THE PLEDGE OF DOCUMENTS OF TITLE IN ONTARIO

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The law governing the pledge of documents of title in Ontario is a curious mixture of statutory provisions and common law concepts. Much of the legislation is of an ancient lineage. It does not purport to create a comprehensive or coherent body of law; it was enacted merely to remedy certain judicially-created annoyances that frustrated commercial practice. This piecemeal approach led to frequent duplication, occasional conflict, and many significant gaps. In more recent years, legislators have borrowed heavily from American sources. This legislation was more comprehensive, but unfortunately the American conception of the documentary pledge differed in several material respects. The problem is exacerbated by a strong federal presence manifested in several sections of the Bank Act.[1] The resultant legislative framework resembles a patchwork quilt, and an examination of each piece of legislation in its original context is necessary to understand the interaction between the various enactments.

1. Development of the Documentary Pledge in England

The law relating to the pledge of documents of title began its development at a time when any transaction not accompanied by actual transfer of possession was viewed with suspicion by the courts, and was liable to be struck down as a fraudulent conveyance.[2] But with the advent of the industrial revolution, industry's insatiable need for credit was no longer satisfied by mortgages on real property. Personal property had become the principal repository of wealth:[3]

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[1] The Banks and Banking Law Revision Act, S.C. 1980, c. 40 (hereafter the "Bank Act").

[2] *Twyne's Case* (1601), 3 Co. Rep. 80b, 76 E.R. 809 (Star Chamber).

[3] G. Gilmore, *Security Interests in Personal Property* (Boston, Little, Brown & Co., 1965), p. 25.

> Nor would the medieval institution of pledge suffice to take up the slack; share certificates and bonds could conveniently be pledged but obviously the equipment of the factory, the rolling stock of the railroad, the stock in trade of the merchant could not be. And yet all this property which could not be pledged because it had to be used in the borrower's business represented a nearly inexhaustible source of prime collateral for loans.

The English courts responded with remarkable innovation. The rule of absolute transfer of possession was so eroded by the courts' acceptance of the chattel mortgage that in 1854 the first of the Bills of Sale Acts[4] was enacted to protect ordinary creditors. In 1862 the House of Lords upheld the equitable mortgage of after-acquired property;[5] and in the 1870s, in a group of Chancery decisions, the floating charge first received legal recognition.[6] This device would prove to be a most reliable work-horse that would afford great flexibility to financers.

The American courts never overcame their suspicion of the chattel mortgage; in the United States it was an exclusively statutory device. Even then, "the idea that the statutory chattel mortgage should continue to be treated as a fraudulent conveyance was a long time dying",[7] and this attitude would later infect mortgages of after-acquired property and of stock in trade. These obstacles prompted the creation of specialized devices such as the trust receipt, the factor's lien, the equipment trust, and the field warehouse.[8] The intolerable complexity of this law was the impetus behind the rationalization of American security law by Article 9 of the Uniform Commercial Code.

There had been, however, an earlier deviation from the rule of absolute physical transfer of possession. Its development was due to the growth in overseas trade rather than industrialization *per se*. It was customary for 17th century shippers to issue bills of lading covering goods stored in the holds of their ships. The merchants, unable to deal with the actual goods while they were in transit, dealt with the bill of lading in lieu of the goods. As early as 1697, in the decision in *Evans v. Marlett*,[9] it was recog-

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[4] (U.K.), c. 36.
[5] *Holroyd v. Marshall* (1862), 10 H.L.C. 191, 11 E.R. 999.
[6] See generally, R.R. Pennington, "The Genesis of the Floating Charge", 23 Mod. L. Rev. 630 (1960).
[7] Gilmore, *op. cit.*, footnote 3 at p. 27.
[8] See generally, Gilmore, *op. cit.*, footnote 3 at pp. 86-195.
[9] (1697), 1 Ld. Raym. 272, 91 E.R. 1078 (K.B.).

nized that the consignee of a bill of lading had sufficient property in the goods to assign it to a third party by endorsing the bill. Merchants would endorse and transfer bills of lading in two distinct circumstances. They would do so in order to transfer absolutely the property in the goods to a buyer. This was the transaction recognized in *Evans v. Marlett*. They would also endorse and transfer the bill of lading to a lender in order to secure his advances. This latter function became crucial upon the emergence of the factor and consignment merchant as commercial entities. Certain merchants who sold goods on their own behalf would also accept consignments of goods from other persons (usually manufacturers, producers and other merchants) who wished to take advantage of the merchant's trade connections. The merchant, in the latter capacity, would often finance the manufacturer by accepting his bill of exchange, which could then be discounted by the manufacturer. The factor regarded the goods primarily as security for money advanced, and derived his profit from interest and commission rather than from resale.

The courts initially had difficulty in tailoring legal concepts to fit both functions. This difficulty is said to have stemmed from "their inability to see the concept of 'property' as anything less than a unitary whole".[10] The landmark case of *Lickbarrow v. Mason*[11] formed the basis for nearly a century of confusion[12] as to the juridical nature of the documentary pledge. The House of Lords decided that the assignment of a bill of lading to a factor, though intended primarily as security, transferred the absolute property in the goods, and the underlying contract from which it stemmed was ineffective to prevent such a transfer unless a limitation appeared on the bill. Subsequent cases attempted to modify this rule, first by use of the trust,[13] and then by recognizing an equitable mortgage.[14]

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[10] N. Miller, "Bills of Lading and Factors in Nineteenth Century English Overseas Trade", 24 U. of Chicago L. Rev. 256 (1956-57), at p. 267.

[11] (1787), 2 H. BL. 211, 126 E.R. 511 (H.L.).

[12] See generally Miller, *op. cit.*, footnote 10 at pp. 267-81.

[13] *Haille v. Smith* (1796), 1 Bos. & Pul. 563, 126 E.R. 1066 (Ex. Chamber).

[14] *In the Matter of Westzinthus* (1833), 5 B. & AD. 817, 110 E.R. 992 (K.B.). In both this case and *Haille v. Smith*, *ibid.*, it was not the consignment (intended as security) that was impressed with a trust or which created an equitable mortgage, but rather the initial transaction between the vendor and purchaser (who later endorsed the bill of lading as security) which was so classified in order to give the vendor priority with respect to any

It was not until 1884 that the matter was clarified by the decision of the House of Lords in *Sewell v. Burdick*.[15] The issue arose out of the wording of the Bills of Lading Act,[16] introduced in 1855 to remedy a defect in the common law. Earlier cases had established that the endorsement and transfer of a bill of lading transferred only the property in the goods, and not the contract of carriage.[17] Section 1 of the Act provided:

> 1. Every consignee of goods named in a bill of lading, and every indorsee of a bill of lading to whom the property in the goods therein mentioned shall pass, upon or by reason of such consignment or indorsement, shall have transferred to and vested in him all rights of suit, and be subject to the same liabilities in respect of such goods as if the contract contained in the bill of lading had been made with himself.

The controversy was that if the view in *Lickbarrow v. Mason* was adopted, the assignment as security would transfer the absolute property in the goods to the assignee, who would then be responsible for the freight and other charges. *Sewell v. Burdick* established that property is not transferred simply by endorsement and delivery of the bill of lading, but by the contract between the assignor and assignee. Thus, the interest that the transferee obtains depends entirely upon the intention of the transferor. The endorsement of a bill of lading as security may be viewed as a mortgage: the endorsee obtains the legal estate subject to the endorser's equitable right of redemption. Alternatively, because a bill of lading is "symbolic" of the goods,[18] the transaction may be viewed as a pledge: the endorsee obtains only a special property in the goods.[19] The court conceptualized the

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surplus resulting from the sale. Thus, the result was the same as if the endorsement and transfer of the bill of lading by the purchaser had been for collateral security, yet the mechanism was conceptually different.

[15] (1884), 10 App. Cas. 74 (H.L.).

[16] 1855 (U.K.), c. 111.

