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When Are Chattel Mortgages Void?

Once again there is confusion about the effect of a chattel mortgage in which the description of the chattel does not satisfy the requirements of the *Bills of Sale Act*, R.S.N.S. 1967, c.23. The traditional view has been that registration is not required as between the parties to a chattel mortgage, but only against certain classes of strangers; however, in a recent decision, the Appeal Division of the Supreme Court of Nova Scotia apparently took a different view.

Earlier this year the Appeal Division heard a very familiar claim by a trustee in bankruptcy, who sought to overturn a chattel mortgage made to a large financial corporation for want of adequate registration. In *Price Waterhouse Ltd.* v. *Royal Trust Corp. of Canada* (1987), 78 N.S.R. (2d) 4, the appellants, acting as trustees for the bankrupt David Matthews, argued that the chattel mortgage to the respondents of a Nissan truck insufficiently described the secured property to satisfy the registration requirements of the *Bills of Sale Act*. The Appeal Court agreed, and, in so holding, made some very significant statements both about the requirements for describing the goods secured under the *Bills of Sale Act*, and about the legal effects — or rather lack of effects — of an imperfectly registered chattel security.

The chattel mortgage simply described the vehicle as "one used 1984 Nissan": it did not include a serial number or a license number or any other details. This casual description may have been sufficient to identify the truck between the parties but can hardly be said to distinguish it from a large number of other Nissan vehicles of that model year. In the event, Royal Trust did not so much rely upon its registration of the mortgage document as upon the return of the truck by Matthews — in effect its repossession — a few days before his assignment into bankruptcy. In these circumstances Mr. Justice Grant, in chambers, took what might be termed the traditional view of such a matter (at p.5-6):

> As between those parties, the chattel mortgage was valid, as against strangers, the description may have been defective, however at that stage, no strangers were involved. . . .
>
> Matthews fell into arrears in his payments to Royal and . . . Royal took possession . . . . This was in the normal course of business and was a remedy available to Royal under the chattel mortgage. The transaction, when the chattel mortgage was granted, was valid. The repossession pursuant to the chattel mortgage was valid. At the date of the bankruptcy, the vehicle had already been delivered to Royal. Possession and ownership had passed to Royal, . . . I hold this lien to be valid . . . .

Sufficient Description

As to the description of the truck, the Appeal Court had no difficulty in holding that it did not express "such sufficient and full description of the chattels . . . that the same may

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and upon incorporation of the Town of Bedford became part of the Town. Title to it vested in the Town of Bedford. *Held*, that a private right-of-way could not co-exist with a public street as defined in the *Towns Act* and in any case the defendants had not acquired such a right-of-way. It was suggested that the long standing use of the strip by the defendants and their predecessors in title should be taken into account if the town should choose to close or dispose of the strip.

To Obtain Decisions

All the decisions summarized in this issue are available from the Nova Scotia Barristers' Society Library, 1815 Upper Water Street, Halifax, N.S. B3J 1S7 (425-2665). Lawyers outside the Metro area may contact the Library for photocopies of decisions. The number in bold face type following the date of the decision is the number under which the decision may be located in the Barristers' Library and the Judges' Library.

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be thereby readily and easily known and distinguished" from other vehicles as required by Section 4 of the *Bills of Sale Act* for a valid registration of a chattel mortgage. In doing so, the Court adopted the approach of Mr. Justice Hallett in *Federal Savings Credit Union* v. *Alchorn and Dorey* (1984), 61 N.S.R. (2d) 217. (The Court also referred to *Royal Bank* v. *A.G. of Canada* (1978), 26 N.S.R. (2d) 352 (N.S.C.A.)) In that case, after a thorough consideration of the authorities, Mr. Justice Hallett had concluded (at p.224-225):

> (1) It is a question of fact whether the description complies with the statutory requirements that it be sufficient and full enough that the chattel to be charged may be readily and easily known and distinguished by third parties.
>
> (2) There must be a sufficient description of the chattel in the document itself that a person looking at the mortgage could determine by proper inquiries whether or not the chattel in question was encumbered.
>
> (3) If there is such information by way of description of the chattel so that the property subject to the charge can be readily and easily known and distinguished, the statutory requirement has been met.

The case before Hallett J. also concerned a motor vehicle but was more difficult because its description in the mortgage contained the correct make, model and license number but the wrong year of manufacture and a nearly illegible, probably erroneous, serial number. In finding the descriptive information in this "borderline case" insufficient, Mr. Justice Hallett observed (p.226):

> Where motor vehicles are the subject of mortgage charges, there must be more specificity of description than with respect to charges against stock in trade because motor vehicles can be accurately described with ease and just as easily can be misdescribed.

