GOOD FAITH DUTIES OF SECURED PARTIES AND RECEIVERS UNDER THE PERSONAL PROPERTY SECURITY ACT

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Mirth presents a detailed discussion of the duties of secured parties and receivers to act in good faith under the Personal Property Security Act *of Alberta. The focus is on ss. 16 and 66 of the Act which set out requirements similar to those codified in Part 8 of the Alberta* Business Corporations Act. *First, the duty of receivers to pursue the best possible price on the sale of assets is considered. Mirth then goes on to discuss how the duty of good faith was defined in pre-PPSA situations and determines that the duty will be of much more positive nature in the future: recent cases indicate that the test will be whether the actions undertaken were "commercially reasonable" in the situation. Mirth continues with an analysis of recent Alberta case law which is tending to offer a broad view of the duty of good faith. Ultimately, Mirth concludes that although the Alberta Court may have gone a little far in shifting the burden, the PPSA provisions have definitely resulted in stricter duties for receivers and secured parties than what existed under the old common law regime.*

Mirth examine en détails les obligations aux termes desquelles créanciers garantis et séquestres sont tenus d'agir en toute bonne foi conformément à la Personal Property Security Act de l'Alberta. L'accent porte sur les paragraphes 16 et 66 de la loi, dont les stipulations sont semblables à celles que codifie l'article 8 de l'Alberta Business Corporations Act. Il examine d'abord l'obligation du séquestre de rechercher le meilleur prix possible dans la vente des biens. Mirth aborde ensuite la façon dont le devoir de bonne foi était défini autrefois et en quoi il sera de nature beaucoup plus positive dans l'avenir: des cas récents indiquent que le test consistera à déterminer si les mesures prises étaient raisonnables sur le plan commercial en l'occurrence. Mirth propose ensuite une analyse du droit jurisprudentiel albertain récent, qui tend à offrir une perspective élargie du devoir de bonne foi. Enfin, Mirth conclut que, bien que la Cour de l'Alberta soit peut-être allée un peu loin en modifiant le fardeau, les stipulations de la PPSA débouchent clairement sur des devoirs plus sévères pour les séquestres et les créanciers garantis que ceux qu'exigeait l'ancien régime de la common law.

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I. QUESTIONS STATED

The purpose of this paper is to examine some of the provisions in the *Personal Property Security Act* of Alberta[1] that are designed for debtor protection and that reflect

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1. S.A. 1988, c. P-4.05 [hereinafter "PPSA"].

substantive law injections into the contracts between secured parties and debtors or amplify developing common law in similar context.

The main theme of this paper is to examine the impact that the PPSA will have for lenders and receivers in respect of their duties towards borrowers and creditors of borrowers. The question to be posed in that regard is will the PPSA affect a material change in the duties and obligations of lenders and their receivers? A sub-question is what might one project as directions for the future in the development of the law in this area?

II. PROVISIONS OF THE PPSA

The primary focus will be the provisions in the PPSA that address a requirement of good faith and commercial reasonableness. This concept is not a new one. It is found in part 8[2] of the Alberta *Business Corporations Act*[3] and has been part of the legislative environment of receivers and secured parties for several years. Part 8 of the ABCA continued in force even after the PPSA became operative. Section 94 of the ABCA states:

> A receiver or receiver-manager of a corporation appointed under an instrument shall (a) act honestly and in good faith and (b) deal with any property of the corporation in his possession or control in a commercially reasonable manner.

Similar concepts appear in sections 16 and 66 of the PPSA. Section 16 is quite narrow and addresses only the acceleration concept that is commonly found in security agreements:

> Where a security agreement provides that the secured party may accelerate payment or performance if he considers that he is insecure or that the collateral is in jeopardy, the security agreement shall be construed to mean that the secured party has the right to do so only if he, in good faith, believes and has commercially reasonable grounds to believe that the prospect of payment or performance is or is about to be impaired or that the collateral is or is about to be placed in jeopardy.

Section 66 has a very wide operation and provides as follows:

> (1) All rights, duties or obligations arising under a security agreement, under this Act or under any other applicable law shall be exercised or discharged in good faith and in a commercially reasonable manner.
>
> (2) A person does not act in bad faith merely because the person acts with knowledge of the interest of some other person.
>
> (3) The principles of the common law, equity and the law merchant, except insofar as they are inconsistent with the express provisions of this Act, supplement this Act and continue to apply.

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2. Section 94.
3. S.A. 1981, c. B-15 [hereinafter "ABCA"].

This section is located outside Part 5, (which is the section that deals with remedies); and it applies to the dealings between parties in and under security agreements all the way from inception to completion of remedy exercise. It imports into security agreements under the PPSA a general concept of good faith and fair dealing.[4] The section also brings into the duties a further concept of "commercial reasonableness." The requirements are conjunctive.

These are not the only PPSA sections that bear the stamp of debtor protection. A few others that might be mentioned (to dispose of them and get on with the main theme of this paper) include the following:

(a) Section 17 imposes a duty of care in custody and preservation of collateral in possession including to some extent a duty to take necessary steps to preserve rights against other persons. The section provides as follows:

(1) A secured party or sheriff shall use reasonable care in the custody and preservation of the collateral in his possession and, unless the parties to the security agreement otherwise agree, in the case of chattel paper, a security or an instrument, reasonable care includes taking necessary steps to preserve rights against other persons.

