1994

Marshalling and the Personal Property Security Acts: Doing Unto Others ...

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Citation Details
Bruce MacDougall, "Marshalling and the Personal Property Security Acts: Doing Unto Others..." (1994) 28:1 UBC L Rev 91.

MARSHALLING AND THE PERSONAL PROPERTY SECURITY ACTS: DOING UNTO OTHERS . . .

BRUCE MacDOUGALL†

Where a senior creditor has access to two funds from the same debtor to satisfy its claims and the junior creditor has access to only one of these funds, it could be equitable to expect that the senior creditor satisfy itself out of the fund in which the junior creditor does not have an interest. Where a court makes an order based on this principle, it has invoked the doctrine of marshalling, sometimes called the two-fund rule.[1] Marshalling is an equitable doctrine and therein lies its strengths and weaknesses. Equity gives it its flexibility, adaptibility and utility. Equity also gives it its uncertainty and lack of clear boundaries.

Marshalling is used to prevent the arbitrary action of a senior creditor from destroying the rights or expectations of a junior creditor or a creditor with less security. It is used to lessen the chance that a junior creditor may lose its security solely at the whim of the senior creditor's choice of property to pursue.[2] As Grant M.R. said in *Trimmer* v. *Bayne (No. 2)*: "A person having resort to two funds shall not by his choice disappoint another, having only one."[3] The doctrine of marshalling is

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1 There is no real way of knowing exactly what the origin of marshalling is. According to one author, the doctrine of marshalling was derived from Roman and civil law and found its way into English law in the mid-seventeenth century: M. Lachman, "Marshaling Assets in Bankruptcy: Recent Innovations in the Doctrine" (1985), 6 Cardozo L. Rev. 671, note 1, 671. See W. Holdsworth, *A History of English Law*, 2d. ed., vol. 6 (London: Methuen & Co, 1937). Early cases on marshalling: *Culpepper* v. *Aston* (1682), 2 Ch. Cas. 115, 22 E.R. 873; *Wright* v. *Simpson* (1802), 6 Ves. Jun. 714, 31 E.R. 1272; *Lanoy* v. *Athol* (1742), 2 Atk. 445, 26 E.R. 668; *Sagitary* v. *Hyde* (1687), 1 Vern. 455, 23 E.R. 581

2 21 *CJS* Creditor and Debtor, (St. Paul, Minn.: West, 1990) at 595.

3 (1803), 9 Ves. Jun. 209, 32 E.R. 582. See also L. B. Curzon, *Equity*, 3d ed. (Plymouth: Macdonald & Evans, 1979) at 106. According to J. Indermaur and C. Thwaites in *A Manual of the Principles*

peculiar in that it attempts to satisfy as many claimants as possible. Most legal principles resolve conflicts among creditors by applying rules of priority.

Justice Story said in relation to marshalling:

> And natural justice requires, that one man should not be permitted, from wantonness, or caprice, or rashness, to do an injury to another. In short, we may apply here the common civil maxim, "sic utere tuo, ut alienum non laedas;" and still more emphatically, the Christian maxim, "Do unto others as you would they should do unto you."[4]

Marshalling is not based on the law of contracts or liens. It is founded instead in equity, being designed to promote fair dealing and justice.[5] It cannot be invoked where to do so would create unfairness or inequity. Marshalling is usually referred to as a "right," but until it is invoked, it is more a potential equity than an equitable right.[6] Until the doctrine is asserted the right to marshall is subject to displacement and to being defeated by subsequent liens.[7]

Equity has its limits. The limits of marshalling are illustrated by the case of *Toronto-Dominion Bank* v. *Whitaker*,[8] where it was argued that the doctrine of marshalling could be used by the court to order the plaintiff to buy land at a certain price on the ground that it was just and equitable to do so. To that Master Funduk said:

> To suggest that the jurisdiction of the court is founded on whatever is "just and equitable" would be a throwback to the days when the ultimate power lay in the Crown and "justice" was dispensed, or not dispensed, by the Crown to those who felt they had grievances not redressable at law and who petitioned the Crown for "justice."

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of Equity (London: Barker, 1913) at 176, marshalling is an application of the principle *Nemo exalterius detrimento fieri debet locupletior* (a person having two funds to satisfy his demands shall not by his election disappoint a party who has only one fund).

4 W. E. Grigsby, ed., *Story's Commentaries on Equity Jurisprudence*, 2d ed. (London: Stevens & Haynes, 1892) at 417.

5 *Meyer* v. *U.S.*, 375 U.S. 233 at 297 (1963). See also: 53 *Am. Jur.* 2d Marshaling Assets (Rochester, N.Y.: Lawyers Co-op., 1970) at 9; *Smyth* v. *Toms* (1918), 1 I.R. (Ch.) 338 at 346-47; *Brown* v. *CIBC* (1985), 50 O.R. (2d) 420 at 427 (H.C.J.); *Caplinger* v. *Patty*, 398 F. 2d 471 at 474 (8th Cir. 1968); *Enloe* v. *Franklin Bank and Trust Co.* 445 N.E. 2d 1005 at 1007-8 (Ct. Apps. Ind. 1983); *Calhoun* v. *Fed. Land Bank of Louisville* 20 S.W. 2d 72 (Ky. Ct. Apps. 1929); and *Harrington* v. *Taylor* 169 P. 690 (S.C. Cal. 1917).

6 *Commonwealth Trading Bank* v. *Colonial Mutual Life Assurance Society Ltd.*, [1970] Tas. S.R. 120 at 130 (S.C.).

7 Marshaling Assets, *supra* note 5 at 20.

8 (4 July 1986), (Alta. Q.B.) [unreported]. Noted at 46 Alta. L.R. (2d) 422.

> The days of the Crown as the ultimate power dispensing "justice," on petitions made to it, through the Chancellor and the Curia Regis are long gone.[9]

The Master refused marshalling because the principles of marshalling did not apply.

Use of the doctrine of marshalling is common in several different areas of the law.[10] It is frequently used in the administration of estates to help determine the distribution of assets. This is usually called marshalling of assets and is to be distinguished from its use in settling priorities between successive encumbrancers, called marshalling of securities.[11] Marshalling in this paper deals with a type of marshalling of securities, namely where the securities are in personal property and potentially subject to a Personal Property Security Act (PPSA).[12] Because of the relatively few cases in this area, much reference will be made to cases where the security is in real property, which cases are plentiful.

This paper deals first with the issue of whether the doctrine of marshalling should be available in the context of a PPSA. It concludes that as long as the usual safeguards are followed, the doctrine of marshalling presents no threat to the certainty and efficiency of a PPSA system. The paper then examines the requirements of marshalling and how these requirements work in the personal property context. Finally,

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9 *Ibid.* at 10.

10 A. Smith, *A Practical Exposition of the Principles of Equity*, 5th ed. (London: Stevens and Sons, 1914) at 614. See S. W. Symons, *Pomeroy's Treatise on Equity Jurisprudence*, 5th ed. (San Francisco: Bancroft-Whitney, 1941). Some regard apportionment as a part of marshalling. The doctrine of apportionment could come into play in a situation where, say, there are two funds: A has a double claim, B has only one claim on one fund, and C has only one claim on the other fund. It would be unfair for B to be able to marshall so as to require A to take from the fund in which B has no interest. This would affect the rights of C. However, the court might order A to realise on its security by apportionment, *i.e.*, A would be deemed to be thrown rateably on the two funds. Some say this is marshalling. Others say it is not because it infringes on the fundamental rule of marshalling that the rights of third parties will not be affected: See R. Derham, "Set-Off against an Assignee: The Relevance of Marshalling, Contribution and Subrogation" (1991) 107 L.Q.R. 126, at 132ff. *Lanoy* v. *Athol*, *supra* note 1; *Gibson* v. *Seagrim* (1855), 20 Beav. 614, 52 E.R. 741; *Flint* v. *Howard*, [1893] 2 Ch. 54 (C.A.); and *Smyth* v. *Toms*, *supra* note 5. Others see it as part of the doctrine of contribution: R. P. Meagher, W. M. C. Gummow and J. R. F. Lehane, *Equity: Doctrines and Remedies*, 2d. ed. (Sydney: Butterworths, 1984) at 309.

