes, as under the PPSA, such party may perfect its security interest by effecting registration at the PPR. To do so does not require the permission of, or even consultation with, the depository bank.

[1] R.C.C. Cuming and C. Walsh, "Possible Implications of Revised UCC Article 9 for Canadian Personal Property Security Acts", online: Uniform Law Conference of Canada <http://www.ulcc.ca/en/poam2/index.cfm?sec=1999&sub=1999jk> ("*ULCC Report*") at para. 27.

One unique deficiency of the OBAPPSA, reminiscent of Article 9, is that it too permits the depository bank to play dog-in-the-manger to a limited extent, to wit, insofar as the non-depository secured party is intent on creating a prioritized control interest in the deposit account.[2] While the non-depository secured party is free to perfect such a security interest by registration, this is a relatively ineffective method of shoring up priority to the deposit account balance. Recall that registration is a lower order of perfection than control and offers attenuated protection. The OBAPPSA has been docked very slightly because a non-depository secured party cannot perfect a security interest in a deposit account by control with ease, simplicity and thrift; under this regime, the depository bank has a dampened veto power. However, insofar as *basic perfection* is concerned, the regime poses no practical impediment to the non-depository secured party. Accordingly, the OBAPPSA, representative of a hybrid bank-directed control model with a control paradigm, has been assigned a strong Criterion A adherence grade of 0.750. Meanwhile, for the reasons set forth in the preceding paragraph, the PPSA, representative of a pure registration model with a registration paradigm, and the AUSPPSA, representative of a hybrid bank-only control model with a control paradigm, have each been assigned an optimal adherence grade of 1.000. Under these regimes, all methods available for creation and perfection of a security interest in a deposit account are accommodated with ease and simplicity.

[2] See Ian Binnie, Michael Burke, John Cameron, Margaret Grottenthaler, Rob Scavone & Henry Wiercinski, "Cash Collateral and the PPSA: The Current Problems and Examples" (February 1, 2011) at 1. Oddly, the authors state the following in support of a bank-directed control model: "We think that there is no policy reason that a Canadian borrower or Canadian business should not be as free to use cash as collateral as it is to spend it. It should not be the responsibility of secured parties or others to determine whether the borrower or business is able to do so."

<u>CRITERION B ~ RISK ASSESSMENT</u>

An optimal deposit account regime will enable any creditor, with minimal effort and expense and prior to its extension of credit to the debtor, to reasonably accurately predict the probable outcome of a priority dispute in respect of the deposit account balance (whether original collateral or proceeds).

<u>FACILITY - TRANSPARENCY - SIMPLICITY - EFFICIENCY - PREDICTABILITY - CERTAINTY - CLARITY - EQUALITY - BALANCE</u>

ANALYSIS

a. Preliminary Note

None of the deposit account regimes are entirely free of Criterion B shortcomings; each exhibits unique deficiencies.

b. Common Deficiency – Undiscoverability of Depository Bank's Prioritized Claim

A common defect, shared by all of the regimes, is that there is no guaranteed method, which does not require the cooperation of the depository bank or the debtor, for a prospective non-depository creditor[3] to discover whether the depository bank has, or will have, a prioritized claim to the deposit account balance. Note, however, that mitigating the severity of this common defect is a presumptive

[3] I use this term to refer to a creditor (whether secured or unsecured) that is not the depository bank. Note that such a creditor may, in fact, be another depository institution, but not the depository institution with which the deposit account is maintained.

state of affairs, across all regimes, which strongly implies the superiority of the depository bank's claim.[4] In other words, since a prospective non-depository creditor can fairly safely assume that the depository bank holds a prioritized claim to the debtor's deposit account balance, the fact that such prioritized claim is not categorically discoverable via public registry search is not particularly problematic from a risk assessment perspective. Built into a non-depository creditor's calculus, while conducting due diligence, is a tacit assumption that, unless otherwise agreed, its proprietary interest in the deposit account balance will be subordinate to that of the depository bank.

First, consider Article 9. Since filing a financing statement is not an effective method of perfecting a security interest in a deposit account as original collateral, a prospective non-depository creditor's search of the personal property registry will not disclose the depository bank's prioritized control interest in the deposit account balance.[5] To confirm the existence of the depository bank's control interest, the non-depository creditor must rely on voluntary disclosure by the depository bank, which the depository bank is under no obligation to furnish.[6] Pattern □ supplies apt illustrative assistance. Assuming Retailer does not disclose to Supplier the existence of Bank's control interest in the deposit account, Supplier has no method of discovering such control interest since it is unable to glean the pertinent

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[4] United Nations Commission on International Trade Law (UNCITRAL), *UNCITRAL Legislative Guide on Secured Transactions* (New York: United Nations, 2010) at Chap III para. 146.

[5] This is technically an overstatement. A potential proceeds-based claim to the deposit account balance may be discoverable via public registry search.

[6] Recall, however, that the non-depository creditor may seek this information from the debtor herself. Moreover, the debtor may request the depository bank to confirm the existence of its security interest perfected by control.

information directly from Bank. From Supplier's perspective, it is safest to assume that Bank holds a prioritized claim to the deposit account balance, and to plan and implement its affairs according to that basic assumption. Article 9 facilitates reasonably clear risk assessment through its adoption of comprehensive bank-friendly rules, and thus scores well on this metric.

The OBAPPSA exhibits a flaw similar to that of Article 9. Again, the depository bank is under no obligation to disclose, to a prospective non-depository creditor, that it has acquired control of the debtor's deposit account. This leaves such interest potentially undiscoverable. The existence of the depository bank's security interest is categorically discoverable only if the depository bank opts to effect registration. But since registration is a lower order method of perfection under the OBAPPSA (i.e. vulnerable to the higher order perfection method of control, which the depository bank enjoys automatically), any risk assessment advantages the OBAPPSA offers over Article 9, in this regard, are negligible.

Under the AUSPPSA, it can safely be assumed that a depository bank has a control interest in its customer's deposit account pursuant to standard account terms. Again, such control interest is not verifiable through a search of the personal property registry. As under the OBAPPSA and Article 9, the non-depository creditor is forced to rely on the depository bank's voluntary disclosure, which the latter is under no obligation to give.

Under the PPSA, a prospective non-depository creditor is able to identify a depository bank's prioritized security interest by searching the PPR. This characteristic of the PPSA represents an incremental improvement over the other regimes vis-à-vis Criterion B. However, this gain is almost completely nullified by the fact that a PPR search will not disclose a depository bank's deposit account set-off rights, which typically prevail over a competing security interest in the deposit account balance. Recall that a depository bank may assert its right of deposit account set-off without effecting registration at the PPR. Therefore, reminiscent of the other regimes, the safest practice for a prospective non-depository creditor, operating under the purview of the PPSA, is to assume that the depository bank holds a superior, though not categorically discoverable, claim to the deposit account balance via its deposit account set-off rights.

c. Unique Deficiency – Undiscoverability of Non-Depository Secured Party's Prioritized Claim

One unique Criterion B deficiency, exhibited by both Article 9 and the OBAPPSA, is that absent the debtor's cooperation, potentially affected creditors are unable to discern whether a party *other than the depository bank* has control of, and a perfected security interest in, the deposit account. In other words, the potential for creditor deception is greater under Article 9 and the OBAPPSA than under the PPSA or the AUSPPSA. Under the latter two regimes, the only undiscoverable priority interests are those held by the depository bank, whether by virtue of its (i) superior deposit account set-off rights, in the case of the PPSA, or (ii) automatic control, in the case of the AUSPPSA.[7] All other prioritized interests are discoverable by conducting a search of the personal property registry. Meanwhile, under both Article 9 and the OBAPPSA, the range of potentially undiscoverable interests is broader since that range includes secured parties other than the depository bank. Article 9 and the OBAPPSA thus produce more “secret lien” potentialities than the other regimes. Pattern □ provides illustrative assistance. Under both regimes, if Wholesaler refrains from disclosing to Supplyco the existence of Accounts Financier’s control interest in the deposit account, Supplyco is unable to glean such information directly from Corrigan Bank.

ADHERENCE GRADES

Article 9 does exhibit some Criterion B defects, but overall, it is quite clear, to all of the debtor’s creditors, that the depository bank will “reign supreme”[8] should a priority dispute arise respecting the deposit account balance. Commercial participants are invited to plan their affairs, and price their credit, accordingly. A registry search is of limited utility for a prospective non-depository creditor under

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[7] See Bruce Whitaker, *Review of the Personal Property Securities Act 2009: Final Report* (Commonwealth of Australia, 2015) (“*Statutory Review*”) at 142, Recommendation 73. Whitaker anticipated receiving calls for the facilitation of control interests in favour of non-depository secured parties, and was surprised that no such calls were initially forthcoming. Nonetheless, he raised the issue with stakeholders. Among respondents, a small number suggested facilitating control interests for non-depository secured parties, while the great majority did not. One respondent, presumably representing banking interests, made a narrow expansion proposal, suggesting that only the ADI and its wholly-owned subsidiaries be allowed to acquire control of an ADI account. At 142, Whitaker rejected this suggestion: “That may be advantageous for the ADI, but would not reflect the reasons why it may be thought appropriate from a policy perspective to allow perfection by control by the ADI itself (particularly if that perfection is automatic, as I discuss below).”

[8] Willa E. Gibson, “Banks Reign Supreme Under Revised Article 9 Deposit Account Rules” (2005) 30 Del. J. Corp. L. 819.

Article 9 since it will only reveal the identity of proceeds claimants but not secured parties with control of the deposit account. Article 9 has been assigned a Criterion B adherence grade of 0.750.

The OBAPPSA has also been assigned an adherence grade of 0.750. One could plausibly argue that the OBAPPSA deserves a higher Criterion B adherence grade than Article 9 given the marginally improved likelihood it offers a prospective non-depository creditor of discovering a competing security interest perfected by registration. But since the OBAPPSA's advantages over Article 9 are rather miniscule in light of the impotence of a security interest in a deposit account perfected by mere registration, the OBAPPSA too has been assigned a Criterion B adherence grade of 0.750.

The PPSA has also been assigned a Criterion B adherence grade of 0.750 even though, in comparison with Article 9 and the OBAPPSA, it contemplates a narrower range of undiscoverable prioritized interests (i.e. only those held by the depository bank) that may come into competition with a prospective non-depository creditor. If a priority interest exists that cannot be categorically discovered through a personal property registry search, such interest belongs to the depository bank, and not to some other non-depository secured party. This narrower range of hidden interests represents an incremental improvement the PPSA offers over both Article 9 and the OBAPPSA, yet not so much of an improvement that it justifies an optimal adherence grade.

The AUSPPSA, too, has been assigned a Criterion B adherence grade of 0.750 for precisely the same reasons that the PPSA earns that mark. The depository bank's priority interest is not categorically discoverable through a public registry search, though again, it can very safely be assumed. All other prioritized security interests are discoverable through such a public registry search. The AUSPPSA thus offers a high degree of clarity to those engaged in risk assessment processes, and has been assigned a strong adherence grade.

CRITERION C ~ DISPUTE RESOLUTION

An optimal deposit account regime will, in the event of a priority dispute in respect of the deposit account balance, furnish a clear and certain priority rule which hinges on easily and inexpensively ascertained objective criteria and evidence.

FACILITY - TRANSPARENCY - SIMPLICITY - EFFICIENCY - CERTAINTY - CLARITY - BALANCE

OUTCOME NEUTRALITY & POST-DEFAULT FOCUS

It is noteworthy that Criterion C is evaluated in an outcome-neutral manner; that is, I do not presuppose that any particular party or class of party, whether depository bank or non-depository creditor, *ought* to prevail in any particular circumstance. Instead, Criterion C ascribes desirability to *any priority outcome* provided the rule furnishing such outcome is clear and certain, and further provided that such outcome hinges on easily and inexpensively ascertained objective criteria and evidence.

Whereas Criterion B places emphasis on *ex ante* predictability (i.e. before the act of lending), Criterion C focuses on post-default certainty. Together, Criteria B and C embody the entire family of PPSL definiteness values. They share content and exhibit substantive overlap, both requiring, for example, and at a minimum, clearly written priority rules. Clear, comprehensive and internally coherent priority rules enable a creditor to both (i) engage in meaningful *ex ante* risk assessment (in conjunction with public registry search results) at and prior to transaction implementation, and (ii) determine its priority position in the event a dispute later arises upon debtor default. Beyond their common requirements for comprehensive and clearly articulated priority rules, these evaluative criteria – Criterion C now our chief focus – also require that such priority rules be straightforwardly ascertained and applied based on easily and inexpensively obtained objective evidence.

ANALYSIS & ADHERENCE GRADES

Article 9 suffers from some shortcomings under Criterion C, but furnishes a comprehensive set of priority rules that make it quite clear and certain, in most foreseeable circumstances, which party will prevail in the event of a priority dispute. Take Pattern □, for example. If Supplier acquires control of Retailer's deposit account via the customer method, it prevails over Bank in the resulting priority dispute. Otherwise, in all other instances, Bank prevails under the legislative priority hierarchy. These outcomes hinge on easily and inexpensively ascertained objective evidence, namely, evidence of whether Supplier is recognized by Bank as the customer in respect of Retailer's deposit account (a matter that will invariably be well documented).

Pattern □ supplies further support for Article 9's impressive performance under Criterion C. Between Supplyco and Accounts Financier, the priority dispute will generally be resolved with reference to whomever acquires control of the deposit account, or, if both acquire control, the order in which such control interests were acquired. Particulars of competing control interests will be revealed in the contractual documentation governing the control interest. Though not producible through a publicly available search process (i.e. printing off the results of a registry search), this evidence is nonetheless relatively easily discoverable and examinable.

Under Article 9, protracted dispute resolution is possible where a Bank claims a security interest in, and automatic control of, a deposit account on the basis of an unwritten security agreement. The outcome hinges on the court's acceptance or rejection of the depository bank's claim that the debtor verbally agreed to the grant of a security interest in the deposit account. One suspects that, across the United States, banks consistently include security granting language in their standard written account terms so that this uncertainty never actually arises. Article 9 has been assigned a strong Criterion C adherence grade of 0.750.

Similarly, the AUSPPSA has been assessed a Criterion C adherence grade of 0.750. Unless the depository bank enters into an explicit subordination agreement with a competing secured or unsecured party, the depository bank prevails in any priority dispute concerning the debtor's deposit account. The discussion of Pattern □, in Chapter 6, furnishes confirmation of this point. The AUSPPSA exhibits the same deficiency as Article 9 in that it invites protracted litigation on the question of whether the depository bank actually obtained a non-written security agreement from the debtor.

In the event that the depository bank is not involved in a priority dispute respecting the debtor's deposit account balance, the AUSPPSA contains priority rules which clearly and predictably settle such a contest on the basis of time of registration, a matter of public record that is easily producible as evidence. Accordingly, based on its general congruity with Article 9 on this metric, the AUSPPSA has been assigned a Criterion C adherence grade of 0.750.

The OBAPPSA sets out a fairly clear priority structure, but exhibits a small degree of uncertainty with respect to the ambiguous interplay between the specialized deposit account priority rules (housed in section 30.1) and the depository bank's deposit account set-off rights (embodied in subsection 40(1.1)). The operative language of subsection 40(1.2), when considered in light of the traditional interpretation of concordant provisions of subsection 40(1.1), leaves it unclear whether the specialized priority rules in section 30.1 affect the depository bank's deposit account set-off rights.[9] But this ambiguity is inconsequential since both analytical avenues – subsection 30.1 or 40(1.1) – nearly always furnish equivalent outcomes: the depository bank prevails. Aside from this ambiguity, the OBAPPSA, like Article 9 and the AUSPPSA, furnishes a comprehensive set of rules that, based on easily and inexpensively obtained objective evidence, clearly and predictably settle priority contests between competing claimants. Accordingly, the OBAPPSA has been assessed a Criterion C adherence grade of 0.750.

The PPSA also performs reasonably well under Criterion C. It furnishes clear and predictable deposit account priority rules that hinge on time of registration, punctuated by a powerful set-off superiority in favour of the depository bank. These rules enable any creditor, with minimal effort and expense, to reasonably accurately predict the probable outcome if a priority dispute arises. One deficiency in the PPSA vis-à-vis Criterion C, is in the opacity of its language governing the interaction between account set-off rights and competing rights arising via security interest. The PPSA could be improved with more explicit statutory language precisely delimiting the depository bank's deposit account set-off rights vis-à-vis competing security interests.

The PPSA might be additionally docked on the basis that, when a priority dispute depends on the availability or unavailability of a bank's deposit account set-off rights, it is occasionally resolved on the basis of subjective evidence concerning,

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[9] See the detailed discussion of this ambiguity in Chapter 4 ~ Description.

for instance, the closeness of connection between impugned accounts,[10] the fairness or unfairness of allowing set-off,[11] or the depository bank's state of knowledge respecting the source of (or existence of some claim to) a particular deposit.[12] This potential for protracted litigation does not bode well for the PPSA's Criterion C adherence. While the PPSA performs reasonably well under Criterion C, it has been assessed an average adherence grade of 0.500, lower than Article 9, AUSPPSA and the OBAPPSA, on account of the obscurity and opacity of its language governing the interaction between deposit account set-off rights and competing rights arising via security interest, and due to its residual tendency to resolve disputes on the basis of subjective evidence that is not easily and inexpensively discoverable.

CRITERION D ~ COMPETITIVE MARKET

An optimal deposit account regime will create an ideally competitive marketplace for security interests in deposit accounts by subjecting all prospective secured creditors to the same substantive and procedural rules.

FACILITY - FLEXIBILITY - SIMPLICITY - EQUALITY - BALANCE

[10] See Clayton Bangsund & Jasmine Lothian, "Inequity in Equitable Set-Off: Telford v Holt Revisited" (2016) 94(1) Can. Bar. Rev. 149 ("*Inequity in Equitable Set-Off*").
[11] Bangsund & Lothian, *Inequity in Equitable Set-Off, ibid.*
[12] See Chapter 3 ~ Set-Off.