(2) Unless the parties to the security agreement otherwise agree, if collateral is in the possession of a secured party or a sheriff,

(a) reasonable expenses, including the cost of insurance and payment of taxes or other charges incurred in the obtaining, maintaining possession of and preserving the collateral, are chargeable to the debtor and are secured by the collateral,

(b) the risk of loss or damage, except if caused by the negligence of the secured party or sheriff, is on the debtor to the extent of any deficiency in any insurance coverage,

(c) the secured party may hold as additional security any increase or profits, except money, resulting from the collateral, and money so received, unless remitted to the debtor, shall be applied forthwith on its receipt in reduction of the obligation secured, and

(d) the secured party or sheriff shall keep the collateral identifiable, but fungible collateral may be commingled.

(3) Subject to subsection (1), a secured party may use the collateral

(a) in the manner and to the extent provided in the security agreement,

(b) for the purpose of preserving the collateral or its value, or

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4. This, as is noted later, is a concept recognized in American jurisdictions but not, until recently, generally accepted in English or Canadian common law jurisprudence outside the context of exercise of equitable remedies.

(c) pursuant to an order of the Court.

This section probably does not add to the law in the sense of a significant departure from common law principles. In so saying one must exclude the position of a sheriff. The latter has (or had) some statutory and crown privileges.[5] One might leave aside also the court-appointed receiver who has some immunity if he acts on the direction of the Court.

The common law position in respect of the duty of care while in possession might best be found in the position of a pledgee. That position is shown by *Miadovnik* v. *Szasz*.[6] The case involved a claim arising out of damage to rhinestones through deterioration while in the hands of a bailee for hire. The court (at p. 561) expressed the duty of such a bailee in the following terms, quoting from Halsbury:[7]

> A custodian for reward is bound to use due care and diligence in keeping and preserving the article entrusted to him on behalf of the bailor. The standard of care and diligence imposed on him is higher than that required of a gratuitous depository, and must be that care and diligence which a careful and vigilant man would exercise in the custody of his own chattels of a similar description and character in similar circumstances.
>
> He is therefore bound to take reasonable care to see that the place in which the chattel is kept, including the tackle used in connection with it, is fit and proper for the purpose, to see that the chattel is in proper custody, to protect it against unexpected danger, should it arise, to recover it, if it be stolen, and to safeguard the bailor's interest against adverse claims ....

Bennett On Receivership[8] describes a duty of receivers at common law that he equates to the statutory duties:

> The duty of the privately appointed receiver and manager to the debtor and others is ultimately to account for the assets and their realization and as well to hold any surplus for the debtor and third party creditors. At common law, and now as expanded by statute federally and in many provinces, this duty of care requires that the receiver act honestly and in good faith as well as deal with property in his possession or under his control in a commercially reasonable manner.

The duty of reasonable care applies apart from statute to the care of property while in possession. The PPSA's s. 17, accordingly, does not appear to add much to existing common law standards.

Some other sections in the Act that address matters of debtor protection include s.18, s.33, s.41, s.56(2), all of Part 5 (the remedies provisions in the statute) and of course ss.

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5. Query how many of the latter he continues to have in light of recent cases like *FCC* v. *Dunwoody*, [1988] 5 W.W.R. 87 (Alta. C.A.), leave denied by S.C.C. [1989] 4 W.W.R. lxx; and *Just* v. *B.C.*, [1990] 1 W.W.R. 385 (S.C.C.).
6. [1955] OWN 556.
7. 1 Halsbury, 2nd ed. 931 at 748-9.
8. (Toronto: Carswell, 1985) at 17.

66 and s. 67. None of these seem likely to have anywhere near the potential impact for the secured party and debtor inter-relationship as does s. 66.

When s. 66 mandates exercise and discharge "in good faith and in a commercially reasonable manner" it does so in reference to all rights, duties or obligations arising under a security agreement, the Act or law. One might query its operation on priorities issues, in light of *Northland Bank* v. *Flin Flon Mines*[9] and *Estevan Credit Union Ltd.* v. *Transam Commercial Finance Corp.*[10] However, Professors Wood and Cumming[11] doubt these decisions, at least insofar as the Alberta statute is concerned. Effectively any and every point of involvement between a secured party and his debtor requires exercise of both good faith and commercial reasonableness.

Following the leading edge of cases on lender duty to customers, as reflected in *Standard Investments* v. *CIBC*[12] and *Clairbourne Industries* v. *National Bank*,[13] these statutory extensions of duty are loaded with potential for both defence and damage claims as against secured parties. While the section's reach extends to the debtor's duties as well it is likely its impact will in practice be much greater for secured parties.[14]

III. SALE DUTY

In the context of sale, McLaren, *Secured Transactions On Personal Property in Canada*, suggests that the PPSA duty is to obtain the *best possible price*.[15] Bennett, however, describes the duty of a receiver on sale more restrictively as follows:

> Subject to fraud or collusion, the receiver has a duty to exercise the powers of sale bona fide and not to sacrifice the assets. However, the privately appointed receiver need not obtain the highest price available even though, from the debtor's point of view, the price actually obtained may be considered disadvantageous.
>
> Therefore, so long as the receiver exercises his power of sale bona fide and obtains a reasonable price for the assets in the circumstances, the court will not readily inquire into the conduct of the sale.[16]

If McLaren's statement of the duty under the PPSA is correct, then obviously such duty will be higher for the receiver of (or the party secured on) personal property than the duty described by Bennett.