11 W. M. C. Gummow, "Marshalling and Protected Assets" (1965) 5 Sydney L. Rev. 120 at 122.

12 The PPSAs in force on 1 January 1994 are as follows: Alberta, S.A. 1988, c. P-4.05; British Columbia, S.B.C. 1989, c. 36; Manitoba, R.S.M. 1987, c. P35; Ontario, R.S.O. 1990, c. P.10; Saskatchewan, S.S. 1979-80, c. P-6.1; Yukon, R.S.Y. 1986, c. 130. Manitoba, New Brunswick and Saskatchewan have plans to proclaim into effect in the near future PPSAs similar to Alberta's and British Columbia's. Northwest Territories' PPSA will be proclaimed in the more distant future. Prince Edward Island has passed a PPSA (S.P.E.I. 1990, c. 42) but has no plans to proclaim it. References in this article will be to sections already in force.

the paper addresses the issue of how marshalling should be implemented. Should it operate by way of subrogation only or should a court also be able to compel the senior creditor to realise its claim out of certain collateral and not others? It concludes that although marshalling by compulsion might be infrequently applied, the option should at least remain available. Throughout the paper, the creditor with two (or more) security interests or items of collateral will be referred to as the "senior creditor." The creditor with one security interest or item of collateral will be called the "junior creditor." A singly-secured creditor who is also the senior creditor does not need the doctrine of marshalling to protect its position from the actions of a doubly-secured creditor. Its priority position is sufficient.

I. MARSHALLING IN THE PPSA CONTEXT

The PPSAs are silent on the question of marshalling. The PPSAs do preserve the principles of the common law, equity and the law merchant, except insofar as they are inconsistent with the Acts.[13] Does this include the doctrine of marshalling?

The question of whether marshalling is available in the context of the PPSA arises mainly because of doubt cast on the matter by the Saskatchewan Court of Queen's Bench case of *National Bank of Canada* v. *Makin Metals Ltd.*[14] In that case, Scheibel J. said:

> [A] review of Canadian jurisprudence shows that while the doctrine of marshalling has been considered in numerous cases involving mortgages against real property, I have not found a case where the doctrine of marshalling has been applied to personal property.[15]

In *Makin Metals*, a bank had a perfected security interest over an eavestrougher's assets. Subsequently, a supplier delivered steel coil to the eavestrougher but failed to register a security interest in the coils. The question arose as to the priority to the steel coils as between the bank and the supplier. The supplier sought to have the doctrine of marshalling applied for its benefit. Scheibel J. held:

> The end result is that the P.P.S.A. has deemed consignment arrangements, such as those between Makin and Elite, to be transactions which create security interests. The P.P.S.A. has also provided a mechanism for con-

13 Alberta, s. 66(3); BC, s. 68(1); Ontario, s. 72; Saskatchewan, s. 64(5); Yukon, s. 63(1). Manitoba has no such express provision.

14 [1993] 3 W.W.R. 318 (Sask. Q.B.) [hereinafter *Makin Metals*]. The Saskatchewan Court of Appeal left this issue open but noted the "substantial body of case law" to the contrary in the U.S.: *National Bank of Canada* v. *Makin Metals Ltd.* (1994), 116 Sask. R. 236 at 240 (C.A.).

15 *Ibid.* at 328.

signors, such as Makin, to protect their security interests by registration. Makin did not register its security interest nor did they confirm it in writing therefore their unperfected interest is subordinate to that of the Bank. . . .[16]

The judge did not think the doctrine of marshalling should upset the priorities as established by the PPSA.

The only case the judge could find where marshalling was considered in the context of the PPSA was *Steinbach Credit Union Ltd.* v. *Manitoba Agricultural Credit Corp.*[17] Scheibel J. interpreted Morse J.'s views in that case to mean that marshalling was not applicable in the PPSA context. In *Steinbach*, the Credit Union took, as security for a third loan to the debtor, a promissory note and a general security agreement. In the first and second loans the same collateral had been given in addition to a real property mortgage. Agricultural Credit Corp. lent the debtor money to buy cattle and took a chattel mortgage as security. Agricultural Credit Corp. registered its purchase money security interest but incorrectly spelled the given name of the debtor on the financing statement. The Manitoba Court of Queen's Bench held that Agricultural Credit Corp. should have priority, despite the error in the financing statement. The Court went on to hold that had it decided the case differently, it would have used the doctrine of marshalling to give Agricultural Credit Corp. priority to the cattle in relation to the first two loans made by the Credit Union.

Morse J. said:

I think counsel for the respondent is correct in submitting that the doctrine [of marshalling] has application where, as here, the securities are in relation to personal property as well as to real property. . . .

The doctrine of marshalling is an equitable doctrine, and it would, in my view, be inequitable to allow the applicant first to satisfy its indebtedness from the proceeds of the sale of the cattle, thereby precluding the responding [sic] from realizing on the only security it has. However, the third loan of the applicant is not secured by a real property mortgage, and the doctrine of marshalling would not, in my opinion, apply to this loan.[18]

It is not entirely clear why the absence of a real property mortgage precluded marshalling in relation to the third loan. There was other collateral available to the bank. Although Morse J. does not say directly that having a real property mortgage is a prerequisite to the application

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16 *Ibid.* at 328.

17 (1991), 2 P.P.S.A.C. (2d) 81 (Man. Q.B.) [hereinafter *Steinbach*]; appeal dismissed without reference to the marshalling point (1991), 2 P.P.S.A.C. (2d) 209 (Man. C.A.).

18 *Ibid.* at 88.

of the doctrine of marshalling, this must be the inference to be drawn from the case, as Scheibel J. did in *Makin Metals*.

There is no basis for such a view in the history of marshalling. No case before had ever made it a requirement that there be mixed personal and real property, or indeed any particular category of property, in order for marshalling to apply. *Steinbach* does contemplate the applicability of marshalling in the PPSA context. But why it should only be applicable when there are real property mortgages mixed in with personal property security is not satisfactorily explained.

Marshalling has a history of expanding to cover situations where fairness requires it. *Quay* v. *Sculthorpe*[19] is an example. In that case, Sculthorpe was a surety to Fox for a debt. The creditor recovered judgment against Sculthorpe and the creditor obtained an order for the sale of Sculthorpe's lands. While the *fi. fa.* was in the sheriff's hands and before the sale, Sculthorpe mortgaged the lands to creditors of his own. The question arose as to whether the creditors of Sculthorpe were entitled to any benefit of marshalling. The court extended the doctrine to their benefit. Van Koughnet C., said:

> There is no doubt that ordinarily, and as a rule, the doctrine of marshalling securities is applied to the case of creditors having repectively a double and a single fund, the property of a common debtor; and I find no case in the English Courts in which this doctrine has been extended so far as is sought to apply it here. It seems to me, however, that the plaintiff's conclusion is right on principle.[20]

There are many cases that have applied the doctrine of marshalling in the context of personal property. In *Re Bread Man Inc.*,[21] the court used the doctrine of marshalling in the context of chattel mortgages and fixed charge debentures given over the assets of a retail bakery business carried on at three locations. In *Smit Tak International Zeesleepen Bergingsbedrijf B.V.* v. *Selco Salvage Ltd.*,[22] marshalling was used to regulate the claims of parties to funds derived from salvaging ships. In *Bissett* v. *Australia and New Zealand Bank Ltd.*,[23] marshalling was applied as between a bank and the secured creditors of a debtor when the collateral included a life insurance policy, a bill of sale over a car, and a collateral deed of

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19 (1869), 16 Gr. 449.

20 *Ibid.* at 451.

21 (1978), 21 O.R. (2d) 59 (S.C.).

22 [1988] 2 Lloyd's Rep. 398 (Ch. D.) [hereinafter *Selco Salvage*].

23 [1961] N.Z.L.R. 687 (S.C.).

mortgage. In *Commonwealth Trading Bank* v. *Colonial Mutual Life Assurance Society Ltd.*,[24] the court said "the doctrine of marshalling has been applied, or discussed on the basis that it was applicable in a proper case, to a great variety of properties and funds including insurance policies. . . ."[25]

The use of marshalling when dealing with personal property is well accepted in the United States. One of the best-known recent U.S. cases on marshalling, *Shedoudy* v. *Beverly Surgical Supply Co.*,[26] dealt with marshalling in the context of assets that included accounts receivable, equipment and inventory of the debtor company. That case involved Article 9 of the *Uniform Commercial Code*, the U.S. model for the PPSAs.[27] The UCC is no more explicit about marshalling than are the PPSAs. U.S. commentators do not doubt that marshalling can apply in the context of Article 9 security interests.[28] In fact, there is no argument like that found in *Makin Metals*. Even those who criticise the application of marshalling in such a context do not doubt that the law would have to be changed to achieve the result they advocate.[29]

Although there is no historical justification for the conclusion in *Makin Metals*, there is a legitimate question of whether marshalling *ought* to be available in the context of the PPSA. The PPSA could work well without marshalling. The PPSA provides a fairly certain, easily-accessible system for regulating priorities. Is there any room for marshalling? The doctrine of marshalling is virtually the same today as in seventeenth-century English cases. Although the risks and circumstances surrounding mortgage lending have changed dramatically since

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24 *Supra*, note 6.