PERSPECTIVES & COMPONENT GRADING

The term "competitive" implies the involvement of two or more rivals. Indeed, underlying the competitive market analysis is a base assumption[13] that numerous – that is, at least two, and hopefully more – parties enjoy at least some form of meaningful access to the deposit account security market. Since every "competition" will, of necessity, involve at least one non-depository secured party, I will consider the matter from such party's perspective. The Criterion D adherence analysis involves consideration of the relative competitiveness, in terms of access to the same substantive and procedural rules, of a non-depository secured party vis-à-vis two distinct classes of competitor: (i) the depository bank with which the deposit account is maintained (i.e. as against the depository bank, how competitive is the non-depository secured party?), and (ii) other non-depository secured parties (i.e. as against other non-depository secured parties, how competitive is the non-depository secured party?). A regime's Criterion D adherence grade is determined with reference to its combined adherence, from both perspectives, to general market ideals, namely, the provision of equal opportunity and a level playing field.

a. vis-à-vis Depository Bank

As between a non-depository secured party and the depository bank, how does the market behave or operate for deposit account balances as personal property security? The short answer, for all deposit account regimes, is that the law

[13] Another starting assumption, addressed in more detail in Chapter 8 ~ Scrutiny, is that a deposit account is like any other account, and thus should be treated in like fashion.

favours the depository bank. Under each regime, the depository bank has a decisive advantage in terms of its ability to monopolize its customer/debtor's deposit account as a source of its priority suite of collateral. At first glance, this uneven playing field may appear problematic. But upon reflection, the concern seems somewhat misplaced, particularly where a regime strictly observes the "principle of universality." In other words, the harmful effects of an uneven playing field are substantially lessened if equivalent treatment is afforded to (i) a depository bank (as account debtor), holding reciprocal claims against the debtor, as against the non-depository secured party, and (ii) a non-depository secured party (as account debtor), holding reciprocal claims against the debtor, as against the depository bank as a secured party.

To say that the law ought to apply equally to similarly situated parties is a truism. The principle of universality is nicely summed up in the maxim, "What's sauce for the goose is sauce for the gander." This is one benchmark against which the regimes are measured under Criterion D. An initial point which must be recognized, however, is that, in relation to the deposit account, a non-depository creditor, by definition, is *not* similarly situated to the depository bank. The depository bank is the account debtor on the deposit account balance, while the non-depository creditor is not. Thus the two parties stand in fundamentally distinctive positions with reference to the debtor's deposit account balance. The principle of universality must be understood in this light.

It becomes apparent that the regimes' Criterion C adherence cannot only be assessed by asking the question, "Do the same substantive and procedural rules apply to all classes of creditor with respect to deposit accounts as personal property security?" To be sure, this remains a relevant question, but it is not the only one. Instead, a further question must be posed with the principle of universality in mind, to wit, "Do both depository banks (with respect to deposit account balances) and non-depository creditors (with respect to general accounts) enjoy the same "account debtor" rights against competing security interests in account debts on which they are liable?" If the answer is yes, then this tends to significantly dampen, if not eliminate, concerns respecting the depository bank's competitive advantage vis-à-vis the deposit account. So long as a regime provides that a non-depository creditor enjoys the same competitive advantage with respect to account debts on which it is liable, the principle of universality is observed, and the regime better adheres under this component of the Criterion D analysis.

b. vis-à-vis Other Non-Depository Secured Parties

The second perspective to be considered in the Criterion D analysis is that of a non-depository secured party vis-à-vis other non-depository secured parties. As between two or more non-depository secured parties, how do the regimes stack up according to the level playing field metric? To what extent is any one class of non-depository secured party favoured over another? Only after considering this perspective, in combination with the vis-à-vis depository bank perspective, can one draw any meaningful conclusions respecting a regime's overall Criterion D adherence level.

Analysis & Adherence Grades

As between the depository bank and the prospective non-depository secured party, the deck is heavily stacked in the depository bank's favour under Article 9. In addition to having a virtually unassailable priority right (whether by virtue of its automatic control or its set-off rights), a depository bank actually has the ability to prevent perfection of the non-depository secured party's security interest in the deposit account as original collateral. Only if the depository bank agrees to recognize the non-depository secured party as customer on the debtor's deposit account, or signs an explicit subordination agreement, will the non-depository secured party have an opportunity to look to a deposit account balance as part of its priority suite of collateral.

Article 9 performs poorly on the universality metric since it is only depository banks, and not other account debtors, who are able to assert automatic control over deposit account balances, and to veto a debtor's ability to facilitate perfection of a security interest in the account debts on which the depository bank is liable. The universality principle is violated. Simply put – using Pattern □ as the prototype – Supplier has no analogous veto power, to that of Bank, respecting the creation and perfection of a security interest in an intangible on which Supplier is account debtor. However, consistent with the principle of universality, Article 9 recognizes the supremacy of a non-depository account debtor's set-off rights vis-à-vis a depository bank with a competing security interest in such account.[14] This feature of Article 9 mitigates the regime's failure to adhere to competitive market principles according to the vis-à-vis depository bank metric.

As among prospective non-depository secured parties, Article 9 furnishes a level playing field. All non-depository secured parties are subject to the same control and non-control based priority rules set out in Article 9, and theoretically at least, have equal access to the control-method of perfection. But this market is rather shallow, again because the depository bank has ultimate discretion as to whether the deposit account will be made available to another reliance creditor. Article 9 has been assessed a weak overall Criterion D adherence grade of 0.250.

Next, consider the AUSPPSA. Again, in comparison with the depository bank, a prospective non-depository secured party is at a competitive disadvantage, and can only assure itself of access to a deposit account balance in extraordinary circumstances under which it receives the depository bank's explicit consent. The depository bank is in a position to monopolize the deposit account as part of its priority suite of collateral. While the AUSPPSA technically violates the principle of universality – since it is only the depository bank, where it is account debtor, that gets the benefit of automatic control and the accompanying superpriority –, such violation is merely formal in nature. It is true that other non-depository secured creditors, who simultaneously act as account debtors vis-à-vis the debtor, cannot

[14] UCC, §§9-403 and 9-404.

rely on the automatic control method of perfection and the favourable priority rules associated therewith. Instead, a non-depository secured creditor must rely on registration-based perfection and priority rules (which will not necessarily operate in its favour), or alternatively, its set-off rights. But since the non-depository secured creditor's set-off rights are so potent, one may safely assert that the AUSPPSA respects this aspect of universality in substance and effect, if not in form.

The AUSPPSA violates the principle of universality in another respect, namely, in the context of *proceeds of* a deposit account balance. Indeed, the AUSPPSA's depository bank favouritism extends so far that a *depository bank's proceeds claim to inventory (acquired with funds traceable to the deposit account balance)* actually takes priority over a *supplier's purchase money security interest in that inventory*.[15] This peculiar rule, which violates the principle of universality (since the non-depository secured party enjoys no analogous right), appears to be the result of a focused lobbying effort. Indeed, in the secured transactions context, it may represent a high watermark of depository bank overreach. It is noteworthy that, in his statutorily prescribed review of the AUSPPSA, Whitaker recommends deletion of s. 57(2A) on account of its total lack of balance and justifiability.[16] Whitaker's recommendation is an attempt to restore balance in Australian personal property security law. Wood explains the problem.

> The bank is able to assert priority over the supplier in respect of the new inventory so long as it can demonstrate that funds in the deposit account were used to acquire it. Not only will its claim to the deposit account be

[15] AUSPPSA, s. 57(2A). See discussion of the peculiarity of this provision in Chapter 4 ~ Description.
[16] Whitaker, *Statutory Review, supra* note 7 at 312, Recommendation 225.

> defeated by the bank, the bank will be able to assert a higher ranking claim to any new inventory that is acquired with those funds. This places the supplier in an almost impossible position. The supplier will never have an assurance that it will be enjoy a higher-ranking claim to the inventory that it supplies.[17]

Among non-depository secured parties, the AUSPPSA furnishes a level playing field. Creation and perfection of a security interest in a deposit account balance is an equal opportunity proposition, and the priority rules are settled with reference to time of registration, which is a universally available means of perfection. The AUSPPSA has also been assessed a weak Criterion D adherence grade of 0.250.

Consider, next, the OBAPPSA. Under this regime, the depository bank occupies essentially the same position as its Article 9 compatriot, albeit with a dampened veto power on the debtor/depositor's ability to facilitate perfection of a security interest. While any non-depository secured party may perfect its security interest via the lower order method of registration, only those secured parties with the sophistication and leverage to procure a control agreement, or some other form of subordination agreement, are able to shore up the deposit account balance as a component of their priority suite of collateral. In this aspect of the vis-à-vis depository bank metric, the OBAPPSA performs comparably with Article 9.

Reminiscent of Article 9, the OBAPPSA does not formally observe the universality principle in terms of its treatment of a non-depository secured party as account debtor, on one hand, and the depository bank as account debtor, on the

[17] Roderick J. Wood, "Acquisition Financing of Inventory: Explaining the Diversity" (2014) 13(1) O.U.C.L.J. 49 at 64.

other. Again, using Pattern □ as an example, Supplier would be unable to avail itself of automatic control were it and Bank to reverse roles. If Bank were to take a security interest in any of Retailer's accounts on which Supplier is liable, Supplier would not be able to avail itself of automatic control and the priority benefits associated therewith to the extent of any reciprocal claim it may have against Retailer. But, as under Article 9, the OBAPPSA confers superiority on Supplier's set-off rights in such a situation, thereby producing a substantively similar outcome. This dampens the negative impact of the OBAPPSA's failure to observe the universality principle from a formal and technical perspective.

Among non-depository secured parties, the playing field is level under the OBAPPSA. Creation and perfection (whether by control or by registration) of a security interest in a deposit account balance is an equal opportunity proposition, and the priority rules apply equally to all non-depository parties. The OBAPPSA has been assessed an overall Criterion D adherence grade of 0.250.

Under the PPSA, a depository bank enjoys a competitive advantage over other secured parties by virtue of its powerful right of deposit account set-off. Only in rare instances, where deposit account set-off is unavailable for the depository bank's benefit (and the depository bank is later registered), or where the depository bank explicitly subordinates its interest to a competing secured party, will the non-depository secured party prevail in a priority dispute. If a non-depository secured party wishes to rely on a deposit account as a source of repayment, it requires the depository bank's active cooperation. Under the PPSA, the market is tilted in the depository bank's favour vis-à-vis non-depository secured parties.

It is noteworthy, however, that under the PPSA, a depository bank is treated precisely the same as any other party, whether by application of the pure secured transaction priority rules (which are pegged to time of registration) or the set-off rules embodied in subsection 41(2). Using Pattern □ as an example, the fact that Bank may avail itself of subsection 41(2) in priority to Supplier's interest is not problematic from a competitive market perspective since, if the roles were reversed (i.e. if Bank held a security interest in a debt owing from Supplier to Retailer), Supplier would similarly be able to assert subsection 41(2) for its benefit. Under the PPSA, the universality principle is substantively, effectually *and formally* observed, thereby mitigating the negative effects of a deposit account market tilted in the depository bank's favour. When situated in the role of account debtor, the depository bank and all non-depository secured parties are subject to, and enjoy the benefit of, the same substantive and procedural rules. The PPSA therefore offers a marginal improvement over the other regimes in this aspect of the vis-à-vis depository bank competitive market metric.

As between non-depository secured parties, the PPSA offers a perfectly competitive set of creation and perfection procedures, and furnishes priority rules which hinge on time of registration, a universally available means of perfection. From this perspective, the PPSA measures up nicely with the other regimes. Based on its advantage over the other regimes in the vis-à-vis depository bank metric, the

PPSA has been assigned an average Criterion D adherence grade of 0.500, representing an improvement over its competitors.

<u>CRITERION E ~ PROCEEDS</u>

An optimal deposit account regime will simultaneously (a) enable a secured creditor, with minimal effort and expense, to claim (i) a deposit account balance as proceeds of its original collateral, and (ii) the proceeds of a deposit account balance either as first or subsequent generation proceeds, and (b) for both (i) and (ii), furnish a clear and certain priority rule that fairly balances the interests of the secured creditor and relevant third parties.

<u>FACILITY - FLEXIBILITY - SIMPLICITY - EFFICIENCY - PREDICTABILITY - CERTAINTY - CLARITY - BALANCE</u>

SUBSTITUTION PRINCIPLE

A litmus test of the overall effectiveness of a security interest in personal property is whether, and to what extent, a secured party can pursue the proceeds of its disposed-of original collateral. If a secured party's original collateral may be transferred to a third party free and clear of the security interest, and if no substitute asset is made available for the benefit of the secured party, the effect of the security interest is essentially nullified. Indeed, absent this substitution feature, the principal purpose – the raison d'être – of taking a security interest can be frustrated, and abruptly so. For this reason, a regime must furnish rules and procedures that give full and fair consideration to the plight of a claimant pursuing a deposit account balance as proceeds of its disposed-of original collateral. Full and fair consideration is similarly owed to a secured creditor with a proceeds claim to property acquired with funds withdrawn from an encumbered deposit account.

a. Deposit Accounts as Proceeds

Recall that personal property security statutes aim to facilitate secured transactions in *all* categories of personal property including inventory, for example. In other words, deposit account financing represents a small slice of a much larger secured financing pie. Priority rules that cut off an inventory supplier's claim to proceeds in a deposit account balance have a harmful impact on the value of the underlying security interest in the inventory, and theoretically drive up the cost of credit in inventory financing. These same considerations apply, *mutatis mutandis*, to financing of general accounts receivable. It is insufficient to consider the deposit account in isolation as a "standalone form" of personal property collateral. Given the reservoir nature of the deposit account, proceeds claimants deserve their due in a deposit account priority dispute.

b. Proceeds of Deposit Accounts

Another discrete aspect of Criterion E pertains to the ability of a secured creditor, including the depository bank, to pursue the proceeds of a deposit account balance, whether as first generation proceeds (i.e. where the deposit account is the secured party's original collateral) or subsequent generation proceeds (i.e. where the proceeds are claimed as a second, third or subsequent generation of proceeds beyond the deposit account balance). When a deposit account financer's collateral is liquidated giving rise to proceeds, the deposit account financier ought to maintain an interest in those proceeds.

c. Nebulous Standards & Tempered Analysis

It is important to recognize that proceeds priority rules need not *guarantee* priority to a proceeds claimant. Because there are other legitimate competing interests that must be considered, it is not a foregone conclusion that a proceeds claimant should have the strongest claim to the deposit account balance, or any form of property, for that matter. In other words, in the deposit account hierarchy (whether *as proceeds*, or *proceeds of*), proceeds claimants do not, and need not, always occupy top spot.[18] Provided a regime delineates a priority hierarchy, on some ostensibly rational basis, it will perform adequately under Criterion E. Since inherently nebulous concepts like "balance" and "fairness" colour the background of Criterion E, it is difficult to evaluate any regime as particularly "good" or "bad". Consequently, my evaluation of the regimes under this metric is tempered and conservative. No regime is assessed with especially high praise or intense ridicule – the results are evened out, thereby neutralizing any concerns one might have with the evaluative criterion itself.

ANALYSIS & ADHERENCE GRADES

[18] A regime's priority rules, by definition, prefer some parties over others. For instance, the priority rules typically favour purchase money claimants over non-purchase money claimants, and purchase money proceeds claimants over non-purchase money proceeds claimants. Another example is the PPSA's preference for vendors over lenders.

Each regime provides that a perfected security interest in original collateral automatically continues perfected in proceeds taking the form of a deposit account balance. Each regime also provides that a security interest continues perfected in proceeds of an encumbered deposit account.[19] Since ability to perfect is not an issue, the remainder of the inquiry therefore focuses on the strength of the regimes' proceeds-based priority rules. Two questions are relevant: How strong is a proceeds claimant's claim to a deposit account as proceeds of its original collateral? And how strong is a proceeds claimant's claim to proceeds of an encumbered deposit account?

Theoretically, at least, each of the regimes furnishes a method(s) for an inventory financier to ensure itself priority to proceeds in the form of a deposit account balance. Specifics of the various methods were furnished in Chapters 4 and 6 in the discussion relating to Pattern □ and Pattern □. To achieve this objective, Article 9, the AUSPPSA, PPSA and OBAPPSA all require the inventory financier to gain the voluntary cooperation of the depository bank. The problem is that securing the depository bank's cooperation is far from assured or easy, particularly since, absent unique circumstances, the depository bank has no incentive to facilitate, at its own expense, a priority interest in favour of the inventory financier. Thus, in many instances, cooperation is not readily forthcoming.

[19] Under the PPSA, depending on the nature of the proceeds, the automatic perfection may be temporary, and thus require a financing change statement within 15 days of attachment: see PPSA, ss. 28(2) and (3).

Article 9 has been assigned an average Criterion E adherence grade of 0.500. Under Article 9, an inventory financier has little chance of successfully securing priority over the depository bank with respect to the deposit account proceeds of its disposed-of inventory. Unless the inventory financier is able to avail itself of the customer method of perfection in respect of the deposit account collecting the proceeds, or procures an express subordination agreement from the depository bank, the proceeds of its original collateral will be lost to the depository bank. Article 9's priority rules all but guarantee that the depository bank will have a prioritized claim to such proceeds. Where the depository bank does not assert a right to the deposit account balance, and where no other party has acquired control of the debtor's deposit account, an inventory financier's purchase money proceeds claim generally defeats competing claims.

As described in Chapters 4 and 6, Article 9 furnishes rules pertaining to the rights of secured parties claiming proceeds of deposit accounts. These rules generally preserve the secured party's priority position with respect to successive generations of cash proceeds. However, some of the operative statutory language – "proceeds of the same type as the collateral, or an account relating to the collateral" – is vague, and invites protracted litigation. Article 9's "proceeds of" priority rules can be criticized for their complexity and lack of clarity.

The OBAPPSA has also been assigned an average Criterion E adherence grade of 0.500. Where a dispute arises over a deposit account balance, the OBAPPSA mimics Article 9's treatment of a proceeds claimant vis-à-vis the depository bank. As demonstrated in Pattern □, it is extremely arduous for a proceeds claimant to establish a higher-ranking claim to the deposit account than the depository bank. This task requires the depository bank's active cooperation, and is not guaranteed to succeed. Better protection exists, however, where the depository bank does not assert a claim to the deposit account balance, and the purchase money proceeds claimant competes with non-control interests held by other non-depository secured creditors, as in Pattern □.

The OBAPPSA provides that a secured party enjoys automatic and continuous perfection against proceeds of an encumbered deposit account balance, and that the general priority rules apply in the normal course. Thus the OBAPPSA, unlike Article 9 and the AUSPPSA, does not confer, on a secured party with control of the deposit account, any special priority status beyond the deposit account itself.