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9. (1987), 38 D.L.R. (4th) 49, (affirmed on other grounds 46 D.L.R. (4th) 766 (Sask. C.A.)).
10. (1989), 78 Sask. R. 285 (Q.B.).
11. *Alberta PPSA Handbook* (Toronto: Carswell, 1991) at 335.
12. (1985), 52 O.R. (2d) 473 (Ont. C.A.), (leave denied by S.C.C. 53 O.R. (2d) 663).
13. (1989), 69 O.R. (2d) 65 (C.A.).
14. See, for example, *Carson Restaurants International Ltd.* v. *A-1 United Restaurants Supply Ltd.*, [1989] 1 WWR 266 (Sask. Q.B.).
15. (Toronto: Carswell, 1989).
16. Bennett, *supra*, note 8 at 23.

The existing Alberta judicial approach to sale (pre-PPSA, and disregarding also s. 94 of the ABCA) is illustrated by *Bank of Nova Scotia* v. *Henuset Resources Ltd.*[17] In that case the Court of Appeal dealt with the test that a court is to apply when approving or rejecting a sale of goods by a receiver.

The goods involved in the sale included an automatic welder. The welder (or the sale or use of it) were the subject of a claim for patent infringement. The welder was sold to the party who had the patent infringement claim. It was argued that the sale was at less than full value. There was another tender at a higher price. The sale to the party with the patent claim, however, eliminated the patent claim.

The task to be performed by the court in considering whether or not to approve a sale was expressed in *Salima Investments Ltd.* v. *Bank of Montreal*:

> We think that the proper exercise of judicial discretion in these circumstances, in the first instance, is to inquire whether the receiver has made a *sufficient effort* to get the best price *and not acted improvidently*."[18]

There are other factors which the court felt could be considered in addition to or supplemental to that initial test and those factors are embodied in the concept of fairness. The question to be asked by the court is whether the entire process was objectively fair to all parties having legitimate interests. However, the court ought not to sit as in appeal from a decision of the receiver reviewing in minute detail every element of the process by which the receiver's decision was reached.

The court concluded that the sale in this case, albeit at a price lower than the tender subsequently received, met the test applicable and should be approved.

Alberta's appeal court has long been fiercely loyal to the integrity of the tender system as also witnessed by the case of *Integrated Building Corp.* v. *Bank of Nova Scotia*,[19] where after tenders closed a higher bid came in and the court held that it was acceptable not to consider the higher bid and to decline any re-tender. In this context, the principles do not generate a single-minded duty to obtain the "best possible price."

IV. PREVIOUS MEANING OF "GOOD FAITH"

There have been a number of statements in the courts over past years that suggest that the duty of a creditor is limited to an absence of bad faith. They are illustrated by the decisions of Justices Tysoe and Davey in the B.C. Court of Appeal in *J & W Investments Ltd.* v. *Black*.[20] There a mortgagee exercising a power of sale was held liable only if the mortgagee acted in bad faith or by sacrificing the collateral wilfully or recklessly. Similarly, a receiver's primary obligation has been described as the protection of the

17. (1989), 70 Alta. L.R. (2d) 320 (C.A.), (leave refused by S.C.C. [1990] A.W.L.D. #379).
18. (1985), 21 D.L.R. (4th) 473 (Alta. C.A.) at 476 [emphasis added].
19. (1989), 67 Alta. L.R. (2d) 432 (C.A.), (leave denied by S.C.C. [1991] A.W.L.D. #151).
20. (1963), 41 W.W.R. (B.C.C.A.) 577.

lender's security and his obligation to the debtor as being only to be fair and not to have an ulterior interest: *Ostrander* v. *Niagara Helicopters Ltd.*;[21] and a pledgee's duty on sale has been described in terms of a duty to act in good faith and not to "conduct the sale in a recklessly improvident manner calculated to result in a sacrifice of the equipment:" *Kimco Steel Sales Ltd.* v. *Latina Ornamental Iron Works Ltd.*[22] Similar statements are found in *Canada Acceptance Group* v. Mager,[23] and *Bay Motors Co.* v. *Traders Finance Corp.*[24]

While some decisions, such as *B.C. Land* v. *Ishitaka*,[25] recognized some lender obligation to act in good faith, they also made it clear that such duty did not extend to saying "that he is under a duty to the [borrower] to take, (regardless of his own interest as mortgagee), all the measures a prudent man might be expected to take in selling his own property." A similar position was stated in *Knight* v. *Patillo Co.*, [26] and *Vanstone* v. *Scott*.[27] Carelessness, by way of example, did not amount to absence of good faith even in the relatively modern case of *Ganvin* v. *Bank of Nova Scotia*.[28]

Good faith pursuit of the creditor's interest primarily and an absence of unfairness to the debtor and others interested is probably the most accepted existing standard. Good faith in this context probably equates to an absence of fraud and an absence of unfairness.

V. A MORE POSITIVE DUTY OF GOOD FAITH

These limitations clearly should not apply to the language of the PPSA. The two-fold requirement of good faith and commercial reasonableness should rule out escape from the effects of carelessness. Further, together they import a positive duty, not a mere absence of bad faith, fraud, wilful misconduct or unfairness.

