

## Lessons Learned - Lesson Seven: How to Take PMSI in Inventory to Ensure No Loss in Priority

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*Cassels developed this **Lessons Learned** series based on our experience with priority disputes between secured creditors and the realization that many secured parties make fundamental errors of law that cause them to lose priority in their collateral. Each lesson in the series will outline a basic mistake and the lesson to be learned...*

### Lessons Seven: How to Take PMSI in Inventory to Ensure No Loss in Priority

The *Personal Property Security Act* (Ontario) (the PPSA) provides for a particular type of security interest known as a purchase-money security interest or “PMSI” which allows for “super-priority” relative to other security interests in the same collateral. A PMSI may arise where a secured party provides funding for all or part of the purchase of goods or supplies goods where all or part of the purchase price remains outstanding. The PPSA also provides for a PMSI to be obtained over equipment. A PMSI over equipment involves a different set of requirements and we will cover these requirements in another edition of our Lessons Learned series.

In recent matters where our firm has been involved, many suppliers and lessors failed to follow the procedures required to obtain a valid PMSI in inventory. The result being that these secured creditors lost the super-priority which they would otherwise have. This lesson is to remind creditors of the steps that need to be followed to ensure a PMSI in inventory is achieved.

In Ontario, inventory is comprised of goods that are held by a debtor for sale, lease, that have been leased, that are to be furnished or have been furnished under a contract of service, or that are raw materials, work in process or materials used or consumed in a business. As discussed in Lesson Six, if a lessee has the right to sublease the goods at the onset, then such goods are inventory in the hands of the lessee.

### Perfection

To obtain a PMSI in inventory, the PMSI must attach to the collateral and a financing statement must be registered at the time (i) the debtor obtained possession of the inventory, or (ii) a third party (at the request

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of the debtor) obtained or held possession of the inventory, whichever is earlier.

*Attachment:* The PMSI will attach to the collateral once (a) value is given, (b) the debtor has rights in the collateral and (c) the debtor has signed a security agreement that contains a description of the collateral sufficient to enable it to be identified.

*Registration:* The PMSI secured party must also register a financing statement. Where the Ontario PPSA applies, the PMSI secured party must ensure that the appropriate collateral classification boxes are checked, which will generally be the “inventory,” “equipment,” “accounts” and “other” boxes. In Ontario, a general collateral description is not required but the appropriate collateral classification boxes must be checked.

## Notice Requirements

A PPSA search against the debtor should be ordered and reviewed, and notice must be delivered to every other party who has, before the date of registration of the financing statement by the PMSI secured party, registered a financing statement that describes the collateral as, or as including: (i) items or types of inventory, all or some of which are the same as the items or types of inventory that will be subject to the PMSI, (ii) inventory, or (iii) accounts. Notice need not be delivered to a secured party who has included a general collateral description that clearly does not extend to the collateral that will be subject to the PMSI. For example, notice need not be sent to a prior secured party where such registration has a general collateral description detailing an office copier with a listed serial number and the collateral over which the PMSI will be obtained consists of motor vehicles with listed VINs.

The notice must state that the person giving it has or expects to acquire a PMSI in inventory of the debtor and describe such inventory by item or type.

The notice must be given to the other secured parties **before** the debtor receives possession of the inventory.

Notice to be given to a secured party named in a registered financing statement may be (i) served by personal service, (ii) delivered by prepaid courier, or sent by registered mail, to the most recent address of the secured party as shown in the financing statement, or (iii) sent by fax or email. It is important to ensure that post office receipts, return receipts or other evidence of receipt are obtained and kept with the relevant PPSA search in the account file as proof that the prior secured party actually received the PMSI notice may be required.

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Care should be taken to ensure all requirements under the PPSA are met for a valid PMSI in inventory to be obtained. The following must occur **before** the debtor obtains possession of the collateral: (1) attachment of the PMSI and registration of the financing statement under the PPSA and (2) PMSI notices must be given to all prior secured creditors. Failure to follow this process may be fatal to the super-priority position afforded to a valid PMSI in inventory.

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*This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.*