The AUSPPSA performs similarly to Article 9 and the OBAPPSA with respect to its treatment of deposit account proceeds. The depository bank prevails over a proceeds claimant in most instances. The proceeds claimant requires the cooperation of the depository bank to reverse this outcome, as demonstrated in Pattern □. Meanwhile, in comparison with Article 9 and the OBAPPSA, a proceeds claimant fares better against non-depository secured creditors under the AUSPPSA since, under this regime, the latter are unable to gain the benefit of control superpriority. This feature of the AUSPPSA bolsters its Criterion E adherence.

Meanwhile, the AUSPPSA far surpasses Article 9 and the OBAPPSA with respect to the priority it confers on the depository bank over *proceeds of the deposit* *account balance*. As detailed in Chapters 4 and 6, the AUSPPSA strongly protects the interests of a depository bank's proceeds claim, so much so that it overrides the protection afforded to purchase money vendors and lenders vis-à-vis their original collateral. This same protection is not afforded to any other deposit account financier, but only to the depository bank. It is difficult to objectively assess the Criterion E adherence of this priority rule. At the same time, it is almost impossible to justify it. Like Article 9 and the OBAPPSA, the AUSPPSA has been assigned an average Criterion E adherence grade of 0.500, though one could argue that it deserves a weaker adherence grade.

Finally, the PPSA, like the other three regimes, has been assigned an average Criterion E adherence grade of 0.500. While the PPSA typically confers a privileged position on the depository bank vis-à-vis a proceeds claimant on the basis of the depository bank's superior account set-off rights, the depository bank does not enjoy any advantages over a proceeds claimant by virtue of any of the pure secured transactions priority rules. Nonetheless, as demonstrated in Pattern □, a proceeds claimant requires the voluntary cooperation of the depository bank to ensure that a deposit account is part of its priority suite of collateral. Meanwhile, where the depository bank is uninvolved in the priority dispute, the PPSA, like the AUSPPSA, clearly favours a purchase money proceeds claimant to all other competing secured parties, as demonstrated in Pattern □.

With respect to proceeds of an encumbered deposit account, the PPSA, like the OBAPPSA, does not confer special protection on the depository bank or any other class of secured creditor. Instead the general perfection and priority rules apply equally across the board.

III. AGGREGATE ASSESSMENT

A. NUMERICAL GRADING & CUMULATIVE ADHERENCE TABLES

It is useful to register the regimes' numerical grades on a cumulative adherence table; the table allows one to isolate and identify significant divergences and general trends in the data. I am reluctant, however, to attach deep meaning to the numerical values assigned to each evaluative criterion, or to place undue emphasis on slight numerical adherence differences. This is not a scientific exercise; it constitutes qualitative, not quantitative, analysis. The cumulative adherence grade earned by each regime gives one, at best, a general sense of the regime's overall adherence to the evaluative criteria and the PPSL values underlying them, along with an idea of that regime's relative adherence in comparison with the other regimes. In this spirit, the variable weighting exercises undertaken below are intended to emphasize the strengths and weaknesses of the various regimes under investigation, and denote how one's philosophical convictions might impact their conclusions about which of the regimes is better or worse.

B. *PRIMA FACIE* AGGREGATE ASSESSMENT

1. *EQUAL WEIGHTING*

The adherence grades assigned to the various regimes, in Part II, are collated in Cumulative Adherence Table 7.2. I assign, on a *prima facie* basis, equal weight to each of Criterion A through Criterion E. In conducting an aggregate assessment of the regimes, this is a useful starting point, and also serves as a convenient launching pad for the more nuanced analyses that follow.

TABLE 7.2
CUMULATIVE ADHERENCE TABLE ~ EQUAL WEIGHTING

Evaluative Criteria ➔ **Regimes ⬇**	**Criterion A** *Creation & Perfection*	**Criterion B** *Risk Assessment*	**Criterion C** *Dispute Resolution*	**Criterion D** *Competitive Market*	**Criterion E** *Proceeds*	**Cumulative Adherence Score** **/5**
Article 9 *Control ~ Pure*	0.250	0.750	0.750	0.250	0.500	2.500 Rank = 4th
PPSA *Registration ~ Pure*	1.000	0.750	0.500	0.500	0.500	3.250 Rank = T1st
AUSPPSA *Control ~ Hybrid*	1.000	0.750	0.750	0.250	0.500	3.250 Rank = T1st
OBAPPSA *Control ~ Hybrid*	0.750	0.750	0.750	0.250	0.500	3.000 Rank = 3rd

Performance Legend ~ Adherence Grade
0.000 = No adherence
0.250 = Weak adherence
0.500 = Average adherence
0.750 = Strong adherence
1.000 = Optimal adherence

2. PRIMA FACIE CONCLUSIONS & CONTRARIAN THEORIES

a. Criterion A Deficiencies Under Article 9

The regimes exhibit similar adherence levels in respect of Criteria B through E. Of the regimes under investigation, Article 9 demonstrates the least overall adherence, primarily due to its Criterion A deficiencies. Indeed, one critical and noteworthy distinction between the PPSA, AUSPPSA, OBAPPSA, on one hand, and Article 9, on the other, is that the former regimes, unlike the latter, furnish a relatively high degree of predictability, certainty and clarity under Criteria B and C, without compromising performance under Criterion A. On this metric, each of the PPSA, AUSPPSA and OBAPPSA plainly outperform Article 9. Article 9's failure to facilitate, in an efficient and inexpensive manner, the perfection of a security interest in a deposit account, speaks poorly to its overall adherence level. This feature of Article 9 is in complete disaccord with entrenched values of personal property security law.

b. The Reliance Creditor Theory

A contrarian theory, which challenges conventional wisdom in the arena of personal property security law, has been advanced. The "reliance creditor theory" posits that making it difficult and expensive for a secured party to create an effective security interest in a deposit account balance is actually a good thing. The theory asserts that making it difficult to create an effective security interest in a deposit account will incentivize specialized reliance creditors to emerge and create an active market for deposit account financing. In other words, under such a regime, deposit accounts will no longer be regarded by secured parties as mere "bonus collateral" which they are happy to acquire, but do not actually rely on when advancing credit. Subscribers to the reliance creditor theory will naturally disagree with the conclusions expressed in the preceding paragraph. I will address the "reliance creditor theory" in Chapter 8.

c. Prima Facie Conclusions

For now, I observe that Article 9 demonstrates the weakest overall adherence to traditional personal property security law norms. Article 9 earns a cumulative adherence score of 2.500. The OBAPPSA outperforms Article 9 with a cumulative adherence score of 3.000, but falls short of the PPSA and AUSPPSA, which each earn cumulative adherence scores of 3.250. On a *prima facie* basis, upon affording equal weight to the evaluative criteria, the PPSA and AUSPPSA emerge as the regime frontrunners. More nuanced analyses follow.

C. CALIBRATED AGGREGATE ASSESSMENT

1. VARIABLE WEIGHTING & IDEOLOGICAL INFLUENCE

The analysis undertaken in Part III.B is premised on the tenuous assumption that each of the evaluative criteria should be accorded the same weight in an aggregate assessment exercise. There are legitimate reasons why one might accord variable weight to certain of the evaluative criteria. For instance, one who attaches great importance to the family of PPSL definiteness values (i.e. 'predictability', 'certainty' and 'clarity') might consider Criteria B and C as weightier than the other evaluative criteria. Another, who is principally focused on balance and fairness, might regard Criterion D as deserving of more weight in an aggregate assessment exercise. Alternatively, another, who attaches little importance to balance and fairness, might believe that Criteria D and E deserve less weight in an aggregate assessment exercise. The possibilities are endless. The following discussion outlines some arguments that support the amplification or deamplification – that is, the diminishment or discounting – of the evaluative criteria.

2. Amplification Arguments

a. Risk Assessment, Dispute Resolution & The Family of Definiteness Values

Given Criteria B's and C's intimate nexus with the family of PPSL definiteness values ('predictability', 'certainty' and 'clarity'),[20] one might regard such evaluative criteria as weightier than Criteria A, D and E. As noted in Chapter 2, a secured transactions regime, first and foremost, aims to promote facilitation. The PPSL definiteness values are intimately and inextricably tied to facilitation; facilitation of meaningful due diligence and risk assessment *ex ante*; facilitation of creation and perfection of a security interest; facilitation of efficient and inexpensive dispute resolution in the event a priority dispute arises. Given the close conceptual link between the prime PPSL value of 'facility' and the PPSL definiteness values of

[20] See Chapter 2 ~ Foundation.

'predictability', 'certainty' and 'clarity', a strong argument can be mounted for the amplification of Criteria B (Risk Assessment) and C (Dispute Resolution) in the aggregate assessment of the various deposit account regimes.

b. Competitive Market & The Level Playing Field

One who is chiefly influenced by conceptions of fairness, balance and equal opportunity might place greater emphasis on Criterion D (Competitive Market) since these considerations are embodied in such criterion. A devoted market enthusiast, for example, would be keen to see the market for deposit accounts, as items of personal property security, open to the greatest possible number of commercial participants on equal procedural and substantive terms. According to the market enthusiast, the natural consequence of this opening up is greater opportunity for the debtor to leverage or exploit its asset, the deposit account, on the most advantageous terms possible. An adherent to this theory – that a level playing field (equal application of substantive rules and procedures) creates a competitive market – might believe that more weight ought to be assigned to Criterion D in an aggregate assessment exercise.

3. Deamplification Arguments

a. Competitive Market of Secondary Importance

Contrary to the arguments set out in Part III.C.2.b, one might argue that Criterion D ought to be deamplified on the ground that it represents PPSL values that are of secondary importance in the PPSL values' overall hierarchy. One who places primacy on 'definiteness' may be willing to sacrifice the inferior values of 'balance' and 'equality'. The argument takes the following form: Since deposit account financing, as a form of primary financing, is inherently risky due to the illusive and fleeting nature of deposit account balances, one should not concern themselves, to too great a degree, with the competitiveness and balance of the deposit account market. Since a debtor can deplete a deposit account balance in an instant, it is not all that important that a competitive market be maintained with respect to this species of collateral. It is far more important that the rules are predictable, certain and clear. The relative fragility of the deposit account as a form of primary "reliance" collateral militates in favour of affording competitive market principles diminished weight in an aggregate assessment exercise.

b. Proceeds, Non-Reliance & Lack of Meaningful Content

Criterion E is a general gauge of the strength of a proceeds claimant's entitlement to its deposit account proceeds, and the proceeds thereof. One might advance a deamplification argument for Criterion E on grounds of non-reliance. The argument takes the following form: Despite theoretically having a right to pursue and seize proceeds of its original collateral, a typical secured creditor (like, for instance, an inventory financier) does not actually rely on its right to pursue proceeds, but rather advances credit to the debtor solely, or at least primarily, on the strength of its rights as against the original collateral.[21] Therefore, legislators need not be too concerned with protecting proceeds claimants in the deposit account context. Since an inventory supplier does not typically grant credit in reliance on a debtor's deposit account balance (but only in reliance on the inventory itself), and since a deposit account financier does not typically grant credit in reliance on the proceeds of the deposit account, Criterion E should be accorded less weight in the aggregate adherence assessment.

As noted above, Criterion E (Proceeds) is also susceptible to being criticized for lacking meaningful content on account of the nebulous concepts that inform it. This also suggests that Criterion E ought to be partially or wholly discounted in the aggregate analysis. Indeed, it can be extraordinarily difficult to decide whether a priority rule is "balanced" and "equitable" when the dispute is between a proceeds claimant and a set-off claimant.

4. *PROCLIVITIES & POSSIBILITIES*

a. The Definiteness Proponent

[21] See, generally, UCC, §9-324, Official Comment 8: "… As a general matter, also like former Section 9-312(3), the purchase-money priority in inventory does not carry over into proceeds consisting of accounts or chattel paper. Many parties financing inventory are quite content to protect their first-priority security interest in the inventory itself. They realize that when the inventory is sold, someone else will be financing the resulting receivables (accounts or chattel paper), and the priority for inventory will not run forward to the receivables constituting the proceeds. Indeed, the cash supplied by the receivables financer often will be used to pay the inventory financing. In some situations, the party financing the inventory on a purchase-money basis makes contractual arrangements that the proceeds of receivables financing by another be devoted to paying off the inventory security interest. … When the proceeds of original collateral (goods or software) consist of a deposit account, Section 9-327 governs priority to the extent it conflicts with the priority rules of this section."

The "definiteness proponent" places a premium on predictability, certainty and clarity in the law, and accordingly affords each of Criteria B (Risk Assessment) and C (Dispute Resolution) fifty percent (50%) additional weight in the aggregate assessment exercise.[22] Meanwhile, the definiteness proponent accepts, to a limited extent, the deamplification arguments set forth in respect of Criteria D and E, and thus accords such evaluative criteria twenty-five percent (25%) less weight.

While the definiteness proponent generally supports market ideals, she thinks they should play a lesser role in the design of a deposit account directive since the market for deposit accounts, as primary reliance collateral, is naturally limited on account of the fragile and fleeting nature of deposit accounts as items of personal property security. The definiteness proponent intuits that Criterion E does contain some meaningful content, and is worthy of consideration in an aggregate assessment exercise. However, she is also bothered by Criterion E's nebulous underpinnings, and accepts, to a certain degree, the non-reliance theory outlined above, which posits that inventory financiers do not actually lend in specific reliance on deposit account proceeds. For the definiteness proponent, the values of predictability, certainty and clarity are paramount to other competing values. Let us examine how the analysis is affected from the perspective of the definiteness proponent.

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[22] See Steven L. Harris and Charles W. Mooney, Jr., "How Successful Was the Revision of UCC Article 9?: Reflections of the Reporters" (1998-2000) 74 Chi.-Kent L. Rev. 1357 ("*Reflections*") at 1363, where the authors embrace this kind of view: "An overarching goal of the revisions was to provide in the transactional context enhanced certainty and predictability from the inception of transactions. This certainty can facilitate transactions even though an understandable rule with predictable consequences may be normatively suboptimal."

In a contest between the regime frontrunners, the definiteness proponent will tend to favour the AUSPPSA over the PPSA due to the amplified effect of the AUSPPSA's stellar performance under Criterion C (Dispute Resolution). The AUSPPSA, a hybrid bank-only control model, outperforms the PPSA, a pure registration model. The OBAPPSA, representative of a distinct hybrid bank-directed control model, and Article 9, a pure bank-directed control model, both trail the AUSPPSA by more substantial margins than the PPSA; hence their lower rankings. However, it is worth noting that, under this evaluative template, the OBAPPSA closes the gap on the PPSA, becoming very comparable in terms of cumulative adherence score. The numerical distinction between these two regimes is slight, perhaps inconsequential.

TABLE 7.3 CUMULATIVE ADHERENCE TABLE ~ THE DEFINITENESS PROPONENT RISK ASSESSMENT & DISPUTE RESOLUTION AMPLIFIED X1.5 COMPETITIVE MARKET & PROCEEDS DEAMPLIFIED X.0.75						
Evaluative Criteria → **Regimes ↓**	**Criterion A** *Creation & Perfection*	**Criterion B** *Risk Assessment*	**Criterion C** *Dispute Resolution*	**Criterion D** *Competitive Market*	**Criterion E** *Proceeds*	**Cumulative Adherence Score** **/5.5**
Article 9 *Control ~ Pure*	0.250	0.750 x1.5 = 1.125	0.750 x1.5 = 1.125	0.250 x0.75 = 0.188	0.500 x0.75 = 0.375	3.063 Rank = 4th
PPSA *Registration ~ Pure*	1.000	0.750 x1.5 = 1.125	0.500 x1.5 = 0.750	0.500 x0.75 = 0.375	0.500 x0.75 = 0.375	3.625 Rank = 2nd
AUSPPSA *Control ~ Hybrid*	1.000	0.750 x1.5 = 1.125	0.750 x1.5 = 1.125	0.250 x0.75 = 0.188	0.500 x0.75 = 0.375	3.813 Rank = 1st
OBAPPSA *Control ~ Hybrid*	0.750	0.750 x1.5 = 1.125	0.750 x1.5 = 1.125	0.250 x0.75 = 0.188	0.500 x 0.75 = 0.375	3.563 Rank = 3rd
Performance Legend ~ Adherence Grade 0.000 = No adherence 0.250 = Weak adherence 0.500 = Average adherence 0.750 = Strong adherence 1.000 = Optimal adherence						

b. The Fairness Proponent

The fairness proponent places emphasis on balance, fairness and equal treatment under the law, affording Criterion D (Competitive Market) fifty percent (50%) additional weight in the aggregate assessment exercise. The fairness proponent will prefer the PPSA's pure registration model to the AUSPPSA's hybrid bank-only control model on account of the amplified effect of the PPSA's superior performance under Criterion D. The fairness proponent focuses on the pure registration model's balance and observance of basic competitive market principles.

In the eyes of the fairness proponent, the PPSA is superior to the AUSPPSA, and the other regimes, because it produces relative predictability and certainty in the law while simultaneously observing, to a greater degree, the PPSL values of balance and equality. The fairness proponent considers the PPSA to be the more adherent regime on account of its egalitarianism and its better observance of competitive market principles.

TABLE 7.4
CUMULATIVE ADHERENCE TABLE ~ THE FAIRNESS PROPONENT
COMPETITIVE MARKET AMPLIFIED X1.5

Evaluative Criteria ➔ **Regimes ⬇**	**Criterion A** *Creation & Perfection*	**Criterion B** *Risk Assessment*	**Criterion C** *Dispute Resolution*	**Criterion D** *Competitive Market*	**Criterion E** *Proceeds*	**Cumulative Adherence Score** **/5.5**
Article 9 *Control ~ Pure*	0.250	0.750	0.750	0.250 x1.5 = 0.375	0.500	2.625 Rank = 4th
PPSA *Registration ~ Pure*	1.000	0.750	0.500	0.500 x1.5 = 0.750	0.500	3.500 Rank = 1st
AUSPPSA *Control ~ Hybrid*	1.000	0.750	0.750	0.250 x1.5 = 0.375	0.500	3.375 Rank = 2nd
OBAPPSA *Control ~ Hybrid*	0.750	0.750	0.750	0.250 x1.5 = 0.375	0.500	3.125 Rank = 3rd

Performance Legend ~ Adherence Grade
0.000 = No adherence
0.250 = Weak adherence
0.500 = Average adherence
0.750 = Strong adherence
1.000 = Optimal adherence

D. *AGGREGATE ASSESSMENT OVERVIEW*

1. *OVERVIEW & RANKINGS*

TABLE 7.5
AGGREGATE ASSESSMENT TABLE

Cumulative Adherence Tables ➔ / **Regimes ⬇**	CAT 1 *Equal Weighting* /5	CAT 2 *The Definiteness Proponent* /5.5	CAT 3 *The Fairness Proponent* /5.5
Article 9 *Control ~ Pure*	2.500 Rank = 4th	3.063 Rank = 4th	2.625 Rank = 4th
PPSA *Registration ~ Pure*	3.250 Rank = T1st	3.625 Rank = 2nd	3.500 Rank = 1st
AUSPPSA *Control ~ Hybrid*	3.250 Rank = T1s	3.813 Rank = 1st	3.375 Rank = 2nd
OBAPPSA *Control ~ Hybrid*	3.000 Rank = 3rd	3.563 Rank = 3rd	3.125 Rank = 3rd

2. *GENERAL TRENDS & INSIGHTS*

Of the regimes under investigation, the PPSA and the AUSPPSA demonstrate the strongest overall adherence levels having regard for the evaluative criteria, however such criteria are weighted. These two regimes consistently rank a close first and second among the regimes examined. Meanwhile, Article 9 and the OBAPPSA exhibit weaker overall adherence levels, and in my view should be dismissed as potential candidates for endorsement or recommendation. This is especially true of Article 9, which exhibits major deficiencies and minimal adherence under Criterion A (Creation & Perfection). Meanwhile, the OBAPPSA merely represents an improvement on a flawed concept. In short, the bank-directed control models, whether pure or hybrid in character, do not adequately observe traditional PPSL values.