[17] See *Thompson v. Dominy* (1845), 14 M. & W. 403, 153 E.R. 532 (Ex.); *Sanders v. Vanzeller* (1843), 4 Q.B. 260, 114 E.R. 897 (Ex. Chamber).

[18] See *Cole v. North Western Bank* (1875), L.R. 10 C.P. 354 (Ex. Chamber); *Sewell v. Burdick*, *supra*, footnote 15 at p. 96.

[19] See *Scrutton on Charterparties and Bills of Lading*, Mocatta, Mustill and Boyd, eds., 18th ed. (London, Sweet & Maxwell, 1974), p. 195 where it is noted that:

> It is impossible to state with any confidence what dealings with a bill of lading will amount to a mortgage as distinguished from a pledge. Probably none of the ordinary commercial dealing with bills of lading amounts to mortgages and the difference between mortgages and pledges is immaterial from a commercial point of view, as it lies chiefly in the exact legal remedies for enforcing the security.

particular transaction as a pledge rather than a mortgage. This may have been done simply to avoid even the remotest possibility of bringing the trade financer within the operation of the Bills of Lading Act.[20] It should be noted, however, that both the courts[21] and the writers[22] prefer to treat the transaction as a pledge.

During the pre-*Sewell* period of confusion over the bill of lading, the courts were called upon to determine the legal consequences of another commercial practice. Its existence may be attributed to the West India Dock Company. Founded in London in 1803, the company was responsible for the introduction of the warehouse receipt system. The company would issue dock receipts for goods stored there, and when properly endorsed would accept the assignment and transfer the goods directly to the transferee. After a number of equivocal decisions regarding the effect of such practice,[23] it was finally setted[24] that the endorsement of a warehouse receipt, unlike that of a bill of lading, would not transfer the property in the goods but represented merely tokens of authority to receive possession. The rationale behind this distinction has been explained as follows:[25]

> [When] goods are at sea the buyer who takes the bill of lading has done all

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[20] Lord Blackburn, in *Sewell v. Burdick*, *supra*, footnote 15 at p. 96, stated that he was "strongly inclined to hold that even if this was a mortgage there would not have been a transfer of 'the' property within the meaning of 18 & 19 Vict. c. 111." He did not, however, express a final opinion, as he noted that this was contrary to the view of Brett M. R. and Baggallay L. J. in the court below.

[21] *Sewell v. Burdick*, *supra*, footnote 15 at pp. 103-5 *per* Lord Bramwell; *Bristol and West of England Bank v. Midland Railway Company*, [1891] 2 Q.B. 653 (C.A.); *Cole v. North Western Bank*, *supra*, footnote 18. Where the pledge of documents of title is accompanied by a hypothecation agreement, the courts are somewhat more disposed to find that a mortgage was intended. See, for example, *Young v. Dencher*, [1923] 1 D.L.R. 432, [1923] 1 W.W.R. 136 (Alta. S.C. App. Div.). But note also the decision of the Privy Council in *Official Assignee of Madras v. Mercantile Bank of India, Ltd.*, [1935] A.C. 53. The Indian Contract Act, 1872 permitted the pledge of documents of title, and deemed it to be a pledge of the goods. Lord Wright stated that even apart from this provision, the transfer of railroad receipts as security would create an equitable charge, with or without a letter of hypothecation. It should, however, be noted that the common law did not view such receipts as symbolic of the goods they covered, so that it was not possible to view the transaction as a symbolic pledge of the goods apart from the operation of the statute.

[22] *Scrutton on Charterparties and Bills of Lading, loc. cit.*, footnote 19; A.T. Carter, "Of Dock Warrants, Warehouse-Keepers' Certificates, etc.", 8 L. Q. Rev. 301 (1892).

[23] See M. Vaughn, "Warehousing Security Transactions: Progeny of Twyne's Case", 20 Baylor L. Rev. 1 (1968), at pp. 4-14.

[24] *Gunn v. Bolckow, Vaughan & Co.* (1875), 10 Ch. App. 491.

[25] Raeburn and Thomas, *Blackburn on Sale*, 3rd ed. (London, Stevens, 1910), pp. 447-8.

> that is possible in order to take possession of the goods, as there is a physical obstacle to his seeking out the master of the ship and requiring him to attorn to his rights; but when the goods are on land, there is no reason why the person who receives a delivery order or dock warrant should not at once lodge it with the bailee, and so take actual or constructive possession of the goods.
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> Besides this substantial difference between them, there is the more technical one that bills of lading are ancient mercantile documents which may be subject to the law merchant, whilst the other class of documents is of invention, and no custom of merchants relating to them has ever been established.

This was in conflict with commercial practice,[26] which clearly regarded the transfer of the warehouse receipt as a transfer of the interest in the goods.

The warehouse receipt eventually did become regarded as a document of title for certain purposes through a curious and indirect process. Problems arose from the rule in *Paterson v. Tash*,[27] which held that although a factor had the power to sell the goods and bind his principal, he could not bind his principal or affect the property in the goods by pledging them for his own debt.[28] Often the factor would find that he required funds to cover his acceptances given to consignors.[29] He would then turn to a broker for advances and pledge bills of lading as security. The rule, therefore, threatened to disrupt the entire mechanism of overseas trade, as "bankers, corn-factors, and brokers who are accustomed to make advances to the merchants will not continue to do so, owing to the extreme difficulty of ascertaining what legal title to goods exists in the party requiring such advances".[30] To

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[26] In *Lucas v. Dorrien* (1817), 7 Taunt, 278 at pp. 290-1, 129 E.R. 112 (C.P.), the court acknowledged that:

> All special juries cry out with one voice, that the practice is, that the produce lodged in the docks is transferred by indorsing over the certificates and dock warrants, and therefore there is no reputed owner, if he does not produce his certificate.

[27] (1743), 2 Str. 1178, 93 E.R. 1110 (K.B.).

[28] Miller, *op. cit.*, footnote 10 at p. 281 states:

> Such a narrow interpretation of the function of the commission merchant, as being no more than a buying or selling agent, although to some extent understandable as a mid-eighteenth century view, was hopelessly out-dated by the nineteenth century.

[29] With the emergence of larger commission houses after 1800, a practice grew whereby the consignor drew his bill upon one of these larger houses instead of drawing it directly upon the consignee. This lending of credit to smaller factorage concerns led to the growth of merchantile banks.

[30] Parliamentary Papers, 1823, Vol. 4, p. 274.

remedy this, a select committee of the House of Commons was appointed to examine the matter.[31] Their efforts led to the enactment of the Factors Act of 1823[32] and 1825.[33] The former Act applied only to factors in whose names goods were shipped; the latter applied to factors entrusted with possession of certain documents of title to goods. In such cases the rule in *Paterson v. Tash* was reversed, and the factor could effect a valid pledge. After two further amendments[34] the position was finally settled in 1889,[35] 30 years after the decline of the factor's pre-eminence in international trade.

The legislation was not particularly concerned that a warehouse receipt was not symbolic of the goods. It did, however, recognize commercial practice by regarding these documents as "documents of title",[36] thereby creating a transferability that did not previously exist under the common law. This transferability existed only in respect of third parties who took from the factor. A transfer of a warehouse receipt did not transfer the property in the goods if the transaction was outside the ambit of the Act. In such cases attornment by the bailee was still necessary. This led to the anomalous result that a mercantile agent could, in excess of his actual authority, encumber goods by pledging a warehouse receipt, even though the owner of the goods could not do so.

Neither the Factors Act, 1889, nor the Sale of Goods Act, 1893[37] made documents of title any more negotiable than they formerly were. The statutes simply created an exception to the principle *nemo dat quod non habet* applicable to both goods and documents of title.

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[31] See generally Sir Wm. Searle Holdsworth, *A History of English Law*, Vol. 8 (London, Methuen & Co. Ltd., Sweet & Maxwell, 1966), pp. 379-84.

[32] (U.K.), c. 83.

[33] (U.K.), c. 94.

[34] 1842 (U.K.), c. 39; 1877 (U.K.), c. 39.

[35] (U.K.), c. 45.

