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Mistaken Discharge and Loss of Priority Remedied By Equity (British Columbia)

By: Jonathan B. Ross and Lorena Vlad

A recent British Columbia Supreme Court case illustrates the dangers posed by a technical loophole in the British Columbia Personal Property Security Act (“PPSA”) and, at the same time, provides some hope for secured creditors who may have fallen victim to the loophole—losing their registered security interest through no fault of their own.

In *KBA Canada*¹, the Court considered whether a mistakenly discharged security interest could be given priority despite the strict priority regime in place under the PPSA.

The facts were not overly complex. The Plaintiff KBA Canada, Inc. (“KBA”) sold printing press equipment to a leasing arm of Wells Fargo, who then leased it to the Defendant 3S Printers Inc. (“3S”). As part of the sale to Wells Fargo, KBA agreed it would purchase and take an assignment of the lease if 3S defaulted. Upon making the lease, Wells Fargo registered a valid Purchase Money Security Interest (“PMSI”) against the equipment in the BC Personal Property Registry (“PPR”). 3S defaulted and pursuant to the sale agreement KBA took an assignment of the lease and security interest from Wells Fargo. Wells Fargo was deleted and KBA was formally substituted as the secured creditor in the PPR registration. Subsequent to the sale transaction, in what appears to be simply an administrative error, Wells Fargo discharged the registered security interest in the PPR. KBA did not approve this discharge, nor did it have knowledge of it at the time. KBA eventually learned of the mistake after which Wells Fargo immediately re-registered the financing statement. The re-registration occurred after the statutory 30-day grace period for the reversal of mistaken discharges. As a result, by the strict operation of the priority regime under the PPSA, KBA lost its PMSI priority to the two prior registered general security holders. KBA sued to regain its priority.

The Court noted it odd that someone other than KBA could discharge KBA’s PMSI, but neither the PPSA legislation nor the standard practice of BC Registry Services, which administers the PPR, have any safeguards to prevent this from happening. Evidence was deposed by the Deputy Registrar that there is “no system notification or administrative process to ensure that an application for discharge has been authorized by the registered security interest holder”².

The source of this unfortunate state of affairs is s. 48 of the Personal Property Security Regulation made under the PPSA, which provides that:

¹ *KBA Canada, Inc. v 3S Printers Inc.*, 2012 BCSC 1078 [“*KBA Canada*”].

² *KBA Canada*, at paragraph 20

s. 48 A registration may be effected in the registry without proof that

(b) the registering party has authority to submit the discharge.

The Court found that the registry treats a discharge as a registration.

KBA argued successfully that despite the discharged registration, it was entitled to regain its priority by the operation of ss. 68 and 70 of the PPSA and the principles of unjust enrichment.

The Court held that ss. 68 and 70 of the PPSA allow the Court to apply principles of equity and fairness, and exercise limited discretion in determining priorities between secured interests. In this case, the Court determined that the circumstances were such that it would be unjust to punish KBA while granting a windfall to the general security holders.

It is important to consider the specific circumstances which allowed for the favourable result for KBA. The registration was discharged in error and no notice of it was received by KBA. Furthermore, no further secured advances were made by any of the affected parties after the discharge. As a result there was no prejudice whatsoever to the remaining secured creditors by the court granting the result it did. Rather, if the Court did not act the remaining creditors would receive a windfall.

This decision is a good reminder that exceptions may be made to the strict priority regime under the PPSA and that unregistered interests may be given priority over registered interests—but only in very limited circumstances. It is also a good illustration of a weakness in the PPSA/PPR system, and a reminder that creditors should be ever vigilant in maintaining and verifying their registrations.

Jonathan B. Ross is an associate in Gowlings' Restructuring and Insolvency Group. He practices out of Vancouver and can be reached at (604) 891-2778 and jonathan.ross@gowlings.com

Lorena Vlad is a law student at the University of British Columbia. She summered with Gowlings in 2012 and will be returning to Gowlings as an articulated student after her graduation in 2013.

**This article has been amended from the version originally published. The original incorrect reference to s. 48 of the PPSA has been amended to correctly reference s. 48 of the Personal Property Security Regulation.*