25 *Ibid.* at 124. See also *Ex p. Alston* (1868), LR 4 Ch. App. 168 (securities being bills of exchange and cargoes of coffee); *Lawrance* v. *Galsworthy* (1857), 3 Jur. (N.S.) 1049 (insurance policy); *Ex p. Salting* (1883), 25 Ch. D 148 (C.A.) (securities being brandy and a guarantee); *South* v. *Bloxam* (1865), 2 H. & M. 457, 71 E.R. 541 (mortgage of books and furniture and two insurance policies).

26 161 Cal. Rptr. 164 (C.A. 1980).

27 National Conference of Commissioners on Uniform State Laws, *Uniform Commercial Code: 1962 Official Text with Comments* (Philadelphia: American Law Institute, 1963); National Conference of Commissioners on Uniform State Laws, *Uniform Commercial Code: 1972 Official Text with Comments and Appendix* (Philadelphia: American Law Institute, 1973) [hereinafter UCC]. The 1962 UCC is the model for the PPSAs in Canada. See B. MacDougall, "Fixtures and the PPSA: Of the Wooden Horse of Troy, Creditors in the Weeds, and Statutory Ambush" (1993) 72 Can. Bar Rev. 496.

28 *E.g.* Lachman, *supra* note 1; and M. Mosman, "Comment: The Proper Application of Marshaling on Behalf of Unsecured Creditors" [1983] Brigham Young L. Rev. 639. See American Law Institute, *Restatement of the Law of Security* (St. Paul: American Law Institute Publishers, 1941) at 151.

29 *E.g.* C. H. Averch and J. P. Prostok, "The Doctrine of Marshaling: An Anachronistic Concept Under the Bankruptcy Code" (1990) 22 U.C.C. L. J. 224.

the seventeenth century, the doctrine of marshalling has remained relatively unchanged.[30]

Two American writers point out that today's financial institutions are very different from those existing in the period when the doctrine of marshalling was first established. Averch and Prostok say that current financial institutions rely on the UCC's election of remedies provisions. From the standpoint of the debtor the freedom of the secured party to liquidate collateral upon default may liberalise interest rates or repayment terms. Election of remedies by a secured lender reduces the risk to the secured lender and invariably the cost of lending, thus reducing the interest rate charged. Additionally, any junior creditor voluntarily extending credit to a debtor knows or should know the priority of its lien position and the relative value of the collateral and should adjust the interest rate charged to reflect the appropriate risk factors.[31] They conclude that the doctrine of marshalling is anachronistic and out of step with the expectations of secured lenders, the laws promoting commercial lending, and the *Bankruptcy Code*. Current lending practices and existing statutes provide an adequate framework for reaching fair and just results without resort to the interpretative difficulties associated with the doctrine of marshalling.[32]

It is important to put these criticisms in context, however. The writers' criticisms are principally about the U.S. technique of imposing marshalling by forcing the senior creditor to take certain action.[33] It is this technique of limiting the senior creditor's options that troubles Averch and Prostok. They see no problem with marshalling by subrogation, which is the usual method of marshalling.[34]

So long as marshalling is not to inconvenience the senior creditor or impair its access to collateral, marshalling in the context of the PPSA can do no harm whether implemented by compulsion of the senior creditor or by subrogation. It will be up to the party who wants marshalling to demonstrate that the rights of the senior creditor will not be endangered or delayed and that the senior creditor will not have to litigate more because of marshalling.[35] There will, of course, always be some delay

30 *Ibid.* at 238.

31 *Ibid.* at p. 227. See also B. Clark, *The Law of Secured Transactions under the Uniform Commercial Code* (Boston: Warren, Gorham & Lamont, 1980) at Supp. 4-17, who also criticises the need for marshalling.

32 *Supra* note 29 at 228.

33 Discussed below in Part III, "Implementing Marshalling."

34 *Supra* note 29 at 237.

35 *Bank of Nova Scotia* v. *Adriatic Developments Ltd.*, [1985] 2 W.W.R. 627 (B.C.S.C.); *Re Bread Man Inc.*, *supra* note 21; *First Investors Corp. Ltd.* v. *Butler Engineering Ltd.*, [1986] 3 W.W.R. 358

involved to the senior creditor when marshalling is involved. However, a senior creditor will always face some form of delay when it has to rely on its collateral to obtain payment. So long as marshalling does not lead to an unreasonable delay, it should not be avoided merely on that basis.[36]

A similar issue can arise as to whether marshalling should be available in the context of the *Bankruptcy and Insolvency Act*,[37] which does not mention marshalling either. In *Re Bread Man Inc.*,[38] the question arose of whether the doctrine of marshalling applied if the debtor had become bankrupt. It was argued that the rights of secured creditors preserved by then s. 50(5) of the *Bankruptcy Act*[39] were limited to those rights set out in the *Bankruptcy Act* and did not extend to permit the invocation of the doctrine of marshalling. The court disagreed. It pointed to s. 50(6) of the *Bankruptcy Act*, which provided:

> The provisions of this Act shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property and civil rights that are not in conflict with this Act, and the trustee is entitled to avail himself of all rights and remedies provided by such law or statute as supplementary to and in addition to the rights and remedies provided by this Act.[40]

Saunders J. then continued:

> Section 50(6) would apply to the rights of secured creditors and other persons as well as the trustee. While s. 49 puts some limitations on the ability of a secured creditor to realize and deal with his security, it is silent with respect to the doctrine of marshalling. There is nothing in the Bankruptcy Act or any other statute of which I am aware which is in conflict with the exercise of such a right and on the basis of the general principle that the

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(Alta. Q.B.); *Seel Investments Ltd.* v. *Greater Canadian Securities Corp. Ltd.* (1967), 65 D.L.R. (2d) 45 (Ont. H.C.); *American National Insurance Co.* v. *Vine-Wood Realty Ltd.* 199 A. 2d 449 (Penn. S.C. 1964); *Associates Realty Credit Ltd.* v. *Brune* 568 P. 2d 787 (Wash. S.C. 1977); *Broadway National Bank of Chelsea* v. *Hayward* 189 N.E. 199 (Mass. S.J.C. 1934); *Calhoun* v. *Fed. Land Bank of Louisville*, *supra* note 5; *Carter* v. *Tanners' Leather Co.* 81 N.E. 902 (Mass. S.J.C. 1907); *In re Concordia Mercantile Co.* 244 P. 2d 1175 (Kan. S.C. 1952); *Enloe* v. *Franklin Bank and Trust Co.*, *supra* note 5; *Greenwich Trust Co.* v. *Tyson* 27 A. 2d 166 (Conn. S.C. Errors 1942); *Parker* v. *Wheeler* 191 N.E. 798 (Ohio Ct. App. 1933); *Victor Gruen Associates Inc.* v. *Glass* 338 F. 2d 826 (9th Cir. 1964); and see J. Shalhoub, "Note: Marshaling: Equitable Rights of Holders of Junior Interests" (1986) 38 Rutgers L. Rev. 287.

36 See Marshaling Assets, *supra* note 5 at 18. See also 21 *CJS* Creditor and Debtor, *supra* note 2 at 598.

37 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

38 *Supra* note 21.

39 *Bankruptcy Act*, R.S.C. 1970, c. B-3. The present provision is s. 71(2) of the *Bankruptcy and Insolvency Act*, *supra* note 37.