[36] Section 1(4) defines "document of title" as including:

> (4) . . . any bill of lading, dock warrant, warehouse-keeper's certificate, and warrant or order for the delivery of goods, and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented:

[37] (U.K.), c. 71.

2. Development of the Documentary Pledge in Canada

Canadian legislation relating to the documentary pledge was enacted at a very early date. Legislation similar to the English Factor Act of 1842[38] had been enacted by the Province of Canada,[39] and was superseded in Ontario by legislation[40] that adopted the English Factors Act, 1889. Of greater importance was a statute passed in 1859, entitled An Act granting additional facilities in Commercial Transactions.[41] Its purpose was simple. Since 1841 bank charters had contained a prohibition against a bank's lending money or making advances on real estate or goods, wares and merchandise — a prohibition which survived until 1967.[42] The commercial community required advances to finance sales transactions. Funds were scarce,[43] but the prevailing policy was that banks should be discouraged from engaging in long-term secured financing so that bank assets might be "promptly available either for mercantile purposes, or for the purposes of meeting claims of depositors and of redeeming notes".[44] It was thought that an exception which permitted banks to take documents of title as collateral security would not significantly erode this policy.

The legislation provided that, notwithstanding anything to the contrary in a bank charter or act of incorporation, "any bill of lading, any specification of timber, or any receipt given by a warehouseman, miller, wharfinger, master of a vessel, or carrier" could be transferred by endorsement to a bank or to a private person as collateral security and:[45]

> 8. ... being so indorsed shall vest in such Bank or private person from the date of such indorsement, all the right and title of the indorser to or in such cereal grains, goods, wares or merchandize, subject to the right of the

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[38] *Supra*, footnote 34.

[39] C.S.C. 1859, c. 59, being the predecessor to the Ontario Act respecting Contracts in Relation to Goods entrusted to Agents, R.S.O. 1877, c. 121.

[40] S.O. 1910, c. 66. See now the Factors Act, R.S.O. 1980, c. 150.

[41] S.C. 1859, c. 20 and after consolidation, An Act respecting Incorporated Banks, C.S.C. 1859, c. 54.

[42] Formerly s. 75(2)(*d*) of the Bank Act, S.C. 1953-54, c. 48.

[43] See R.H. Anstie, "The Historical Development of Pledge Lending in Canada", 74 Canadian Banker 81 (1967), at pp. 82-3.

[44] See Falconbridge, *Banking and Bills of Exchange*, 3rd ed. (Toronto, Canada Law Book Ltd., 1924), p. 219.

[45] C.S.C. 1859, c. 54, s. 8.

> indorser to have the same re-transferred to him, if such bill, note or debt be paid when due; ...

The legislation was enacted before the decision in *Sewell v. Burdick*,[46] during a period in which *Lickbarrow v. Mason*[47] was the prevailing rule. The endorsement of the document vested in the bank all right and title of the endorser. But unlike *Lickbarrow v. Mason*, the transfer was not absolute; the borrower was given a statutory right to have the bill of lading re-transferred upon payment of the debt. Thus, the conceptual model was the mortgage rather than the pledge,[48] with a statutory right of redemption in place of the equitable right. It is interesting to compare the Act with post-*Sewell v. Burdick* legislation. The Factors Act treats a documentary pledge as a symbolic pledge of the goods. Section 3 provides that a "pledge by a mercantile agent of the documents of title to goods shall be deemed to be a pledge of the goods."[49] Thus, whereas in England the documentary pledge would likely be conceptualized as a pledge, in Canada it was to be treated as a statutory mortgage.[50]

No Canadian case has dealt directly with the question whether the interest obtained by the transferee is sufficient to trigger the application of the federal and provincial legislation equivalent to the Bills of Lading Act, 1855.[51] *Sewell v. Burdick* is inapplicable, as there the court was dealing with a true pledge. It is useful to note the decision in *Canadian Imperial Bank of Commerce v. Gulf Transport Ltd.*[52] The court rejected the proposition that the ownership vested in the bank by virtue of its having taken a s. 88 Bank Act security (which is the same as if the bank had acquired a bill of lading)[53] is an absolute ownership. The debtor was not a

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[46] (1884), 10 App. Cas. 74 (H.L.).

[47] (1787), 2 H. BL. 211, 126 E.R. 511 (H.L.).

[48] Although the model may have been the mortgage, the statute does not use the typical mortgage terminology of beneficial interest and right of redemption. Possibly this is due to the application of the Act to the province of Quebec, which does not recognize these concepts. See J. Fenston, "Section 88 of the Bank Act and 'le droit de suite' ", 11 R. du B. 298 (1951).

[49] R.S.O. 1980, c. 150.

[50] It should be noted that in some provinces such as Saskatchewan there is no legislation equivalent to the Mercantile Law Amendment Act. Thus non-bank lenders taking security on the basis of a documentary pledge likely will be taken to have intended a pledge rather than a mortgage.

[51] Language identical to the English legislation is used in the Bills of Lading Act, R.S.C. 1970, c. B-6, s. 2 and the Mercantile Law Amendment Act, R.S.O. 1980, c. 265, s. 7(1).

[52] (1971), 19 D.L.R. (3d) 104, 1 Nfld. & P.E.I.R. 468 (S.C. in banco).

[53] See the Bank Act, S.C. 1980, c. 40, s. 178(2)(*c*).

mere agent for the bank; therefore the bank was not responsible for freight charges.

The legislation also recognized the then current mercantile practice respecting warehouse receipts. It did this in the same indirect fashion of the factors legislation. Rather than altering the underlying rules so as to give the warehouse receipt the same characteristics as a bill of lading, the legislation merely created an exception to the common law requirement of attornment where such documents were pledged as collateral security.

A further amendment in 1861[54] permitted a person engaged in the calling of a warehouseman, miller, wharfinger, master of a vessel, or carrier, by whom a receipt might be given, to endorse a receipt covering his own goods. The amendment also gave the bank priority over the interest of an unpaid vendor.

After a number of further revisions,[55] the provisions pertaining to the documentary pledge were substantially recast by the Bank Act of 1890.[56] The provisions have undergone little change since that time and today appear as ss. 186 and 187 of the present Bank Act. The Act introduced the present definition of the warehouse receipt and bill of lading.[57] It rejected the device by which a bailee could create fictitious receipts covering his own goods, in favour of the much wider s. 178 security interest. Later amendments to the Bank Act were primarily concerned with the expansion of the s. 178 device.

Falconbridge suggests that the purpose of s. 87 (now s. 187) of the Act was simply to import the provisions of the Factors Act into the Bank Act in order "to give to a bank dealing in good faith with a factor or agent entrusted with the possession of goods, etc., the same protection as is given to private individuals so dealing with such factor or agent."[58] Section 187(1)(*c*) of the Bank Act, like the Factors Act,[59] applies to documents of title that are used in the ordinary course of business as proof of possession or control of the goods, or that authorize or purport to

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[54] An Act to amend c. 54 C.S.C. entitled: An Act respecting Incorporated Banks, S.C. 1861, c. 23.

[55] S.C. 1865, c. 19; S.C. 1871, c. 5; S.C. 1880, c. 22. For a more extensive review of these enactments, see Anstie, *op. cit.*, footnote 43 at pp. 85-7, and Falconbridge, *op. cit.*, footnote 44 at pp. 234-59.

[56] S.C. 1890, c. 31, s. 73.

[57] Now Bank Act, S.C. 1980, c. 40, s. 2(1).

[58] See Falconbridge, *op. cit.*, footnote 44 at pp. 251-2.

[59] R.S.O. 180, c. 150, s. 1(1)(*a*).

authorize, either by endorsement or delivery, the possessor of the document to receive the goods thereby represented. But unlike the Factors Act, s. 187(1)(*c*) does not require that the possessor of the document be a mercantile agent.