3. Regime Enhancement Potential, Implications & Recommendations

At this point in the analysis, the PPSA and the AUSPPSA exhibit the strongest overall adherence to the evaluative criteria and the PPSL values underlying them. Between them, it is difficult to adjudge one better than the other. In the following discussion, I describe how both of these statutes could be improved, and I will demonstrate that once these potential changes are considered, the balance tips in favour of the PPSA.

a. AUSPPSA

The AUSPPSA's weakness is its lack of balance, fairness and equality, largely embodied in Criterion D (Competitive Market). In his statutory review for the Australian Government, Whitaker recognizes the regime's weaknesses, and offers recommendations for improvement. In recommending deletion of AUSPPSA s. 57(2A),[23] he states the following.

> This seems to be a very generous concession, and the policy behind it is not clear. In the case of an ADI that has a security interest over an ADI account with it, for example, the effect of the section seems to be that the ADI would have a super-superior priority claim to any property that was acquired using funds from the ADI account. It is hard to understand why this should be so.

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[23] Whitaker, *Statutory Review*, *supra* note 7 at 312.

> … A small number of respondents argued that s 57(2A) is appropriate, and should be retained. The great majority of respondents were of the view, however, that the section should be deleted. That is my view as well.[24]

I agree with Whitaker's assessment. Deleting AUSPPSA s. 57(2A) is a necessary first step in achieving improved balance, fairness and equality under the Australian deposit account regime.

In assessing the appropriateness of the AUSPPSA's superpriority rule favouring the depository ADI, Whitaker recommends that the Government reconsider its original choice.

> Recommendation 223: That Government consider, as part of the further consultations referred to in Recommendations 64 to 76, whether it is appropriate for a security interest that is perfected by control to be entitled to a super-priority for each of the types of collateral listed in s 21(2)(c).[25]

Whitaker recognizes that perfection and priority are distinct concepts, and that the AUSPPSA's hybrid bank-only model could be amended such that it does not confer a superpriority on a depository ADI with automatic control. Indeed, the regime could be structured in a manner that confers automatic perfected status (via control or some other label) on a depository bank that takes a security interest in its customer's deposit account, but does not give the depository bank's control interest superpriority over competing security interests perfected by other methods. Under such a regime, Australian legislators would be adopting a hybrid bank-only control *model*, but would not be adopting a control *paradigm*.

[24] *Ibid.* at 312.
[25] *Ibid.* at 311.

It will be interesting to learn whether or not the Australian Government considers it appropriate for a depository ADI's security interest in an ADI account, perfected by virtue of the automatic control rule, to be entitled to a super-priority. If the Government considers this state of affairs inappropriate, it will be doubly interesting to observe how the AUSPPSA, a hybrid bank-only control model, is amended in a manner that dispenses with the control paradigm. It may be difficult to enhance the AUSPPSA's hybrid bank-only control model in a manner that produces similar levels of balance, fairness and equality to those exhibited by the PPSA without simultaneously compromising on certainty, simplicity and efficiency. This will be the challenge for Australian lawmakers should they decide to dispense with the control paradigm, yet retain a hybrid bank-only control model.

In its current state, the AUSPPSA's hybrid bank-only control model necessarily fragments, or bifurcates, the deposit account market, placing depository banks in an advantageous position over their non-depository competitors. The bank-only control model, by its very nature, creates an unbalanced regime marked by inequality and asymmetry. These characteristics are the essence of the bank-only control model, making it difficult to imagine how the AUSPPSA's deficiencies could be meaningfully improved without concomitantly introducing complexity and uncertainty to the law. This flaw in AUSPPSA's bank-only control model is deeply structural, and may not easily be overcome with minor statutory reform.

b. PPSA

In contrast with the AUSPPSA, the PPSA's defects can be remedied with relative ease. Specifically, its Criterion C (Dispute Resolution) adherence can be enhanced with the addition of explicit statutory language more precisely delimiting the depository bank's contractual and equitable rights as account debtor including its right of deposit account set-off. In other words, the PPSA registration paradigm could match the AUSPPSA under Criterion C without compromising or sacrificing its stronger adherence levels under Criterion D. My suggested language for PPSA s. 41 is set out in Appendix C.

I recommend against the PPSA's abandonment of the registration paradigm in the deposit account context. Instead, I suggest the continued embrace, by the PPSA, of the registration paradigm, coupled with the introduction of more explicit statutory language precisely delimiting the depository bank's contractual and equitable rights as account debtor, including its deposit account set-off rights, vis-à-vis competing secured parties. The PPSA produces relative predictability and certainty in the law while simultaneously observing the values of balance and equality. In comparison with the control paradigm, the registration paradigm, as embodied in a pure registration model, better adheres to the PPSL values on account of its egalitarianism and stronger observance of competitive market principles.

CHAPTER 8 ~ SCRUTINY

I. THE CASE FOR CONTROL

In Chapter 7, I demonstrated how common law Canada's registration paradigm performs admirably in comparison with various iterations of the control paradigm. Under the PPSA, registration serves (i) an effectuation function, as a simple and efficient method of perfecting a security interest, (ii) a due diligence function, facilitating the discovery of competing interests by searching third parties, and (iii) an evidential function, setting out a fair and objectively determinable standard upon which priority disputes are resolved. Having regard for the evaluative criteria, the PPSA plainly outperforms Article 9 (representative of a pure bank-directed control model) and, to a lesser extent, the OBAPPSA (representative of a hybrid bank-directed control model). Of the control models examined, only the AUSPPSA, representative of a hybrid bank-only control model, exhibits aggregate adherence levels similar to the PPSA.

According to traditional PPSL values, registration, as a paradigm for deposit account perfection and priority ordering, performs comparatively well. Proponents of the control paradigm must therefore explain what makes control superior to registration; what features or benefits of a control paradigm justify a departure from traditional personal property security law ideals and the *status quo*. In this chapter, I critically examine the principal arguments advanced in favour of a control paradigm. They exhibit variety and are drawn from numerous sources, most prominently: 1. academic literature promoting the adoption of a pure bank-directed control model (as per Revised Article 9) on the basis of the reliance creditor theory; and 2. the OBA PPSL Subcommittee's proposal for adoption of the OBAPPSA, a hybrid bank-directed control model. Those cited may not advance precisely the same arguments, or place equal emphasis on the same points, but they share the view that control is better than registration as a paradigm for deposit account perfection and priority ordering. Interestingly, traditional PPSL values,[1] in some way or another, inform all of their views.

I have subdivided the control proponents' arguments into four strains, but they are not entirely discrete, nor are they exhaustive. Instead, the arguments are interconnected and exhibit substantial overlap, resulting in some redundancy in the discussion that follows. Separately considering each line of argument assists the reader in understanding the nuanced views of control proponents. In my view, the arguments advanced in support of a control paradigm do not withstand scrutiny. Here are my reasons.

II. CRITICAL EXAMINATION

A. PROTOTYPE SELECTION ~ UNIFORMITY

1. EQUIVOCALITY & INTELLECTUAL GUIDANCE

[1] identified in the chapter subheadings.

First, consider the 'uniformity' argument: For reasons of standardization, ease and efficiency, the PPSA should adopt a legislative regime substantially uniform to that of the Article 9 and the *Civil Code of Quebec*. The argument is unpersuasive on an intellectual level. 'Uniformity', as a PPSL value, is equivocal in the cash collateral debate. Since questions must be answered in a logical sequence, 'uniformity' offers limited guidance. Consider my statement in Chapter 2, reproduced here.

> 'Uniformity' is certainly a worthwhile ideal, but it does not, by itself, furnish any intellectual guidance in the deposit account perfection and priority ordering debate. Here is why. Control proponents argue that Canadian jurisdictions ought to adopt the deposit account control paradigm to, *inter alia,* bring Canadian law in line with American law. But, of course, it can also be argued, with equally persuasive intellectual force, that American law should be brought in line with Canadian law via adoption of the registration paradigm. Either solution addresses the uniformity concern. Therefore, in this debate, 'uniformity' is equivocal as a PPSL value, and is not named in support of the articulation of the evaluative criteria.[2]

The most important aspect of the uniformity initiative is selecting the appropriate paradigm and prototype model from which to pursue a policy of uniformity.[3] To suggest otherwise is to hold the view that it is better, not to learn from one's (or another's) mistake, but to make the same mistake repeatedly for the sake of consistency.[4] Simply put, the PPSL value of 'uniformity' offers no theoretical

[2] Chapter 2 ~ Foundation.

[3] Louise Gullifer, "What Should We Do About Financial Collateral?" (2012) 65 Current Legal Problems 377 at 378: "…the question of what the law should be comes logically before the question of harmonization."

[4] See Charles Neider, ed., *The Complete Essays of Mark Twain* (Da Capo Press, 2000) at 577 (*Consistency*): "There are those who would misteach us that to stick in a rut is consistency – and a virtue; and that to climb out of the rut is inconsistency – and a vice."; While discussing the function of principles, Nozick puzzled over a similar conundrum in a more "micro" setting. See Robert Nozick, *The Nature of Rationality* (Princeton: Princeton University Press, 1993) at 8: "If case A, calling for a decision of justice, is decided wrongly, that is bad. If now case B, relevantly similar, is decided differently – that is, correctly and *if* that decision introduced an additional bad into the world – not the result in case B itself but the comparative bad of the two cases being decided differently – and

guidance in identifying the appropriate prototype model to work from. As stated by Gullifer, "the question of what the law should be comes logically before the question of harmonization."[5]

2. *REALITY & PRACTICAL GUIDANCE*

Notwithstanding its failure to offer theoretical guidance, the PPSL value of 'uniformity' does offer some practical guidance. Within North America, all fifty American states have adopted a bank-directed pure control model for deposit accounts. Additionally, Quebec, Canada's lone civil law jurisdiction, recently adopted a similar model.[6] An argument can certainly be mounted that benefits associated with uniformity, including the vanquishing of conflict of law problems (in practical terms),[7] would be realized were Canada's common law provinces and territories to adopt a similar model to that of Article 9. I do not find the argument particularly compelling, however, since I prefer Gullifer's perspective on the matter. The question of what the law should be deserves to be prioritized over the object of statutory uniformity.

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this bad stands over and above the badness involved when case A was decided incorrectly, then *this* context of justice is a comparative one, invoking the formal maxim of justice. One function of principles, then, may be to avoid this particular type of injustice, ensuring that like cases will be decided alike. (Whether it would be better to decide both cases wrongly – avoiding the comparative injustice – or to decide one of them correctly – avoiding injustice in that individual case but incurring the comparative injustice – presumably will depend upon particular features of the situation and the cases."

[5] Gullifer, *supra* note 3 at 378.

[6] *Civil Code of Québec*: see Bill 28, *An Act mainly to implement certain provisions of the Budget Speech of 4 June 2014 and return to a balanced budget in 2015-16*, 1st Sess., 41st Leg., Québec, 2014, s. 325.

[7] Clayton Bangsund, "'But I Didn't Mean To': The Role of Intent in American and Canadian Anti-Preference Law" (2013) 50(4) Alta. L. Rev. 815 at 839.

B. RELIANCE CREDITOR THEORY ~ FACILITY

1. EASE V. STRUGGLE IN DEPOSIT ACCOUNT FINANCING

Conventional wisdom is that a secured transactions regime should comprehensively – for all forms of personal property – facilitate risk assessment, transaction implementation and dispute resolution with transparency, efficiency, ease and thrift.[8] The "reliance creditor theory" is contrarian in nature, posing a direct challenge to conventional wisdom. In short, the reliance creditor theory recommends (i) an abandonment of the core PPSL values of 'facility', 'transparency' and 'efficiency' in the specific context of deposit account financing, and (ii) instead an embrace of difficulty, secrecy, inefficiency and increased expense. The theory posits that by sacrificing facility generally, one actually encourages reliance deposit account financing.

Proponents of the reliance creditor theory assert that, for deposit accounts, creation and perfection of an *effective* security interest – that is, a security interest more or less assuring the secured party of priority to the deposit account in the event a dispute arises – ought to be difficult and costly to achieve (for everyone but the depository bank).[9] This way, a debtor with a deposit account has available a discrete and valuable asset – not subject to a blanket security interest – that it can

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[8] See Chapter 2 ~ Foundation.

[9] Randal C. Picker, "Perfection Hierarchies and Nontemporal Priority Rules" (1998-2000) 74 Chi.-Kent L. Rev. 1157 at 1160; Steven H. Harris and Charles W. Mooney, Jr., *Security Interests in Personal Property: Cases, Problems and Materials,* 4th ed. (New York: Foundation Press, 2006) ("*SIPP*") at 441.

leverage to its advantage in a subsequent transaction with a reliance creditor.[10] Under such a regime, a secured creditor is properly "matched" with its reliance collateral, and is consequently willing to offer credit to the debtor on less expensive terms than it otherwise would.

The above theory furnished philosophical support for the bank-directed pure control model adopted by Revised Article 9. The idea, under this system of "perfection hierarchies", is that control is a proxy for reliance. One who goes to the bother and expense of acquiring control of a deposit account balance is actually monitoring and relying on it, and thus more deserving of priority. Consider Picker's articulation of the reliance creditor theory, and his explanation of how the deposit account control paradigm embraces or embodies it:

> Absent a cost, creditors may take too much collateral. Uninformed borrowers will ignore the scope of the security interest sought, while informed borrowers may be reluctant to tip their hands by negotiating over the scope of the security interest. An initial creditor may take a very broad security interest without any intent of taking the steps necessary to ensure a return on some of the collateral. At the same time, the breadth of the security interest taken by the nonreliance creditor may impair the ability of a reliance creditor to obtain a return on its investment in monitoring collateral. All of this shrinks the credit available to the debtor.
>
> A perfection hierarchy may solve this problem. Let perfection through filing vest priority rights against one class of creditors, say unsecured creditors and lien creditors. At the same time, create a second method of perfection – say, control – that makes it possible for a second creditor to jump ahead of the filed secured creditor. If this second method of perfection is sufficiently costly, we will discourage nonreliance creditors from using it and thereby create a way for reliance creditors to recover on their efforts by allowing them to obtain priority. This structure does a better job of matching

[10] Picker, *ibid.* at 1179: "In this story, the debtor has given something of little value to the nonreliance creditor and seems to have received nothing in return. The debtor would have been better off to save the security interest in deposit accounts for the later reliance creditor."

> collateral taken and reliance on it, assuming that control is a good proxy for reliance.[11]

To briefly recap, in order to facilitate reliance deposit account financing *specifically*, reliance creditor theorists argue for the abandonment of facility, transparency and efficiency in secured financing *generally*.[12] The sacrifice is justified on the basis that more reliance deposit account financing opportunities are created. Under the control paradigm, depository banks, and those non-depository secured creditors fortunate enough to acquire control of their debtors' deposit accounts, are placed in a position to effectively monitor and rely on their collateral. In introducing difficulty and expense to the process of acquiring an effective security interest in a deposit account, and thus discouraging secured parties from taking casual non-reliance security interests, the deposit account is effectually carved out as a form of independent reliance collateral.

2. *Competitive Market Flaw*

In the following excerpt, Gibson exposes a major flaw in the reliance creditor theory, at least insofar as Article 9 embraces it.

> At least one commentator [Picker] has posited the control rules will bring greater efficiency to the overall deposit account financing market because

[11] Picker, *ibid.* at 1158. Also see 1180: "If the costs of taking the security interest in deposit accounts were higher, the nonreliance creditor might not do so, the reliance creditor could then do so, as it would have priority and could recover the policing costs for the deposit account, and more credit would be available."

[12] See United Nations Commission on International Trade Law (UNCITRAL), *UNCITRAL Legislative Guide on Secured Transactions* (New York: United Nations, 2010) at Chap III para. 146, where the control paradigm's lack of transparency is justified on the basis that a similar lack of transparency is exhibited under the registration paradigm on account of the depository bank's right of deposit account set-off, which does not hinge on registration.

> the increased costs associated with obtaining control will dissuade lenders for which the deposit account collateral is unnecessary to secure financing. Instead, those lenders will utilize other collateral of the debtor, preserving the deposit account collateral for reliance creditors. This increases financing opportunities for debtors and allows them to maximize their wealth through a more efficient allocation of their resources. This analysis requires the presumption that depositary banks will only reject control requests made by non-reliance creditors, and that depositary banks will engage in the due diligence necessary to determine which creditors are reliance creditors. Nothing in Revised Article 9 restricts banks from refusing control requests even if a reliance creditor makes such a request, nor does the article impose upon the bank the duty of determining if a requesting party is a reliance creditor.
>
> …
>
> Logically, a depositor can achieve such a conveyance only if he has access to competitive market prices offered by secured parties wishing to collateralize deposit accounts in exchange for funding. If depositary banks exercise their veto authority to close out competing parties when concern for payment system integrity is nonexistent, depositors would be faced with non-competitive market prices offered by their depository bank that becomes the sole supplier in deposit account loan products. No market is perfectly competitive, but unnecessary restrictions result in over-inflated prices, rather than competitive ones, and unnecessarily restricts supply and demand to the detriment of the market and its participants.[13] [square bracketed text added]

If the bank-directed pure control model adopted under Article 9 is really a "market initiative" – that is, an effort to give debtors new and discrete assets for use in leveraging credit at highly competitive pricing –, then why is the deposit account financing market so heavily tilted in the depository bank's favour? Under Article 9, the depository bank, itself enjoying automatic control to the extent that it takes a security interest in the deposit account, has unfettered discretion as to whether any other party may acquire an effective security interest in the account. It has little incentive to facilitate creation and perfection of an effective security interest in a

[13] Willa E. Gibson, "Banks Reign Supreme Under Revised Article 9 Deposit Account Rules" (2005) 30 Del. J. Corp. L. 819 at 854.

deposit account in favour of one of its market competitors.[14] The depository bank's veto power has the natural effect of *eliminating* competition, instead creating a deposit account financing monopoly for the benefit of depository banks.[15] Market principles are not advanced by conferring on the depository bank an unfettered veto power over a debtor's capacity to grant a security interest in her own property.

