University of Western Australia

University of Western Australia-Faculty of Law Research Paper

No. 2014-39

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Electronic copy available at: http://ssrn.com/abstract=2503786

Protecting the prepaying buyer of goods from the seller's insolvency

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Where a buyer has paid for goods in advance of delivery, the buyer runs the risk of losing both the goods and the money paid if the seller becomes insolvent. There are legal avenues that the prepaying buyer can pursue, but they have their limitations, are inaccessible to most buyers, and ill-suited for protecting prepayments. This article will argue that there is a need for legal reform to enhance the legal position of the prepaying buyer. It examines two strategies which could be adopted to protect the prepaying buyer. While neither would completely eliminate the risks posed by the insolvency of the seller, they nonetheless deserve consideration.

INTRODUCTION

Suppose a buyer, X, agrees to buy goods from a seller, Y, and the contract requires payment to be made in advance of delivery. If Y becomes insolvent before delivering the goods, X is left in a precarious position. Unless property in the goods has passed, X will not be able to recover them. X may have a claim against Y for breach of contract damages. But the problem with such a claim is that it is a personal remedy. Even if successful, X is relegated to the status of unsecured creditor in Y's bankruptcy. As the secured creditors and priority unsecured creditors are likely to claim the bulk of Y's available assets, X is unlikely to be able to recover the prepayment. This is a risk faced by prepaying buyers, yet little appears to have been done to enhance their legal position.

There are legal avenues that a knowledgeable prepaying buyer may pursue to reduce the likelihood of loss, but they have their limitations, are not easily accessible to buyers, and there are doubts whether some apply to prepayments for goods. The aim of this article is to explain why, and suggest how, the law should be reformed to enhance the legal position of the prepaying buyer. This article is organised along the following lines. First, it will examine the plight of the prepaying buyer and the justification for providing preferential treatment. Next, it will evaluate the various legal avenues that a prepaying buyer may pursue to protect against loss. It will examine each of the avenues in detail and discuss their shortcomings and suitability. Finally, it will draw on overseas developments to offer suggestions on how the law may be reformed to protect prepaying buyers.

PLIGHT OF THE PREPAYING BUYER

Before proceeding to discuss the plight of the prepaying buyer, it would be useful to say something about terminology. A buyer who pays in advance is usually referred to as a "prepaying buyer". But sometimes a distinction is made between a buyer who pays in advance to enable the seller to acquire or manufacture the goods, and a buyer who has paid in advance but has not taken delivery of the goods. The former is referred in the legal literature as a "financing buyer" and the latter as a "prepaying buyer".[1] According to Boodman, the terms "prepaying buyer" and "financing buyer" are "not juridical terms of art but arise as distinct concepts due to doctrinal usage".[2] In this article, the terms "prepaying buyer" and "financing buyer" are used interchangeably, as the distinction is not important for the purposes of this article. While the discussion that follows will focus on prepayments for goods, many of the issues dealt with also apply to prepayment for services.

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[1] See Jackson TH and T Kronman A, "A Plea for the Financing Buyer" (1975) 85 Yale L J 1 at 3, fn 9: "The term 'financing buyer' is used to describe the prepaying buyer who is also serving a financing function. As such, the term does not include the prepaying buyer who is not a financier: the buyer who simply pays for an item and does not take immediate possession."

[2] Boodman M, "The Prepaying Buyer: Another Perspective" (1986) 11 Can Bus LJ 257.

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Although prepayments are common, not all purchases will require the buyer to make an advance payment. There are three types of purchases which are likely to involve prepayments.[3] The first is where the goods have not been manufactured and must be specially ordered. An example is the purchase of a custom-built vessel. The seller will usually require from the buyer an advance payment in the form of a deposit before starting work. The second type of purchase is where the buyer and seller are not dealing with each other on a face-to-face basis and it is not possible to physically transfer possession of the goods when payment is made. Goods bought by mail order, over the telephone, or through the internet are examples of this type of purchase. For such transactions, there is often a time lag between placement of the order and delivery of the goods. The third type of purchase is where the goods are too large or bulky for the buyer to transport and have to be delivered by the seller or a designated delivery service. The purchase of knock-down furniture, consumer durables such as refrigerators, and building materials are common examples.

Prepayments do not usually pose any problems, unless the seller becomes insolvent before delivering the goods. But even if goods have not been delivered when the seller becomes insolvent, the prepaying buyer may still be entitled to them if property in them has passed. The rules for determining whether property in goods has passed are found in the *Sale of Goods Act*.[4] Generally, if property has not passed, the prepaying buyer can only sue the seller for breach of contract damages. This offers little by way of comfort if the seller is insolvent. If the buyer has made a large prepayment, the estate of the bankrupt or insolvent seller will receive a windfall gain.

Spittlehouse v Northshore Marine Inc [1994] 18 OR (3d) 60 CA provides a good illustration of the injustice that a prepaying buyer could suffer if the seller becomes insolvent before delivery of the goods. In that case, the buyers of a boat had paid for 90% of the price in instalments when the seller became insolvent. Property had not passed as it was agreed that the seller will retain title until the price was fully paid. A secured creditor of the seller seized the boat to enforce its security interest. In *Royal Bank v 216200 Alberta Ltd* (1986) 33 DLR (4th) 80, the Saskatchewan Court of Appeal held that if property had not passed, a buyer has no rights to the goods. Fortunately for the prepaying buyer in *Spittlehouse*, the Ontario Court of Appeal refused to follow *Royal Bank*. It held that the buyer could, on payment of the balance of the price, take delivery of the boat.

Not surprisingly, Wood has described the plight of the prepaying buyer as "an unhappy one".[5] The prepaying buyer has few rights. If the prepaying buyer is lucky, the seller's insolvency practitioner (a term which includes receivers, bankruptcy trustees, liquidators and administrators) may complete the sale. But this depends on a number of factors including whether the balance of the purchase price exceeds the realisation value of the goods and whether goods of that particular description are available.[6] If the insolvency practitioner refuses to complete the sale, the prepaying buyer is left with an unsecured claim which may amount to very little. As an unsecured creditor of the seller, the buyer has to compete with other unsecured creditors for the limited pool of assets available for distribution after the secured and priority creditors have been satisfied. The likelihood of the prepaying buyer recovering even a tiny fraction of the money paid is remote. According to Mokal, a study of firms in the United Kingdom undertaken in 2000 showed that "in an overwhelming majority of formal insolvency proceedings, nothing is distributed to general unsecured creditors".[7]

TAKING OF SECURITY

If there is a risk that a seller would become insolvent before delivery of the goods, a prepaying buyer could protect itself by taking some form of security. The buyer could, for example, ask the seller for a performance or payment bond, but they are expensive, inappropriate for many types of transactions

[3] Close AL, "The British Columbia Buyer's Lien – A New Consumer Remedy" (1995) 25 Can Bus LJ 127 at 140-141.