40 The present equivalent is s. 72(1) of the *Bankruptcy and Insolvency Act*, *ibid.*

> unsecured creditor should be in no better position than the debtor, I can see no reason for not applying the doctrine.[41]

Of course, courts can go too far. The dangers of marshalling to the certainty of the PPSA is illustrated by *Matter of Samuels & Co., Inc.*,[42] where the issue arose of whether the claim of an unpaid seller of cattle already delivered to the buyer was subordinate to the claim of a holder of a perfected security interest in the same goods. The District Court held for the unpaid seller. The 5th Circuit Court of Appeals overturned this decision and adopted as its own the views of the dissenting judge at the District Court level. There, Godbold J. said:

> My brothers have not concealed that their orientation in the case before us is to somehow reach a result in favor of the sellers of the cattle, assumed by them to be "little fellows," and against a large corporate lender, because it seems the "fair" thing to do. We do not sit as federal chancellors confecting ways to escape the state law of commercial transactions when that law produces a result not to our tastes. Doing what seems fair is heady stuff. But the next seller may be a tremendous corporate conglomerate engaged in the cattle feeding business, and the next lender a small town Texas bank. Today's heady draught may give the majority a euphoric feeling, but it can produce tomorrow's hangover.[43]

II. REQUIREMENTS

The requirements for marshalling generally are relatively settled. There is no particular reason why marshalling in the context of the PPSA should have any different requirements. It is the application of these requirements that may cause difficulty. In *First Investors Corp. Ltd.* v. *Butler Engineering Ltd.*,[44] Berger J. set out the following objectives to guide the court's discretion in using marshalling:

1. To satisfy the debt of the well-secured first mortgagee.
2. To ensure that the paramount rights of the first mortgagee to pursue his remedies to recover the debt are not interfered with.
3. If the court is persuaded that objectives one and two will be satisfied, then the court may apply the doctrine of marshalling so as not to prejudice subsequent mortgagees whose security would otherwise be extinguished or diminished.

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41 *Re Bread Man Inc., supra* note 21 at 64. Note that the doctrine of marshalling has also been applied in *Re Harrison* (1922), 51 O.L.R. 634 (H.C.), a bankruptcy case.

42 526 F. 2d 1238 (5th Cir. 1976).

43 *Ibid.* at 1242.

44 *Supra* note 35.

4. The doctrine should not be applied if it will result in prejudice to third parties.[45]

The following sections discuss the requirements of marshalling.

A. Two Funds

Where two creditors have identical collateral for their debts marshalling cannot apply, because one creditor does not have the advantage of two funds, while the other has only one: the two-fund doctrine is the basic requirement of marshalling. Thus in *Toronto-Dominion Bank* v. *Whitaker*,[46] where both creditors had mortgages against all 18 quarter sections of the mortgagor's land, marshalling was held not to apply. Even where there are two funds available to the senior creditor and only one to the junior creditor, marshalling will not be available if the senior creditor needs both funds to satisfy its obligations.[47] Furthermore, one of the funds available to the senior creditor must be the fund available to the junior creditor.[48]

The two funds must exist at the relevant time. An extra fund cannot be created so as to make marshalling possible.[49] Some courts, however, have been less rigid in applying this principle and have shown a willingness to create or assist in the creation of a second fund. In *Gribble* v. *Stearman & Kaplan, Inc.* there was a proceeding to foreclose a deed of trust on an entire tract of land (26.8 acres).[50] Before the foreclosure, the owner had entered into a contract of sale for 10 acres of the land over which the purchaser (the "vendee") had a lien. There was a surplus remaining after the foreclosure sale satisfied the deed of trust. The question arose of whether the purchaser's lien was extinguished or whether it could cause the proceeds from the foreclosure sale to be marshalled so as to allow the surplus to be used to satisfy the purchaser's

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45 *Ibid.* at 364.

46 *Supra* note 8.

47 *W.R.W. Enterprises Ltd.* v. *Mielke* (5 July 1988), (Alta. Q.B.) [unreported]. Noted at 60 Alta. L.R. (2d) 428.

48 Other cases that have looked to the two-fund rule: *Re Holland* (1928), 28 S.R. N.S.W. 369; *Jenkins* v. *Brahe & Gair* (1902), 27 V.L.R. 643 (Practice Ct.); *Miles* v. *Official Receiver*, [1963] A.L.R. 620 (High Ct. Aus.); *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp.* (1920), 57 D.L.R. 500 at 503 (Ont. S.C.A.D.); *Royal Bank* v. *Izen* (1921), 60 D.L.R. 467 at 468 (B.C.C.A.); *In re Concordia Mercantile Co.*, *supra* note 35; *Telefest, Inc.* v. *Vu-TV, Inc.* 591 F. Supp. 1368 (N.J. U.S.D.C., D. 1984).

49 *In re Professional Life Assurance Co.* (1867), L.R. 3 Eq. 668. See also *American National Insurance Co.* v. *Vine-Wood Realty Ltd.*, *supra* note 3; *Production Credit Association of Madison* v. *Jacobson* 388 N.W. 2d 655 (Wisc. Ct. App. 1986) (second fund only came into existence if the first was exhausted).

50 239 A. 2d 573 (Md. Ct. App. 1968).

lien. The court recognised that the doctrine of marshalling required two funds and that, possibly, the foreclosure sale created only one fund. The court did not allow that to be an obstacle in this case. Judge Finan said:

> The case at bar does not present a classic example for the application of the doctrine of marshalling[51] of assets, however, the end which this doctrine seeks to accomplish may be, and in equity should be, achieved in the instant case.
>
> The owner of the whole tract certainly recognized its susceptibility of division having entered into a contract of sale for the ten acres which gave rise to the vendee's lien prior to the execution of the deed of trust.[52]

So, the court allocated the sale price to the two parcels of land—the 16.8 acres and the 10 acres—thus creating two funds. It then applied the doctrine of marshalling to have the funds to satisfy the deed of trust come first from the 16.8 acre tract. That left most of the "fund" from the 10 acre tract to satisfy the purchaser's lien. It is easy to imagine a similar technique being used where a senior creditor has taken a security interest in all present and after-acquired property of the debtor. Although this might technically be one fund, it would rarely be inequitable to split it up so as to satisfy the requirements of marshalling. A similar approach might even be defensible where the senior creditor's collateral is in a sweeping category such as "inventory."

The two funds available to one creditor should exist by virtue of the same debt. Obviously, one fund cannot be used by a creditor to satisfy a debt for which that fund or security was not given.[53] A minor exception to this common debt rule is a *Barnes* v. *Racster*[54] situation where the senior creditor has two funds, one of them arising exclusively from one debt and the other arising from that debt and a second debt. *Barnes* v. *Racster* is authority for the proposition that it might be possible to apply marshalling in this situation,[55] despite the fact that the two funds do, in a sense, arise from different debts.

It has been held that there can be two "funds" even though one of the "funds" is in fact a right of set-off. In *Selco Salvage*,[56] the plaintiff and the defendant jointly salvaged a number of ships. For some of the salvage jobs, the money proceeds went to the plaintiff who would then be

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51 This spelling is used throughout in this judgment—unusual for a U.S. case. See also Clark, *The Law of Secured Transactions under the Uniform Commercial Code*, *supra* note 31.

52 *Supra* note 50 at 578.

53 See T. Cleaver, "Marshalling" (1991) 21 Vic. U. Well. L. Rev. 275 at 284.

54 (1842), 1 Y. & C.C.C. 401; 62 E.R. 944.

55 *Supra* note 53 at 284.

56 *Supra* note 22.

responsible for paying the defendant its share. In other salvage jobs, the positions were reversed. The plaintiff was unaware that the defendant had sold some of its rights under the salvage contracts to the banks. The banks therefore claimed as assignees of the defendant's rights. The plaintiff was informed that the defendant had paid money to the banks including the plaintiff's share of certain salvage monies where the defendant was the principal contractor. The banks claimed that they were entitled to the monies without any deductions or set off because they had no notice of the plaintiff's interest and because the defendant was simply a debtor of the plaintiff. The plaintiff brought an action to recover the amounts paid to the banks. The plaintiffs had monies which were owing to the defendant from other salvage jobs in which the plaintiff was the principal contractor.

The banks argued for the right to marshall on the basis that there were two funds to which the plaintiff could resort: the funds from the jobs where the plaintiff was the principal contractor and the funds from the jobs where the defendant had been the principal contractor (all of which had all been paid to the banks). It was argued for the plaintiff that there could be no marshalling where all the first claimant (the plaintiff) had was rights of set off. This was, it was said, because the doctrine applied only where there were what could truly be described as "funds" to which the first claimant was entitled to resort.

Warner J held for the banks on this point. He said:

> Bearing in mind that equity is concerned to achieve fairness rather than to give effect to technicalities, I can see no reason why, where the first claimant is liable to the debtor or his assigns in respect of two debts, as against which he is entitled to exercise a right of set-off, those debts should not be regarded, for the purposes of the equitable doctrine of marshalling, as funds to which the first claimant is entitled to resort.[57]

The question has arisen in at least one case as to whether the doctrine of marshalling can apply when the single claimant in fact has more than one fund to resort to. In *Canada Trustco Mortgage Co.* v. *Wenngatz Construction and Holdings Ltd.*,[58] the bankrupt company owned six properties, all of which were subject to a first mortgage held by Canada Trustco. The Bank of Nova Scotia held a second mortgage on one of the properties. It also held some other security, but was unsecured for a large part of its claim. The Bank asserted that the principle of marshalling should apply to require Canada Trustco to realise on its securities in

57 *Ibid.* at 406. Warner J. had to square two older cases: *Webb* v. *Smith* (1882), 30 Ch. D. 192 (C.A.); and *Moxon* v. *The Berkeley Mutual Benefit Building Society* (1890), 59 L.J. Ch. 524.