It must also be observed that, even if the depository bank acquiesces and facilitates a control interest in the deposit account in favour of a third party by executing a tripartite control agreement, the depository bank retains priority over the non-depository reliance creditor except under the most extraordinary of circumstances. Indeed, from a competitive market perspective, both Article 9's pure bank-directed control model and the OBAPPSA's hybrid bank-directed control model are seriously flawed.

To be fair to Article 9 and the OBAPPSA, the deposit account financing market is not very competitive under the PPSA's registration paradigm either. Under the PPSA, the depository bank enjoys a natural competitive advantage over non-depository creditors on account of its powerful right of deposit account set-off. But it is noteworthy that, as a matter of pure secured transactions law, the PPSA's pure registration model creates a perfectly competitive market in deposit account financing; the depository bank is subject to precisely the same creation, perfection

[14] Gibson, *ibid.* at 847: "It seems unlikely that banks will grant control to lenders if they view them as competitors. In light of the financial interests that banks have in the accounts they maintain, their willingness to grant control to other creditors is at best questionable, especially the kind of control that would subordinate their security interests."
[15] Ingrid M. Hillinger, David L. Batty & Richard K. Brown, "Deposit Accounts Under the New World Order" (2002) 6 N.C. Banking Inst. 1 at 56.

and priority rules, vis-à-vis the deposit account, as all other parties. Perhaps more significantly, the PPSA does not go so far as to give the depository bank the ability to interfere with a depositor's autonomy to grant to a third party a security interest in its deposit account.

Ironically, Article 9's pure bank-directed control model is in disaccord with the reliance creditor theory put forward in justification of its adoption. Both Article 9 (a pure bank-directed control model) and the OBAPPSA (a hybrid bank-directed control model) exhibit significant flaws, and do not produce legal systems that actually embrace the reliance creditor theory or the competitive market principles underlying it.[16] Instead, these regimes create *de facto* monopolies for depository banks in the niche market of deposit account financing. "Reliance creditor" is a euphemism for "depository bank", the overwhelmingly dominant player in the deposit account financing market under a bank-directed control model.

3. A Dubious Proposition: Deposit Accounts as Reliance Collateral

Setting aside the competitive market defect exhibited by the control paradigm, it is worth considering whether the reliance creditor theory is otherwise sound. In other words, assuming there is a perfectly competitive market for deposit account financing (which there is not), and further assuming that a debtor, at his discretion, can grant any prospective creditor a security interest in his deposit account, is the deposit account an attractive and useful form of reliance collateral for

[16] Gibson, *supra* note 13 at 854.

a creditor to take? If not, is it worth upsetting the traditional values of personal property security law, in the name of the reliance creditor theory, for this small slice of the much larger secured transactions pie?

The deposit account, as a source of collateral, exhibits a primary characteristic that is both appealing and disquieting to a prospective secured creditor. The deposit account is *liquid*;[17] it does not require liquidation through any maturation process other than customer demand. It is an intangible form of "pure money."[18] On account of its liquidity, then, the deposit account may initially seem like an ideal form of collateral. After all, with no storage costs and no public auctions, no other form of collateral could be better or easier for a secured creditor to realize against. But one soon recognizes that this very same attribute – pure, ready liquidity – also makes the deposit account decidedly non-idyllic.[19] Without some feature preventing the debtor from accessing and depleting the deposit account, the non-depository secured party is in a hopelessly precarious state, subject to the whims of the debtor and/or the depository bank, both capable of depleting it in an instant and without notice to the non-depository secured party.

Indeed, even for a non-depository secured party with control under the tripartite control agreement method, the deposit account is, absent additional procedural safeguards, a wholly illusive form of personal property security. It is true

[17] See Ontario Bar Association, Business Law Section, Personal Property Security Law Subcommittee, "Perfecting Security Interests in Cash Collateral" (February 6, 2012), online: OBA <http://www.oba.org/submissions> ("*OBA Proposal*") at 2 (Details of Proposal).
[18] *Ibid.* at 2 (Background Paper); also see Gullifer, *supra* note 3 at 403.
[19] Robert M. Scavone, "Cash Collateral Under the PPSA: The Case for Control" (2012) 53 Can. Bus. L.J. 263 at 283.

that, for the deposit account to be a *useful* form of reliance collateral, the secured party must have *absolute control* of the deposit account (i.e., monitoring privileges and the ability to prevent customer access, a lightning quick and efficient default-response protocol, and/or control pursuant to the customer method).[20] But this does not stand as an argument in favour of adoption of the control paradigm for deposit account perfection and priority ordering under the PPSA. Rather, it simply speaks to the kind of steps a secured party would have to take, *in any jurisdiction*, to ensure itself of priority to a debtor's deposit account balance.

Deposit account security interests are at once powerful and fragile.[21] For any creditor but the depository bank, a reliance security interest in a deposit account is a dubious proposition at best.[22] Perhaps deposit accounts are considered a secondary source of collateral; a blanket security item; the kind of security that one casually takes as a supplement to its primary reliance collateral. Given the deposit account's reservoir nature, there is a live argument to this effect.

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[20] The same is not true for other forms of primary collateral, like inventory and accounts receivable.

[21] Hillinger, Batty & Brown, *supra* note 15 at 43: "Under the new regime, everyone is at risk. Lenders secured by security interests in goods risk subordination of their claims to identifiable cash proceeds to creditors with control of the deposit account into which the cash proceeds are deposited. Creditors with control of a deposit account risk subordination to lenders with a prior filed interest in property the debtor acquires with proceeds of the deposit account. The promised rose garden brings many thorns with it."; Also see 54: "The depositary bank's position of supremacy is extremely fragile given the ease with which a depositor can transfer funds out of a deposit account and the uncertainty of its priority to proceeds of a deposit account."

[22] Ian Binnie, Michael Burke, John Cameron, Margaret Grottenthaler, Rob Scavone & Henry Wiercinski, "Cash Collateral and the PPSA: The Current Problems and Examples" (February 1, 2011) at 4: "The practical reality is that even where the cash sits in a deposit account in the name of the debtor, creditors are not relying on that asset as being available to satisfy their obligations. It is well understood that cash can be dissipated at any time as payment for other goods and services or by set-off by the depository institution."

4. *EXTERNALITIES: ONE STEP FORWARD & TWO STEPS BACK?*

a. Facilitation of Reliance Deposit Account Financing

For the moment, disregard (i) the lack of a competitive market in deposit account financing under a control paradigm, and (ii) the inherent fragility and illusiveness of the deposit account as a form of standalone reliance collateral. Let us assume that, just as desired, the control paradigm creates a competitive market in deposit account financing under which reliance creditors acquire prioritized security interests in their debtors' deposit accounts. Some externalities ought to be considered. For instance, it is useful to consider the impact, if any, a control paradigm for deposit accounts might have on other sectors of the secured credit marketplace.

b. Impact on Inventory Financing & General Accounts Receivable Financing

One unique aspect of the deposit account is its inherent reservoir nature. For most businesses, the deposit account is a collecting ground of sorts. Consider my statement in a recent article in the Banking & Finance Law Review.

> … the deposit account plays a central role – arguably as important of a role as any other species of personal property – in the lives of many Canadians, individuals and artificial entities alike. Savings and surpluses are commonly stored in deposit accounts. Additionally, deposit accounts are frequently used for paying invoices and expenses, and receiving compensation, commissions and sales revenues (i.e. performing a reservoir function).

> Simply put, a great deal of commerce is effectuated through the medium of deposit accounts.[23]

Delineating priority rules for deposit accounts is a tricky undertaking because a great deal of business runs through deposit accounts. By their very nature, deposit account balances are susceptible to claims by primary reliance creditors *and* secondary proceeds claimants, among others. Thus, deposit account priority rules necessarily impact on the value of other forms of collateral, and the pricing of other primary forms of secured credit.

Consider, for example, the plight of the inventory supplier who supplies inventory to a debtor on purchase money terms. If the security interest in inventory terminates upon the debtor's ordinary course resale of the inventory – that is, the inventory is sold free and clear, and the proceeds vanish into the debtor's deposit account and are captured by another secured party with control –, the value of the primary security interest is diminished, and the pricing of that primary credit is affected.[24] The same reasoning applies, *mutatis mutandis*, to general accounts receivable financing, another common form of primary secured credit. Thus, while a deposit account control model *might* facilitate reliance deposit account financing, it

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[23] Clayton Bangsund, "The Deposit Account & Chose in Action at Common Law & Under the PPSA: A Historical Review" (2014) 30(1) B.F.L.R. 1 ("*Historical Review*") at 37.

[24] There are sound policy reasons for giving a priority preference to a purchase money secured creditor, whether in respect of their original collateral or its proceeds. See Ronald C.C. Cuming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law*, 2nd ed. (Toronto: Irwin Law, 2012) at 439; Clayton Bangsund, "A Critical Examination of Recently Proposed Amendments to the *Bank Act* Security Provisions" (2012) 75(2) Sask. L. Rev. 211 at 228: "The recognition of a super-priority for purchase money security interests reflects the PPSA's policy objective of facilitating financing for the acquisition of new assets by a debtor who previously granted a general security interest (i.e. in all present and after-acquired personal property) to another creditor. Provided the purchase money creditor follows certain prescribed procedures, it will enjoy priority over the prior registered creditor."

concomitantly has a harmful impact on reliance inventory financing and reliance accounts receivable financing. In this sense, adopting the control paradigm for deposit accounts is like taking one step forward and two steps back.

5. THE PRINCIPLE OF UNIVERSALITY

In Chapter 7, I invoked the "principle of universality", which essentially embraces the idea that, where at all possible, the law ought to apply equally, across the board, to all similarly situated parties.[25] With this principle in mind, consider the position of the OBA PPSL Subcommittee, which recommends the adoption of a control paradigm for financial accounts, but not for consumer deposit accounts[26] or "general accounts."[27]

Assume, for a moment, that the reliance creditor theory is valid. Suppose that a control paradigm does create more and better financing opportunities for debtors and reliance creditors, and that this is true for both investment property financing and deposit account financing. Then, according to the principle of universality, the same should also be true for general accounts financing. Control proponents should advocate for a control paradigm for *all* forms of intangible personal property (of which deposit accounts are merely one unique subspecies), not just commercial

[25] See, for instance, Noam Chomsky, *9-11: Was There an Alternative?* (New York: Seven Stories Press, 2011) at 150: "The answers are doubtless contentious, but at least the reaction should meet the most elementary moral standards: specifically, if an action is right for us, it is right for others; and if wrong for others, it is wrong for us. Those who reject that standard can simply declare that acts are justified by power; they can therefore be ignored in any discussion of appropriateness of action, of right or wrong."

[26] See Chapter 4 ~ Description.

[27] I use the term "general account" as a more specific reference to the term "account": see PPSA, s. 1(1)(b).

deposit accounts. The control paradigm, in the general accounts receivable context, should create even more and better financing opportunities for debtors and reliance creditors. One is left wondering why the 'coherency' argument advanced by control proponents is reserved for commercial deposit accounts, and not broadly advanced in respect of all forms of intangible personalty.

Indeed, the demand for a deposit account control paradigm would be more palatable if the rationale underlying it were applied and promoted consistently. If reliance creditor theorists fully embraced their theory, they would advocate for adoption of a control paradigm across all species of intangible personal property. According to the logic, this would vastly increase the number of discrete reliance security interests debtors are able to grant in exchange for more affordable credit. But, as suggested by Gibson, the reliance creditor theory, and the bank-directed control model, appears less concerned with establishing new financing opportunities for debtors, and more concerned with reinforcing the dominion of depository banks.[28] The hybrid bank-directed control model proposed by the OBA PPSL Subcommittee certainly exhibits this focus. It is telling that, to avoid political controversy, the OBA PPSL Subcommittee recommends against inclusion of the

[28] Gibson, *supra* note 13 at 825: "The favorable treatment provided to banks by Revised Article 9 suggests that the drafter's decision to include deposit accounts as original collateral was motivated by a desire to provide banks greater sovereignty, rather than to increase financing opportunities for their depositors."

consumer deposit account under the control paradigm, thereby leaving it under the registration paradigm.[29]

C. SECURED DERIVATIVES TRANSACTIONS ~ FACILITY

Control proponents claim, *inter alia*, that a control-based priority structure favouring banks and other deposit-taking institutions is necessary to facilitate certain types of sophisticated financial transactions including, for instance, derivatives transactions.[30] In their view, the registration paradigm does not facilitate time-sensitive secured derivatives transactions with enough ease.[31] They believe that derivatives transaction participants should benefit, as a special class of reliance creditor, under the control paradigm.[32]

1. RISK MANAGEMENT & DERIVATIVE TRANSACTIONS

Before delving into the details of this aspect of the control proponents' argument, it is important to understand what a derivatives transaction is, and the

[29] OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 17 at 2 (Details of Proposal): "Consumer accounts are excluded partly because the deposit account control regime in Article 9 of the UCC does not apply to consumer accounts and partly to allay some commentators' fears that financial institutions would exploit their dominant position at the expense of consumers. We believe that consumers and financial institutions would actually both benefit if consumer accounts were included within the definition of financial account, and subject to the control regime; but we are concerned that critics of the Proposal may view consumers differently. Therefore, with a view to minimizing controversy, consumer accounts are excluded. But for those concerns (which we do not believe would be justified), we would have included consumer accounts in the control regime."

[30] See Anthony Duggan, "Current Issues in Secured Transactions Law in Canada: An Ontario Perspective", in Louise Gullifer and Orkun Akseli, eds., *Secured Transactions Law Reform: Principles, Policies and Practice* (London: Hart Publishing, 2016) 95.

[31] OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 17 at 3.

[32] Jennifer Babe, "One-on-one with Jennifer Babe: Modern Finance: Panel Recommends Business Law Updates for Ontario" (Winter 2016) Practical Law 64 ("*One-on-one*"), online: practicallaw <www.practicallaw.ca> at 64.

purpose it serves. The National Commission on the Causes of the Financial and Economic Crisis in the United States furnishes a concise description:

> Derivatives are financial contracts whose prices are determined by, or 'derived' from, the value of some underlying asset, rate, index, or event.[33]

A derivatives transaction serves a risk management purpose. It performs an insurance function, and amounts, in essence, to a sort of bet – a hedge – that pays off, or does not pay off, or triggers an obligation to pay, according to the actual unfolding of events, for example, a drop in the relative value of the Canadian dollar, or an increase in the prime rate of interest. Over-the-counter derivatives transactions commonly create series of running debt obligations. These debt obligations, like any, may be secured or unsecured, and are often reciprocal. While the hedge, embodied in the detailed terms of the derivatives contract, is concerned with risk management on a *macro level* (e.g. protecting against a fall in the price of wheat), the decision whether to secure obligations arising under the derivatives transaction is concerned with risk management on a *micro level* (i.e. if I am "in-the-money" on this derivatives transaction, how can I ensure that my debtor counterparty pays and that I receive the benefit of my hedge?).

2. RISK TOLERANCE & SECURED DERIVATIVES TRANSACTIONS

A derivatives contract, then, is essentially like any other credit transaction, and brings with it the attendant risk of non-performance due to a lack of

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[33] National Commission on the Causes of the Financial and Economic Crisis in the United States, *The Financial Crisis Inquiry Report* (January 2011), online: <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf> ("*Financial Crisis Inquiry Report*") at 45.

counterparty financial wherewithal. If one cannot trust that the other will pay according to the terms of a derivatives contract, she has the choice to secure the transaction. But it is not imperative that a derivatives transaction be secured, no more so than it is imperative that an operating credit line be secured. This decision is a function of risk tolerance. If parties to a derivatives transaction are comfortable with each other's ability to pay in the future, say based on familiarity or a proven track record of performance in past transactions, and are comfortable relying on the basic set-off and netting rights inherent in a relationship of reciprocal indebtedness, they may reasonably choose to structure the transaction in an unsecured manner. It all hinges on their willingness or unwillingness to accept the risk of each other defaulting on future payment obligations.

3. A SPECIAL CASE?

The question arises whether derivatives transactions are sufficiently important, as a class of commercial transactions, to warrant the creation of separate rules for the governance of deposit accounts that confer material advantages on depository banks and other major financial institutions.[34] The suggestion is that, in the macro-world of business, derivatives transactions are more important than other forms of commercial transaction. I do not accept this premise.

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[34] Philip R. Wood, *Set-Off and Netting, Derivatives, Clearing Systems*, 2nd ed. (London: Sweet & Maxwell, 2007) ("*Set-Off & Netting*") at para. 10-005: "The main users of derivatives are sophisticated investors, especially banks, insurers, pension funds, mutual funds, corporate and hedge funds. These are all sophisticated investors who hold large pools of intangible financial assets (loans, bonds, shares) whose value they wish to protect, in the same way that the rest of the world protects their buildings, their houses, their manufactures, their oil, their other tangible possessions, and also hope to make a profit out of them."

I grant that, in some instances, it may be difficult for a financial player to assure itself of priority to a counterparty's deposit account balance in a secured derivatives transaction governed by the PPSA. This requires, at the very least, the cooperation of the depository bank, which may not be readily forthcoming. It may additionally require the negotiation and execution of subordination agreements with prior registered secured parties, which is also difficult to accomplish in many circumstances.[35] But this holds true for credit transactions of all varieties. For example, it is often immensely difficult, in a rushed financing transaction, for a commercial lender to assure itself of priority to a key asset. Is expecting derivatives transaction participants to live in that same reality, and play by the same rules, really that objectionable? The OBA PPSL Subcommittee explains that the PPSA's priority and subordination rules are "not acceptable" in derivatives transactions.