[4] See eg, *Sale of Goods Act 1895* (WA), ss 16, 17 and 18. Each Australian State and Territory has passed similar legislation.

[5] Wood RJ, "Law Reform Commission of British Columbia Report on the Buyer's Lien: A New Consumer Remedy" (1988) 14 Can Bus LJ 118.

[6] Wood, n 5 at 118.

[7] Mokal RJ, *Corporate Insolvency Law* (Oxford University Press, Oxford, 2005) p 100.

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and often beyond the reach of sellers.[8] Alternatively, the buyer could ask for a security interest in the seller's assets. The buyer could, for example, take a security interest in all the seller's assets, though it is unlikely the seller will agree. An easier option is to obtain a security interest in the goods purchased. The seller is more likely to agree to this where the goods cost a great deal, such as specialised machinery, and the sale is important to the seller's business. As such, this is not an avenue open to the average consumer buying goods costing a few thousand dollars, such as a refrigerator or flat screen television.

To successfully take a security interest, the buyer must comply with the relevant provisions of the *Personal Property Securities Act 2009* (Cth) (PPSA). For a security interest to attach, the grantor must have rights in the collateral, or the power to transfer rights in the collateral to the secured party and (2) the secured party must have given value for the security interest, or the grantor must have done an act by which the security interest has arisen.[9] The grantor does not need to have full ownership rights, but "must however have some degree of control or authority over collateral" placed in its possession. With goods owned, or in the possession of the grantor, the security interest attaches as soon as the secured party has given value or the grantor has signed a security agreement. But with after-acquired goods, the security interest will attach when the grantor acquires the collateral.

For the security interest to be enforceable against third parties, the secured party must either take possession or control of the collateral, or the grantor must have signed or adopted a written security agreement containing a description of the collateral.[10] Enforceability does not guarantee priority and for the secured party to prevail over other secured parties, the secured party must perfect its security interest. Perfection can be achieved by taking any of the following perfection steps: taking possession of the collateral, taking control of the collateral (if it is controllable property such as an ADI account) or registering the security interest in the Personal Property Securities Register.[11] Attachment does not have to precede the taking of any of these perfection steps, but perfection is not effective until attachment has taken place and the security interest is enforceable against third parties.

Under PPSA, the first registered or perfected security interest takes priority.[12] Registration in the Personal Property Securities Register is the usual method of perfection. PPSA does not stipulate a deadline for registration. In theory, it is possible to register a security interest right until the time a priority contest takes place, but the secured party could lose priority to a competing secured party who has registered its interest first. Neither is it mandatory to register a security interest. As such, it is not an offence if a grantor or its officers fail to register a security interest. Assuming the security interest has not been perfected by other means, failure to register would affect it in two main ways. First, the security interest will vest in the grantor immediately before the grantor enters formal insolvency proceedings.[13] Secondly, it will lose priority to a perfected security interest.[14] If the grantor is a company, s 588FL of the *Corporations Act 2001* (Cth) gives the secured party effectively 20 business days from grant to register the security interest. Failing which it will be unenforceable against the company's insolvency practitioner.

Even if the security interest is perfected, there is no guarantee the secured party will have priority to the goods. The priority status of a perfected security interest "depends upon the nature and status of the interest or interests with which it is in competition".[15] There are two groups of claimants who can trump the buyer's security interest. The first are secured parties with prior security interests in the seller's assets. Often the seller is financed by a bank or other lender with a security interest in all the

[8] Hulse BD, "Prepaying Purchaser: What if the Seller Goes Broke?" (2005) 14 Bus L Today 19.

[9] *Personal Property Securities Act 2009* (Cth), s 19.

[10] *Personal Property Securities Act 2009* (Cth), s 20.

[11] *Personal Property Securities Act 2009* (Cth), s 21.

[12] *Personal Property Securities Act 2009* (Cth), ss 55(4) and 55(5).

[13] *Personal Property Securities Act 2009* (Cth), s 267.

[14] *Personal Property Securities Act 2009* (Cth), s 55(3).

[15] Cuming RCC, Walsh C and Wood RJ, *Personal Property Security Law* (2nd ed, Irwin Law, Toronto, 2012) p 297.

seller's assets, including the goods bought by the buyer. Under the "first-in-time rule"[16], the buyer's security interest will be subordinated to the earlier security interest, unless it falls within one of the specified exceptions.[17] The buyer can, of course, protect itself by obtaining a subordination agreement from the earlier secured party whose security interest is in conflict with the buyer's security interest. PPSA expressly provides for the priority of a particular secured party to be altered by a subordination agreement to which it is a party.[18] But, whether this will be forthcoming is another matter.

The second group of claimants who can trump the prepaying buyer's security interest are buyers in the ordinary course of business. Section 46(1) of PPSA provides that:

> A buyer or lessee of personal property takes the personal property free of a security interest given by the seller or lessor, or that arises under section 32 (proceeds – attachment), if the personal property was sold or leased in the ordinary course of the seller's or lessor's business of selling or leasing personal property of that kind.

It does not apply to serial-numbered personal property (such as motor vehicles, aircraft or watercraft) if they are held as inventory, nor where the buyer has actual knowledge that the transaction is a breach of the security agreement which gave rise to the security interest.[19] The effect of s 46(1) is that the prepaying buyer's security interest is cut-off when the goods are sold in the seller's ordinary course of business. Even though the prepaying buyer's security interest will attach to the proceeds of sale, this may be of little value if the seller is insolvent or the proceeds have been dissipated.

There are several other PPSA provisions that can cut-off a security interest. For example, under s 47(1) a buyer for new value, who intends to use goods mainly for personal, domestic or household purposes, takes it free of a security interest if the market value of the goods is $5,000 or less. This provision is subject to a few exceptions. It does not apply to serial-numbered personal goods and the buyer must not have actual or constructive knowledge that the sale violates the security agreement. Under s 45(3) of PPSA, a buyer of a motor vehicle from a licensed motor vehicle dealer takes it free of a security interest granted by the dealer or by another party if the buyer furnishes new value, does not hold the motor vehicle as inventory, and have no actual or constructive knowledge that the sale violates the security agreement.