A similar change in the direction of the law was beginning to be accepted, to a degree, in the common law over the past 15 or 20 years. In the hallmark *Cuckmere Brick* case,[29] the English court took a mortgagee to task for not getting the true market value of property. The mortgagee sold it without regard to its value if sold as an apartment (as opposed to a single-family property). Lord Justice Salmon held that "a mortgagee, in exercising his power of sale, does owe a duty to take reasonable precautions to obtain the true market value of the mortgaged property." That case has recently been followed in some Canadian cases: see, for example, *Royal Bank of Canada* v. *Cramer*[30] and *Bank of Montreal* v. *Petronek*.[31] However, "reasonable precautions" to obtain "true market

21. (1973), 1 O.R. (2d) 281 at 286-87 (H.C.J.).
22. (1984), 3 P.P.S.A.C. 237 at 241 (Ont. Co. Ct.).
23. (1964), 48 W.W.R. 128 (Man. C.A.).
24. (1959), 19 D.L.R. (2d) 331 (N.B.C.A.).
25. (1911), 45 S.C.R. 302 at 317 per Duff, J (S.C.C.).
26. [1927] 3 D.L.R. 13 ((N.S.C.A.).
27. (1908), 9 W.L.R. 257 (Alta. C.A.).
28. (1982), 37 O.R. (2d) 389 (H.C.).
29. [1971] 1 Ch. 949 (C.A.).
30. (1990), 73 O.R. (2d) 677 (H.C.).
31. (1984), 52 C.B.R. (Alta. Q.B.) 17 at 25.

value" may still fall short of the PPSA standard, particularly if the latter requires the obtaining of the "best possible price" that would be realizable on an ordinary commercial sale.

Perhaps the PPSA standard is close to that of a court-appointed receiver, which, as described by Bennett, would be as follows:

> As a fiduciary to all, the court-appointed receiver must manage and operate the debtor's business as though the debtor's business were his own.[32]

This is a significantly higher standard than that applicable to privately appointed receivers.[33] In *Doncaster* v. *Smith*,[34] this kind of duty was extended to render a receiver-manager (court appointed) liable for failure to get tax advice on the possible advantages of amalgamating companies to avoid tax. In *Panamerica de Bienes Y Servicios* v. *Northern Badger Oil & Gas Ltd.*,[35] a receiver-manager was fixed with responsibilities for clean-up of abandoned resource wells, and was prevented from simply walking away from them. The court-appointed receiver was also recognized as having a very high level of responsibility in *Alberta Treasury Branches* v. *Invictus Financial Corp. Ltd.*,[36] *Fotti* v. *777 Mgmt. Inc.*,[37] and *C.C.B.* v. *Simmons Drilling Ltd.*[38] It appears to stem both from his status as an officer of the court and as a fiduciary for *all* parties.

While the privately-appointed receiver under the PPSA is not likely to be treated as having quite such fiduciary status, he does owe some duty to both the borrower and third parties in the requirement that he act in good faith and in a commercially reasonable manner,[39] the duty to use reasonable care in the custody and preservation of the collateral,[40] the duty to notify others of sale process[41] and the duty to account for surplus proceeds.[42] The duty is probably not as severe as that imposed upon a court-appointed receiver; but there is some risk that any action identifiably disadvantageous to the debtor or third parties will bring an onus upon the creditor or his receiver to show why the action was "commercially reasonable." Such standard of duty may not be far removed from that of a court-appointed receiver in practical reality.

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32. Bennett, *supra*, note 8 at 118.
33. *Ibid.* at 23.
34. [1987] 5 W.W.R. 444 (B.C.C.A.).
35. [1991] 5 WWR 577 (Alta. C.A.) (leave to appeal to the Supreme Court of Canada denied January 16, 1992).
36. (1986), 42 Alta L.R. (2d) 181 (Q.B.).
37. [1981] 5 W.W.R. 48 (Man. Q.B.).
38. (1989), 76 C.B.R. 241 (Sask. Q.B.).
39. S. 66 PPSA.
40. S. 17 PPSA.
41. S. 60 PPSA.
42. S. 61 PPSA.

Indeed, there is some authority for the proposition that the selling creditor under the PPSA is akin to that of an agent or fiduciary for sale. In *Copp* v. *Medi-Dent Service*[43] the Ontario Court cited, with approval, the following summary of an orally-delivered decision of Steele, J. of the High Court in an unreported decision in *National Bank of Canada* v. *Marguis Furst Ltd.*[44] summarized as follows:

> Generally there are two tests that may be applied to the conduct of a sale as referred to by the Court of Appeal in *Wood* v. *Bank of Nova Scotia* (1980), 14 R.P.R. 1 (Ont. C.A.). One is the less stringent test which is that the creditor who sells must act in good faith. The plaintiff has clearly complied with that test. The other test is the more stringent one, that the creditor must take reasonable care that the proper value is obtained. While it is not a trustee for the debtor it cannot act negligently in the sale. I adopt the principal as stated in *Debor Contracting Ltd.* v. *Core Rentals Ltd. and Parks* (1982), 44 C.B.R. (N.S.) 9 Ont. H.C.J.) (a Mechanic's Lien action) that the creditor must "act a role somewhat akin to that of an agent or fiduciary for the purpose of a sale". *Latina Ornamental Iron Works Ltd.* (1984), 3 P.P.S.A. 237 (Ont. Co. Ct.) at p. 241 where the test was that the sale be in good faith and not be in a recklessly improvident manner calculated to result in a sacrifice of the equipment.
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> In my opinion the proper test under the PPSA is the more stringent one that I have enunciated.
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> Whether a sale is commercially reasonable is a question of fact in every case.

In *Copp* the court held that the requirement of commercial reasonableness required more than mere good faith.

It might be noted, as a footnote, that the *Wood* case cited by Steele, J. in *Marguis* identified the good faith test as the "less stringent test" and the "flagrant" misconduct of the seller as the "more stringent test."[45] This level-of-stringency thought had been treated the other way around in the *Wood* case, upon which *Marguis* founded itself.