This comment must surely apply with equal force to all goods that are mass reproductions of a single model but bear individual serial numbers. They are easily, but only, distinguishable by an accurate recording of their particular numbers.

To state, as Mr. Justice Hallett did, that the sufficiency of description is a question of fact provides little indication by itself of the criteria to be applied in making the necessary determination. Helpfully, Mr. Justice Hallett provided further guidance in applying the Act by elucidating the functions of his three criteria (p.226-227):

> The question of fact that must be answered in each case is whether or not the description of the chattels charged is sufficient and full enough to be readily and easily known and distinguished. Where a specific chattel such as a motor vehicle is made the subject of the charge and the description is clearly misleading . . . it cannot be said that the statutory requirement has been met even if, through the exercise of reasonable care, the searcher could have likely ascertained that the vehicle incorrectly described . . . was the same vehicle which was the subject matter of the Registry search. The statute does not require third parties interested in ascertaining whether chattels are encumbered or unencumbered to exercise reasonable care. This is not what the statute states . . . However, the statute requires that the description of the chattels mortgaged be sufficient that they can be readily and easily known to third parties. This is an onerous but a fair requirement to be imposed on those who seek to establish a charge against personal property that remains in the possession of the owner despite the transfer of the legal title to the mortgagee.

Mr. Justice Hallett's remarks make clear that the secured party is the one who must exercise reasonable care, so as to ensure the selection and use of descriptive language which will not mislead unsuspecting third parties. The Appeal Division's approval of this case confirms that the requirements for description in the *Bills of Sale Act* are stringent expectations that should be applied so as to protect strangers to the transaction.

Effect of insufficient description

Having found the description of the Nissan truck unsatisfactory, the Appeal Court next considered the effect of the chattel mortgage. Overruling the trial judge, the Court in the *Price Waterhouse* case roundly declared

> In this province, it has always been held that a bill of sale which is found to be void for noncompliance with the *Act* is void for all purposes.

The Court stated:

> Where ... the description is insufficient to readily and easily identify the chattel as required by the *Act*, no encumbrance is created and the chattel mortgage is void.

Thus:

> There can be no repossession under a void chattel mortgage and the trustee has the right to recover possession of the vehicle or its value from a mortgagee holding the goods for the purpose of sale.

Regretably the Court provided scant authority for its declaration of the effect of the Act. There are grounds to believe the Court made a significant departure from the traditional interpretation of the Act and reached a conclusion *per incuriam* in the face of higher authority.

The *Bills of Sale Act* section 2 states:

> Every sale or mortgage which is not accompanied by an immediate delivery and an actual and continued change of possession of the chattels sold or mortgaged shall be absolutely void as against creditors and as against subsequent purchasers or mortgagees claiming from or under the grantor in good faith, for valuable consideration and without notice, whose conveyances or mortgages have been duly registered or are valid without registration, unless the sale or mortgage is evidenced by a bill of sale duly registered; ...

The difficult problem is to determine the meaning of the phrase "absolutely void". In holding an imperfectly registered chattel mortgage as "void for all purposes", the Appeal Court adopted an apparently literal interpretation. However, the phrase is not unqualified. The registerable transaction is only expressed to be "absolutely void" against three named classes of strangers; the parties themselves are conspicuously not included. This omission has been sufficient grounds for other courts to hold that registration is not required as between parties to a chattel mortgage, which continues to be valid and enforceable between them at common law.

Traditional approach

Mr. Justice Grant followed this traditional approach in chambers when he held that Royal Trust had a valid chattel mortgage and had validly exercised its right of repossession upon the mortgagee's default. Authorities such as *Re Shelly Films Ltd.* (1963), 37 D.L.R. (2d) 469; [1963] 1 O.R. 431 (Ont. C.A.) and *In re Vesterfelt* (1963), 40 D.L.R. (2d) 137 (Ont. H.C.) suggest his decision was wrong only in the final holding because it failed to respect the rights of the mortgagor's creditors, represented by the trustee, to overturn the mortgage before Royal Trust had completely expended its rights by sale of the repossessed truck.

The Appeal Court could find support for this last distinction in the *Bills of Sale Act* section 13 and in Mr. Justice Hallett's opinion in *Re Crichton Enterprises Ltd.* (1980), 38 N.S.R. (2d) 348 (N.S.S.C.) Its final disposition of the case was entirely appropriate, for a secured party like Royal Trust cannot perfect its security in a chattel mortgage that is not properly registered merely by taking possession of the mortgaged goods. But the Court could not call in aid Hallett J.'s judgment in *Re Crichton Enterprises* or in *Federal Savings* v. *Alchorn* for the proposition that the chattel mortgage was "void for all purposes". In each case Mr. Justice Hallett explicitly limited his decision to holding the transaction void against a specific class of protected strangers to it.