> …, in the case of global and domestic capital and financial market transactions (such as derivatives, repo, securities loans and transactions cleared with a central counterparty or clearing house) the certainty of priority with respect to cash collateral is critically important. Additionally, the delays and uncertainty associated with obtaining subordinations and acknowledgments are not acceptable or practical in capital markets and derivatives transactions.[36]

4. Hostility v. Friendliness

The registration paradigm, under the PPSA, is unacceptable to the derivatives industry.[37] The OBA PPSL Subcommittee notes that the PPSA's deposit account registration paradigm is unfriendly to derivatives industry participants because it

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[35] See Scavone, *supra* note 19 at 270.
[36] OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 17 at 4 (Details of Proposal).
[37] Also see Babe, *One-on-one, supra* note 32 at 64.

requires them to take steps, which may or may not prove successful, to ensure priority status when they secure obligations arising under derivatives transactions. Granting, for the sake of argument, that derivative transactions must be secured by cash collateral in a manner that assures priority for the secured counterparty (this may assist a bank, for example, in meeting its capital adequacy requirements on account of a lower risk-weighting of its assets[38]), it is worthwhile pinpointing the PPSA's registration paradigm's flaws insofar as the interests of derivatives transaction participants are concerned.

a. Pattern Ψ (psi)

First**,** consider Pattern Ψ, involving an over-the-counter interest rate swap between Opco and its derivatives counterparty, Derivative Bank.[39] The first registered blanket security interest of Opco's general lender, Lending Bank, comes into conflict with Derivative Bank's (i) later registered security interest in Opco's deposit account at Derivative Bank, and (ii) right of deposit account set-off. In a priority dispute with Lending Bank in respect of Opco's deposit account balance, Derivative Bank (the depository bank) will prevail pursuant to its right of deposit

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[38] Office of the Superintendent of Financial Institutions (OSFI), *Capital Adequacy Requirements* (December 2014), Chapter 5, paras. 43(a) and 71. However, see para. 2, where the OSFI states: "For example, exposures may be collateralised by first priority claims, in whole or in part with cash or securities, a loan exposure may be guaranteed by a third party, or a bank may buy a credit derivative to offset various forms of credit risk. *Additionally banks may agree to net loans owed to them against deposits from the same counterparty.*" (emphasis added) Indeed, the OSFI consistently recognizes the efficacy of set-off and netting arrangements as a means of collateralizing a bank's assets. See, for example, paras. 63, 73 and 75.

[39] The OBA PPSL Subcommittee would regard Pattern Ψ as an "SP FI Scenario." The same fact pattern could easily be modified into a "SP Obligation Scenario." See OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 17 at 2 (Details of Proposal).

account set-off unless Lending Bank procures a subordination agreement from Derivative Bank providing otherwise.[40] True – as a matter of pure secured transaction priorities, Lending Bank prevails over Derivative Bank by virtue of its earlier registration. But the powerful right of deposit account set-off, which does not hinge on time of registration (or, indeed, any registration at all), supersedes the pure secured transaction priority rule and offers ample protection to Derivative Bank in Pattern Ψ. Derivative Bank prevails in this scenario.

Given the obscurity and opacity of the PPSA provisions dealing with the interaction between set-off rights and security interests, it is understandable that law firms are unwilling to give strongly worded legal opinions to their clients, assuring them of success in the event a priority dispute arises.[41] Again using Pattern Ψ as an illustrative example, this may leave Derivative Bank uncomfortable with its position, leery of entering into the derivatives transaction with Opco. But if Derivative Bank is comfortable with its deposit account set-off rights, as codified in the PPSA, and is convinced of Opco's financial wherewithal, then it may decide that this risk is tolerable, and that it will indeed proceed with the Pattern Ψ swap transaction.

b. Pattern Σ (sigma)

Consider a variation of the secured derivatives transaction entered into in Pattern Ψ. In Pattern Σ (*sigma*), Opco and Empire Derivatives ("Empire") enter into

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[40] PPSA, s. 41(2).

[41] Scavone, *supra* note 19 at 269.

an interest rate swap on the same basic terms as the derivatives transaction described in Pattern Ψ, but in this case neither is a depository institution.[42] Since Opco is, in a sense, purchasing insurance from Empire, it agrees to transfer funds, as necessary, to Empire's deposit account maintained at Wembley Bank in order to secure payments under the swap.[43] Empire effects registration against Opco at the personal property registry, as does Opco against Empire.

Now suppose that Newton Bank, Opco's general lender, has a prior registration against all of Opco's present and after-acquired personal property. Between Newton Bank, holding a first registered security interest in Opco's personal property, and Empire, holding a later registered security interest but also covering its position through receipt of an actual transfer of funds, who prevails? Is the PPSA

[42] Depending on the unique attributes of Opco and Empire, an over-the-counter derivatives transaction of this nature may be subject to mandatory central counterparty clearing under which a regulated clearing agency or clearing intermediary is responsible for collecting, holding and keeping records of posted collateral. See National Instrument 94-101, *Mandatory Central Counterparty Clearing of Derivatives and Related Companion Policy* (January 19, 2017), Appendix A (Mandatory Clearable Derivatives); National Instrument 94-102, *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions and Related Companion Policy* (January 19, 2017): "The Instrument mitigates many of these risks to customers by establishing robust collateral and recordkeeping requirements. It requires a customer's positions to be collateralized at the regulated clearing agency and obligates the regulated clearing agency and clearing intermediaries to keep records that identify customers and their positions …." As National Instruments 94-101 and 94-102 were being finalized, the Canadian Securities Administrators sought and received comments from numerous industry participants. One commenter "argued that provincial personal property security laws in the common law provinces should be amended to allow the perfection of security interests in cash collateral by way of control." The CSA responded as follows: "No change. We note that federal bankruptcy and provincial personal property security legislation are outside of the jurisdiction of the provincial securities regulatory authorities. The Committee is seeking to implement requirements which protect customer collateral, to the extent possible, under existing Canadian federal and provincial legal frameworks." See NI 94-101, Annex A.

[43] Gullifer, *supra* note 3 at 384. Gullifer would label Pattern Σ a "title transfer" transaction.

unfriendly to Empire in this instance, even though it took the proactive step of having margin funds transferred to its deposit account at Wembley Bank?

As a preliminary matter, it is important to accurately identify the property in dispute in Pattern Σ, and the key players' various relationships to that property and each other. Importantly, it is *not* Empire's deposit account balance at Wembley Bank that is subject to the priority dispute in Pattern Σ. That deposit account is the property of Empire, and is not subject to Newton Bank's security interest in *Opco's personal property*.[44] Instead, Opco's property is the notional account that was generated upon Opco's transfer of margin call funds to Empire.[45] On this contingent account, Empire is the "account debtor" and Opco is the "creditor".[46] With respect to this account, who, between Newton Bank and Empire, has priority, and on what grounds?

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[44] Newton Bank's security interest in Opco's personal property does not continue into Empire's deposit account balance. In Saskatchewan, for example, ss. 28(1) and s. 31(2)-(3) of the SPPSA apply in favour of Empire with respect to any claim Newton Bank might assert against Empire's deposit account balance. This outcome is necessary to ensure the "free flow of funds" within the Canadian banking system. It is important to note, however, that Empire's deposit account balance at Wembley Bank is subject to a security interest in favour of Opco. Specifically, Empire's account balance is collateral for Opco's conditional chose (i.e. the contingent account) which was created when the absolute transfer of funds was effected under the terms of the swap, and may simply dissipate if and when payment obligations mature thereunder. Indeed, the absolute transfer from Opco to Empire is predicated on this very forecast. To the extent that the parties' positions thereafter change, causing Opco's conditional chose to mature into an unconditional right of payment from Empire, Opco's security interest in Empire's deposit account may come into conflict with Empire's various creditors including, for example, Wembley Bank.

[45] *I Trade Finance Inc. v. Bank of Montreal*, [2011] S.C.R. 360, 2011 SCC 26 at para. 47: "The initial relationship between i Trade and Webworx was that of creditor and debtor. When it advanced funds to Webworx under the agreements, i Trade, as creditor, acquired a chose in action in the form of the debt obligation (*Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805, at para. 29). Concurrently, also pursuant to the agreements, it passed title to the funds to Webworx. There is no doubt that when it did so, i Trade consented to Webworx having use of the funds."

[46] The OBA PPSL Subcommittee would regard Pattern Σ as an "SP Account Scenario." Again, see *OBA Proposal*, *supra* note 17 at 2 (Details of Proposal).

In a priority dispute, Empire, the derivatives counterparty, again prevails over Newton Bank on account of its superior set-off rights (though, strictly speaking, these are not *deposit account set-off* rights).[47] To the extent that Empire is "in-the-money" under the terms of the swap, it may assert its right of set-off in priority to Newton Bank's first registered security interest in Opco's personal property. The margin fund balance (on which Empire is account debtor, and Opco is creditor) acts as the monetary limit of such priority. Newton Bank's security interest takes priority after Empire's limited set-off priority is exhausted.

In Pattern Σ, Empire, a derivatives counterparty who takes the proactive step of having margin call funds transferred to its deposit account, is able to "loosely secure" its interest, and effectively assure itself of priority. This actual transfer strategy – a form of "quasi-possessory security interest" – is powerful. It is analogous to a possessory security interest in tangible property.[48] The outcome is justifiable on reliance grounds (i.e., Empire is relying on its ability to apply the transferred funds against any debt that may become owing by Opco pursuant to the swap) and also on the basis that no third party, including Newton Bank, will be deceived by any balance, or lack thereof, in Opco's deposit account since the funds have been transferred to Empire's deposit account.

c. Pattern Φ (phi)

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[47] PPSA, s. 41(2).

[48] Whether Opco transfers the funds contingently, or absolutely, the analysis remains the same. ISDA appears to view the situation otherwise. See Letter from Francois Bourassa (ISDA) to Allen Doppelt (Ontario Government) and Doug Morrison (Alberta Government) (June 8, 2009) ("*2009 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.

Consider a final variation of the secured derivatives transaction described in Pattern Σ. In Pattern Φ, Opco simply grants Empire a security interest in its deposit account maintained at Mulberry Bank.[49] Empire effects registration, and its security interest in Opco's deposit account eventually comes into conflict with Carlton Bank's earlier registered security interest in all of Opco's present and after-acquired personal property.

In Pattern Φ, Empire cannot assert set-off against Opco's deposit account balance because it is not the account debtor on such deposit account; Mulberry Bank is. Instead, Carlton Bank prevails over Empire in this priority dispute on account of its first registered security interest.[50] Unless Empire procures a subordination agreement from Carlton Bank, it will lose the priority competition to Carlton Bank, the first registered secured party.

In this narrow instance, one can argue that the PPSA is unfriendly to Empire, the derivatives counterparty, because it does not grant Empire a special priority privilege (in contrast, Article 9 and the OBAPPSA do confer such a privilege, assuming cooperation from the depository bank, Mulberry Bank, is forthcoming). But again, this is consistent with all other manner of secured transaction. True, the PPSA does not confer advantages on Empire in Pattern Φ. However, if Empire is unhappy with this state of affairs, it can request the transfer of funds from Opco, as it did in Pattern Σ. If Opco remains in ostensible control of its deposit account

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[49] The OBA PPSL Subcommittee would regard Pattern Φ as a "3P FI Scenario." Again, see *OBA Proposal*, *supra* note 17 at 2 (Details of Proposal).

[50] PPSA, s. 35(1)(a)(i).

balance at Mulberry Bank, there is no legitimate reason, that I can think of, why the general registration-based priority rules should not apply to govern entitlements to the balance in that account.

For most intents and purposes, the PPSA facilitates derivatives transactions. Derivatives transaction participants who utilize the right of set-off as a tool in structuring their affairs typically stand in a stronger position than first-registered secured party competitors. In this regard, a bank-directed control model offers a very limited advantage over a registration model or a bank-only control model. Indeed, in his Australian Government-commissioned statutory government review, Whitaker specifically recommends against the AUSPPSA's adoption of a bank-directed control model.

> Recommendation 73: That the Act not be amended to allow a secured party other than the ADI itself to perfect by control over an ADI account.[51]

5. SCEPTICISM

It is worthwhile recalling that the derivatives industry bears some of the responsibility for the 2008 financial crisis, commonly described as the "most severe

[51] Bruce Whitaker, *Review of the Personal Property Securities Act 2009: Final Report* (Commonwealth of Australia, 2015) ("*Statutory Review*") at 142. At the outset of his review, Whitaker anticipated calls for the creation of control interests of non-depository secured parties, and was surprised that none were initially forthcoming. Nonetheless, he raised the issue with stakeholders. Among respondents, a small number suggested permitting control interests in favour of non-depository secured parties, while the great majority did not. One respondent made an odd suggestion that only the ADI and its wholly-owned subsidiaries be permitted control interests. At 142, Whitaker rejected this suggestion as follows: "That may be advantageous for the ADI, but would not reflect the reasons why it may be thought appropriate from a policy perspective to allow perfection by control by the ADI itself (particularly if that perfection is automatic, as I discuss below)."

financial crisis since the Great Depression."[52] Mere months after that crisis erupted, this industry demanded that Canada's secured transactions regime be reformed for the benefit of its members.[53] The OBA PPSL Subcommittee investigated the matter and agreed, stating "it is critical that Ontario create *now* a legal regime that enables secured parties to have a *clear, certain, automatic and instant* first priority security interest in cash collateral."[54] (emphasis original) Unconvinced by the OBA PPSL Subcommittee's position, Cuming, Walsh & Wood issued the following statement in their personal property security law treatise:

> The Article 9 approach to deposit accounts, in its ubiquitous deference to the depository bank, arguably goes far beyond what is needed to satisfy the concerns with the existing rules as they relate to financial collateral. It remains to be seen whether the Ontario PPSL Committee will end up recommending a more attenuated regime.[55]

The PPSA control paradigm desired and sought by the financial industry confers more protection on its members than is necessary. Provincial and territorial legislators may sense this as most jurisdictions have not launched into a legislative reform effort despite ongoing financial industry pressure. The existing PPSA arguably furnishes adequate protection for derivatives transactions participants. My

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52 See, generally, National Commission, *Financial Crisis Inquiry Report*, *supra* note 33 at xv and 45-51; Also see American Bar Association, Banking Law Committee, Business Law Section, *The Financial Crisis of 2007-2009: Causes and Contributing Circumstances* (September 2009) at 8; The Department of the Treasury, *Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation* (June 2009), online: <http://www.financialstability.gov/docs/reg/FinalReport_web.pdf> ("*A New Foundation*") at 2.

53 Bourassa, *2009 ISDA Letter*, *supra* note 48; Letter from Francois Bourassa (ISDA) to Allen Doppelt (Ontario Government) and Doug Morrison (Alberta Government) (April 13, 2010) ("*2010 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>; Letter from Katherine Darras (ISDA) to Robin Edger (Ontario Government) (May 7, 2012) ("*2012 ISDA Letter*"), online: ISDA <http://www2.isda.org/regions/canada/>.

54 OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 17 at 3.

55 Cuming, Walsh & Wood, *PPSL, supra* note 24 at 74.

suggested language for PPSA s. 41(2), set out in Appendix C, would furnish additional certainty, clarity and comfort to these important commercial actors.[56]

D. INVESTMENT PROPERTY ANALOGY ~ COHERENCY

1. DEPOSIT ACCOUNT V. INVESTMENT PROPERTY: ANALOGICAL COMPARISON

a. Standardization for Sophisticated Financial Transactions

Recall that 'coherency', as a PPSL value, embodies the ideal of treating like property alike. Indeed, this is one of the main arguments advanced in support of the adoption of a control paradigm for deposit accounts: Given the deposit account's likeness to investment property, it should be subject to the same type of control

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[56] See, for example, Office of the Superintendent of Financial Institutions (OSFI), *Guideline E-22 re: Margin Requirements for Non-Centrally Cleared Derivatives* (September 2016), which sets out initial and variation margin requirements for covered transactions: "The full amount necessary to fully collateralize the mark-to-market exposure of the non-centrally cleared derivatives must be exchanged, subject to the MTA (minimum transfer amount) discussed in paragraph 15. To reduce adverse liquidity shocks and in order to effectively mitigate counterparty credit risk, variation margin should be calculated and exchanged for non-centrally cleared derivatives subject to a single, legally enforceable netting agreement. Where a legally enforceable netting agreement is not in place, variation margin must be exchanged on a gross basis except when paragraph 24 applies." OSFI, *Guideline E-22*, para. 23 defines when a netting agreement is deemed "legally enforceable": "Covered FRFI's have executed a written, bilateral netting contract or agreement that creates a single legal obligation, covering all included bilateral transactions subject to netting. The result of such an arrangement would be that the institution only has one obligation for payment or one claim to receive funds based on the net sum of the positive and negative mark-to-market values of all the transactions with that counterparty in the event that the counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances; … Covered FRFI's must conduct sufficient legal review and have a well-founded legal basis to verify that, in the event of any legal challenge, the relevant courts or administrative authorities would find the exposure under the netting agreement to be the net amount under the laws of all relevant jurisdictions. In reaching this conclusion, the legal review must address the validity and enforceability of the entire netting agreement under its terms."

paradigm as investment property.[57] Control proponents assert that because deposit accounts and investment property are the preferred classes of collateral used in securing sophisticated financial transactions, they should be subject to substantially similar perfection and priority rules.[58] The control paradigm facilitates efficient execution of sophisticated financial transactions by eliminating the need for transaction participants to conduct registry searches, effect registrations and request subordination agreements from prior registrants. In interrogating the 'coherency' argument, it is necessary to ask whether deposit accounts and investment property are sufficiently analogous as to warrant or demand equivalent treatment under the PPSA. Or are there key differences in their conceptual and/or practical orientation that suggest they deserve dissimilar treatment?

b. Similarity

i. Securities Account Credit Balance

In terms of underlying legal structure, a deposit account is identical to a particular variety of investment property, namely, a credit balance in a securities account (a "securities account credit balance").[59] A subspecies of "financial asset,"[60] the securities account credit balance is a monetary credit balance held in a "securities account"[61] with a securities intermediary. It represents a demand

[57] Bourassa, *2009 ISDA Letter*, *supra* note 48; OBA PPSL Subcommittee, *OBA Proposal*, *supra* note 17 at 14 (Background Paper); Gibson, *supra* note 13 at 848.
[58] OBA PPSL Subcommittee, *OBA Proposal*, *ibid.* at 1 (Background Paper).
[59] STA, s. 1(1)(oo)(v).
[60] STA, s. 1(1)(oo); PPSA, s. 2(1)(p.1).
[61] STA, s. 1(1)(dd); PPSA, s. 2(1)(qq.1).