VI. MEANING OF "COMMERCIALLY REASONABLE"

Section 66(1) requires not only reasonableness but "commercial" reasonableness. Is reasonableness in the sense of the older case-law, tested in the reality of forced-sale circumstances, no longer intended? "Commercially" means "in a commercial manner, from a commercial point of view," per the Oxford English Dictionary. That doesn't really help answer the question, for what is a "commercial" act must be determined in the light of the circumstances generally applicable. However, it would appear from some recent case law that the adverb "commercially" may in fact change the expectations.

McLaren's "Commercial Transactions"[46] suggests that "commercially reasonable" imports an objective standard; whereas the requirement a "good faith" as viewed in some cases (including *Ishitaka* and *Black*) offers a subjective test:

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43. (1991), 3 O.R. (3d) 570 (Ont. Ct. Gen. Div.).
44. (1987), 8 A.C.W.S. (3d) 333.
45. *Wood* v. *Bank of Nova Scotia* (1980); 14 R.P.R. 1 at 4 (Ont. C.A.).
46. *Supra*, note 15 at 17-18.

The concept of commercial reasonableness can be best described as the actions of the reasonably prudent business person in similar circumstances. It is both an objective and pragmatic standard of conduct, conditioned by the established practices of the business community. The concept is not fixed and rigid, but rather is shaped by changing circumstances.

In cases decided under the prior Act, there had been some confusion between the requirement of good faith and the requirement of commercial reasonableness, arising largely from historical precedents in pre-Act law. In the evolution of secured transactions from conditional sales via chattel mortgages and realty mortgages, the concept of "good faith" on the part of the mortgagee when realizing on the collateral was carried forward. The mortgagee's standard of conduct was good faith – they could not act in a manner that was reckless and improvident, and calculated to result in a sacrifice of the goods. The mortgagee was not obliged, regardless of their own interests, to take all measures that a prudent person might when selling their own property. The standard was expressed as subjective, with the basis of fault being bad faith on the part of the mortgagee and this standard was imported into cases decided under the Act. In *Royal Bank* v. *Michaels*, the sale of the specially equipped vehicle without an appraisal was held to be commercially unreasonable. It would appear that the Court arrived at the right result for the wrong reason, having expressly relied on *J & W Investments Ltd.* v. *Black*, which espouses a subjective test. In the circumstances of the *Michaels* case an unappraised sale would likely be found unreasonable from an objective standpoint also. A questionable disposition was found reasonable in the case of *Kimco Steel Sale Ltd.* v. *Latina Ornamental Iron Works*, because the "plaintiff acted in good faith and did not proceed in a recklessly improvident manner." The ruling may have been correct as to the good faith of the plaintiff, but fails to answer the question of whether the sale was reasonable by commercial standards.

The aims of the Act in protecting both parties to a contract would be gravely hampered by restricting the concept of commercial reasonableness to a subjective test, and indeed would become mired in a debate as to whether an unreasonable belief could form the basis of an honest belief, thus permitting a party to act unreasonably but in good faith. Further, a subjective standard would permit poor business judgment acted on in good faith to take precedence over standard, widely accepted business practices. Clearly, the legislature contemplated that an objective standard of commercial reasonableness would best achieve the goals of the Act. By way of contrast, the Acts of Alberta, British Columbia and Saskatchewan expressly require that all rights and duties under those Acts be performed both in good faith and in a commercially reasonable manner, indicating that separate and distinct standards are contemplated.

Whether the test for "commercially reasonable" is objective or subjective (or indeed, whether or not the test for good faith itself has moved away from subjectivity as *Cuckmere Brick* would suggest) "commercially reasonable" clearly offers a higher standard or duty than mere good faith in the *Black* and *Kimco Steel* sense.

The term was addressed by the Ontario County Court in *Donnelly* v. *I.H.C.C.*[47] The court held that a sale of a truck "as is" to a related company for less than what was owing on a lease and without establishing a market value was not "commercially reasonable." No bad faith or improper motives were found. Under this authority, the term certainly means more than the case law requirement of good faith and without sacrifice.

47. (1983), 2 PPSA c. 290 (Ont. H.C.).

In *Royal Bank* v. *Michaels*[48] the lender sold without getting an appraisal, and that was treated as not being "commercially reasonable."

In the *Copp* case, above, an absence of advertising, publicity or appraisal was viewed as not being "commercially reasonable." Indeed, the court there expressly found the requirement of commercial reasonableness to be a higher standard than mere "good faith."

An American case, *Mallicoat* v. *Volunteer Finance*,[49] described the requirement of commercial reasonableness in these terms:

> The requirement that the property be disposed of in a "commercially reasonable" manner seems to us to signify that the disposition shall be made in keeping with prevailing trade practices among reputable and responsible business and commercial enterprises engaged in the same or a similar business. It is general in scope and effect and is not mutually exclusive of the express requirement that notice of the intended disposition, whether by public or private sale, be sent to the debtor. The purpose of this notice, without doubt, is to enable the debtor to protect the debtor's interest in the property by paying the debt, finding a buyer or being present at the sale to bid on the property or have others do so, to the end that it is not sacrificed by a sale at less than its true value.[50]

The need for due regard for practices and knowledge of similar trades was recognized also in the recent Ontario case of *Bank of Montreal* v. *Judges*.[51] In this case a bank holding a general security agreement sold the property of a film processing company without resort to the aid of industry-knowledgeable person. The sale occurred by public auction after brief ads in the Globe & Mail and flyers mailed to yellow-page listings for photo businesses. A net of $7800 was realized.

