



Update: Financing The Purchase of Vehicles - A New Take on an Old Case

by Diane Brooks

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Last year, Blaneys on Business brought to your attention the Ontario Superior Court of Justice decision which awarded the salvage and proceeds from two trucks to ING Insurance Company of Canada, in priority to the rights of the lender in those same trucks, GE Canada Equipment Finance G.P. That decision just didn't ring true to us and now, the Ontario Court of Appeal has agreed.

To refresh your memory on the background, GE financed two highway tractors for Brampton Leasing and Rental Inc. by conditional sales contract, properly registering its interest in the tractors under Ontario's Personal Property Security Act (PPSA) and reserving title to them until they were fully paid for.

Brampton leased the vehicles to a third party, or sublessee, who obtained insurance from ING, naming itself as lessee and Brampton as lessor, but not naming GE.

The vehicles were stolen and ING made payment to cover the total loss to Brampton, on Brampton's false declaration that no one else, other than the third party sublessee and Brampton had a secured interest in the vehicles. When the salvage of the trucks were recovered, ING took possession of them. GE commenced an action against ING claiming that GE was entitled to the salvage and any proceeds of sale.

The Ontario Superior Court held that ING was entitled to the salvage and any proceeds, effectively holding that section 4(1)(c) of the PPSA, which provides that the Act does *not* apply to a transfer of an interest in an insurance policy, and section 9, which states that a security agreement is effective against third parties "except as otherwise provided by this *or any other Act*," made room for statutory condition 6(7) of the Insurance Act to prevail.

The Ontario Court of Appeal however, took a different view of the interplay between the conflicting statutes. In its judgement, section 4 (1)(c) of the PPSA was never intended to address priority disputes. The only purpose of the section was so that insurance companies did not have to file financing statements under the PPSA to validate their security interests taken in insurance policies. So, while title to the salvage of the trucks was transferred to ING pursuant to statutory condition 6(7), that transfer of title was NOT free and clear of encumbrances and the title that ING took was subject to GE's prior lien. Statutory condition 6(7) puts the insurer in the same position as the insured - their title is subject to GE's lien. The court's logic is quite compelling - if a debtor wanted to defeat a secured creditor's lien, he/she could purchase insurance and in the event of a total loss of the vehicle, the secured creditor's lien could be extinguished at the option of the insurance company. That is not a reasonable conclusion and cannot be what the legislators intended.

Having dealt with the issue above, the Court of Appeal had to continue and consider another argument advanced by ING at trial that the trial judge found unnecessary to consider. Section 28(1) of the PPSA provides that a purchaser for value of collateral sold in the ordinary course of business takes free and clear of liens created by the seller. In dispensing with this argument, the Court of Appeal found that (1) a transfer of title pursuant to statutory condition 6(7) was not a sale and (2) even if it were a sale, it was most certainly not in the ordinary course of Brampton's business.

ING was also permitted to raise another argument at appeal, that section 25(1) of the PPSA prevented GE's security interest from attaching to the vehicles in ING's hands. Their argument was based on their view that GE had "impliedly" authorized dealing with the collateral free of their security interest and accordingly, their lien was released upon the transfer of title. ING argued that by authorizing Brampton to deal with insurance related matters and by classifying their collateral as inventory, GE implicitly authorized Brampton to deal with the vehicles and hence, the GE lien would not continue after an intervening event such as a sale or transfer of title for insurance purposes. The Court of Appeal disagreed with ING on this point as well and ultimately decided that the dishonest acts of Brampton should be born by ING.

A Comforting Conclusion

The Court of Appeal decision should be of great comfort to secured lenders. It upholds, again, the sanctity of Ontario's personal property security regime by noting that secured creditors should not lose priority as a result of a debtor misleading its insurers because to lose such priority would undermine normal good faith financings.

It also makes clear that any title acquired by insurers is subject to prior liens and that now insurance companies are advised to conduct PPSA searches prior to paying out claims or they risk taking a salvage that is already encumbered. ■