Falconbridge commented that:[60]

> The omission of the word "agent" in the later Bank Acts has the result that, especially under clause (*c*) of the present s. 87(1), the mere possession of a warehouse receipt or bill of lading "by or by the authority of the owner" of goods confers on the possessor a dangerous power to deprive the owner of his title by giving security to a bank under s. 86, a power which is not subject to any of the limitations applicable under any of the Factors Acts.

Whether or not this was intended,[61] the result is that documents of title possess a greater degree of negotiability where such documents are pledged to a bank.

The Act of 1859 was of general application. The Acts of 1861 and 1865 related to banking, while the legislation of 1871 and onward was federal (post-Confederation) banking legislation. In 1887 the Province of Ontario enacted the first in a series of Mercantile Law Amendment Acts,[62] with provisions relating to the documentary pledge. These provisions were, in substance, copied from the 1865 legislation. The difference between this legislation and the 1880 Bank Act, now only of historical interest, resulted in a constitutional question that was raised in *Tennant v. Union Bank of Canada.*[63] The case established that Parliament has jurisdiction to legislate over every transaction within the legitimate business of a banker even though it may interfere with property and civil rights in the province. Federal legislation was able to confer upon a bank privileges as a lender which provincial law did not recognize. It did not otherwise affect the validity of provincial legislation. Except by use of the Bank Act devices, banks were prohibited from lending on the security of goods.[64] Thus, there were two spheres of law: one for the bank and one for the other lenders.

In 1910, a revision of the Mercantile Law Amendment Act[65]

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[60] Falconbridge, *Banking and Bills of Exchange*, 6th ed. (Toronto, Canada Law Book Ltd., 1956), pp. 202-3.

[61] The term "agent" was dropped in the 1906 revision.

[62] R.S.O. 1887, c. 122.

[63] [1894] A.C. 31 (P.C.).

[64] Bank Act, S.C. 1954, c. 48, s. 75(2)(*d*).

[65] S.O. 1910, c. 63.

incorporated many of the provisions of the Bank Act relating to the documentary pledge. The Act adopted the definition of bills of lading[66] and warehouse receipt[67] contained in the Bank Act. It also adopted the provisions concerning goods manufactured from pledged articles,[68] the priority of the advance over the claim of an unpaid vendor,[69] and the provisions for realization of the goods on non-payment of the debt.[70] The major difference between the present Mercantile Law Amendment Act,[71] which has not been substantially changed since the 1910 enactment, and the present Bank Act provisions, is that the former permits a warehouseman to pledge fictitious warehouse receipts covering his own goods[72] and limits the time in which the pledge may be held.[73] Both these features were deleted from the Bank Act in 1890.[74] In addition, there is the above-noted difference between the Factors Act and s. 187 of the Bank Act.

A further legislative development occurred in Ontario in 1946, with the enactment of the (Uniform) Warehouse Receipts Act.[75] It was the first time that the Legislature dealt directly with the common law's failure to recognize warehouse receipts as documents of title (*i.e.*, to view them as symbolic of the goods they represent). In a report by the British Columbia commissioners to the Conference of Commissioners on Uniformity of Legislation in Canada in 1943, the intent of the Act was stated as follows:[76]

> This Act is conceived with the idea of making negotiable warehouse receipts documents of title. The necessity of the Act arises by reason of the fact that in practice the public treat warehouse receipts as documents of title, and it appears to be desirable from the point of view of business. Under the present law they are not. The Act creates a distinction between negotiable receipts on the one hand and non-negotiable receipts on the other, defining the rights attached to each.

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[66] Now R.S.O. 1980, c. 265, s. 1(*a*).
[67] *Ibid.*, s. 1(*c*).
[68] *Ibid.*, s. 10, equivalent to Bank Act, S.C. 1980, c. 40, s. 179(7).
[69] *Ibid.*, s. 12, equivalent to Bank Act, s. 179(1).
[70] *Ibid.*, s. 13, equivalent to Bank Act, s. 179(4).
[71] R.S.O. 1980, c. 265.
[72] *Ibid.*, s. 9.
[73] *Ibid.*, s. 11.
[74] S.C. 1890, c. 31.
[75] Now R.S.O. 1980, c. 528. Similar legislation has been adopted in Alberta, British Columbia, Manitoba, New Brunswick and Nova Scotia.
[76] *Proceedings of the 24th Conference of Commissioners on Uniformity of Legislation* (1943), p. 101.

The Act was modeled upon the American Uniform Warehouse Receipts Act of 1906. The provisions relating to non-negotiable warehouse receipts are merely declaratory of the common law.[77] However, in respect of negotiable warehouse receipts, the Act did not embrace the common law position that the transferor obtained only the title possessed by his transferee, but adopted the concept of negotiability. The commissioners, aware of this departure, chose the somewhat watered-down version of negotiability found in the Washington Warehouse Receipts Act. Section 40 of the Act provided that negotiation was not impaired by virtue of a breach of duty, or by loss, theft, fraud, accident, mistake, duress or conversion. The Washington Act restricted these circumstances to breach of duty, fraud, mistake or duress.[78] Further sections[79] complete the negotiability concept by protecting *bona fide* holders for value without notice.

The American jurisdictions, however, had also enacted the Uniform Bills of Lading Act, which made a similar distinction between negotiable and non-negotiable documents.[80] As no equivalent legislation has been enacted in Canada, the anomalous result is that negotiable warehouse receipts are now not only documents of title, but also have a negotiability not possessed by bills of lading.

Neither the Bank Act nor the Mercantile Law Amendment Act adequately recognizes the distinction between negotiable and non-negotiable receipts that has been created by the enactment of the Warehouse Receipts Act. Although the Mercantile Law Amendment Act contains provisions[81] which make the Act subject to the Warehouse Receipts Act, these relate only to the method of transfer (the proper method of endorsement). It fails, as does the Bank Act, to distinguish between negotiable and non-negotiable documents of title pledged as collateral security. The necessity for this distinction is simple: production of the negotiable warehouse receipt is required before the warehouseman will surrender the goods. A non-negotiable

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[77] See H. Gutteridge, "Law of Warehouse Receipts in England and America", 41 Canadian L. Times 194 (1921), at p. 200.

[78] *Proceedings of the 25th Conference of Commissioners on Uniformity of Legislation* (1944), pp. 67-71.

[79] R.S.O. 1980, c. 528, ss. 22, 27 and 28.

[80] Uniform Bills of Lading Act, 4 U.L.A. 31.

[81] R.S.O. 1980, c. 265, s. 8(1).

receipt does not have this requirement of production.[82] If non-negotiable receipts are pledged, the pledgor may be able to obtain possession without the receipt, and may sell or mortgage the goods to a purchaser who will have no means of establishing the prior interest.[83]

3. The Field Warehousing Phenomena

Field warehousing is essentially a late 19th century American development.[84] Its existence may be attributed to the hostile attitude of the American courts towards mortgages of inventory or stock in trade.[85] It is primarily a financing device; a sacrificial altar upon which the borrower may place his inventory to attract the advances of lenders. The device rapidly became institutionalized. In 1960 six large companies operated 95% of the 6,000 field warehouses in use.[86] The institutionalized system typically involves the leasing by the warehousing company of a portion of the borrowers premises for a nominal sum. The premises are then sealed off and access may be had only by permission of the custodian. Signs are posted to notify the public (*i.e.*, any potential lender visiting the premises). The crucial link is the custodian, usually a former employee. He is licensed and/or bonded in accordance with state law. He issues the receipts, which may then be pledged by the borrower to the lender. Unlike a factoring company, the field warehouse involves three parties: the borrower, the warehouseman, and the lender. The warehousing company simply puts the warehousing system in place. The

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[82] The Warehouse Receipts Act, R.S.O. 1980, c. 528, s. 6(1) provides that the warehouseman shall in the case of a non-negotiable warehouse receipt, deliver the goods upon the satisfaction of the warehouseman's lien and an acknowledgement of the delivery of the goods. There is an added requirement of surrender of the receipt in respect of a negotiable warehouse receipt.