The Court held that such sale was not commercially reasonable. The specialized goods should have been evaluated and the sale handled by persons knowledgeable in the film business. On this part of the case the Court awarded damages against the bank of some $31,000.

The bank was also taken to task for failing to identify a legal position in paying out sale proceeds. A landlord had locked the debtor tenant out and the Court treated that as lease termination. The bank, after the lock change, paid the landlord its rent arrears claim out of chattel sales proceeds. The Court held that the bank should not have done so because the landlord no longer had any distress right and had no right to priority over the bank. (This, however, was possibly not a result following from the "commercial reasonableness" requirement.)

In *Royal Bank of Canada* v. *Cramer*,[52] the Ontario Supreme Court found a bank liable for $28,000 for damages arising out of its failure to advertise properly a luxury yacht sold

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48. (1983), 2 PPSA c. 302 (Man. C.C.).
49. (1966) 3 U.C.C. reporting service 1035 (Tennesse C.A.).
50. *Ibid.* at 1038.
51. Unreported, (January 9, 1991) Ont. Ct. (Gen. Div.) January 9, 1991.
52. *Supra*, note 30.

under creditor remedy process. The Court applied *Cuckmere Brick*,[53] and held that in addition to the duty to take reasonable care the lender had a duty to obtain whatever is the true market value of the mortgaged property.

The Supreme Court of Canada addressed sale duties of a bank in realizing upon s. 178 *Bank Act* security in *National Bank of Canada* v. *Corbeil*.[54] Section 179(10) of the *Bank Act*,[55] requires a bank to act honestly and in good faith in the sale of its security, and to "deal with the property in a timely and appropriate manner."

The bank in this case took possession of merchandise on which it held security, decided that its value was too low to justify further effort, renounced its rights in the merchandise and abandoned it to a third party (a trustee in bankruptcy of a third party).

When the bank sued for its debt claim, the debtor counterclaimed for the value of the goods abandoned. The debtor succeeded at trial, but failed in the Court of Appeal. The Supreme Court restored the trial judgment.

Gonthier J., speaking for the Court, described the duties on sale by reference to Crawford and Falconbridge:

> [Subsection 179(1)] provides that in conducting any sale, whether under the powers of the Act or pursuant to an agreement with its customer, the bank must act honestly and in good faith. This provision was added in 1980, but probably is only declaratory of the prior law. For example, it had been decided variously that the bank was under an implied duty to act in good faith, and reasonably, to effect a provident sale. It need not take all the pains in selling that a reasonably prudent owner would do in his self-interest, but it could not, for example, accept the first offer received merely because it was sufficient to cover the sum owing to the bank. It has been held that the bank must obtain the best price "possible," but that must be understood as meaning the best price possible by a bank acting in accordance with the required standard. It does not establish the standard.[56]

He held that when the bank decided to renounce, it was incumbent on the bank to notify the debtor of that intention and to make it clear that the goods were thereafter the debtor's to deal with. It had no right without first doing so to abandon the goods. For such wrongful handling it was subjected to judgment for the value of the goods based on their cost.

In light of the level of the above discussion it has reasonable prospect of becoming the accepted rule on a broad base. However, it should be remembered that what is the standard to apply, missing in the case of the *Bank Act*, may be set by the legislation. In the PPSA the standard is a "commercially reasonable" one. It may be higher than that of the *Bank Act*. It is a requirement conjoined to "good faith" in the PPSA. As such it

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53. *Supra*, note 29.
54. [1991] S.C.J. No. 12. (S.C.C.).
55. R.S.C., c. B-1.
56. Crawford & Falconbridge, *Banking and Bills of Exchange* 8th ed. (Toronto: Canada Law Book, 1986) vol. 1 at 432.

seems quite probable that the approach in cases like *Donnelly*, *Micheals*, *Cramer* and *Judges* would be accepted in the Supreme Court of Canada as reflecting the duty under the PPSA's s. 66.

VII. THE AMERICAN ROOT CONCEPT

The PPSA concept originated in the United States, where it was born to the Uniform Commercial Code. American precedents should therefore be of some assistance in construing the PPSA and other PPS statutes in Canada. The concept of commercial reasonableness is something which has had a history in American jurisprudence. It is reflected not only in the personal property security provisions adopted in the American states but also in other provisions in the Uniform Commercial Code. McLaren, "Secured Transactions,"[57] cautions readers to exercise care in referring to American case law because Article 9-507(2) to the Uniform Commercial Code attempts to set out tests for what is "commercially reasonable" and the Alberta PPSA, and other Canadian statutes, do not do so. Nonetheless, some consideration of the U.S. roots is warranted.

The concept is perhaps an off-shoot or outgrowth of a common-law concept that American courts have implied into contracts more generally: — an obligation of "good faith and fair dealing." This kind of obligation was treated at some length in a paper delivered in March, 1989, in an Insight seminar in Vancouver called "Lender Liability, The New Risks for Creditors." This paper was written by Thomas N. Bucknell and Gerry N. Stehlik of Seattle, Washington. The article develops the concept of good faith and fair dealing at considerable length and, no doubt, with far more reliable analysis of American jurisprudence than the present writer could usefully offer. Suffice it to say that in the context of a generally-accepted principle of "good faith and fair dealing" in American contract law, the adoption of a statutory duty of good faith and commercial reasonableness was probably not a massive change.