PURCHASE MONEY SECURITY INTEREST

One of the principal shortcomings of taking an ordinary security interest is that it does not guarantee the prepaying buyer priority. So instead of taking an ordinary security interest in the goods bought, the prepaying buyer could try taking a purchase money security interest (PMSI). Under PPSA, a PMSI enjoys "super-priority". What this means is that in a priority contest with an earlier registered or perfected non-PMSI security interest it will take priority[20], unless the non-PMSI security interest has been perfected by control.[21] Taking a PMSI is important where the earlier ranking security interest holder is unprepared to enter into a subordination agreement either with the prepaying buyer or the seller. But to qualify for super-priority status, the security interest must fall within the definition of PMSI. This is where the problem lies. Fitting a prepayment into the definition of PMSI is difficult.

Section 14(1) defines a PMSI, in relevant part, as:

(a) a security interest taken in collateral, to the extent that it secures all or part of its purchase price;
(b) a security interest taken in collateral by a person who gives value for the purpose of enabling the grantor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights.[22]

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[16] *Personal Property Securities Act 2009* (Cth), s 55.

[17] See eg, *Personal Property Securities Act 2009* (Cth), ss 57 and 62.

[18] *Personal Property Securities Act 2009* (Cth), s 61.

[19] *Personal Property Securities Act 2009* (Cth), s 46(2).

[20] *Personal Property Securities Act 2009* (Cth), s 62.

[21] See *Personal Property Securities Act 2009* (Cth), s 57.

[22] Sections 14(1)(c) and 14(1)(d) are not relevant for the purposes of this article as they cover deemed security interests.

The security interest taken by a seller in goods sold to secure payment of the purchase price will fall under s 14(1)(a). Typical examples are goods sold on retention of title basis, or goods sold on credit with the seller taking a security interest in the goods. This type of PMSI is commonly referred to as a "seller PMSI". A security interest taken in goods sold to secure repayment of money lent to enable the purchase of the goods will fall under s 14(1)(b). A good example is when a bank which lends part of the purchase price to a buyer to enable it to acquire goods takes a security interest in the goods. This type of PMSI is commonly referred to as a "lender PMSI" and is wide enough to cover prepayments.

The priority given to a PMSI is an exception to the PPSA "first-in-time" rule. Wood and Cuming gave the following rationale for the "first-in-time" rule:

> Once the financing statement is registered any person who is planning to deal with someone named as debtor in the financing statement has the ability to determine whether or not the interest he intends to acquire will be subject to a security interest having a prior status. If such a person goes ahead and acquires an interest in the personal property described in the financing statement without making some accommodation with a registering party or obtaining a discharge of the financing statement, there is no reason to give his interest priority over a subsequent security interest acquired by the registering party.[23]

But not everyone agrees with the granting of super priority to PMSIs. Gough said that it:

> assumes that financial accommodation for the purpose of, for example, paying wages and salaries through cheques drawn on an overdrawn account is less important than the purchase of stocks or plant or equipment. This is not a real world distinction. Credit, as a matter of business need, is indivisible in the sense that all business inputs, including wages, overheads, equipment and supplies are all vital to an ongoing business.[24]

On the issue as to whether super-priority status should be accorded to PMSIs, Shupack raised a relevant point:

> Once we accept that we live in a society that, for whatever reasons, has chosen to permit secured credit, we can assume that the society has also decided to permit PMSI's that have priority over both unsecured creditors and secured creditors. Once we have made the decision that a hierarchy among creditors does make sense, the argument against extending a two tier hierarchy into a three tier hierarchy virtually disappear.[25]

Duggan and Brown have suggested that there are two main policy justifications for abandoning the "first-in-time" rule.[26] The first is that the PMSI-holder adds "new money" to the grantor's enterprise. By facilitating the acquisition of new assets, the PMSI-holder is increasing the profitability of the grantor, thereby reducing the risk of default. All creditors would stand to gain from the injection of additional resources. But even if this was not the case, the earlier secured parties are no worse off, as each additional dollar of debt incurred is offset by an additional dollar of asset acquired. It would therefore be unfair to deny the PMSI holder priority. Goode articulated the following rationale for granting super-priority:

> what establishes the priority for the purchase-money security interest is not merely its attachment to the new asset ab initio but the inequity that would result in allowing the prior chargee a windfall increase in his security brought about not with the debtor's money or new funds injected by the prior chargee but with financing provided by the later incumbrancer.[27]

The second policy justification is that PPSA strongly favours the first-in-time secured party, thus giving it a situational monopoly over the grantor's present and future borrowing requirements. Under PPSA, a creditor can take a security interest in the after-acquired property of the grantor and obtain

[23] Cuming RCC and Wood RJ, "Compatibility of Federal and Provincial Personal Property Law" (1986) 65 Can Bar R 267 at 285 cited in Drinkwater A, "The Rise and Fall of Purchase Money Security Interests at General Law and under Article 9 Regimes" (2010) 21 JBFLP 5 at 12.

[24] Gough WJ, *Company Charges* (2nd ed, Butterworths, London, 1996) p 436.

[25] Shupack PM, "Defining Purchase Money Collateral" (1992-1993) 29 Idaho L Rev 767 at 775.

[26] See Duggan A and Brown D, *Australian Personal Properties Law* (LexisNexis, Chatswood, 2012) pp 162-163.

[27] Gullifer L (ed), *Goode on Legal Problems of Credit and Security* (4th ed, Sweet & Maxwell, London, 2008) p 215.

priority by registering it before other creditors. Any future advances that the first-in-time secured party makes will enjoy the same priority as the original advance. As there will be no personal property left for other creditors to take a first-ranking security interest, the grantor may find it difficult to obtain financing from other sources. Thus, the aims of the super-priority rule are to counterbalance the situational monopoly of a prior secured party and to encourage the financing of new assets.[28]

As "a second in time, first is right rule of priority would completely undermine the institution of secured credit" the PMSI priority is restricted in two ways.[29] First, it only applies if the credit extended is used for the purpose of acquiring the collateral in which the PMSI is taken. There must be a nexus between the value given and the asset acquired. Secondly, the PMSI priority applies only to the extent that the credit is actually used to acquire the asset. Both these restrictions, as will be explained below, stand in the way of a prepaying buyer claiming a PMSI in the goods purchased. Jackson and Kronman observed that the definition of PMSI was "not formulated with the financing buyer in mind".[30]

The prepaying buyer faces a number of obstacles when taking a PMSI. They stem from the definition of PMSI in s 14(1)(b). The first obstacle is proving that the prepayment was in fact used by the seller to acquire the new asset. This can be illustrated by the following example. Suppose a buyer purchases a custom-built boat to be constructed by the seller. As required by the contract, the buyer pays the price in advance. The buyer then takes a PMSI in the boat under construction. Section 14(1)(b) requires that the money paid is used to acquire the goods. Where the goods are to be manufactured, the best way that the buyer can comply with the tracing requirements is to pay the seller's suppliers directly instead of paying the money to the seller for expenditure on the manufacture of the boat.[31] This would "involve an expensive bookkeeping system that would raise the cost of the entire transaction sufficiently to make it unattractive" to the seller.[32] Unfortunately, there is no other viable option. If the money was paid to the seller who in turn used it to pay its suppliers, it makes the task of tracing difficult.

