Cassels

Priority Fight – Unpaid Supplier Taking on a Bank

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Every now and then you read a case that seems like a law school exam question. The recent decision of *The Bank of Nova Scotia and Scotia Dealer Advantage Inc. v Darcy Tucker Holdings Ltd.* is a perfect example. In this case, the Court of King's Bench of New Brunswick found that a lender to customers purchasing vehicles from a dealership had priority over a supplier of those vehicles even though the supplier was never paid by the dealership for the vehicles and may not have transferred title to the dealership.

Facts

DMR Auto Sales (DMR), a car dealership, entered into an arrangement with Darcy Tucker Holdings Inc. (DTHI), a vehicle wholesaler, whereby DTHI supplied vehicles to DMR. DMR would sell those vehicles to its customers in the ordinary course of business and would sometimes arrange financing of those vehicles with a bank, in this case, The Bank of Nova Scotia (BNS). Part of this arrangement included DTHI retaining the registration of the vehicles in its name until DMR paid DTHI after the vehicles were sold.

DMR sold four vehicles (the Vehicles) to four separate customers, and each of the customers signed credit agreements with DMR for financing that DMR then assigned to BNS. BNS took purchase money security interests or PMSIs in the Vehicles and proceeded to register financing statements within fifteen (15) days of the customer taking possession of the respective vehicle, as required under the *Personal Property Security Act* (New Brunswick) (the PPSA).

A sales representative of DMR allegedly engaged in fraudulent activity by selling the Vehicles to the customers without paying DTHI for those vehicles. DTHI was not aware of these transactions.

Who Has Priority to the Vehicles?

The Court found that BNS had priority over DTHI to the Vehicles. Although the Court did not go into detail on the question of ownership, the Court did find that except for retaining registration of the Vehicles (which was in the name of DTHI), all other indicia of title in the vehicles resided with DMR, and through it, with the customers.

The Court went on to hold, however, that the PPSA is not concerned with ownership but is instead concerned with a proprietary interest. As such, a debtor in lawful possession of the collateral, such as DMR, had sufficient rights to support the attachment of a security interest to that collateral regardless of the fact that the debtor's interest does not amount to full title or ownership.

In this case, DMR was found to be in lawful possession of the vehicles because DTHI permitted the vehicles to be placed or remain at DMR's premises while also providing DMR with keys to the vehicles. The Court noted that possession is of particular importance in these kinds of cases and referenced Section 30(2) of the PPSA which states that "*A buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free of any perfected or unperfected security interest given by the seller or lessor,… whether or not the buyer or lessee knows of it."* Based on this, the Court held that the customers took the vehicles free of any perfected or unperfected security interest that DTHI might have had, because any potential customers would naturally believe that DMR had the authority to sell and transfer title in the vehicles to the customers upon seeing the cars for sale on DMR's premises.

BNS's PMSI

With respect to BNS's PMSI in the Vehicles, the Court held that BNS had a super-priority in the Vehicles pursuant to Section 34 of the PPSA, as the credit agreements in question met the definition of PMSI, and BNS perfected the security interests within fifteen (15) days as required under the PPSA. The Court found that DTHI retained registration of the Vehicles as security for the amounts owed to it by DMR, but DTHI did not take any additional steps to perfect its security interest. As such, BNS's PMSI trumped DTHI's unperfected security interest.

Takeaways

The Court's decision in this case demonstrates the importance of possession in instances where suppliers are not paid for goods by a party that then sells those unpaid goods to unassuming customers. The decision also illustrates that the PPSA is primarily concerned with proprietary interest over ownership when determining priority disputes.