Until recently, there does not appear to be any similar concept in judicial treatment of contract duties in common law Canada, except for the good faith prerequisite to exercise of equitable remedies. The civil law, which applies in Quebec, has long imported a general duty of good faith to contracts, and indeed even recognizes a principle of abuse of rights: — that it may be a wrongdoing to exercise a contractual right in a manner that is abusive.[58] Such principles are generally not part of the common law.[59] The law of contract to a substantial degree is made by the parties' choice of terms in the contract. This is inherent in the general principle of freedom of contract.[60] Indeed, Atiyah, in *The Rise and Fall of Freedom of Contract* identified the failure of the principle of good faith as being a 200-year-old development attributable to the economic liberalism of the late 18th century:

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57. *Supra*, note 15 at 7-16 of Volume 1.
58. *National Bank of Canada* v. *Houle*, [1990] 3 S.C.R. 122 (S.C.C.) at 145, 156-158.
59. *Anson's Law of Contract* 26th Ed. (New York: Oxford University Press, 1984) at 165.
60. See Côté, *An Introduction to the Law of Contract* (Edmonton: Juriliber, 1974), at 1-4, where such principle is broadly discussed; and see *Anson's Law of Contract*, *ibid.* at 4-6 and 125.

> We should begin by noting that in the latter half of the eighteenth century there were signs of an emerging principle of good faith in contract law. The idea of good faith would, of course, have been completely congruent with the traditional morality, though it needed someone like Mansfield to enunciate and apply the principle in a wide variety of cases. Mansfield began this task, but it was never completed, for the economic liberalism which he also favoured and helped to develop, ultimately proved fatal to anything as paternalistic as a general principle of good faith.[61]

Anson, too, relates the general principle of freedom of contract to *laissez-faire* economics.[62] Atiyah concluded that, with the exception of some "relics," the "stillborn principle" of good faith did not survive in English common law.[63]

However, it appears to be enjoying a modern-day re-birth even apart from statute. The B.C. Court of Appeal recently implied in a lease an agreement to negotiate renewal rent in good faith: *Empress Towers Ltd.* v. *Bank of Nova Scotia*.[64] A subsequent Nova Scotia trial court decision imported a broad duty of good faith to commercial contracts generally: *Gateway Realty Ltd.* v. *Arton Holdings Ltd.*[65] In the latter case, the absence of good faith was used not only as a shield against a claim but as a sword to enforce a claim against the offending party. Another example of application of a perceived duty of good faith may be found in *Moose Produce Ltd.* v. *Royal Bank*.[66] One might note also the duty of "good faith and reasonable" care attached specifically to receivers in the *Cuckmere Brick* and *Petronek* cases.[67]

VIII. DUNPHY LEASING TREND LINE

A broad case-law-based concept of good faith and reasonableness has even appeared recently in Alberta jurisprudence. For example, extensive discussion of an obligation on a lender to act generally in good faith is found in the recent decision of Mr. Justice Power in *Bank of Nova Scotia* v. *Dunphy Leasing Enterprises Ltd.*.[68] While the decision of the trial court was reversed by the Alberta Court of Appeal, a statement on the good faith duty point was carefully avoided. Fraser J.A., did, however, note that an absence of good faith could "properly influence a court's assessment of reasonable time" in the context of demands to pay.[69]

Dunphy Leasing could be reduced to just another example of how a lender, by exercising remedies through appointment of a receiver too promptly after making demand for payment, can risk a liability for a high degree for damages. The Bank of Nova Scotia

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61. *The Rise and Fall of Freedom of Contract* (London: Oxford, 1979).
62. Anson, *supra*, note 59 at 4.
63. Atiyah, *supra*, note 61 at 168.
64. [1991] 1 WWR 537 (B.C.C.A.), leave denied by S.C.C., April 4, 1991.
65. (1991), 108 N.S.R. (2d) 387, affirmed by C.A. April 10, 1992, unreported, see *Lawyers' Weekly*, referencing cite 1206-009.
66. (1986), 59 C.B.R. (N.S.) 300 (P.E.I.S.C.).
67. *Supra*, note 29 and note 31.
68. (1990), 105 A.R. 161 (Alta. Q.B.), reversed [1992] 1 W.W.R. 577, leave to appeal granted by S.C.C. June 4, 1992.
69. *Ibid.*

in that case was suing for a debt balance of about $1.5 million. It lost its suit and ended up with a counter-claim judgment of some $2 million, largely because of its appointment of a receiver within 20 hours after making demands on its loans. Power, J., applied *Lister* v. *Dunlop*,[70] and the more recent Ontario Court of Appeal decision in *Kavcar Investments* v. *Aetna Financial*[71] to reach that result.