monetary debt obligation – a legal chose in action – owing from the securities intermediary to the customer. When a securities intermediary liquidates a customer's investment, sale proceeds may be held in a securities account credit balance until reinvested or otherwise redirected. This account is functionally equivalent to a deposit account, albeit with a securities intermediary in the place of a depository bank. The securities account credit balance is a unique form of investment property, and is subject to the PPSA's investment property control paradigm. This arguably strengthens the case for adoption of a control paradigm for deposit accounts.

ii. Payment Function

The deposit account and the securities account credit balance also share a payment services function.[62] For instance, a customer may draw a cheque on, or effect an electronic transfer to or from, either type of account.[63] On one view, this point also militates in favour of a common control paradigm for perfection and priority ordering for deposit accounts and securities account credit balances. Clear and consistent rules are required for both species of property given that the transfer of property rights is inherent in, and even the essence of, payment. Of course, one could argue, instead, that this point militates in favour of a common registration paradigm for deposit accounts and securities account credit balances.

c. Dissimilarity

[62] Harris & Mooney, *SIPP*, *supra* note 9 at 444.
[63] Gibson, *supra* note 13 at 849 and 851.

i. Archetypal Investment Property

Keep in mind that the securities account credit balance is a very specific type of investment property, and is not representative of investment property as a general class. Investment property typically represents a debtor's equity stake in an organization, entitling its holder to, *inter alia*, voting rights in the organization, dividends and the benefits of any gain in unit price. "Investment property"[64] can take many forms including, without limitation, a "certificated security,"[65] "uncertificated security,"[66] or "security entitlement."[67] Indeed, when the average individual discusses her investment property, she is generally referring to *this* kind of property. And for this kind of investment property, the control proponents' coherency argument is weak because a deposit account holder does not have rights equivalent to those of a shareholder.

ii. Distinctive Policy Concerns

Gibson observes that "the policy reason underlying the Article 8 control framework was to insure the integrity of securities trades executed through an indirect holding system."[68] An indirect holding system differs from a direct holding system in that, under the former, the names and holdings of investors are not recorded and maintained by the issuer. Instead, the issuer typically issues one global security certificate, or a series of such certificates, which are held by a general

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[64] PPSA, s. 1(1)(y.1).
[65] STA, s. 1(1)(e); PPSA, s. 1(1)(e.1).
[66] STA, s. 1(1)(kk); PPSA, s. 1(1)(vv.1).
[67] STA, s. 1(2)(hh); PPSA, s. 1(1)(ss.2).
[68] Gibson, *supra* note 13 at 852.

depository institution for and on behalf of the ultimate investors. In Canada, that depository institution is the Canadian Depository for Securities ("CDS"). CDS is the legal owner of the shares, holding them as a top-tier intermediary on behalf of middle-tier intermediaries, who maintain their holdings on behalf of additional lower-tier intermediaries, leading eventually and ultimately, to the investor. Technically, the investor owns a security entitlement, best conceptualized as an electronic derivative of the underlying financial asset – a dematerialized version of that asset held with (and against) the investor's securities intermediary.

The STA, which adopts a control framework for investment property, modernizes and rationalizes the law as it pertains to the holding and transfer of security entitlements held through an indirect book-based system, thereby protecting the integrity of that system. Whereas there was once no standard and uniform method of transferring interests in investment property held in an indirect holding system, there now is under the STA. The PPSA was amended to dovetail with the STA, utilizing the STA's control framework to govern perfection and priority ordering of security interests in investment property. The integrated system that results represents an improvement over the former state of affairs, which forced awkward concepts like "deemed possession" of intangible securities.[69] Indeed, Gibson notes that the control paradigm "naturally complements the indirect holding system under which the majority of publicly traded stocks are held."[70]

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[69] See, for example, SPPSA s. 2(5), a provision that is arguably obsolete in light of the STA amendments.
[70] Gibson, *supra* note 13 at 852.

In contrast, a deposit account is not maintained in an indirect holding system.[71] Instead, a customer holds a direct claim against the depository bank. It is therefore noteworthy that the principal policy reason underlying the STA, in the investment property context, is entirely absent in the deposit account context. Unlike pre-STA securities transfer systems, the integrity of Canada's banking and payment system is not in any way imperiled. Indeed, the banking industry has been very adept and proficient in operating a smooth and effective funds transfer system, based largely on set-off and netting principles. Canada's monetary transfer system does not require a comprehensive statutory overhaul in the same vein as the pre-STA securities transfer system. In common law Canada, where deposit accounts are currently subject to the PPSA's registration paradigm, deposit account funds are regularly transferred from one person to another, and from one account to another, in smooth and efficient fashion.

iii. Inventory & Accounts Proceeds Reservoir

Consider another distinctive feature of the deposit account. The deposit account commonly performs a reservoir function; that is, revenues generated from the sale of a debtor's business inventory commonly collect in a deposit account or accounts.[72] The same cannot be said of investment property for any but the largest and most sophisticated of business entities. Most businesses use an operating deposit account – not a securities account credit balance or some other form of

[71] It is noteworthy that a securities account credit balance, though a financial asset in a securities account, is not held in an indirect holding system. The customer's monetary claim is held directly against the securities intermediary, and is not referenced to any other entity further up the chain.
[72] Bangsund, *Historical Review, supra* note 23 at 37.

investment property – to collect revenues and pay general expenses. Here, there is a material distinction in the practical orientation of deposit accounts and investment property of all varieties; a distinction suggesting, for example, that different considerations ought to apply in defining the priority status of proceeds claims. In this important regard, the deposit account, which acts as a natural reservoir for the collection of proceeds generated upon the liquidation of other kinds of primary reliance collateral, is markedly different from all kinds of investment property including the securities account credit balance (which typically acts as a reservoir only for the proceeds of disposed-of *investment property*).

2. DEPOSIT ACCOUNT V. GENERAL ACCOUNT: ALTERNATE ANALOGICAL COMPARISON

a. Similarity

Engage, now, in another juridical comparison, this time between the general account and the deposit account. A general account typically represents a debtor's short-term debt claim, entitling her to payment of a specified monetary amount plus interest from the account debtor according to governing contractual terms. Likewise, a deposit account represents a short-term demand debt claim, entitling the depositor customer to an immediate monetary payment from the depository bank upon demand according to the governing contractual terms. On a juridical level, then, a deposit account does not merely *resemble* an account receivable. It *is* an account receivable.[73] A deposit account is a subspecies of account,[74] and is distinctive only in that a depository bank, and not some other person or entity, is liable on the liquidated debt obligation.[75] Indeed, the PPSA observes this consistency. Both the deposit account and the general account receivable fall within the statute's definitions of "intangible"[76] and "account,"[77] thereby promoting coherency under the statute.[78]

b. Dissimilarity

To be sure, the deposit account and general account also exhibit key practical distinctions. For instance, a general account typically lacks a payment services function, and is better conceptualized, not as a reservoir, but as a *tributary leading to the reservoir*. Additionally, an unmatured general account, unlike a deposit account, is not a true demand obligation, and is thus less liquid, thereby attracting more discounting. Nonetheless, the deposit account and the general account have identical underlying legal structures. Again, the PPSA arguably observes the PPSL

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[73] UNCITRAL, *supra* note 12 at Chap I para. 125.

[74] Gibson, *supra* note 13 at 851: "Similarly, a depositor does not have actual possession of deposited funds, nor does she have the right to withdraw the exact funds it deposited; '[a] deposit account, unlike a securities account, is simply a debtor-creditor relationship.'"

[75] The deposit account is a specific variety of account receivable owing from bank to customer. For a detailed historical review of the deposit account and the chose in action, see Bangsund, *Historical Review*, *supra* note 23.

[76] PPSA, s. 1(1)(x).

[77] PPSA, s. 1(1)(b).

[78] A securities account credit balance, while perhaps the juridical equivalent of an account in the sense of representing a simple right to payment, is not an "account" for the purposes of the PPSA, because it is explicitly excluded from the term's definition. See PPSA, s. 1(1)(b): "'account' means a monetary obligation not evidenced by chattel paper, an instrument or a security, whether or not it has been earned by performance, but does not include investment property."

value of 'coherency' by treating deposit accounts and general accounts receivable in precisely equivalent fashion, subjecting them to a common registration paradigm.

3. *Equivocality At Best*

There is certainly a striking similarity between the deposit account and the securities account credit balance. However, there are also some important differences between these two varieties of property. Because the deposit account performs a reservoir function, typical deposit account proceeds claimants, like inventory suppliers and account financiers, arguably deserve special attention, and possibly a higher-ranking status, in the deposit account priority hierarchy. To weaken the deposit account proceeds entitlements of these parties, through the adoption of a control paradigm, is to devalue their security interests, and to correspondingly increase the cost of inventory and accounts financing. These same concerns are not engaged (at least not to the same extent) for securities account credit balances.

A second key point to bear in mind is that the prototypical investment property (that is, investment property that is not a securities account credit balance) and the deposit account exhibit considerable differences in terms of juridical nature and underlying legal structure. Indeed, the principal policy reason for adopting a control paradigm for investment property – namely, protecting the integrity of electronic securities transfers in an indirect holding system – is entirely absent in the deposit account context. This significantly diminishes the overall persuasiveness of the 'coherency' argument advanced by control proponents.

Finally, recall that the deposit account is identical, on a conceptual level, to the general account. Realizing conceptual coherency, as between deposit accounts and investment property, will of necessity create incoherency, as between those property types (i.e., deposit accounts and investment property, which would be subject to the control paradigm) and all other intangibles (like general accounts, which would remain subject to the registration paradigm). The 'coherency' argument, advanced by control proponents in favour of a deposit account paradigm shift, is equivocal at best.

III. CONTROL: BANK-ONLY MODEL V. BANK-DIRECTED MODEL

In this chapter, the various arguments supporting adoption of a bank-directed control model have received a great deal of attention. In my view, these arguments do not justify the PPSA's adoption of the control paradigm for deposit accounts, and the abandonment of traditional PPSL values. There is little to recommend about Article 9, and while the OBAPPSA outperforms Article 9 according to the evaluative criteria, as a bank-directed control model it inherits many of the American regime's flaws. Therefore, if Canadian legislators are serious about, or insistent on, adopting a control paradigm for deposit accounts, they should consider a tempered version of the Australian model, namely, a hybrid bank-only control model.[79]

Under the AUSPPSA, the depository bank's automatic control privilege is functionally equivalent to a set-off privilege. In other words, control is a general proxy for set-off, or is at least capable of being legislatively adjusted or gauged as such. It is true that the AUSPPSA currently expands the depository bank's protection, as a control party, well beyond the basic recognition of a set-off privilege. The statute should be scaled back accordingly. But the AUSPPSA, unlike Article 9 and the OBAPPSA, does not allow the depositary bank to interfere with or override the decisions of its commercial customers. Thus, while arguably deficient on account of its inherently hierarchical structure, there is much to recommend about the simplicity of Australia's hybrid bank-only control model.

If Canadian legislators do adopt an Australian style hybrid bank-only control model, it is not imperative that they give a depository bank's control interest superpriority over competing security interests. As discussed in Chapter 7, perfection and priority are distinct concepts, and automatic perfection by control need not imply superpriority. The PPSA could be structured in a manner that confers automatic perfected status (via control or some other label) on a depository bank who takes a security interest in its customer's deposit account, but does not give the depository bank's automatically perfected security interest a privileged

[79] See Chapter 1 ~ Research Project: If the control paradigm is adopted, which model-type is more desirable: a pure control model or a hybrid control model? If a hybrid control model is desirable, which is to be preferred: a hybrid bank-only control model such as Australia's AUSPPSA, or a hybrid bank-directed control model such as the OBAPPSA proposed by the OBA PPSL Subcommittee?

priority status over competing security interests perfected by other methods. Under such a regime, Canadian legislators would be adopting a hybrid bank-only control *model*, but would not be adopting a control *paradigm*. One positive feature of such an approach is that it would avoid inundation of the PPR with registrations by depository banks, and thereby avoid the passing on of fees associated with those registrations to depositor customers.

Book IV ~ Conclusion

CHAPTER 9 ~ THESIS

The central question I posed at the outset of this research project is whether, and to what extent, Canadian common law jurisdictions ought to amend the PPSA in a manner that permits or mandates a security interest in a deposit account to be *perfected by control*.[1] I am now prepared to answer this question formally.

In my view, Canadian common law jurisdictions ought not amend the PPSA in in a manner that permits or mandates a security interest in a deposit account to be perfected by control. The PPSA should not adopt the control paradigm as a replacement for the existing registration paradigm.[2] The registration paradigm is superior to the control paradigm, and any iteration of control model, because it embraces and adheres to the core PPSL values of 'facility', 'transparency', 'efficiency', 'predictability', 'certainty' and 'clarity' without compromising, or wholly abandoning, 'balance' and 'equality'.[3] While the registration paradigm moderately adheres to basic competitive market principles (chiefly represented in the PPSL values of 'equality' and 'balance'[4]), the control paradigm does not.

[1] Chapter 1 ~ Research Project: To what extent, if at all, should Canadian common law jurisdictions amend the PPSA in a manner that permits or mandates a security interest in a deposit account to be perfected by control?

[2] Chapter 1 ~ Research Project: Should Canadian PPSA jurisdictions replace the registration paradigm with a control paradigm?

[3] Chapter 1 ~ Research Project: What characteristics are exhibited in an optimal system of integrated legislative rules and regulations governing security interests in deposit account balances that interact with set-off principles and other principles of law and equity?

[4] See Chapter 2 ~ Foundation: "The term 'equal', as a PPSL value, has a narrow meaning intimately tied to the free market economic ideal of effective competition. The general idea is that a level playing field – a system of legal rules that places all participants, regardless of class or character, on an equal

In his classic work, *The Road to Serfdom*, Friedrich Hayek extolled the importance of the competitive market and its indispensability to the liberal ideal.

> The liberal argument does not advocate leaving things just as they are; it favours making the best possible use of the forces of competition as a means of coordinating human efforts. It is based on the conviction that, where effective competition can be created, it is a better way of guiding individual efforts than any other. It emphasizes that in order to make competition work beneficially a carefully thought-out legal framework is required, and that neither the past nor the existing legal rules are free from grave defects.[5]

Hayek emphasized the need for a "carefully thought-out legal framework" to "make the best possible use of competitive forces as a means of coordinating human efforts." He recognized legislation as a key tool for planning in the "liberal way" – that is, planning *for* competition and not *against* it.[6] In his three-part exposition on *Law, Legislation, and Liberty,* Hayek identified the proper "concern of the law."

> The concern of the law is not who the particular persons shall be to whom particular things belong, but merely to make it possible to ascertain boundaries which have been determined by the actions of individuals within the limits drawn by those rules, but determined in their particular contents by many other circumstances.[7]

Also consider Hayek's remarks on Locke's view of the "justice of competition".

> …what has been correctly said of John Locke's view on the justice of competition, namely that 'it is the way in which competition is carried on,

footing – creates an optimally competitive secured credit marketplace. … As a general matter, the PPSA aims to place all commercial entities, regardless of class or character, on an equal footing vis-à-vis the debtor and each other. In this narrow sense, the PPSA embraces the PPSL value of 'equality'. … As a PPSL value, then, 'balance' commands that lawmakers, in fashioning priority rules, weigh the legitimate interests of all affected parties."

[5] Friedrich A. Hayek, *The Road to Serfdom* (London: The Institute of Economic Affairs, 2005) at 45.

[6] *Ibid.* at 46.

[7] Friedrich A. Hayek, *Law, Legislation and Liberty, Volume 1: Rules and Order* (Chicago: The University of Chicago Press, 1973) at 108.

> not its result, that counts', is generally true of the liberal conception of justice, and of what justice can achieve in a spontaneous order.[8]

In the deposit account reform debate, control proponents are too preoccupied with "who the particular persons shall be to whom particular things belong"[9] in a spontaneous order, and not enough concerned with "the way in which competition is carried on." In advocating for the control paradigm, they subvert competitive market principles. In doing so, they sacrifice fundamental PPSL values[10] on the altar of deposit account financing.[11]

The registration paradigm is more consistent with Hayek's conception of the virtuous because, unlike the control paradigm, the registration paradigm is premised on egalitarianism; it enjoys the natural advantage of applying equally to all. As such, the registration paradigm is more conducive with competitive market principles, and the liberal ideal, than is the control paradigm. In my view, the registration paradigm is superior to the control paradigm, and ought to be retained, and enhanced, by Canadian common law jurisdictions.

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[8] Friedrich A. Hayek, *Law, Legislation and Liberty, Volume 2: The Mirage of Social Justice* (Chicago: The University of Chicago Press, 1976) at 38.

[9] See, for example, Benjamin Geva, "Security Interests in Bank Deposits Under UCC article 9: A Perspective" (2013) Universidad Nacional Autónoma de México, Instituto de Investigaciones Juridicas 31 ("*A Perspective*") at 56.

[10] And, to a certain degree, other primary forms of secured credit like inventory and accounts financing.

[11] It is interesting to observe that this massive sacrifice is to be made for a form of financing that, according to Scavone, "does not really exist." See Robert M. Scavone, "Cash Collateral Under the PPSA: The Case for Control" (2012) 53 Can. Bus. L.J. 263 at 283: "First, 'deposit account financing' as such does not really exist as a separate category of financing in Canada. Canadian lenders would rarely if ever advance credit to a borrower on the security of a demand deposit account alone, the balance of which (if not restricted through a flawed asset arrangement) could drop to a zero or negative balance at any time."

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APPENDIX ~ ENHANCEMENT

Proposed language for PPSA ss. 41(1), (2), (2.1) and (2.2) and (2.3)[1]

Section 41

(1) In this section,

(a) "account debtor" means a person who is obligated pursuant to an intangible or chattel paper;

(b) "assignee" includes a secured party who has a security interest in an intangible or chattel paper as original collateral or as proceeds, and a receiver.[2]

(2) Unless the account debtor has made an enforceable agreement not to assert rights, defences or claims arising out of the contract or a closely connected contract, the rights of an assignee of an intangible or chattel paper are subject to

(a) the terms of the contract between the account debtor and the assignor that confer on the account debtor a right of contractual set-off or account combination,[3]

(b) any defence or claim arising out of the contract or a closely related contract where the account debtor meets the requirements for equitable set-off[4]*or abatement of price, and*

(c) any other defence or claim of the account debtor against the assignor that accrues before the account debtor has knowledge of the assignment.

