

Financial Services Flash

AIRD & BERLIS LLP
Barristers and Solicitors

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Surplus Equity When Disposing of Assets Subject to a PMSI

The *Personal Property Security Act* (“PPSA”) in Ontario and the other common law provinces provides for the distribution of a surplus recognized on secured assets under a security agreement. In Ontario, section 64(1) of the PPSA instructs that any surplus be paid to: first, any person with a perfected security interest in the collateral that is subordinate to that of the secured party; second, any person with an interest in the surplus who has notified the secured party in writing of their interest before the distribution of proceeds occurs; and finally the debtor or another known owner of the collateral.

However, it is common for one creditor (for example, the debtor’s operating lender) to have general security over all of a debtor’s present and after-acquired assets, but another creditor (for example, an equipment financier) to have a purchase-money security interest (“PMSI”) granting it super-priority over specific assets. In such situations, when a specific asset subject to a PMSI is sold for an amount greater than the balance due to the creditor holding the PMSI, who is entitled to the surplus equity? *Royal Bank of Canada v. Ramco Sales Inc.*, a recent case before the Alberta Court of Queen’s Bench, revolved around the parallel section of the Alberta PPSA, section 61, and dealt with this very question.

The secured property at issue consisted of four pieces of equipment belonging to a company in receivership (“Ramco”). Ramco had purchased these items with funds advanced by the Canadian Western Bank (“CWB”). CWB held a separate PMSI over each piece of equipment. Royal Bank of Canada (“RBC”) held a first priority general security interest over all of Ramco’s present and after-acquired assets. One of the issues between the parties was which lender was entitled to the surplus equity if any equipment subject to a PMSI was sold for greater than the amount owed to CWB. CWB argued that any surplus equity from any of the four pieces of equipment should be applied against any deficiency outstanding on the other three PMSIs it held. RBC disagreed and argued that each piece of equipment was discrete and, as a secured lender with a PPSA registration covering Ramco’s equipment generally, it was entitled to any surplus.

The Court found that section 61(1) of the Alberta PPSA required that, “if there is a surplus after the collateral has been disposed of, it first goes to the party who has a subordinate interest insofar as the PMSI is concerned.” Therefore, RBC was entitled to any amount recovered in excess of that necessary to make CWB whole on the PMSI. CWB could not treat the four pieces of equipment collectively and use surplus on one piece of equipment to cover losses on another.

The Court also reasoned that a PMSI is only granted for assets not previously owned by a debtor and is limited to loans that can be traced to identifiable, discrete items of property. To allow surplus proceeds from one item subject to CWB’s PMSI to be used to fund a shortage from another, to the detriment of RBC, would go beyond the principle behind a PMSI – to allow debtors to acquire additional assets without being beholden to a single creditor.

An older Ontario case resulted in a holding similar to that in Ramco. At the trial level of *Canadian Imperial Bank of Commerce v. International Harvester Credit Corp. of Canada*, it was found that International Harvester was owed \$16,000 for a trailer, but was entitled to the full proceeds of its liquidation, being \$23,000. The Ontario Court of Appeal reversed

the trial judgment and directed the surplus funds to a subordinate secured party.

The key to remember from this line of case law in Alberta and Ontario (and likely other Canadian common law jurisdictions) is that any surplus after payment for the specific discredet item must be paid to the subsequent secured creditors, in order of priority.

The Financial Services Group at Aird & Berlis LLP has a great deal of experience in advising secured creditors regarding PMSIs and can assist in any issues that arise in connection therewith. For more information, please contact any member of the Financial Services Group. Details can be found on our [Financial Services, Insolvency and Restructuring web page](#), by clicking on [members](#).

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