Suppose the buyer complies with the strict tracing requirements, there is yet another obstacle to overcome. Although the PMSI in the component parts will continue in the finished product,[33] the prepaying buyer will not be able to claim super-priority for that portion of the value of the finished product attributable to intangible inputs such as labour, power, administration. This would make the acquisition of a valid PMSI covering the entire value of the finished product impossible, and a PMSI even to the extent of the component parts, unnecessarily expensive.[34] Not surprisingly it has been suggested that "even the most conscientious financing buyer will never achieve legal parity with the purchase money lender".[35] The strict tracing requirements make it difficult for the prepaying buyer to take a PMSI, but equally they provide the justification for giving a PMSI super-priority. Resolving the issue is not a matter of removing the tracing requirements.

OWNERSHIP OF UNDELIVERED GOODS

Instead of taking a security interest or a PMSI in the goods purchased, the prepaying buyer can seek to acquire ownership in the goods purchased while in the possession of the seller. As owner, the prepaying buyer will be able to claim the goods to the exclusion of other creditors. Whether ownership has passed to the buyer is determined by the rules laid down in the *Sale of Goods Act* (SGA). The SGA rules on transfer of ownership vary according to the type of goods. There are two basic rules.

[28] Hakes RA, "According Purchase Money Status Proper Priority" (1993) 72 Or L Rev 323 at 406.

[29] Cuming, Walsh and Wood, n 15, p 440.

[30] Jackson and Kronman, n 1 at 5.

[31] Jackson and Kronman, n 1 at 28.

[32] Jackson and Kronman, n 1 at 28.

[33] *Personal Property Securities Act 2009* (Cth), s 103.

[34] Jackson and Kronman, n 1 at 31.

[35] Jackson and Kronman, n 1 at 30.

The first is that where there is a contract for the sale of specific or ascertained goods, property passes at such time as the parties intend it to pass taking into accounts factors such as the terms of the contract, the conduct of the parties and the circumstances of the case.[36] But where the parties have not expressed any intention, or there does not appear to be one, SGA provides a number of sub-rules for ascertaining the parties' intention.[37] For example, where there is an unconditional contract for the sale of specific goods, property passes when the contract is made, regardless of whether they have been delivered.[38] The second basic rule is that where there is a contract for the sale of unascertained or future goods by description, property will pass to the buyer if they are in a deliverable state and unconditionally appropriated to the contract by either the seller or buyer with the assent of the other.[39]

Although in theory a buyer who has paid in advance for specific or ascertained goods runs the risk of losing the prepayment and goods when the seller becomes insolvent, in practice this is unlikely to happen because property will usually pass at the time of the contract or when the goods are ascertained.[40] The issue of ownership is more likely to surface where the goods have not been ascertained (as where the buyer enters into an agreement to buy part of cargo on a particular ship) or the goods are future goods (as where the goods have to be manufactured). This was illustrated in *Re Wait* [1927] 1 Ch 606. There, Wait bought 1,000 tons of wheat which was to be transported on the vessel *Challenger*. He resold 500 tons of the wheat to a buyer who paid in advance. But the wheat that was sold had not been physically separated from the rest of the wheat on board the vessel. Before the wheat could be delivered, Wait was declared bankrupt and the buyer sought to claim the goods. The Court of Appeal held that the buyer had no claim to the goods as ownership had not passed. This is because under s 16 of the *Sale of Goods Act 1893* (UK), ownership of unascertained goods only passes when they have been identified. As the wheat had not been physically separated from the bulk, this condition had not been satisfied.

SGA in some jurisdictions now provide relief for prepaying buyers of part of a bulk of goods. For example, s 25A of the New South Wales SGA provides that where a buyer has entered into a contract of sale for a specific quantity of unascertained goods of which some or all form part of a single identified bulk and the buyer has paid for some or all of the goods forming the bulk, property in the undivided share in the bulk is transferred to the buyer and the buyer becomes an owner in common of the bulk. This is only a presumption and can be displaced by agreement between the parties. Prepaying buyers of unascertained goods forming part of an identified bulk quantity of goods in jurisdictions which have adopted a provision similar to s 25A are less likely to suffer losses if the seller becomes insolvent.

Claiming ownership of future goods raises more issues. Future goods are defined in SGA as "goods to be manufactured or acquired by the seller, after the making of the contract of sale".[41] They are distinct from unascertained goods. Generally, where the goods sold are to be manufactured, property will pass to the buyer when the goods have been completed and appropriated. It is possible, however, for the parties to agree that property in the goods to be manufactured should pass before they are completed. Such agreements are usually found in contracts for the construction of ships where the practice is to provide for property to pass to the buyer as and when an instalment of the price is paid corresponding to a completed stage of production.[42]

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[36] See eg, *Sale of Goods Act 1895* (WA), s 17.

[37] See eg, *Sale of Goods Act 1895* (WA), s 18.

[38] See eg, *Sale of Goods Act 1895* (WA), s 18, r 1.

[39] See eg, *Sale of Goods Act 1895* (WA), s 18, r 5.

[40] Ulp J, "Equitable Proprietary Rights in Insolvency: The Ebbing Tide?" (1996) JBL 482 at 484.

[41] See eg, *Sale of Goods Act 1895* (WA), s 5.

[42] Bridge M et al (eds), *Benjamin's Sale of Goods* (8th ed, Sweet & Maxwell, London, 2010) at [5-092].

According to *Benjamin's Sale of Goods*, there is no problem with framing a sale of goods contract so as to pass property at any stage of manufacture.[43] As Lord Watson said in *Seath v Moore* (1886) 11 App Cas 350 at 380:

> Where it appears to be the intention, or in other words the agreement, of the parties to a contract that at a particular stage of its construction, the vessel, so far as then finished, shall be appropriated to the contract of sale, the property of the vessel as soon as it has reached that stage of completion will pass to the purchaser, and subsequent additions made to the chattel thus vested in the purchaser will, *accessione*, become his property.[44]

A provision that property will pass in the course of production is found not just in contracts for the manufacture of ships, but also in contracts for the manufacture of other customised goods. Such a provision was, for example, found in a contract for the manufacture of customised heat exchangers.[45] As it is possible for parties to agree to the passing of property even while goods are being manufactured, the best course for the prepaying buyer is to claim ownership as early as possible. The earliest point in the production process that property can pass is when the goods are identified as goods to be delivered under the sale contract.[46] This avenue will not be of much assistance to a prepaying buyer where the goods have not been ascertained or identified. So, if for example, a buyer pays a deposit on the signing of the contract and before any work has begun the seller becomes insolvent, there will be nothing which the buyer can claim.