Greater solace for the Appeal Court may be had from *Re Smiths' Estates and Canadian Acceptance Co. Ltd.* (1980), 40 N.S.R. (2d) 707 (N.S.S.C.) Without any discussion of the underlying difficulty in interpreting Section 2 of the *Bills of Sale Act*, Mr. Justice MacIntosh stated (at p.719):

> The word "void" in the corresponding legislation of Ontario has been interpreted on many occasions by the courts of that province as meaning voidable. And to some degree explains the reasoning in cases such as *In re Vesterfelt*. However, Nova Scotia courts appear to take the view that the protection provided by the *Bills of Sale Act* is only available to those who comply strictly with its provisions. For a review of this question reference is made to the decision of Coffin, J., (as he then was) in the case of *Re Scott*. This court has not seen fit to interpret the words "absolutely void" as meaning voidable.

Void or voidable?

However, it is impossible to find support for this view in the case of *Re Scott* (1963), 40 D.L.R. (2d) 328. Upon reviewing the authorities generally, including the leading opinion of the Ontario Court of Appeal in *Re Shelly Films Ltd.*, Mr. Justice Coffin there concluded (at p.334):

> Although some of the cases do hold such bills to be "absolutely null and void" ... there is authority to support the theory that bills of sale, which are defective, are not void but voidable.

Thus, a perusal of the authorities referred to by the Appeal Court, yields precious little support for its interpretation of the Act. A wider review, such as Mr. Justice Coffin made, discloses the practice of reading "void" as meaning "voidable", and for good reason. The *Bills of Sale Act*, and other chattel security registration acts like it, contain an inherent contradiction. A chattel mortgage can hardly be both valid *inter partes* without registration and void vis-a-vis third parties at one and the same time. By calling the transaction "voidable", courts like those in *Re Scott*, *In re*

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Vesterfelt and *Re Shelley Films Ltd.* were able to let the parties enforce their rights under the mortgage at least [illegible] the statutorily protected third parties intervened.

The effect of the Appeal Court's judgment is to deny that possibility, indeed to deny any validity to the chattel mortgage at all. As it plainly stated, noncompliance with the Act will be held to render the chattel mortgage "void for all purposes". In concluding that "no encumbrance is created" the Court presented the startling result that, *even in the absence of creditors or other third party claimants*, a borrower is free of the security interest he thought he had granted over his goods and the lender, far from being secured, can do nothing to restrain his disposition of them. No policy reasons stand out to commend this destruction of a genuine transaction that would otherwise be valid and enforceable at common law. Nor does the *Bills of Sale Act* necessarily have to be interpreted in a way that produces this result.

In any event, it is beyond doubt that the Appeal Court's choice of interpretation of the Act is erroneous. Unfortunately, the decision in this case seems to have been reached without advertence to the judgment of the Supreme Court of Canada in *Royal Bank of Canada* v. *First Pioneer Investments Ltd.* [1984] 2 S.C.R. 125; (1985), 12 D.L.R. (4th) 1. That case concerned an unregistered debenture subject to the *Corporation Securities Registration Act* of Ontario. The factual differences are not significant, however, for the crux of the issue was the proper interpretation of the section of the legislation rendering the transaction void for lack of registration in precisely similar terms to the Bills of Sale statutes. The Supreme Court held the unregistered debenture "to be valid in so far as it embodies an enforceable contract" between the secured lender and its debtor, but as against the creditors of the debtor "the same logic dictates that it should be declared void *ab initio* pursuant to s. 2" of the Act.

Although the logic of the judgment is difficult to follow, it is clear that the Supreme Court considered that unregistered chattel security transactions are validly enforceable contracts *inter partes*. In the face of this decision, the Nova Scotia Appeal Court's opinion that a statutorily imperfect description of collateral creates no encumbrance on it and that such a transaction is void for all purposes cannot stand.

What, then, is the effect of noncompliance with the requirements of the *Bills of Sale Act*? Unfortunately, the Supreme Court provided no clear answer. The only alternative interpretation to date, — namely, to read "void" as "voidable" as the Ontario Appeal Court did in *Re Shelly Films Ltd.*, — was expressly overruled by the Supreme Court. In its place the Court posited the proposition that a secured transaction can be both valid *inter partes* and void *ab initio* vis-a-vis the statutorily protected classes of strangers. On its face, this is an impossible confusion of language and the very real dilemma over the voidness of imperfectly registered chattel securities remains.

— Hugh Kindred

Note: For further commentary on the Supreme Court's decision see Kindred and Black, "Unsecured Creditors and Unregistered Chattel Securities" (1986), 64 Can. Bar Rev. 386.

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