[83] The Factors Act will not be of any assistance to such a purchaser because the pledgor, even if he is a mercantile agent, will not be in possession of the documents of title with the consent of the owner (the pledgee). Prior to the Personal Property Security Act (hereafter "PPSA"), R.S.O. 1980, c. 375, the Bills of Sale and Chattel Mortgages Act, R.S.O. 1970, c. 45 could only be invoked if the transaction was categorized as a mortgage. Under the PPSA, an ordinary course buyer will be entitled to priority pursuant to s. 30(1).

[84] See generally Comment, "Financing Inventory Through Field Warehousing", 69 Yale L.J. 663 (1960); Gilmore, *op. cit.*, footnote 3 at pp. 146-95; Skilton, "Field Warehousing as a Financing Device", [1961] Wis. L. Rev. 221, 403.

[85] See Gilmore, *ibid.*, at pp. 24-47.

[86] See Comment, *supra*, footnote 84 at pp. 681-2.

warehouse receipts issued may then be used as collateral security for a loan. The system also enhances the value of the security; the institutionalized character of the warehouse system carries with it tacit assurance that the system will be policed, as well as an understanding that the warehouse company will stand behind the receipts that are issued.[87] The conditions for release from the warehouse are usually contained in the loan agreement. The conditions may range from a very strict demand that a portion of the loan equivalent to the value of the goods withdrawn be paid, a release up to a specified amount, or a more relaxed "master" receipt system under which receipts are issued at periodic intervals showing the goods that are in the warehouse, but with no attempt to match particular goods to particular receipts.

The two principal doctrinal sources of the field warehouse device were the pledge cases on the "symbolic" or "constructive" delivery of bulky goods, impossible or inconvenient to move, and the still relatively novel idea of effecting a pledge of goods by delivery of a document of title which symbolically represents the goods.[88] The concept of pledge brought with it the requirement of possession. This is usually the weakest link in a field warehousing system. If the borrower infiltrates the system and is allowed to deal with the goods without the permission of the warehouseman, the secured party has effectively lost possession of the goods.

Assuming the system is operating as it should, one must look to the law of documents of title in order to understand the implementation of the system. One might assume that the lender would demand a negotiable document of title because of the near invulnerable status that the holder is granted. However, this is not the general practice in the United States: usually non-negotiable warehouse receipts are issued.[89] Negotiable receipts require the matching of receipts to the desired lot. This is inconvenient where only a portion of the lot is required. Because non-negotiable receipts do not need to be matched to particular goods, the

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[87] The system is not foolproof. American Express, the parent corporation of a warehousing company that had been involved in the Allied Crude Vegetable Oil & Refining Co. "Salad Oil Swindle", paid out $55 million as a result of an infiltrated warehousing system. See Speidel, Summers and White, *Commercial and Consumer Law*, 2nd ed. (St. Paul, Minn., West, 1974), pp. 197-204.

[88] Gilmore, *op. cit.*, footnote 3 at p. 154.

[89] Speidel, Summers and White, *op. cit.*, footnote 87 at pp. 186-7; Gilmore, *op. cit.*, footnote 3 at p. 152.

financer may by delivery order authorize the release of *ad hoc* quantities of goods. Traditionally the receipts were issued in the name of the lender, but the Code[89a] now also provides for perfection by registration.[90] Registration eliminates the traditional attack on the warehouse system on the ground that the loss of dominion over the goods relegates the security interest to an unperfected status because the interest is no longer perfected by possession. A filing is therefore strongly advised.[91] Gilmore notes that:[92]

> It has, however, always been part of the mystique of field warehousing that filing was neither necessary nor desirable and the bank should content itself with its status as pledgee of the warehouse receipt. The finance companies, who are not much given to mysticism, file, whether there is a warehouse or not.

The popularity of the device in the United States had only a limited spill-over effect into Canada. The device has never achieved the widespread popularity, and certainly has never become institutionalized, as it has in the United States. This may be attributed to the more hospitable legal climate in Canada towards the granting of security on inventory. The Canadian field warehousing cases typically involve a bank as lender. Accordingly, it is the provisions of the Bank Act that have been considered. As with the American development, there are two doctrinal sources: the pledge, and the law associated with documents of title. However, in Canada certain legislative provisions have displaced much of the significance of the common law concepts of pledge and possession that so greatly influenced American law.

The Bank Act defines the warehouse receipt as including:[93]

> 2(1) ...

[89a] Uniform Commercial Code, Official Text, 9th ed. (Philadelphia, American Law Institute, 1978) (hereafter "UCC").

[90] UCC 9-304(3).

[91] Note, however, that if the field warehousing agreement does not provide for the granting of a security interest, possession will be essential for enforceability against third parties (UCC 9-203(1)). The real usefulness of the field warehouse is not the fact that it creates a security interest, but that it affords the lender much greater supervision over the collateral, thereby assuring that there will be adequate collateral in the event of default. Field warehousing is particularly suited to the needs of seasonal manufacturers, such as canneries, where the entire year's product is processed and the stock gradually sold off during the year.

[92] Gilmore, *op. cit.*, footnote 3 at p. 149.

[93] S.C. 1980, c. 40, s. 2(1).

> (*a*) any receipt given by any person for goods, wares and merchandise in his actual, visible and continued possession as bailee thereof in good faith and not as of his own property,
>
> (*b*) receipts given by any person who is the owner or keeper of a harbour, cove, pond, wharf, yard, warehouse, shed, storehouse or other place for the storage of goods, wares and merchandise ... delivered to him as bailee, and actually in the place or in one or more of the places owned or kept by him, whether such person is engaged in other business or not ...

The case of *Merchants Bank v. Monteith*,[94] decided in 1885, established that the same sort of proof of actual, visible and continued possession is not necessary where a warehouseman is engaged. Thus, a certain degree of laxity (not specified in the case) is afforded a warehouseman, which may be contrasted with the American position where possession and public notice of the security interest are crucial elements. The decision in *Monteith* was probably influenced by the fact that when it was decided there was still a provision in the Bank Act[95] that permitted a warehouseman to pledge fictitious receipts covering his own goods.

La Banque Nationale v. Royer,[96] decided in 1910, is the earliest Canadian decision in the area of field warehousing. The bank and the debtor had entered into an arrangement by which the debtor leased two portions of a building to a clerk of the debtor. The premises, located on the opposite side of the street from the debtor's place of business, were boarded up and locked. The clerk kept the keys and reported to the bank when goods were dispersed and accounted for the proceeds. There was some evidence of occasional laxity in that the debtors sometimes received goods without the permission of the warehouseman. The Quebec Court of Appeal found there to be a valid pledge of warehouse receipts in favour of the bank. The court was heavily influenced by the fact that at the time it was decided s. 88 of the Bank Act allowed banks to lend on the security of goods, but had not yet legislated a registry system.[97] Cross J. stated that the ability to create secret liens through the use of s. 88 security

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[94] (1885), 10 O.R. 529 (Ch. D.)

[95] See An Act to amend "An Act relating to Banks and Banking", S.C. 1880, c. 22, s. 7.

[96] (1910), 20 Que. K.B. 341.

[97] The registration requirements were added in 1923 to meet the criticism directed against the so-called "secret lien" authorized by s. 88.

indicated that "the element of exclusive physical possession has come to be of less significance, though it would, no doubt, continue to be an important element to be considered in cases where fraud was an issue."[98]

Re Wedlock,[99] decided in 1926 after the registry requirements had been put into place, involved a very weak warehousing system. The borrower was a company in the business of selling automobiles. The company leased part of its premises to the secretary-treasurer of the company for a nominal sum. The leased premises were used to exhibit the automobiles stored there. It was open to the public during business hours and was not barred or locked at those times. Employees of the company passed through it in the regular course of business. One of the keys was in the hands of the secretary-treasurer, who made daily checks of the cars on hand and accounted for any proceeds to the bank. Mathieson C.J., after noting that because the case involved a warehouseman a lesser proof of possession was necessary, upheld the validity of the system, though warning that "it is a frail structure to support credit and would go down before a breath of fraud or undue advantage".[99a] The learned judge, however, did not consider two significant changes in the Bank Act which distinguished the previous cases. A warehouseman could no longer pledge receipts covering his goods, and a Bank Act registry had been established. Both these changes indicate that a stricter view was to be taken of the requirement of either visible possession or a warning to third parties that the inventory was encumbered.