It is common practice among sellers to secure inventory financing using their present and after acquired property as security. If the secured party has authorised the transfer, the buyer takes free of the security interest. But if the secured party has not, the buyer can still take it free of the security interest if s 46(1) applies. Under this provision, a buyer who acquires personal property in the ordinary course of the seller's business of selling personal property of that kind takes free of a security created by the seller, regardless of whether the interest is perfected, provided the buyer does not know that the sale breaches the security agreement. But it does not cover a security interest given by a third party, such as the person from whom the seller bought the goods.

There is no difficulty applying s 46(1) where the goods have been delivered. But for a while it was unclear whether it applied to undelivered goods. In *Royal Bank*, a case involving s 30(2) of the Saskatchewan PPSA (the equivalent of s 46(1) of PPSA), the court held at 87 that:

> Those persons who paid part of the purchase price for goods in the possession of the vendor which were in a deliverable state, and identified in some fashion as being the goods purchased, have priority over the security interests of the appellant.

From the above, it is possible to conclude that what is crucial to the application of s 46(1) is not delivery, but transfer of ownership.[47] As such, the fact that goods have not been delivered will not preclude the application of s 46(1).

Related to the issue of undelivered goods is whether s 46(1) will apply if the goods purchased are still under production. Does the fact that goods are still "work-in-progress" mean that they are not "goods" for the purposes of s 46(1)? This issue was addressed in *Kinetics Technology International Corp v Fourth National Bank of Tulsa* 705 F 2d 396 (1983). There, a company which designs and supplies process furnaces (KTI), entered into a contract with a manufacturer of customised heat exchangers (OHT). The contract required OHT to build eight furnace economisers to KTI's specifications. Some of the materials (KTI goods) for the manufacture of the furnace economisers were to be supplied by KTI. KTI agreed to make progress payments to OHT at various stages of

[43] Bridge et al, n 42 at [5-092].

[44] Cited in Bridge et al, n 42 at [5-092].

[45] *Kinetics Technology International Corp v Fourth National Bank of Tulsa* 705 F 2d 396 (1983).

[46] Dadson A, "A Fresh Plea for the Financing Buyer" (1986) 11 Can Bus LJ 171 at 184.

[47] Contra *Chrysler Corp v Adamatic, Inc* 208 N W 2d 97 at 107 where the court held that "to be afforded a status as a buyer in ordinary course of business, we conclude that such status must be determined as of the time he actually took possession of the goods".

construction. It was further agreed that title to the KTI goods would remain in KTI and title to goods acquired by OHT from various sources for use in the KTI contract would also pass to KTI when the first progress payment was made.

FNB, which had extended a line of credit to OHT, took a security interest in OHT's inventory. It filed a financing statement covering, inter alia, "All inventory now or hereafter owned by the Debtor". Sometime after starting work on the contract, OHT experienced financial problems and approached FNB for additional financing. FNB agreed on condition that the loan was secured by progress payments specified in the KTI contract. Shortly after, but before completion of the furnace economisers, OHT shut down its operations and handed the keys to its plant to FNB. KTI demanded the surrender of its goods, but FNB refused on the ground that it had a security interest in OHT's inventory. KTI then sued FNB for conversion and succeed at the trial court. FNB appealed the decision.

One of the key issues before the appeal court was whether KTI qualified as a buyer in the ordinary course of business under s 9-307 of the *Uniform Commercial Code* (UCC) (the UCC equivalent of s 46(1) of PPSA). If it did, then KTI would take the goods free of FNB's security interest. FNB argued that there was no sale in the ordinary course of business as the eight KTI furnace economisers were only "nuts and bolts" and not completed goods. As OHT only sold finished goods built to customers' specifications s 9-307 did not apply.

The Court of Appeal disagreed with FNB and gave its reasons:

> The Bank's argument fails because when the sale occurred, KTI was not buying "nuts and bolts" or sheet steel out of OHT's inventory; it was buying eight heat economizers that have been identified to the contract. OHT's business consisted of custom fabricating steel pursuant to the terms of contracts with its customers. KTI contracted to buy custom-made goods from OHT, as was OHT's regular practice. The contract for sale was thus in the ordinary course. This was *not* a contract for sale of raw materials by OHT, which would not have been in OHT's ordinary practice, but was instead a contract for sale that typified OHT's business. So long as the goods were designated as those to be incorporated into KTI's eight furnace economizers, it is irrelevant that the fabrication was not complete.[48]

Where a prepaying buyer succeeds in claiming ownership, it will normally be protected from other competing interests. One reason why a seller may refuse to transfer ownership before goods are fully paid is that the buyer may have sub-contracted the manufacture of the goods to a third party.

TRUST

If the prepaying buyer is unable to take security or claim ownership of the goods, another avenue open to the buyer is to argue that the prepayment is money held in trust. Subject to limited exceptions, money held in trust by a bankrupt or insolvent person is not available to the trustee in bankruptcy or liquidator. This principle applies to both express trusts and imputed trusts.[49] The attractiveness of arguing that property in the hands of the bankrupt or insolvent is impressed with a trust is the "alteration of the [prepaying buyer's] legal status: from the lowly (and often unpaid) unsecured creditor to the beneficiary with rights that prevail over all creditors".[50] Where the prepayment is characterised as trust money, the buyer is entitled to recover it, if the purposes for which the trust is created fails. But this is conditional upon the buyer being able to identify the trust money.

The trust relation can be created by the buyer at the time the prepayment is made. For example, a buyer can send the seller a prepayment cheque with a note attached stating that the money is sent on condition that it is held by the seller in trust until the goods have been delivered. It is open to the seller to refuse the order on that basis, but even if the seller accepted the order, unless the money is kept in a separate account, the buyer may find it difficult to trace the money.[51] If the money cannot be traced,

[48] *Kinetics Technology International Corp v Fourth National Bank of Tulsa* 705 F 2d 396 at 402 (1983).

[49] Moffat G, Bean G and Dewar J, *Trust Law Text and Materials* (4th ed, Cambridge University Press, Cambridge, 2005) p 763.

[50] Moffat, Bean and Dewar, n 49, p 764.