58 (1986), 60 C.B.R. (N.S.) 270 (B.C.S.C.).

such a manner as to preserve the ability of the Bank to recover on its second mortgage on the one property. The trustee of the bankrupt objected on the basis that the principle of marshalling would prejudice the rights of the unsecured creditors and that the Bank had security on other property of the debtor. The Court held for the Bank. McEachern C.J.S.C. said:

> Mr Kempf [for the trustee] relies principally upon the use of the word "only" in the usual definitions of the doctrine of marshalling. [as in "only one fund"] I cannot give effect to this submission. I think "only" is used in these definitions to define with precision the different positions of the senior and junior encumbrancers, inter se, and does not refer to other securities held by the latter. In principle, I see no reason why marshalling should not operate as between the two encumbrancers regardless of extrinsic rights of one of them to other recourse against the debtor so long as the other requirements and limitations of the doctrine do not stand in the way.[59]

A situation that does not seem to have been litigated is where there is more than one senior creditor with two (or more) funds. Does marshalling for the benefit of the junior creditor have to be against one or the other of the senior creditors?[60] There is no reason why the junior creditor cannot seek to marshall against whichever senior creditor it pleases. As long as all the requirements of marshalling are met, especially that the security position of the senior creditor be protected, there should be no objection to shielding one senior creditor from marshalling and not another.

It has frequently been said that the doctrine of marshalling depends upon the funds or assets in question being under the control of the court.[61] In "*The Arab*"[62] the question arose of whether the court could compel seamen to go against the solvent owner rather than the ship for their wages. Dr Lushington said the court had no such authority:

> It is undoubtedly true, that if one party has the security of several funds, and another but of one, the Court will compel the former to elect that security which will permit of the latter being paid.... in this direction the Court will always go, so far as is in its power, *but then the funds must be under its control* [emphasis added].[63]

In that case the funds were not under the control of the court. This is generally interpreted to mean that the funds or assets must be either in

59 *Ibid.* at 273.

60 See Cleaver, *supra* note 53 at 139.

61 See, *e.g.*, *Webb* v. *Smith*, *supra* note 57; and *Commonwealth Trading Bank* v. *Colonial Mutual Life Assurance Society Ltd.*, *supra* note 6.

62 (1859), 5 Jur. (N.S.) 417.

63 *Ibid.* at 417.

court or in the hands of some person subject to direction by the court as to their application.[64] This may mean that all affected parties should be made part of any action involving litigation so that they will be bound by the court's order.[65]

B. Common Debtor

Marshalling will generally only apply where the two creditors have securities given by the same debtor.[66] The doctrine was formulated by Orde J. in *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp.* as follows:[67]

> It must, of course, be almost universally the case that in the application of the doctrine there will be a single debtor and two creditors, and that in cases where there are two debtors the doctrine is inapplicable, not because there are two debtors but because it would be inequitable as between those debtors to marshal the securities.[68]

Thus, there *can* be cases where it would not be inequitable as between those debtors to marshall. Orde J. continued:

> In other words, the real test is not whether or not the debts to the first and second mortgagees are owed to them by the same person, but whether or not, in working out the equities among the persons interested, the two debts ought to be paid by the same person. It is clear . . . that if as between the two joint debtors the debt owing by them jointly to the first creditor should in fact be paid by the one who is indebted to the second creditor, then the doctrine of marshalling would apply.[69]

The question of two legal persons being considered a common debtor for the purposes of marshalling will often arise in the context of a corporate debtor. The court in *Montmor Investments Ltd.* v. *Montreal Trust Co.*[70] alluded to the possibility that a corporate veil could be lifted

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64 Derham, *supra* note 10 at 134.

65 Meagher, Gummow and Lehane, *supra* note 10 at 306, citing and interpreting *Lawrance* v. *Galsworthy*, *supra* note 25.

66 *Re O'Leary* (1985), 61 A.L.R. 674 at 680 (Fed. Ct. Aus.); *Canada* v. *French* (15 January 1985), (Ont. H.C.J.) [unreported]; *Westcoast Savings Credit Union* v. *P. E. DeVito & Associates Ltd.* (24 February 1986), (B.C.S.C.) [unreported]; *Bartley* v. *Pikeville National Bank & Trust Co.* 532 S.W. 2d 446 (Ky. Ct. App. 1976); *In re Beacon Distributors, Inc.* 441 F. 2d 547 (1st Cir. 1971); *Parker* v. *Wheeler*, *supra* note 35; *Savings & Loan Co.* v. *Bear* 154 S.E. 587 (Va. S.C. App. 1930); *Ex p. Kendall* (1811), 17 Ves. Jun. 514, 34 E.R. 99.

67 (1920), 47 O.L.R. 362. See also *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp.*, *supra* note 48; and *Farm Credit Corp.* v. *McLane* (1983), 30 Sask. R. 320 (Q.B.).

68 *Ibid.* at 368.

69 *Ibid.* at 369.

70 (1984), 53 B.C.L.R. 275 (S.C.).

so as to make a shareholder and the company a common debtor for the purposes of the doctrine of marshalling. However, in that case, the court found that there was not such unity between the various corporate entities to justify lifting the corporate veil. In the U.S., most courts have declined to lift the corporate veil so as to use the doctrine of marshalling because the proponent has not met the high standard of proof (clear and convincing evidence) required to rebut the presumption of separate entities.[71] The decision to lift the corporate veil will be made in accordance with the general rules of when it is appropriate to do so.[72]

An old exception to the common debtor rule related to the property of a wife not being considered separate from that of her husband. In *Bank of Nova Scotia* v. *Adriatic Developments Ltd.*[73] the court referred to the case of *Tidd* v. *Lister*,[74] where it was held that marshalling could apply against the wife of a mortgagor who had charged her own property to secure the creditor's debt. However, in *Adriatic Developments*, the court refused to extend this exception to allow a wife's property to be marshalled where the principal debtor was the husband's company, particularly where the wife was neither a director nor a shareholder. Courts should be careful not to bring nineteenth-century attitudes about husbands and wives into late twentieth-century cases on marshalling. The property-of-a-wife exception to the common debtor rule would best be allowed to disappear.

Another exception to the common debtor rule relates to sureties. The extent to which sureties and guarantors can be considered identical debtors to the principal debtor is somewhat complex. It is complex in part because there are two common-debtor problems. First, are the surety (A) and the principal (B) to be considered a common debtor? If so, then they will both be treated as if they are B. This raises the second problem. If the senior creditor's claim was initiated by B but the junior creditor's claim is against A (not in A's capacity as a surety but as a debtor

71 See *In re Vermont Toy Works, Inc.*, 82 Bankr. 258 (Vt. Bankr. D., 1987), 135 Bankr. 762 (D. Vt. 1991) and M. Emamzadeh, "Marshaling in Bankruptcy: Questioning the Recent Expansions to the Common Debtor Requirement" (1992) 30 Duquesne L. Rev. 309 at 325; but compare *In re Jack Green's Fashions for Men—Big and Tall* 597 F. 2d 130 (8th Cir. 1979) [hereinafter *Jack Green's Fashions*] and *In re Multiple Services Industries, Inc.*, 18 Bankr. 635 (Wis. Bankr. E.D. 1982).

72 *E.g. Kosmopoulos* v. *Constitution Insurance Co.*, [1987] 1 S.C.R. 2. See 21 *CJS* Creditor and Debtor, *supra* note 2 at 602; J. Shalhoub, *supra* note 35 at 297. The issue arises in the context of partnerships as well. In *Enloe* v. *Franklin Bank and Trust Co.*, *supra* note 5, the court held that the requirement of a common debtor was not satisfied where assets of one fund were partnership assets and the assets of the other fund were individual assets of a partner. A possible exception to this principle is the situation where the partner has become entitled in equity to the partnership assets, and is primarily liable for the partnership debts: Marshaling Assets, *supra* note 5 at 16.

73 *Supra* note 35.