However, Mr. Justice Power described the rule in *Lister* v. *Dunlop* as an extension or example of a broad duty of good faith that a creditor owes to his debtor. His discussion of the duty is almost American in its tone:

> The borrowers contend that banks have an obligation to their customers to act responsibly and intelligently and to make no decision adversely affecting the borrower except upon a reasonable and informed basis. Those obligations could arise in contract as an implied term of the banker-customer agreement; it could arise in negligence as a duty of care owed by the bank to its customer; or they can simply be recognized as they were in *Lister [Ronald Elwyn Lister Limited]* v. *Dunlop Canada Limited* as a duty imposed upon the creditor to give reasonable notice of its intention to enforce payment.[72]

While this passage refers to argument of counsel, it is clear that the trial court was persuaded by such argument. It stated the essence of *Lister* v. *Dunlop* as:

> The essence of the decision by the Supreme Court in *Lister* v. *Dunlop*, supra, is that lenders must act in good faith and give bona fide consideration to the requirement of reasonable notice.[73]

Power, J. found an absence of good faith and bona fide consideration by the bank in *Dunphy*. He then repeated his view that:

> *Lister* v. *Dunlop* recognizes and imposes ethical obligations of good faith, open and honest communication, and a bona fide exercise of reasonable judgment — its thrust is to require minimum standards of business ethics. It was the fundamental failure by the bank to perform the obligations and meet the standards implicit in *Lister* v. *Dunlop* which give rise to liability in this case.[74]

What had the bank done wrong in *Dunphy Leasing*? The court noted several things. A conflict of attitude and approach between the local bankers and head office was noted. The limited "capacity" of the local people was a factor. The fact that the bank decided in March of 1982 to appoint a receiver, but delayed while (with the borrower's unknowing cooperation) the bank patched up holes in its security, and then moved in to appoint a receiver within days after the security was patched up appeared to be a very significant factor in the court's mind.

The passages quoted above are only three of several statements by Power, J., as to some positive obligation to exercise good faith and to deal fairly. Those statements are

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70. [1982] 1 S.C.R. 726 (S.C.C.).
71. (1989), 70 OR 2(d) 225 (C.A.).
72. *Supra*, note 68 at 206.
73. *Ibid.* at 211.
74. *Ibid.* at 214.

not unprecedented. Their avoidance in the Court of Appeal's judgement leaves Mr. Justice Power's reflections as a possible harbinger of future trends. Indeed, it is not a lone voice prophesying in the wilderness, as *Empress Towers* and *Gateway Realty* illustrate. One might add the comments of Mr. Justice Lambert, in the B.C. Court of Appeal in *Waldron* v. *Royal Bank*,[75] who in describing the underlying principle in *Lister* v. *Dunlop*, described it as part of a "call to fairness to which the law has responded" and likened it to an almost fundamental element of law:

> The call for fairness in the enforceability of security agreements responds to the same fundamental demands as those which have resulted in the constitutional protection against unreasonable seizure conferred and confirmed by s. 8 of the Canadian Charter of Rights and Freedoms.[76]

Notwithstanding these recent judicial trends, when viewed in the light of English (and therefore Alberta) common law contract principles, the statutory imposition of a broad duty of good faith and commercial reasonableness to be tested objectively on all aspects of personal property security transactions brings a very different perspective to their operation and enforcement. It potentially places the courts in the position of hind-sight second guessing any or all the conduct of the parties to an agreement.

Perhaps what could be most significant about the views Mr. Justice Power expressed in *Dunphy Leasing* is his suggestion that the lender bore an onus of proof in respect of its performance of good faith and fairness obligations, at least insofar as reasonable notice is concerned. If, indeed, secured parties have an obligation to prove that they have acted in good faith and with commercial reasonableness throughout, then the positive active requirement of the concept would make life very different for them indeed. From prior judicial approaches such as those mentioned in section IV above, it had seemed clear that the debtor held an onus to establish that there was bad faith, fraud or unreasonable action. Inasmuch as not even negligence or carelessness was treated as bad faith, shifting the obligation over to be some onus to show good faith and commercial reasonableness would offer a dramatic change.

A concept of lender onus would surely be an extreme treatment of any "good faith" duty; positive proof of good faith would be virtually impossible. "Commercial reasonableness" would be more readily established, by appraisals, knowledgable business advice, etc. However, to impose a lender onus even as to that, at least for the PPSA, is not properly extensible as any sort of rule. The duty, while practically a duty more relevant to secured parties and receivers, is a duty which the PPSA's s. 66 imposes on all parties, not just one. Further, the primary rule in civil litigation is that he who affirmatively asserts bears the onus of proof: *Smith* v. *Nevins*.[77] Perhaps more to the point, the imposition of any primary burden to establish good faith and commercial reasonableness would itself be unfair or juridically unreasonable. Therefore it seems unlikely that so far-reaching an extension of the secured parties' and receivers' duties can be justified.

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75. [1991] 4 WWR 289 (B.C.C.A.).
76. *Ibid.* at 294.
77. [1925] S.C.R. 619 at 638 (S.C.C.) Duff, J.

Nonetheless, the two-part s. 66 standards appear to be heightened ones, and readiness to win a contest over the meeting of those standards should be a prime focus of secured parties and receivers in the conduct of PPSA-governed functions. Even if the primary onus of proof remains with he who asserts lack of good faith or unreasonableness, in the context of a statutory duty tested in civil litigation mere doubt as to performance could easily shift the burden. The creation of a secondary or rebuttal onus of the kind discussed by Duff, J., in *Smith* v. *Nevins*,[78] or a *prima facie* case of unreasonableness as discussed in *Kavcar Investments Ltd.* v. *Eetna Financial Services Ltd.*, could result.[79] In that light, s. 66 offers a marked departure from the law and practice applicable 50 years ago and may carry receivers even beyond the *Cuckmere* rules.

More to the point, these standards apply not only to the security realization process but to all the inter-action between parties under the PPSA. The focus on ability to show good faith and commercial reasonableness becomes therefore critical for secured parties in all their dealings. When considered outside the context of remedy exercise, a dramatic change in the law of contract applicable to personal property security is clearly the result.

78. *Ibid.* at 639.
79. *Supra*, note 71 at 238.