[51] Moffat, Bean and Dewar, n 49, p 768.

the prepaying buyer will be left with an unsecured claim. Requiring the seller to keep a separate account for prepayments may be too onerous an obligation.

But, even if a buyer does not initiate the creation of a trust, the seller can do so. This was what happened in *Re Kayford Ltd* [1975] 1 WLR 279. There, the company carried on a mail order business in bedding quilts, chair covers and other similar merchandise. Its customers either paid the full price in advance, or paid a deposit for goods ordered. When the company's chief suppliers went into liquidation, the company found it difficult to fulfil its customers' orders. The company was advised by its accountant to deposit prepayments from its customers into a "Customers' Trust Deposit Account". The object of doing this was that if the company had to go into liquidation, the prepayments could be refunded to those customers who had not been supplied with the goods. The company initially paid the prepayments into a dormant deposit account, but later altered the name of the account. It subsequently went into voluntary liquidation.

The question before the court was whether the prepayments paid into the account were held on trust for the buyers or whether they formed part of the general assets of the supplier. Megarry J said:

> despite the loose ends … I feel no doubt that the intention was that there should be a trust. There are no formal difficulties. The property concerned is pure personalty, and so writing, though desirable, is not an essential. There is no doubt about the so-called "three certainties" of a trust. The subject matter to be held on trust is clear, and so are the beneficial interests therein, as well as the beneficiaries. As for the requisite certainty of words, it is well settled that a trust can be created without using the words "trust" or "confidence" or the like: the question is whether in substance a sufficient intention to create a trust has been manifested.[52]

Not only did Megarry J declare the existence of a trust, he also supported the idea of paying prepayments into a trust account where the company had doubts about its ability to fulfil its obligations. Megarry J said:

> In cases concerning the public, it seems to me that where money in advance is being paid to a company in return for the future supply of goods or services, it is an entirely proper and honourable thing for a company to do what this company, upon skilled advice, namely, to start to pay the money into a trust account as soon as there begin to be doubts as to the company's ability to fulfil its obligations to deliver the goods or provide the services.[53]

Although not essential, it is important that the prepayments are held separate from other money belonging to the seller. Otherwise the buyer will have to rely on the rules of tracing to recover the prepayments and this could pose a heavy evidentiary burden for consumers given the widespread use of credit cards.[54]

It is possible to identify three reasons why the creation of express trusts is not a suitable solution to the prepaying buyer's problems.[55] First, it would cause inconvenience to sellers as they will be forced to adopt elaborate accounting mechanisms to keep track and hold prepayments. Sellers are not likely to accept customer's orders on condition that they are held in trust, nor are they likely to create trusts for the prepayments on their own volition. Secondly, the administrative burden on sellers would far outweigh the benefit to buyers in the few cases where trust rights would be needed. It does not make sense to penalise all sellers, for the sins of a few. Thirdly, it would limit the ability of sellers to use prepayments as working capital, thus depriving them of a valuable source of interest-free credit.

If there is no express trust, can a prepaying buyer persuade the courts to recognise a remedial constructive trust over the goods? According to McKendrick, courts would be slow to recognise a remedial constructive trust in favour of the buyers.[56] He said that for courts to recognise such a trust, the seller must have engaged in some form of wrongful conduct. Although a failure to deliver goods,

[52] *Re Kayford Ltd* [1975] 1 WLR 279 at 281-282.

[53] *Re Kayford Ltd* [1975] 1 WLR 279 at 282.

[54] Law Reform Commission of British Columbia, *Report on the Buyer's Lien: A New Consumer Remedy*, LRC 93 (1987) Ch 5.

[55] Law Reform Commission of British Columbia, n 54, Ch 5.

[56] McKendrick E, "The Passing of Property in Part of a Bulk" in Palmer N and McKendrick E (eds), *Interest in Goods* (2nd ed, LLP, London, 1998) p 391.

after having received payment, is wrongful, it is wrongful only in the sense that it is a breach of contract.[57] Constructive trusts are normally imposed where there is a breach of fiduciary duty, unconscionable dealing or undue influence. A breach of contract would not fall into any of these categories.

Equitable lien

Finally, a buyer can claim that it has an equitable lien in the undelivered goods. An equitable lien has been described as "a right against property which arises automatically by implication of equity to secure the discharge of an actual or potential indebtedness".[58] It is similar to an equitable mortgage or charge except that it arises by operation of law and not by agreement. Unlike the common law possessory lien, the equitable lien is not dependent on possession. Its implication can be precluded or qualified by implied or express agreement between the parties.[59] Well known examples of the equitable lien are the lien arising in favour of a vendor to secure the repayment of the balance of the purchase price and the purchaser's lien to secure repayment of the instalments of the purchase price.

The equitable lien "arises in a number of different situations; it has been hard to find a general consistent principle to describe its application, or to justify the situations in which it will not arise".[60] In *Hewett v Court (1983)* 149 CLR 639 at 668, Deane J attempted to formulate the circumstances in which an equitable lien will arise in a contractual relation:

> The circumstances are (i) that there be an actual or potential indebtedness on the part of the party who is the owner of the property to the other party arising from a payment or promise of payment either of consideration in relation to the acquisition of the property or an expense incurred in relation to it, (ii) that the property (or property arguably including that property) be specifically identified and appropriated to the performance of the contract, and (iii) that the relationship between the actual or potential indebtedness and the identified or appropriated property be such that the owner would be acting unconscientiously or unfairly if he were to dispose of the property (or, if it be appropriate, more than a particular portion thereof) to a stranger without the consent of the other party or without the actual or potential liability having been discharged.

Although, the equitable lien originally arose in relation to contracts of sale of land, it is now well established that both a vendor's lien and purchaser's lien can arise in in relation to personalty, more specifically intangible property.[61] But, it is less certain whether it applies to contracts for sale of goods. According to the authors of *The Law of Personal Property*, "there are clear judicial statements that the doctrine of equitable lien does not apply to contracts for the sale of goods".[62]

It appears that there are two principal arguments that have been advanced in support of the conclusion that no equitable lien can arise in a contract for sale of goods.[63] The first is that the expression "the rules of the common law" in SGA does not include the principles of equity.[64] The second argument is that SGA constitutes an exclusive code of the legal relations arising out of a contract of sale. Both these arguments have been challenged by a number of academic commentators from both the United Kingdom and Australia.

Hardingham questioned the validity of the first argument by referring to the judgment of the Full Court of the Supreme Court of South Australia in *Graham v Freer(1980)* 35 SASR 424. There, the court concluded that there was nothing inherent in a contract for sale of goods which took it outside

[57] McKendrick, n 56, p 391.