74 *Tidd* v. *Lister* (1852), 3 De G.M. & G. 857, 43 E.R. 336.

in A's own right) then the two creditors do not have common debtors. This complexity might account for the relatively unsettled nature of the law in this area. *Halsbury* says:

> If one creditor has a claim against C and D, and another creditor has a claim against D only, the latter creditor cannot require the former to resort to C *unless the liability is such that D could throw the primary liability on C, for example where C and D are principal and surety* [emphasis added].[75]

This exception was applied in *Brown* v. *CIBC*.[76] In that case, the plaintiff had a third mortgage on one parcel of land given by the personal defendant. That parcel was subject to a second mortgage given to the defendant bank. That second mortgage was collateral security for the liability of the personal defendant on a guarantee of the indebtedness of a third party. The personal defendant was therefore a surety for the third party, on whom the personal defendant could throw the primary liability. The bank had other security besides the second mortgage, and the court held that marshalling was applicable despite the lack of a common debtor. The Ontario High Court of Justice applied the following passage from the decision of Bell J. in the Supreme Court of Pennsylvania case of *Neff* v. *Miller*:[77]

> Here is a surety, whose money has been applied in payment of the debt of his principal, to the exclusion of his own proper creditors. That he would be entitled to come in, by way of substitution, upon the estate of the principal, is every-day equity; and I think it equally clear that his creditor, who has suffered by the appropriation of a fund which otherwise would have been available for the discharge of his claim, may well ask to stand upon this equity to the extent of the deprivation to which he has been subjected.[78]

However, courts have been inconsistent in applying the logic of this approach. In *Bank of British Columbia* v. *Tamavi Holdings Ltd.*,[79] a mortgagee held a second mortgage on the property of a guarantor as security for a guarantee of the debt of the bankrupt. The mortgagee also held security on the assets of the bankrupt. A mortgagee holding a third mortgage on the property of the guarantor sought to require the holder of the second mortgage to exhaust its remedies against the assets of the bankrupt before having recourse to its second mortgage guarantee. The court declined to apply marshalling because the holder of the second

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75 *Halsbury's Laws of England*, 4th ed., vol. 16 "Equity" (London: Butterworths, 1976) at 962-3, para. 1427.

76 *Supra* note 5.

77 *Neff* v. *Miller*, 8 Barr. 347.

78 *Brown* v. *CIBC*, *supra* note 5, at p. 426.

79 *Bank of British Columbia* v. *Tamavi Holdings Ltd.* (1978), 29 C.B.R. (N.S.) 111 (B.C.S.C.).

mortgage had only one fund belonging to the guarantor to which it could resort. The fact that it had other security from another person was irrelevant to marshalling.

In *Fiatallis North America Inc.* v. *Pigott Construction Ltd.*,[80] a somewhat different scenario arose. In that case, a junior creditor of the debtor could not rely on marshalling to force the senior creditor to rely on its security given by the guarantor. Curiously, in that case, the court said that while there was a fund from the debtor (*i.e.*, machines or the funds from their disposal), the guarantee did not constitute a "fund."[81] Unfortunately, the court did not explain how it was limiting the term "fund."[82]

That a principal and a surety should be treated as a common debtor is, therefore, a proposition that cannot be wholly supported by reference to the cases. If it can be shown that a senior creditor can satisfy its claim without prejudice or delay solely or principally from collateral given by the principal then a creditor of the surety should surely be able to seek marshalling. It might not be fair or logical to permit marshalling where it would mean that the senior creditor would make its claim against the surety instead of the principal. In that case, the surety is, subject to the contract of suretyship, probably going to make a claim against the principal debtor and so any benefit to the junior creditor seeking marshalling would be illusory.[83]

C. Equal Securities

It is generally thought that the claimant who asserts the right to marshall—or indeed to prevent marshalling—should be of rank equal or superior to the other claimant.[84] It will be rare that a secured party would need marshalling to satisfy its claim against inferior claimants. Marshalling will usually arise, therefore, in the context of equal claimants. Obviously the idea that the securities or the claimants should be

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80 (1992), 3 P.P.S.A.C. (2d) 30 (Ont. C.J. Gen. Div.).

81 *Ibid.* at 35.

82 See also *Farm Credit Corp.* v. *McLane, supra* note 67.

83 On sureties see *South* v. *Bloxam, supra* note 25, at H. & M 463, E.R. 543. *South* v. *Bloxam* was distinguished in *The New Zealand Loan and Mercantile Agency Co.* v. *Loach* (1912), 31 N.Z.L.R. 292 (S.C.); and *Re Manawatu Transport* (1984), 2 N.Z.C.L.C. 99.

84 The B.C. Court of Appeal was faced with the question of equal securities in *Montreal Trust Co.* v. *Montreal Trust Co. of Canada* (1988), 24 B.C.L.R. (2d) 238. The Court held that there was a fair question to be tried. But we do not have the court's final view on the matter. See also *Re Steacy* (1917), 39 O.L.R. 548 at 550 *per* Masten J.; Gummow, *supra* note 11 at 121; *Williamson* v. *Loonstra* (1973), 34 D.L.R. (3d) 275 B.C.S.C.); and *Webb* v. *Smith, supra* note 57.

"equal" cannot be taken literally. No securities or claimants are ever equal. In a secured transaction involving personal property and the PPSA, there is going to be a ranking. One secured party will have priority over another.

Having equal rights, therefore, appears to mean that the two creditors should have interests of the same nature though of different priority. If they are of the same nature, then the question of their respective priorities is not an obstacle to marshalling; in fact, it will create the need to marshall. Being of the same nature does not mean the claimants necessarily have to have the same status. In *Bank of Nova Scotia* v. *Adriatic Developments Ltd.*,[85] a judgment creditor who had registered a judgment against particular land was considered equal to a mortgagee of that land. In Canada, one court allowed a secured creditor to marshall against a doubly-secured municipality.[86] In the U.S., there is conflicting authority as to the availability of marshalling against the federal government in income tax cases.[87] A statute might grant a special status to a certain class of persons such as to make them "equal" to a secured creditor.[88] One odd exception is that there can be no marshalling in favour of charities.[89]

The principle of marshalling is usually applied only to benefit secured creditors.[90] In *Bissett* v. *Australia and New Zealand Bank Ltd.*,[91] a debtor sought unsuccessfully to invoke the doctrine of marshalling. This seems logical, but it can be argued that if a court can marshall in favour of a debtor and also do justice to the other parties concerned, then marshalling should be available.[92] In *Williamson* v. *Loonstra*,[93] Ruttan J. thought that:

> The doctrine does not extend to all creditors of every degree, it does not apply in favour of an unsecured creditor and it does not apply in favour of a

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85 *Supra* note 35.

86 *Re Harrison* (1922), 69 D.L.R. 658 at 660 (Ont. S.C.).

87 *American National Insurance Co.* v. *Vine-Wood Realty Ltd.*, *supra* note 35, at 453; *Meyer* v. *US*, *supra* note 5.

88 See *Re Watkins*, [1938] N.Z.L.R. 847 (C.A.); and *In re Coote (Dec'd)*, [1939] N.Z.L.R. 457 (S.C.).

89 *Becher* v. *Hoare* (1885), 8 O.R. 328 (Ch. D.) at 336.

90 *Greenwich Trust Co.* v. *Tyson*, *supra* note 35 at 174. See also *Johnson* v. *Lentini* 169 A. 2d 208 (N.J. S.C. 1961); *Bissett* v. *Australia and New Zealand Bank Ltd.*, [1961] N.Z.L.R. 687 (S.C.); *Re Tremain*, [1934] N.Z.L.R. 369 at 380 (C.A.); *Re Watkins*, *supra* note 88 (a special class could be created by statute); and *Jenkins* v. *Brahe & Gair*, *supra* note 48.

91 *Bissett* v. *Australia and New Zealand Bank Ltd.*, *supra* note 90.