It is clear that by American standards the documents of title in *Re Wedlock* were fictitious, while those issued in *La Banque Nationale v. Royer* were of dubious validity. These warehousing schemes were put into place because the borrower, being a retail seller, could not grant s. 88 security to the bank.[100] The courts' lackadaisical attitude towards the requirement of possession by the warehouseman may reflect an understanding of these circumstances, but may be criticised because due regard was not given to the interests of creditors and subsequent mortgagees who may have been misled into thinking that the inventory was unencumbered.

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[98] *Supra*, footnote 96 at p. 349.

[99] [1926] 2 D.L.R. 263, 7 C.B.R. 147 (P.E.I. S.C. in Bkcy.).

[99a] *Ibid.*, at p. 270 D.L.R., p. 154 C.B.R.

[100] This restriction was removed in the most recent Bank Act revision, S.C. 1980, c. 40, s. 178(1)(*a*).

4. The Provisions of the Personal Property Security Act

The provisions of the Ontario Personal Property Security Act[101] relating to the pledge of documents of title are very similar to the American Article 9 provisions. The Act provides three general methods of perfection, each of which has application to the documentary pledge. Section 24 provides that possession of a negotiable document of title by the secured party, or on his behalf by someone other than the debtor or the debtor's agent, perfects a security interest in it for so long as possession continues. Section 25 permits perfection by registration of a security interest in a document of title. The temporary perfection rules of s. 26 are in two parts. Section 26(1) provides that a security interest in a negotiable document of title is temporarily perfected for the first 10 days after it attaches to the extent it arises for new value given under a signed security agreement. Under this section a lender may make loans that enable the borrower to acquire negotiable documents of title on the security of those documents. Section 26(2) provides that a perfected security interest in a negotiable document of title or in goods held by a bailee is temporarily perfected for 10 days after the collateral comes under the control of the debtor, where the secured party makes it available for the purpose of:

> (2) ...
> (i) ultimate sale or exchange,
> (ii) loading, unloading, store, shipping or transshipping, or
> (iii) manufacturing, processing, packaging or otherwise dealing with goods in a manner preliminary to their sale or exchange.

This section covers the situation where the bank has possession or control of the collateral, but releases it to the debtor to allow the above stated dealings.

Examining these sections alone, one might conclude that, aside from temporary perfection, a security interest in negotiable documents of title may be perfected by possession or registration, whereas a security interest in a non-negotiable document of title may only be perfected by registration. There is, however, a more

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[101] R.S.O. 1980, c. 375.

specific section that deals with the perfection of security interests in goods held by a bailee. Section 28(1) provides that a security interest in goods covered by a negotiable document of title is perfected by perfecting a security interest in the document (by possession or registration). Section 28(2) provides that a security interest in goods in the possession of a bailee where not covered by a negotiable document of title is perfected by:

> (2) ...
>
> (*a*) issuance of a document of title in the name of the secured party;
>
> (*b*) a holding on behalf of the secured party pursuant to section 24; or
>
> (*c*) registration as to the goods.

The underlying rationale of these provisions is that "so long as a negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in the document and the proper way of dealing with such goods is through the document".[102] Where a non-negotiable document of title is involved, "title to the goods is not looked on as being locked up in the document and the secured party may perfect his interest directly in the goods".[103] Section 28(2) enumerates the methods by which such perfection as to the goods may occur. Registration is an obvious method. The other two methods — attornment and the issuance of documents of title in the name of the secured party — are simply elaborations of methods of perfection by possession. It would seem, therefore, that it is not useful to think of a perfected security interest in non-negotiable documents of title, even though s. 25 suggests this is possible. The non-negotiable documents have no value as collateral because they do not represent the goods.

The position of negotiable documents of title is different. One may register a security interest in such documents. The commercial practice is that the lenders will take possession of the document of title. Indeed, this is often an essential element, as s. 10 provides that a security interest is not enforceable against a third party unless the collateral is in the possession of the secured party, or the debtor has signed a security agreement. Often such a

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[102] See Official Comment to UCC 9-304, at para. 2.

[103] *Ibid.*, at para. 3.

security agreement will not exist, and possession of the document is therefore a necessary condition for enforceability.[104]

Perfection by registration may be important where the lender has taken a floating charge or floating lien security on all the assets of the debtor. Registration, however, represents an inferior method of perfection. Section 31(1)(*b*) provides that the rights of a holder of a negotiable document of title, who takes it in good faith for value, are to be determined without regard to the PPSA. Section 31(2) provides that registration does not constitute constructive notice where such a transferee is involved. Thus, perfection by registration (as well as temporary perfection) is liable to be defeated by a subsequent party who takes possession of the document.

5. Harmonizing the Various Enactments

The law relating to the documentary pledge is characterized by a number of overlapping, conflicting and interlocking statutory provisions. In attempting to rationalize the resultant structure, two basic tenets should be emphasized. First, the principle of federal paramountcy dictates that the provisions of the Bank Act will prevail notwithstanding conflicting provincial legislation. Secondly, s. 69 of the PPSA provides:

> 69 . . . where there is conflict between a provision of this Act and a provision of any general or special Act, other than the *Consumer Protection Act*, the provision of this Act prevails.

The failure of the Bank Act to distinguish between negotiable and non-negotiable receipts creates difficulties. The whole policy behind treating warehouse receipts as documents of title was that production of the receipt was necessary in order to obtain the goods.[105] Yet the Bank Act applies to non-negotiable receipts, in which title is not locked up in the document. The Warehouse Receipts Act simply underscores the fact that not all warehouse

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[104] Note, however, that the standard conditions of contract of the Royal Bank of Canada letter of credit contains a provision under which the debtor agrees:

> 3. To give the Bank from time to time security by way of bills of lading, warehouse receipts and any other security required by the use of the Bank covering all of the property which may be purchased through Credit.

It would seem that in the absence of such an agreement, the secured party, in order to take advantage of the temporary perfection provision in s. 26(2), must surrender the document to the debtor under a letter of trust or similar document.

[105] See *supra*, footnote 26. See also *Canadian Pacific Ry. Co. v. Canadian Bank of Commerce* (1916), 30 D.L.R. 316, 44 N.B.R. 130 (S.C.).

receipts need be produced, and makes such instances readily identifiable.[106] The pledgor can obtain possession of the goods without the non-negotiable receipt, and can fraudulently sell or encumber the goods to third parties. Section 30(1) of the PPSA will protect ordinary course buyers. Subsequent secured and unsecured creditors are not so protected. Section 22, which subordinates unperfected security interests to such creditors, has no application to non-PPSA security interests.[107]

A non-bank pledgee of a non-negotiable document of title is in a different position. Although the provisions of the Mercantile Law Amendment Act are similar to those of the Bank Act, the PPSA governs in case of conflict. A security interest in goods covered by a non-negotiable document of title cannot be perfected under the PPSA by mere endorsement and delivery of the document, but requires attornment by the warehouseman or registration of the security interest. Thus, a non-bank pledgee of such documents who does not so perfect his interest is subject to defeat by executing creditors,[108] the trustee in bankruptcy,[109] and holders of subsequent security interests.[110]

Such situations will not, however, be common; in practice no lender will intentionally lend money upon the security of straight bills of lading or non-negotiable warehouse receipts without taking the precaution of being named as consignee in the case of a bill of lading, or as the party to whom the goods are to be surrendered in the case of a warehouse receipt.

The Warehouse Receipts Act does distinguish between negotiable and non-negotiable documents. The definition of a warehouse receipt does not, however, encompass all warehouse receipts.[111] Documents of title may be divided into the following categories:

(1) negotiable warehouse receipts under the Warehouse Receipts Act;

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[106] Section 5(1) of the Warehouse Receipts Act, R.S.O. 1980, c. 528, provides that a warehouseman who issues a non-negotiable receipt shall cause to be plainly marked upon its face the words "non-negotiable" or "not negotiable".