[58] Hardingham IJ, "Equitable Liens for the Recovery of Purchase Money" (1985) 15 Melb Univ L Rev 65.

[59] Hardingham, n 58 at 65.

[60] Beale H et al, *The Law of Personal Property* (Oxford University Press, Oxford, 2007) p 156.

[61] Beale et al, n 60, p 158.

[62] Beale et al, n 60, p 159.

[63] See Phillips J, "Equitable Liens – a Search for a Unifying Principle" in Palmer N and McKendrick E (eds), *Interest in Goods* (2nd ed, LLP, London, 1998) p 985.

[64] See eg, *Sale of Goods Act 1895* (WA), s 59(2).

the scope of equitable principles.[65] Worthington pointed out that even though the question whether the "rules of common law" included the rules of equity had not been authoritatively determined in England, it was an unstated assumption in many reported cases that the rules of equity did apply.[66] She also added that "this assumption is now unlikely to be challenged".[67]

On the second argument, Hardingham said that Atkin LJ's contention in *Re Wait* that SGA was an exclusive code overlooked the fact that there are provisions in SGA that says precisely the opposite.[68] For an example, he referred to s 4(2) of the *Goods Act 1958* (Vic) which provides that:

> The rules of the common law including the law merchant save in so far as they are inconsistent with the express provisions of this Part and in particular the rules relating to the law of principal and agent and the effect of fraud misrepresentation duress or coercion mistake or other invalidating cause shall continue to apply to contracts for the sale of goods.

Hardingham's opinion is shared by other commentators such as Phillips, who drew attention to the fact that "other remedies, such as injunctive relief, have been held available to the buyer of goods even though not specifically referred to in the Act".[69]

The above counter-arguments suggest that it is possible that a purchaser's lien can arise in a contract for sale of goods in Australia. However, until it is authoritatively determined, doubts will remain whether it is possible for a prepaying buyer to claim an equitable lien against the seller's goods to secure repayment of the prepayment.

The advantage of an equitable lien is that it creates a right in rem, thus making the holder a secured creditor. Under PPSA, an equitable lien is excluded from the definition of security interest under s 12(1) of PPSA as it is a non-consensual interest. But despite this, s 73(1) of PPSA provides that in a contest between an interest arising by operation of the general law and a security interest, the former will take priority. But there is one problem a non-consensual lien claiming priority under s 73(1) will face. The lien must arise in relation to the provision of goods or services and the security interest holder must have provided the goods and services. It is hardly likely that the provision of purchase money would qualify as the provision of goods and services. Unless it does, it is difficult to see how an equitable lien will meet the s 73(1) requirements.

If s 73(1) does not apply to a priority contest between an equitable lien and a PPSA security interest, it may be necessary to resort to general law principles. Under the general law, it is well established that where there is a contest between a legal interest and an equitable interest, the legal interest will take priority even if the equitable interest was created earlier, provided the legal interest had no notice of the earlier equitable interest. A PPSA security interest being a statutory interest will in all probability be treated as a legal interest.[70] This would mean that even if a prepayment did entitle the buyer to an equitable lien in the seller's goods, the equitable lien could still be defeated by a later created PPSA security interest.

RECOMMENDATIONS AND CONCLUSION

We looked at various measures which a prepaying buyer could consider taking under the current law to protect against the insolvency of the seller. A few observations about them can be made. First, they are not likely to be accessible to the vast majority of buyers, as they are likely to lack the knowledge and resources to take them Secondly, it is doubtful whether some of the measures can be taken in relation to prepayments for goods. A good example is the equitable lien. It has not been authoritatively determined whether it applies to contracts for sale of goods. Thirdly, sellers are likely to see the measures taken by buyers as imposing on them an unnecessary burden and restricting their freedom to use prepayments as working capital.

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[65] Hardingham, n 58 at 76.

[66] See Worthington S, "Equitable Liens in Commercial Transactions" (1994) 53 Cambridge LJ 263 at 268-269.

[67] Worthington, n 66 at 269.

[68] Hardingham, n 58 at 77.

[69] Phillips, n 63, p 985.

[70] See Gedye M, Cuming RCC and Wood RJ, *Personal Property Securities in New Zealand* (Brookers, Wellington, 2002) p 19.

It is because there is little that a prepaying buyer can do to protect itself under the current law that some form of legal reform is necessary. A possible solution is the introduction of a statutory lien developed along the lines of the British Columbia buyer's lien. The buyer's lien scheme was introduced in 1993 following the recommendations of the British Columbia Law Reform Commission. The challenge faced by the Commission at that time was devising a remedy that would reinforce the legal position of the prepaying buyer without disrupting business practices or frustrating the legitimate expectations of other interested parties.[71]

The Commission decided that the buyer's lien was the most appropriate remedy and the sale of goods legislation the most hospitable environment for it. As a result, eight new provisions, forming a new Pt 9, were added to the British Columbia *Sale of Goods Act*.[72] The key provision in Pt 9 is s 75 which states that:

(1) If in the usual course of a seller's business the seller makes an agreement to sell goods and

  (a) the buyer pays all or part of the price

  (b) the goods are unascertained or future goods, and

  (c) the buyer is acquiring the goods in good faith for use primarily for personal, family or household purposes,

then the buyer has the lien described in subsection (2).

(2) The lien under subsection (1) is for the amount the buyer has paid towards the purchase price of the goods and is against

  (a) All goods

    i. that are in or come into the possession of the seller and are held by the seller for sale,

    ii. that correspond with the description of or with any sample of the goods under the agreement to sell, and

    iii. the property in which has not passed to a different buyer under a different contract of sale, and

  (b) any account in a savings institution in which the seller usually deposits the proceeds of sale.

The buyer's lien is essentially a consumer remedy as it as it only arises where the buyer is "acquiring the goods in good faith for use primarily for personal, family or household purposes" from a seller in the usual course of the seller's business.[73] There are two other conditions which must be satisfied before the lien can be asserted. First, the buyer must have paid all or part or the purchase price. Secondly, the goods must be unascertained or future goods. According to Close this would confine the lien to transactions where it is actually needed as goods that do not satisfy this requirement would have been appropriated and title to them passed to the buyer.[74]

Where the buyer's lien arises, it attaches to two categories of property. The first category is all goods in the seller's possession which correspond with the contract description.[75] This can be illustrated in the following example. Suppose X buys a refrigerator of Model F from Y and pays for it in advance. But, before the refrigerator can be delivered to X, Y becomes insolvent. There are 10 refrigerators of Model F and another 10 refrigerators of Model G in Y's store. If no particular refrigerator of Model F has been identified as the subject matter of the sale, X's lien will attach to the 10 refrigerators of Model F in Y's store. It will not attach to the 10 refrigerators of Model G, as they do not "correspond with the description" of the refrigerator sold to X. If another five Model F refrigerators are delivered to Y before they are appropriated, they would also become subject to X's lien as they have come "into the possession of the seller" to be held for sale. X's lien would however not bind a refrigerator that has been appropriated to another buyer.