92 See Marshaling Assets, *supra* note 5 at 29.

93 *Williamson* v. *Loonstra*, *supra* note 84.

judgment creditor unless he has obtained a charge on the estate that he seeks to have marshalled in his favour.[94]

In the U.S. there is a line of cases that recognises limited rights of unsecured parties to marshall or to object to marshalling. In *Jack Green's Fashions*,[95] the trustee in bankruptcy applied for an order requiring the bank to proceed against the individual debtor's assets before proceeding against the debtor corporation's assets. The application was granted and was upheld on the appeals. The 8th Circuit of the Court of Appeals said:

> In this case it would be in the highest degree inequitable to allow the Bank to exhaust the business assets of the corporate bankrupt without first looking to the real estate mortgaged to it. To permit such a course would leave the general creditors of the business with nothing.[96]

The decision in *Jack Green's Fashions* turns on s. 544(a) of Title 11 of the *Bankruptcy Code*, which grants a trustee in bankruptcy the status of a hypothetical lien creditor—a secured creditor—as of the date the petition was filed.[97] Some bankruptcy courts have assumed, as in *Jack Green's Fashions*, that a trustee is empowered to request the remedy of marshalling on behalf of unsecured creditors. But, as one writer says, "this assumption confuses the status of the trustee with the status of those he represents: the traditional requirement is not that marshaling be invoked by a secured creditor, but that it be invoked for secured creditors."[98]

There is, however, no reason why an unsecured creditor who can be said to have a specific interest in the debtor's property should not be able to marshall. Provided the other requirements of marshalling are met, secured creditors can suffer no injury. An unsecured creditor might have

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94 *Ibid.* at 278-79. In *Re Bread Man Inc.*, *supra* note 21, it was held that the third parties who may not be prejudiced by the principle of marshalling do not include unsecured creditors of the debtor. See also *Canada Trustco Mortgage Co.* v. *Wenngatz Construction and Holdings Ltd.*, *supra* note 58; *In re Careful Laundry* 104 A. 2d 813 (Md. Ct. Apps. 1954); and *Merrill* v. *National Bank* 173 U.S. 131.

95 *Supra* note 71.

96 *Ibid.* at 133. This was followed in *Farmers & Merchants Bank* v. *Gibson*, 7 Bankr. 437 (Fla. Bankr. N.D. 1980) and *In re Multiple Services Industries, Inc.*, *supra* note 71.

97 There is no equivalent provision in the *Bankruptcy and Insolvency Act*, *supra* note 37.

98 Lachman, *supra* note 1 at 678. This criticism of *Jack Green's Fashions* was specifically rejected in *In re Vermont Toy Works, Inc.*, *supra* note 71, and was criticised in B. Weintraub and A. N. Resnick, "A Trustee's Power to Compel a Secured Creditor to Pursue Remedies against a Guarantor: Marshaling of Assets Revisited Again" (1993) 25 U.C.C. L. J. 377. On *Jack Green's Fashions* see also I. D. Labovitz, "Marshaling under the U.C.C.: The State of the Doctrine" (1982) 99 Banking L. J. 440; Mosman, *supra* note 27; and B. Weintraub and A. N. Resnick, "Compelling a Senior Lienor to Pursue Remedies Against a Guarantor—A Misapplication of the Marshaling Doctrine" (1985) 18 U.C.C. L. J. 178. Not following *Jack Green's Fashions*: *In re United Medical Research, Inc.* 12 Bankr. 941 (Cal. Bankr. C. D. 1981). See also *Pomeroy's Treatise on Equity Jurisprudence*, *supra* note 10 at 1064.

sufficient status to invoke marshalling when it has caused collateral to be seized under a judgment enforcement measure. In fact, the unsecured creditor's status could be said to be sufficient upon the issue of the writ of execution and delivery of it to a sheriff.[99]

To be distinguished from the issue of the status of the parties is that of forcing a creditor through marshalling to realise on a security of a lower status or rank than another. In *Marine Midland National Bank* v. *Roosa Construction Associates, Inc.*[100] the senior creditor had a first mortgage on land and some other undefined interest in certificates of indebtedness. The junior creditor argued that the senior creditor should be required by application of the doctrine of marshalling to proceed first on the certificates. The court disagreed. Aulisi J. said "We know of no rule of law which provides that one must first proceed on a junior interest before proceeding on a senior interest."[101]

D. Third Party Rights

It is often said that the doctrine of marshalling will not be applied to the prejudice of third parties.[102] The question is: who constitutes third parties?

In *Re Bread Man Inc.*,[103] Saunders J. said:

> It seems to me that third parties who may not be prejudiced by the application of the doctrine do not include unsecured creditors of the debtor. It is logical that bona fide subsequent purchasers and mortgagees of the property without notice should be protected for their interest in the property would be seriously affected by the application of the doctrine. In most cases they would have no way to anticipate the possible exposure to marshalling.... It is also logical that unsecured credits [sic] of debtors should not be protected for in the absence of a statutory provision, they should have no better right to the fund than the debtor himself.[104]

99 By the same reasoning the trustee in bankruptcy should be able to obtain marshalling for the benefit of the estate. This approach to marshalling in favour of unsecured creditors is similar to that taken in *Shedoudy* v. *Beverly Surgical Supply Co., supra* note 26, where the court applied marshalling in favour of an unsecured crediror who had obtained a "lien" through seizure of collateral (*i.e.*, had become a "judgment creditor").

100 284 N.Y.S. 2d 649 (S.C. App. Div. 3rd Dep. 1967).

101 *Ibid.* at 651. See also *Webb* v. *Smith, supra* note 57.

102 See *e.g. The New Zealand Loan and Mercantile Agency Co.* v. *Loach, supra* note 83 at 298; *Averall* v. *Wade* (1835), L. & G. *temp.* Sugd. 252; *Dolphin* v. *Aylward* (1870), L.R. 4 App. Cas. 486; *Flint* v. *Howard, supra* note 10; *Barnes* v. *Racster, supra* note 5; *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp., supra* note 67; *Williamson* v. *Loonstra, supra* note 84; *Victoria & Grey Trust Co.* v. *Brewer,* [1970] 3 O.R. 704 (H.C.J.); *Enloe* v. *Franklin Bank and Trust Co., supra* note 5; *John W. Stone Oil Dist.* v. *M/V Mr. W. Bruce* 752 F. 2d 184 (5th Cir. 1985); *S. Lotman & Son Inc.* v. *Southeastern Fin. Corp.* 263 So. 2d 499 (Ala. S.C. 1972).

103 *Re Bread Man Inc., supra* note 21.

104 *Ibid.* at 63. See also "*The Chioggia,*" [1898] P. 1.

A third party will not be affected if it has no chance of recovering anything from the debtor in any event.[105]

The invoking of the doctrine of marshalling cannot thereby displace or impair a prior acquired lien or contract right to conveyance of legal title, especially where the person invoking the doctrine had actual knowledge of the facts.[106] Purchasers of property are usually protected from the equitable doctrine of marshalling.[107] The fact that marshalling might not be applied against a partner's or a shareholder's property when the debtor is the partnership or the corporation is an example of the protection of third parties. According to American equity, the properties are not those of the same debtor.[108] It should be remembered that a system like the PPSA might give a creditor special rights to particular collateral, such as a purchase money security interest.[109] The doctrine of marshalling should not frustrate this statutory priority, though it might well affect the way it is implemented.

Some U.S. courts include unsecured creditors as third parties who should not be affected by marshalling. The court in *In re Spectra Prism Industries Inc.*[110] allowed the representative of the unsecured creditors (i.e., the trustee in bankruptcy) to apply to block a junior creditor from marshalling. This case has been criticised on the ground that, in essence, the appellate panel's holding eliminates the use of the marshalling doctrine in bankruptcy cases because general unsecured creditors that naturally are affected by marshalling may, through the trustee as a judicial lien creditor, block such an order.[111]

The basis for allowing such action by the trustee is the same s. 544(a) of the *Bankruptcy Code* that in *Jack Green's Fashions* allowed the trustee to apply to marshall on behalf of unsecured creditors. In *In re Center Wholesale, Inc.*[112] the court treated unsecured creditors as third parties

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105 *Associates Realty Credit Ltd.* v. *Brune*, *supra* note 35.

106 *Calhoun* v. *Fed. Land Bank of Louisville*, *supra* note 5.

107 *Brown* v. *CIBC*, *supra* note 5; *Jones* v. *Beck* (1871), 18 Gr. 671 (C.A.); *Clark* v. *Bogart* (1880), 27 Gr. 450; *Pierce* v. *Canavan* (1882), 7 O.A.R. 187; *Renwick* v. *Berryman* (1886), 3 Man. R. 387; *Fraser* v. *Nagle* (1888), 16 O.R. 241; *Johal* v. *Sahota* (1986), 2 B.C.L.R. (2d) 218 (S.C.).

108 *Savings & Loan Co.* v. *Bear*, *supra* note 66, at 595.

109 The enhanced priority that can be achieved by a purchase money security interest is dealt with in the PPSAs: Alberta, s. 34; BC, s. 34; Manitoba, s. 34; Ontario, s. 33; Saskatchewan, s. 34; Yukon, s. 33.