[107] See *Rogerson Lumber Co. Ltd. v. Four Seasons Chalet Ltd.* (1980), 113 D.L.R. (3d) 671, 29 O.R. (2d) 193 (C.A.).

[108] PPSA, s. 22(1)(*a*)(ii).

[109] *Ibid.*, s. 22(1)(*a*)(iii).

[110] *Ibid.*, s. 35(1)(*b*).

[111] The Act applies only to warehousemen who receive goods for storage for reward. In

(2) non-negotiable warehouse receipts under the Warehouse Receipts Act;
(3) warehouse receipts that are not covered by the Warehouse Receipts Act which under the common law are neither negotiable nor symbolic of the goods;
(4) order bills of lading which are not negotiable in the strict sense but are symbolic of the goods; and
(5) straight bills of lading which are neither negotiable nor symbolic of the goods.

The PPSA distinguishes between negotiable and non-negotiable documents of title, but does not define these terms. A document of title is defined as:[112]

> (*i*) ... any writing that purports to be issued by or addressed to a bailee and purports to cover such goods in the bailee's possession as are identified or fungible portions of an identified mass, and that in the ordinary course of business is treated as establishing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers.

This definition is sufficiently wide to cover all the classes of documents of title enumerated above.

It is clear that negotiable warehouse receipts are to be considered negotiable documents of title under the PPSA. It is equally clear that straight bills of lading, non-negotiable warehouse receipts, and warehouse receipts not covered by the Warehouse Receipts Act are non-negotiable documents. The real problem lies in classifying order bills of lading. The policy behind the perfection sections is that "title to the goods is locked up with the document". This is simply a manifestation of the symbolic character of order bills of lading. Thus, for the purposes of these sections, order bills of lading should be considered to be "negotiable". However, a problem arises when one applies this characterization to the other sections of the Act. Section 31(1)(*b*) provides that the rights of a holder of a negotiable document of title who takes in good faith for value are to be determined without regard to the Act. This section appears to refer to negoti-

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addition, s. 31 excludes receipts given in respect of the storage of furs, garments and home furnishings, other than furniture, that are ordinarily used by the person placing them in storage or a member of his family or household.

[112] PPSA, s. 1(*i*).

ability in the sense of an ability to obtain a better title than one's transferor. If one treats order bills of lading as negotiable for the purposes of this section, certain difficulties arise. The section forces a determination of the rights of a holder of the bill of lading without regard to the PPSA, yet under the common law the transferee of such a document will obtain only those rights possessed by the transferor (subject to the Factors Act exception). It is submitted that the application of this section should be restricted to documents that possess a true concept of negotiability. Its application to order bills of lading will create a "gap" in which common law concepts must be resorted to in order to determine priorities. Furthermore, a court could be faced with the conceptually difficult task of using pre-PPSA concepts to resolve priorities where the competition involves a security agreement that is not worded in terms of the traditional reservation or transfer of a property interest, but simply grants to the lender a security interest in the collateral. This problem does not exist in the United States because there negotiable bills of lading are both symbolic of the goods and negotiable in the true sense of the word.[113] Accordingly, one need not look to the interest of the transferor to determine that of the transferee. In Canada, the term "negotiable" should be recognized as referring to two distinct characteristics. Order bills of lading should be considered negotiable for the purpose of determining the appropriate method of perfection, but not for the application of s. 31(1)(*b*).[114]

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[113] Gilmore, "The Commercial Doctrine of Good Faith Purchase", 63 Yale L. J. 1057 (1953-54), at p. 1077 states that the conceptual step that led to the negotiable character of the bill of lading was the application of the merger doctrine:

> . . . just as the only payment that will discharge the obligor on a negotiable instrument is payment to the holder, so, in the documentary adaptation of the rule, the only delivery that will discharge the issuer is delivery to the holder of the document. Once that premise had been accepted, with the necessary corollary that title derived from the document prevails over title derived from the goods, an immense new source of commercial credit opened up.

The American courts did not, however, take the further step and give warehouse receipts a similar treatment, though such receipts were held to be symbolic of the goods. See Vaughn, *op. cit.*, footnote 23 at pp. 17-19.

[114] Even more obscure is the position in Saskatchewan, which has not enacted the Warehouse Receipts Act. As a result, there are no documents of title negotiable in the true sense. Nevertheless the Saskatchewan PPSA, S.S. 1979-80, c. P-6.1, s. 31(4) provides that a holder of a negotiable document of title has priority over an interest perfected by registration, or by temporary perfection, if the holder was for value without notice. To have any effect at all this must refer only to order bills of lading.

Very difficult problems arise in respect of the relationship between the Bank Act provisions and the PPSA. Prior to 1967 there were two entirely independent spheres: the Bank Act provisions applied to banks, while provincial law (the Mercantile Law Amendment Act) applied to other lenders. In the 1967 revision of the Bank Act the restriction prohibiting banks from lending on the security of goods was deleted. This permitted banks to use provincial security devices. Thus, three alternatives exist:

(1) The provisions of the Bank Act are exclusive: a bank that takes a document of title as security necessarily falls under the Bank Act provisions and no other provincial law may add to or modify the rights of the bank;
(2) The bank can elect the regime under which it is taking security; and
(3) The Acts should be read as creating two sets of concurrent rights and remedies (*i.e.*, the rights and remedies are cumulative): an election is required only where there is a conflict between the two Acts (or alternatively, where such a conflict arises the federal paramountcy rule governs).

The issue is important because there are significant differences between the treatment of the documentary pledge by the PPSA and by the Bank Act. The statutes contain different provisions for realization upon the collateral in event of default,[115] with the PPSA placing more extensive duties on the secured party. The PPSA contains temporary perfection provisions,[116] provisions permitting the registration of a security interest in negotiable documents of title,[117] and more extensive proceeds provisions.[118] These provisions are more favourable to the lender than those of the Bank Act. Although a bank may surrender the document of title to the debtor pursuant to a trust receipt or letter of trust, the temporary perfection rules of the PPSA will not apply unless the original interest is perfected under the PPSA.

The question then is whether a pledge of documents of title to a

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Thus, order bills of lading are negotiable, while warehouse receipts are not; precisely the opposite position as Ontario.

[115] PPSA, R.S.O. 1980, c. 375, Part V; Bank Act, S.C. 1980, c. 40, s. 179(4).

[116] *Ibid.*, s. 26.

[117] *Ibid.*, s. 25.

[118] *Ibid.*, s. 27.

bank can be said to be perfected under the PPSA. If the two regimes are cumulative, the bank may take advantage of the temporary perfection provisions of the PPSA because such documents will have been perfected by possession. If the two regimes are exclusive, the documents cannot be said to be perfected under the PPSA and the bank must register a financing statement in respect of the trust receipt.

It is possible that a court might view the trust receipt as so closely connected with the pledge under the Bank Act that the PPSA should not apply in respect of the trust receipt. But even in this case the Factors Act would apply,[119] and a subsequent purchaser or pledgee in good faith for value would take free of the trust receipt.[120]

An attempt to attach an intention to choose one regime over another may well be a fictitious exercise. In most cases the bank will intend merely to take possession of the document of title as security, without directing its mind towards which regime should apply. It would, however, be possible to create a presumption to prefer one regime (perhaps in favour of the application of the Bank Act) unless a contrary intention is shown. The possibility of concurrent rights is superficially attractive, but difficult to apply. There is no precise criteria for determining when the two regimes conflict. In addition, one may question whether a bank should be entitled to claim benefits under both statutes and thereby obtain a more favourable position than that available under either Act alone.

The relationship between the PPSA and other provincial enactments gives rise to three further questions. The first involves the relationship between the Mercantile Law Amendment Act and the PPSA. It has been shown that the ability to effect a valid pledge of non-negotiable documents of title[121] under the Mercantile Law Amendment Act must now yield to the PPSA, which requires registration or attornment by the warehouseman to perfect the interest. The Mercantile Law Amendment Act also

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[119] *A.-G. Can. v. Mandigo* (1964), 46 D.L.R. (2d) 563 (Que. Q.B., App. Div.).