[71] Law Reform Commission of British Columbia, n 54, Ch 1.

[72] *Sale of Goods Act* RSBC 1996, c 410, ss 74-81.

[73] *Sale of Goods Act* RSBC 1996, c 410, s 75(1)(c).

[74] Close, n 3 at 132.

[75] *Sale of Goods Act* RSBC 1996, c 410, s 75(2)(a).

The second category of property that the buyer's lien would attach to is any account in a savings institution into which the seller usually deposits the proceeds of sale.[76] Close said that this aspect of the buyer's lien reflected the British Columbia Law Reform Commission's concern to create a remedy that was tied to the prepayment yet avoided the difficulties raised by other schemes such as requiring the money to be held in trust in a segregated account maintained by the seller.[77] Wood is doubtful whether restricting the lien to an account at a savings institution would prove useful to the buyer for two reasons.[78] First, the bank may exercise its right of set-off regardless of whether it is aware that the funds in the account are made of prepayments. Secondly, the buyer will have no remedy if the account is empty or overdrawn.

There are two ways by which the lien can be discharged. The first is when the sale is completed by delivery of the goods to the buyer, and the second is when the prepayment is refunded.[79] The seller has the option of discharging the lien by delivery of the goods or by refund of the prepayment. The trustee (a term which includes a sheriff, a trustee in bankruptcy, a liquidator and a receiver) who assumes control of the seller's property is under a duty to ensure that property subject to the lien is dealt with for the buyer's benefit.[80] This would undoubtedly add to the trustee's workload and may not be well received. The trustee is however not liable to the buyer if it deals with the property in good faith and without knowledge of the lien.

A major strength of the buyer's lien is that it will take priority over other PPSA security interests.[81] But, where more than one buyer's lien is in competition, it is unclear which interest will have priority. Similarly it is unclear whether the buyer's lien will take priority where it is competition with another statutory lien or a deemed trust.[82] It would appear that this is a matter for the courts to decide. This is unsatisfactory as it creates uncertainty and would only encourage litigation. Where there are two or more buyer's liens over the same property, and both cannot be fully satisfied, the *Sale of Goods Act* states that "the shortfall must be attributed to the buyers' claims in the proportions that their respective claims bear to the sum of those claims".[83] In other words, the buyers will have to share the losses suffered on a pro-rata basis.

It is clear from the above that the buyer's lien functions like a "super floating charge"[84], but with the added advantage of not having to comply with any kind of registration. More importantly, it protects prepaying buyers without imposing any administrative burden on sellers. As Close observed:

> For the vast majority of buyers and sellers, the buyer's lien scheme will operate "transparently". The lien will flicker into existence when a prepayment is made, hover over the transaction for a few hours or days until specific goods are appropriated to the sale, then vanish with neither the buyer nor the seller having been aware that it existed. It is only where some event intervenes which prevents the transaction from being completed that the buyer's lien will acquire significance as a remedy.[85]

But, as we have discussed earlier, the buyer's lien is not without shortcomings. A major weakness is that the buyer's lien only protects consumer buyers. This leaves out commercial buyers, many of whom are not in a position to take protective measures.

Instead of introducing a statutory lien, an alternative approach would be to amend PPSA to reinforce the position of prepaying buyers. This was the approach proposed by Jackson and Kronman.

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[76] *Sale of Goods Act* RSBC 1996, c 410, s 75(2)(b).

[77] Close, n 3 at 133.

[78] Wood, n 5 at 121.

[79] *Sale of Goods Act* RSBC 1996, c 410, ss 76(1)-76(2).

[80] *Sale of Goods Act* RSBC 1996, c 410, s 78.

[81] *Sale of Goods Act* RSBC 1996, c 410, s 77.

[82] Wood, n 5 at 121.

[83] *Sale of Goods Act* RSBC 1996, c 410, s 80(1).

[84] *Cancedar Log Homes Ltd v Hodson* 2009 BCSC 222 at [66].

[85] Close, n 3 at 135.

They offered two variants.[86] The first involved abolishing the strict requirement in s 9-107(b) (the previous Art 9 equivalent of PPSA s 14(1)) by deleting the words "if such value is in fact used".[87] But, as they have conceded, elimination of the tracing requirement is bound to prove controversial. This is because the concept of PMSI is closely tied to the nexus between the acquisition of the collateral and the secured obligation. Without this nexus, the PMSI will undermine the rights of prior secured financiers.

The second variant involved the addition of a new sub-section (c) to s 9-107 to read as follows:

> A security interest is a "purchase money security interest" to the extent that it is …
> (c) taken by a buyer who makes advances to a seller to enable the seller to manufacture, assemble or process goods for the buyer during the period of one year following the advance, and the collateral securing the advance consists of (i) materials acquired after the advance has been made which are necessary for the manufacture, assembly or processing of the contract goods, and (ii) goods manufactured, assembled, or processed after the advance has been made which could be used to satisfy the contract (whether or not in a deliverable state).

The proposed provision limits the buyer PMSI priority to materials acquired or goods manufactured during the period of one year after the advance is made. This is to ensure that the prepayment is actually used to enable the seller to complete the contract. Although the addition of this new subsection will enable the prepaying buyer to achieve parity with the purchase money lender, it suffers from two defects. First, it is restricted to prepayments made to enable goods to be manufactured, processed or assembled. Prepayments for finished goods are not covered by it. Secondly, the PMSI can still be cut-off if the goods are sold in the ordinary course of the seller's business.

Both the British Columbia buyer's lien and the buyer's PMSI proposed by Jackson and Kronman are not without weaknesses. But, just because they are not perfect is no reason for not considering them. Each has its own merits and, with some further modifications, may well prove to be a workable solution. There is no legislative scheme that can completely eliminate the risks faced by a prepaying buyer when the seller becomes insolvent. What is important is that the current law is changed to make it easier for buyers to take measures to protect their prepayments. Until this is achieved, the plight of the prepaying buyer will unfortunately remain an unhappy one.

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[86] Jackson and Kronman, n 1 at 36-37.

[87] Section 9-107 defines a purchase money security interest as:

> A security interest is a "purchase money security interest" to the extent that it is
> (a) taken or retained by the seller of the collateral to secure all or part of its price; or
> (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

The definition of PMSI is now found in *Uniform Commercial Code*, s 9-103.