(2.1) Notwithstanding clause (2)(a), the rights of an assignee who acquires a security interest in an account as proceeds of original collateral are not subject to an account debtor's right of contractual set-off or account combination if

(a) the assignee gives a notice to the account debtor before the proceeds security interest in the account arises that

(i) states that the assignee expects to acquire an interest in the account as proceeds of its original collateral, and

(ii) provides details of the instrument, money or transfer of funds that will give rise to the account sufficient to permit the account debtor to reasonably ascertain the account transaction to which it relates; and

(b) the assignee's proceeds security interest in the account is continuously perfected.

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[1] The proposed statutory amendments are being developed in consultation with members of a Working Group of the Canadian Conference Personal Property Security Law's comprised of Tamara Buckwold, Cynthia Callahan-Maureen, R.C.C. Cuming, Anthony Duggan, Catherine Walsh and Roderick Wood.

[2] Modelled on the language of SPPSA s. 41(1).

[3] "Account combination" is also variably referred to as "account consolidation", "blending", or "current account set-off".

[4] Modelled on the language of MPSSA s. 41(2) and OPPSA s. 40(1.1).

(2.2) Subsection (2.1) does not operate[5] *in favour of the assignee if the account debtor acquires, in addition to its rights, defences and claims as account debtor on the account, a security interest in the account that, pursuant to this Part, has priority over the security interest of the assignee.*

(2.3) A notice referred to in subsection (2.1) may be given in accordance with section 68, provided however that, where notice is given to a deposit-taking institution in respect of a deposit account, notice must be given at the branch of account.

(2.4) For purposes of subsection (2.3), the branch of account

(a) is the branch of the deposit-taking institution the address or name of which appears on the specimen signature card or other signing authority signed by the assignor with respect to the deposit account or that is designated by agreement between the deposit-taking institution and the assignor at the time of opening of the deposit account,

(b) if no branch has been identified or agreed on as provided in paragraph (a), is the branch that is designated as the branch of account with respect thereto by the deposit-taking institution by notice in writing to the assignor, or

(c) if neither paragraph (a) nor (b) apply, is located at the mailing address identified in written communications between the deposit-taking institution and the assignor relating to the deposit account.

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<u>Explanatory Notes</u>

The proposed PPSA s. 41(2) applies to both intangibles and chattel paper, and thus has general import. For example, a commercial retailer might assert, under the provision, its contractual and equitable set-off rights against an accounts financier (assignee) who presses for payment of an unsecured account (on which the commercial retailer is account debtor) assigned to it by a wholesale supplier as part of a factoring arrangement. Indeed, the provision bears materially on any commercial relationship in which there is reciprocal indebtedness. Its importance is pronounced for industries in which reciprocal indebtedness is probable or inherent. In the banking industry, for example, where

[5] The word "apply" may be more appropriate than the word "operate".

reciprocal debt obligations are endemic to the bank-customer relationship, deposit accounts are highly susceptible to set-off claims by depository banks under PPSA s. 41(2).

In contrast to the proposed s. 41(2), ss. 41(2.1) and (2.2), as drafted, apply only to intangibles because the factual circumstances contemplated in s. 41(2.1) are implausible in the chattel paper context. In fact, they are similarly implausible in the general accounts receivable context. Without explicitly saying so, PPSA ss. 41(2.1) and (2.2) are focused primarily – though not squarely – on the deposit account as a unique form of intangible personal property. For most businesses, the deposit account is a collecting ground of sorts. It performs a reservoir function,[6] gathering and disbursing the proceeds of other tangible and intangible personal property from a variety of sources. As such, the deposit account is inherently susceptible to competing claims of proceeds claimants, on one hand, and the depository bank as a contractual set-off claimant, on the other. The proposed amendments in ss. 41(2.1), (2.2) and (2.3) are principally aimed at furnishing greater certainty for these competing claimants. The proposed legislative amendments represent, not so much an alteration of the existing law of set-off, but rather statutory clarification thereof.

The presumptive analytical starting point is that a depository bank's contractual and equitable rights – however those rights may be defined or limited at common law and equity – supersede the rights of a competing assignee, whether such assignee asserts his interest in the deposit account as original collateral or as proceeds. For instance, an assignee takes his interest subject to the depository bank's right of set-off, constituted of

[6] Clayton Bangsund, "The Deposit Account & Chose in Action at Common Law & Under the PPSA: A Historical Review" (2014) 30(1) B.F.L.R. 1 at 37.

contractual and equitable set-off tenets.[7] In exceptional circumstances, a proceeds assignee may defeat the depository bank's set-off right. In order for the proceeds assignee to succeed, the depository bank must be given advance notice that particular incoming funds are subject to the assignee's proprietary interest. Meanwhile, no assignee who acquires a security interest in a deposit account as original collateral may claim an interest that pre-exists or supersedes the bank's original rights as account debtor. With respect to the deposit account, the depository bank is *the* original claimant, and any assignee who takes a first order assignment of the deposit account is subject to the depository bank's contractual and equitable rights, including those of set-off.

Illustrative Scenarios

The effect of the proposed amendments is demonstrated in the following scenarios:

Scenario I

A opens a deposit account at Bank on standard account terms furnishing Bank a right of contractual set-off against the deposit account balance. No initial deposit is made. Instead, the deposit account has a nil balance. Bank then grants A an unsecured revolving operating line of credit of $100, which A draws down entirely. A subsequently grants C a security interest in the nil deposit account balance to secure a $100 debt. C effects registration at the PPR and gives Bank notice of her security interest. A later deposits $100 cash, from an unrelated source, into the deposit account. A defaults vis-à-vis both Bank and C, and a priority dispute arises with respect to the deposit account balance.

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[7] Clayton Bangsund, "Deposit Account Set-Off Under the PPSA" (2017) 80(1) Sask. L. Rev. 11.

- Bank prevails; PPSA s. 41(2). C knows, when she acquires a security interest in A's intangibles, that she takes subject to the contractual and equitable rights of the account debtors on those intangibles. In these circumstances, both account combination and the unconnected claims notification rule of equitable set-off, as those doctrines are recognized and embodied in PPSA s. 41(2)(a) and (c), are available to Bank. The close connection rule of equitable set-off may be additionally available to Bank under s. 41(2)(b).

Scenario II

To secure a $100 debt owing from A to C, A grants C a security interest in all present and after-acquired personal property. C effects registration at the PPR, thus perfecting his security interest. A then opens a deposit account at Bank on standard account terms furnishing Bank a right of contractual set-off against the deposit account balance. An initial deposit of $100 is made. Simultaneously, Bank grants A an unsecured revolving operating line of credit of $100. A immediately draws down the operating line in its entirety, and subsequently defaults vis-à-vis both Bank and C. Who prevails, as between Bank and C, with respect to the deposit account balance?

- Bank prevails; PPSA s. 41(2). C knows, when he acquires a security interest in A's intangibles, that he takes subject to the contractual and equitable rights of the account debtors on those intangibles. Again, in these circumstances, both account combination and the unconnected claims notification rule of equitable set-off are available to Bank. The close connection rule of equitable set-off may also be available under s. 41(2)(b).

- If Bank gained knowledge of C's security interest prior to establishment of the deposit account, say by reviewing a PPR debtor name search against A and then acquiring factual confirmation of the security interest in its discussions with A, this would arguably put Bank on notice of C's security interest, thus depriving it of account combination and/or equitable set-off rights vis-à-vis C.[8] In these circumstances, Bank has a choice. First, it may choose to furnish the operating line to A in a subordinate position to C. Or, it may insist, before the operating line of credit is made available to A, that C execute an express agreement disavowing its priority position over Bank. With a subordination agreement in hand, Bank may then freely advance credit under the operating line of credit. Bank may additionally have a security interest in the deposit account balance. If this is the case, its security interest can be elevated above C's security interest via subordination agreement as per PPSA s. 40.

[8] See Philip R. Wood, *English and International Set-Off* (London: Sweet & Maxwell, 1989) ("*International Set-Off*") at para. 16-37: "Where the reciprocal claims are eligible for current account set-off, the assignee will take subject to the debtor's combination of the accounts. Thus if a customer has two current accounts at the bank, one in debit and one in credit, and if there is no agreement to keep them separate and the customer assigns the credit balance, the bank may set off the debit balance against a claim by the assignee for the credit balance. It is considered that this is not because the two accounts are in law one single blended account. Two accounts are two accounts. The proper rationale is that an assignee takes subject to a liquidated cross-claim which the assignor incurred in favour of the debtor prior to notice of assignment provided that the cross-claim matures due and payable before the assignee commences action for the assigned claim – *i.e.* the rule applicable to independent set-off against assignees. The only differences are that current account set-off is self-help and, because the accounts are each treated as immediately due and payable, the cross-claim will inevitably mature before the assignee commences his action."; also see para. 16-33: "Where the assignor and the debtor agree that the claims shall be set off and the assignor assigns the claim owing to him to an assignee, the assignee should take subject to this contract … provided that the agreement was made prior to the notice to the debtor (deposit-taking institution) of the assignment and provided (probably) that both the assigned claim and the cross-clam were incurred before the notice."

Scenario III

To secure a $100 debt owing from A to C, A grants C a security interest in all present and after-acquired personal property. C effects registration at the PPR, thus perfecting her security interest. A then opens a deposit account at Bank on standard account terms furnishing Bank a right of contractual set-off against the deposit account balance (i.e. account combination). No initial deposit is made. Simultaneously, Bank grants A an unsecured revolving operating line of credit of $100. C discovers the existence of A's deposit account and notifies Bank of her security interest. A later draws down the operating line entirely, then deposits $100, from an unrelated source, into the deposit account. A subsequently defaults vis-à-vis both Bank and C, and a priority dispute arises with respect to the deposit account balance.

- Bank prevails; PPSA s. 41(2). Bank was unaware of C's security interest in the deposit account balance at the time the credit line was made available to A (i.e. when Bank committed to the supply of future operating credit). A and Bank expressly agreed, at that time, that Bank was entitled to a current account set-off in the nature of account combination. C acquired its security interest in the deposit account subject to that right. It does not matter that Bank made advances to A after learning of C's first registered security interest in the deposit account balance. Bank may set off the operating line against the deposit account in priority to C's security interest. In order to defeat Bank in these circumstances, C requires a blocked account arrangement or something akin.

Scenario IV

A grants C a security interest in his car to secure repayment of a $100 loan. C effects registration at the PPR, thereby perfecting his security interest. A opens a deposit account at Bank on standard account terms furnishing Bank a right of contractual set-off. No initial deposit is made. Instead, the deposit account has a nil balance. Simultaneously, Bank grants A a revolving operating line of credit of $100. C discovers the existence of the deposit account and gives Bank notice, stating that he expects to acquire an interest in the deposit account as proceeds of his original collateral (the car, which is being sold to D), and that the personal property whose disposition will give rise to such proceeds will take the form of a certified cheque drawn by D in favour of A. Subsequently, a certified cheque matching the description set out in the notice is in fact deposited into A's deposit account. A subsequently defaults vis-à-vis both Bank and C, and a priority dispute arises with respect to the deposit account balance.

- C prevails; PPSA s. 41(2.1). In this narrow circumstance, where Bank is furnished with advanced notice of a proceeds deposit, C defeats Bank's contractual set-off rights. Bank is unable to establish a right of equitable set-off in these circumstances, and does not have any other contractual rights that would enable it to override C's proceeds claim under s. 41(2.1).
- In reality, it will be very difficult for C to reap the benefit of PPSA s. 41(2.1). In order to do so, he must have intimate knowledge of A's business dealings such that he can meet the notice requirements set out in PPSA s. 41(2.1)(a). The debtor monitoring required to glean this information is time consuming, resource intensive, intrusive and expensive. Most secured parties possess neither the expertise nor the appetite

to engage in this level of debtor monitoring. As such, it will only be rare instances in which PPSA s. 41(2.1) comes to the rescue of a deposit account proceeds claimant. Still, in circumstances like these, where the secured party does possess detailed information about its proceeds, and does exercise a high degree of diligence in notifying Bank of its interest, there is no reason why Bank should be given license to convert C's property. The carve-out in PPSA s. 41(2.1) aims to clarify that no account debtor, including a depository bank, has a license to knowingly convert the property of another.[9]

Scenario V

A opens a deposit account at Bank on standard account terms furnishing Bank a right of contractual set-off against the deposit account balance. No initial deposit is made. Simultaneously, Bank grants A a revolving operating line of credit of $100; the terms confer on Bank an express right of contractual set-off against A's deposit account balance and any other credit balance A has or may have with Bank. A additionally grants Bank a security interest in all present and after-acquired personal property to secure repayment of the operating line. Bank effects registration at the PPR. A then grants C a security interest in his table saw to secure repayment of a $100 loan. C effects registration, thereby perfecting his security interest. C discovers the existence of the deposit account and gives Bank notice, stating that he expects to acquire an interest in the deposit account as proceeds of his original collateral (the table saw), and that the proceeds whose disposition will give immediate rise to such proceeds will take the form of a certified cheque drawn by the

[9] Clayton Bangsund, "Set-Off & Security Interests" (2017) 50(1) UBC L. Rev. 1 at 9.

buyer, D, in favour of A. Subsequently, a certified cheque matching the description in the notice is in fact deposited into A's deposit account. A subsequently defaults vis-à-vis both Bank and C, and a priority dispute arises with respect to the deposit account balance.

- Bank prevails; PPSA ss. 35(1)(a)(i) and 41(2). First, Bank's security interest in the table saw has priority over C's security interest in the table saw. Similarly, Bank's security interest in the deposit account, whether conceptualized as original collateral or proceeds, has priority over C's proceeds security interest in the deposit account; PPSA s. 35(1)(a)(i). Moreover, Bank's contractual and equitable set-off rights override C's proceeds security interest pursuant to PPSA s. 41(2). PPSA s. 41(2.2) clarifies that C cannot defeat Bank by virtue of PPSA s. 41(2.1) since Bank holds a prioritized security interest to the security interest held by C. In other words, C cannot enhance its position vis-à-vis Bank (a party with a higher ranking security interest) simply by giving a proceeds notice pursuant to PPSA s. 41(2.1). PPSA s. 41(2) resolves the matter in favour of Bank on account of its superior contractual and equitable set-off rights.

Scenario VI

A opens a deposit account at Bank on standard account terms furnishing Bank a right of contractual set-off against the deposit account balance. No initial deposit is made. Simultaneously, Bank grants A a revolving operating line of credit of $100; the terms confer on Bank an express right of contractual set-off against A's deposit account balance and any other credit balance A has or may have with Bank. A additionally grants Bank a security interest in all present and after-acquired personal property to secure repayment of the operating line. Bank effects registration at the PPR. A subsequently purchases a drill from C on secured credit terms, granting C a purchase money security interest in the drill (as equipment) to secure repayment of its $100 purchase price. C effects registration at the PPR prior to relinquishing possession of the drill to A, thereby conferring superpriority status on C's security interest in the drill and its proceeds pursuant to PPSA s. 34(2)(a). C discovers that A has plans to sell the drill to D, and gives notice to Bank stating (i) that she expects to acquire an interest in the deposit account as proceeds of her original collateral (the drill), and (ii) that the proceeds whose disposition will give rise to such proceeds will take the form of a cheque drawn by the buyer, D, in favour of A. Subsequently, a cheque matching the description in the notice is in fact deposited into A's deposit account. A subsequently defaults vis-à-vis both Bank and C, and a priority dispute arises with respect to the deposit account balance.

- C prevails; PPSA s. 41(2.1). In this instance, PPSA s. 41(2.2) does not apply to override the application of PPSA s. 41(2.1) because C's purchase money security interest in the deposit account, as proceeds, has priority over Bank's original collateral security interest in the deposit account; PPSA s. 34(2)(a). Provided she gives adequate notice under PPSA s. 41(2.1)(a), C will enjoy priority to the deposit account balance as proceeds of her purchase money collateral.

Scenario VII

A, a wholesaler, grants C, an inventory financier, a purchase money security interest in its inventory. C effects registration at the PPR, thereby perfecting its security interest and assuring itself of priority to the inventory and its proceeds. B later attends A's business and expresses interest in purchasing an item of the encumbered inventory on unsecured credit terms. Prior to an agreement being struck between A and B, C serves B with notice, under s. 41(2.1), claiming a proceeds interest in the prospective account on which B will be liable. A and B subsequently enter into a contract providing for the sale of the item from A to B on unsecured credit terms. A fails to deliver the item to B pursuant to the terms of the contract. A subsequently defaults vis-à-vis C. C presses B for payment of the account, and ultimately sues B to recover payment.

- B prevails; PPSA ss. 41(2). In these circumstances, B may have contractual set-off rights within the scope of s. 41(2)(a), and C can override those contractual set-off rights by serving a proceeds notice. However, C cannot override B's additional contractual and equitable rights (including equitable set-off rights), as embodied in PPSA ss. 41(2)(b)-(c). In this instance, B has the right to withhold payment for the item and to repudiate the credit sale contract. In the event that the contract has not been repudiated, B can take the position that its obligation to make payment on the account is conditional on A's delivery of the item. If the credit sale contract is repudiated, B can take the position that its payment obligation no longer exists (or, in fact, never arose). In either case, B's right to withhold payment on the intangible is invulnerable to C's proceeds claim. It is noteworthy that B likely holds equitable set-off rights in these circumstances as well, which cannot be overridden by C's proceeds interest.

Scenario VIII

A, a wholesaler, grants C, an inventory financier, a purchase money security interest in its inventory. C effects registration at the PPR, thereby perfecting its security interest and assuring itself of priority to the inventory and its proceeds. B later attends A's business and expresses interest in purchasing an item of the encumbered inventory on unsecured credit terms. Prior to an agreement being struck between A and B, C serves B with notice, under s. 41(2.1), claiming a proceeds interest in the prospective account on which B will be liable. A and B subsequently enter into a contract providing for the sale of the item from A to B on unsecured credit terms. A delivers the item to B pursuant to the terms of the contract. A subsequently defaults vis-à-vis C. C presses B for payment of the account, and ultimately sues B to recover payment. B defends on the basis that he has (i) a right of abatement under contract and/or by operation of the *Sale of Goods Act*, or in the alternative, (ii) a right of equitable set-off.

- B prevails; PPSA ss. 41(2). In these circumstances, B may have contractual set-off rights within the scope of s. 41(2)(a), and C can override those contractual set-off rights by serving a proceeds notice. However, C cannot override B's abatement and equitable set-off rights as embodied in PPSA ss. 41(2)(b)-(c).