[120] *Lloyds Bank, Ltd. v. Bank of America National Trust and Savings Association*, [1938] 2 K.B. 147 (C.A.).

[121] See *Champlain Sept-Iles Express Inc. v. Metal Koting Continuous Colour Coat Ltd.* (1982), 38 O.R. (2d) 182 (Prov. Ct.) for a discussion of the position of straight bills of lading and other non-negotiable documents in relation to the definition of "bill of lading" under the common law as well as under the Mercantile Law Amendment Act.

contains provisions for realization on the security in the event of default,[122] a time limitation of six months on the length of time a documentary pledge may be held,[123] provisions allowing a warehouseman to pledge fictitious receipts covering his own goods,[124] and a provision that a pledge of documents of title shall not be made under the Act to secure the payment of any debt unless the debt is contracted at the time of the acquisition of the document or upon the written promise that such document would be given.[125] Because of the imperative nature of Part V of the PPSA, it is likely that the secured party must conform to that Part when enforcing the security upon default. It is less clear whether there is a conflict with the other provisions. It may be argued that they are simply in addition to the PPSA requirements. It is submitted that the better view is to recognize that the PPSA takes a functional approach so as "to sweep aside the bewildering variety of statutory, common law, and equitable rules which have developed around the existing security devices."[126]

The second concern is the relationship between the PPSA and the Factors Act. A possible conflict may occur where a lender releases a document of title to the debtor, and relies upon the temporary perfection provisions as against subsequent parties. If such a party could not establish himself as a holder of the documents of title under s. 31(1)(*b*), or as an ordinary course puchaser of the goods, he may attempt to invoke the Factors Act. This would likely occur where a subsequent secured party has merely registered his interest (and has not taken possession of the documents so as to establish himself as a holder), or where a purchaser does not qualify as an ordinary course purchaser but has purchased "in the ordinary course of business of a mercantile agent".[127] It has been said that the PPSA was designed so to

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[122] R.S.O. 1980, c. 265, s. 13(1).

[123] *Ibid.*, s. 11(1) and (2).

[124] *Ibid.*, s. 9. The Bank Act formerly contained a similar provision, which was repealed in 1890. It has been criticized as an invitation to abuse because it permits the pledgor to deal with the goods after pledging the receipts. See *Royal Canadian Bank v. Ross* (1877), 40 U.C.R. 466 (Q.B.), at p. 473.

[125] *Supra*, footnote 122, s. 11(3).

[126] J.S. Ziegel, "The Draft Ontario Personal Property Security Act", 44 Can. Bar Rev. 104 (1966), at p. 113.

[127] Factors Act, R.S.O. 1980, c. 150, s. 2(1). It may well be that there is no additional scope for this provision in respect of purchasers; *i.e.*, it is completely encompassed by the ordinary course purchaser provision of the PPSA.

replace the exceptions of *nemo dat* rule that are contained in older statutes,[128] with the result that the Factors Act would no longer apply to the documentary pledge transaction. But perhaps this is too superficial an approach. The Factors Act was not concerned with the problem of "secret liens" so much as it was with the ability of a mercantile agent to bind his principal in respect of goods or documents of title entrusted to him. It did not matter whether the principal was the owner or merely a secured party.[129] The object and intent of the Act is different from that of ss. 30(1) and 31(1)(*b*) of the PPSA, which are concerned with the purchaser's ability to take free of a security interest. Thus, a strong argument may be made that the Factors Act deals with a special case, and should not be superseded by the more general provisions contained in the PPSA.

Finally, there is the question of the rights of an unpaid vendor. The PPSA expressly provides that the Act does not apply to a lien given by statute or rule of law.[130] Section 3(2) provides:

> (2) The rights of buyers and sellers under subsection 20(2) and sections 39, 40, 41 and 43 of the *Sale of Goods Act* are not affected by this Act.

The enumerated sections deal with the ability of the seller to reserve the right of disposal of having the bill of lading made out to the order of the seller, the unpaid seller's liens, and the right of stoppage *in transitu*. Curiously, s. 45 is excluded. This section provides, *inter alia*:[131]

> 45. Subject to this Act, the unpaid seller's right of lien or retention or stoppage in transitu is not affected by any sale or other disposition of the goods that the buyer may have made, unless the seller has assented thereto, but where a document of title to goods has been lawfully transferred to a person as buyer or owner of the goods and that person transfers the document to a person who takes the document in good faith and for valuable consideration, then ... if the last-mentioned transfer was by way of pledge or other disposition for value, the unpaid seller's right of lien or

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[128] See Catzman *et al.*, *Personal Property Security Law in Ontario* (Toronto, Carswell Co. Ltd., 1976), p. 144.

[129] *Lloyds Bank, Limited v. Bank of America National Trust and Savings Association*, *supra*, footnote 120.

[130] PPSA, s. 3(1).

[131] Sale of Goods Act, R.S.O. 1980, c. 462, s. 45. A similar provision to s. 45 of the Sale of Goods Act exists in the Mercantile Law Amendment Act, R.S.O. 1980, c. 265, s. 12. The Ontario Law Reform Commission has recommended the deletion of s. 45 as being repetitive.

> retention or stoppage in transitu can only be exercised subject to the rights of the transferee.

It may be argued that the exclusion of this section from the enumeration in s. 3(2) of the PPSA indicates that an unpaid seller's lien should not have priority in such a case. The better view is that s. 3(2) simply removes those rights from the purview of the PPSA, and should not be taken to limit the ability of other statutes to affect such rights. Thus, there was no reason to include s. 45 in the enumeration. In this respect, the rights of an unpaid seller under the PPSA are identical to those under the Bank Act.[132]

6. Conclusions

Three major alterations to the law are recommended. First, those provisions of the Mercantile Law Amendment Act that pertain to the pledge of documents of title should be repealed. The provisions are outdated; they should yield to the more comprehensive and rational approach of the PPSA. Their continued existence will only create uncertainty.

Second, Article 7 of the Uniform Commercial Code should be examined as a possible model for the systematic reform of the law governing documents of title. The Ontario Law Reform Commission has made such a recommendation in its report[133] on the Sale of Goods. A comprehensive treatment is necessary to create the rational "mesh" that exists between Article 7 and Article 9.

Finally, the sections of the Bank Act that relate to the documentary pledge should be repealed. These provisions were originally enacted to circumvent the restriction that prohibited banks from lending on the security of goods, wares and merchandise. The restriction no longer exists, and the continued presence

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[132] S.C. 1980, c. 40, s. 179(1).

[133] *Report on the Sale of Goods*, Vol. 2 (1979), p. 329.

of these sections will only lead to conflict with provincial law. One must note, however, that the s. 178 Bank Act security provisions incorporate these sections,[134] and their deletion would require a major re-examination of the s. 178 device. Unfortunately there appears to be little progress at present in this regard.[135]

[134] Section 178(2) provides, *inter alia*:

> (2) Delivery of a document giving security on property to a bank under the authority of this section vests in the bank in respect of the property therein described ... the same rights and powers as if the bank had acquired a warehouse receipt or bill of lading in which such property was described ...

[135] See the submission of the M.U.P.P.S.A. Committee of the Canadian Bar Association, reproduced in 4 C.B.L.J. 369 (1979-80), presented to the Finance Committee of the House of Commons. A growing number of writers are calling for a repeal of the Bank Act security provisions, at least in jurisdictions where there is a PPSA in force. See Ziegel and Cuming, "The Modernization of Canadian Personal Property Security Law", 31 U. of Tor. L.J. 249 (1981), at pp. 254-6; McLaren, *Proceedings of the Tenth Annual Workshop on Commercial and Consumer Law*, J. S. Ziegel, ed. (Toronto, Canada Law Book Ltd., 1982), p. 162.