110 28 Bankr. 397 (9th Cir. App. Panel 1983).

111 B. Weintraub and A. N. Resnick, "Marshaling of Assets in Bankruptcy Cases: The Specter of *Constance* v. *Hawes* Appears Again" (1984) 16 U.C.C. L. J 384 at 386. See also Lachman, *supra* note 1, and F. W. Koger and P. Acconcia, "Marshaling: A Fourth Act Sequel to Commercial Tragedies?" (1989) 57 U.M.K.C. L. Rev. 205.

112 759 F. 2d 1440 (9th Cir. 1985).

who should not be affected by marshalling and said that, "[o]therwise, [the junior creditor] would be able to take advantage of collateral for which it never bargained, namely, $990,000 worth of [the bankrupt's] inventory . . . to the detriment of the general unsecured creditors."[113] But those unsecured creditors do not "bargain for" any particular collateral at all. This judgment means that marshalling would rarely, if ever, be available as it can almost always be said to affect unsecured parties.[114]

However, no absolute rules about who can and cannot constitute third parties should be made. Marshalling is an equitable doctrine that acts *in personam* and in the interests of fairness. Sometimes such interests will dictate that unsecured parties be protected from the effects of marshalling. If unsecured creditors who have issued and delivered a writ of execution have sufficient status to invoke marshalling, then they should also be capable of being third parties whose interests might preclude marshalling. Unsecured creditors' interests should also be taken into account in situations where marshalling might frustrate what limited rights are given to them by the PPSAs. All PPSAs contain provisions making unperfected security interests subordinate to the interests of unsecured creditors in certain circumstances.[115] Marshalling should not be available where it would frustrate this legislative policy. Suppose Secured Party 1 has a security interest in Y which is unperfected. Then SP2 acquires a perfected security interest in Y and Z. If SP2 realises on collateral Y, should SP1 be entitled to marshall so as to be subrogated to SP2's perfected claim on Z? Allowing SP1 to do so could frustrate the PPSA's policy of subordinating unperfected security interests to the interests of unsecured creditors in certain circumstances.[116] The interests of the unsecured creditors in such a situation are third party interests which should prevent SP1 from invoking the doctrine of marshalling so as to be subrogated to SP2's interest in Z, if that means that SP1 will acquire a priority position vis-à-vis the unsecured creditors it would not otherwise have.[117] Cuming and Wood see the *Makin Metals*

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113 *Ibid.* at 1447.

114 This has been criticised in Lachman, *supra* note 1 at 687-88.

115 Alberta, s. 20; British Columbia., s. 20; Manitoba., s. 22; Ontario, s. 20; Saskatchewan., s. 20; Yukon, s. 19.

116 *I.e.*, in those set out in note 115.

117 The author acknowledges Professor Ronald C. C. Cuming for providing this example. Of course, if being subrogated to SP2's claim in Z does not change the status of SP1's security interest from unperfected to perfected, then marshalling has not damaged the interests of the unsecured creditors.

case, discussed earlier,[118] as justified to the extent that it stands for such a proposition. They say:

> [I]t is possible that the case does not stand for the proposition that the doctrine of marshalling can never apply under the Act. The case might stand for the proposition that the doctrine of marshalling does not protect a secured party who has lost priority simply because he failed to perfect his security interest. Since marshalling is an equitable doctrine, it should be applied only when the secured party seeking to invoke it is not the author of his own misfortune.[119]

There should be no sweeping rule to the effect that unsecured creditors will always be third parties whose interests should not be affected by marshalling. As the foregoing examples illustrate, however, there should be no sweeping rule the other way.

E. Procedural Requirements

The invoking of the doctrine of marshalling is dependent upon a timely claim by the junior creditor.[120] By failing to raise the question of marshalling promptly, the right to invoke the doctrine may be waived, or lost through laches.[121] The court should look at the situation existing when the doctrine of marshalling is invoked. All the requirements for marshalling must exist then.[122] Until the junior creditor takes all the necessary steps, it can lose the right to marshall to subsequent liens, charges or conveyances.[123]

In the U.S., at least, marshalling can be ordered even where the senior creditor is not realising on its security.[124] The situations where this could happen are rare. It would be difficult for the junior creditor in such a case to prove that the senior creditor's security position will not be impaired in the future if it is deprived of some of its collateral. The junior creditor might, however, be able to seek an injunction against the senior creditor to do nothing to cause the second fund to be impaired or disappear or be discharged.

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118 See Part I, above.

119 R. C. C. Cuming and R. J. Wood, *British Columbia Personal Property Security Act Handbook*, 2d ed. (Toronto: Carswell, 1993) at 442.

120 *In re Professional Life Assurance Co., supra* note 49; *Broadbent* v. *Barlow* (1861), 3 DeG. F. & J. 570, 45 E.R. 999; *Vandever Invest. Co. Ltd.* v. *H. E. Leonhardt Lumber Co.* 503 P. 2d 185 (Okla. S.C. 1972); Shalhoub, *supra* note 35, at 296-97.

121 Marshaling Assets, *supra* note 5 at 20.

122 *American National Insurance Co.* v. *Vine-Wood Realty Ltd., supra* note 35.

123 Marshaling Assets, *supra* note 5 at 21; 21 *CJS* Creditor and Debtor, *supra* note 2 at 607-08.

124 *Shedoudy* v. *Beverly Surgical Supply Co., supra* note 26; Clark, *supra* note 30 at Supp. 4-9.

All necessary parties should be joined before the court will order marshalling.[125] This is the responsibility of the party who seeks marshalling.[126] Also, that same party should ensure that all the necessary evidence in relation to the property to which marshalling would apply is before the court.[127] The creditor asking for marshalling must show that the senior creditor will not be burdened by the order, that the other collateral is readily available to the senior creditor and that rights of other creditors will not be prejudiced.[128]

The fact that some property is outside the jurisdiction may preclude marshalling. Marshalling acts *in personam*. If the court has the jurisdiction over all the necesary parties, so that it can enforce its orders and decrees, then an order of marshalling may be appropriate, even though some of the property is outside the jurisdiction.[129]

In *Goodman* v. *Parkhurst*,[130] the question of collateral in a different jurisdiction arose in the context of marshalling. The double claimant satisfied his claim out of property in B.C. and the single claimant asked the B.C. Supreme Court that he be allowed to stand in the place of the double claimant against the Ontario property. The court refused to order marshalling (in this case by subrogation). Hutcheon J. said:

> [A] court ought to decline jurisdiction to make an order unless it is satisfied that the judgment would be effective. Apart from the many doubts I have about whether the doctrine of marshalling applies to a person who has a charge against land created by the statute, and whether there is sufficient connection between the parties to bring the case within the exception to the rule that only a court in the province or state in which the land is situated can grant a remedy relating to that land, I am without any evidence of the law of Ontario. Without such evidence I am unable to say whether a direction that the Ontario property be available to a judgment creditor in British Columbia would be effective.[131]

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125 See *In re Vermont Toy Works, Inc., supra* note 71.

126 *Selco Salvage, supra* note 22 at 407. But in *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp., supra* note 67, the court ordered marshalling even though one of the brothers was not a party to the action.

127 *Royal Bank of Canada* v. *Hallmark Golf Developments Ltd.*, (1993), 12 Alta. L.R. (3d) 362 (C.A.). A party seeking marshalling may have to raise it at trial in order to raise it on appeal: *St. Clair Savings Assn.* v. *Janson* 318 N.E. 2d 538 at 544 (Ohio Ct. App. 1974); but, compare *Montreal Trust Co.* v. *Montreal Trust Co. of Canada, supra* note 84.

128 *Associates Realty Credit Ltd.* v. *Brune, supra* note 35 at 793. See also *Moody Day Company* v. *Westview Nat. Bank, Waco* 452 S.W. 2d 572 (Texas Ct. Civil App., 1970) and *Victor Gruen Associates Inc.* v. *Glass, supra* note 35.

129 See *Associates Realty Credit Ltd.* v. *Brune, supra* note 35.

130 *Goodman* v. *Parkhurst*, [1980] 6 W.W.R. 601 (B.C.S.C.)

131 *Ibid.* at 603.

Such qualms will probably be less of a concern in the PPSA context. Jurisdictional and enforcement issues relating to personal property are less problematic than they are in relation to land.

III. IMPLEMENTING MARSHALLING

Realisation on security under the PPSA is largely achieved without the involvement of the courts. Marshalling, however, is not a self-help remedy and will be available only by judicial intervention. Marshalling can be effected by the courts in one of two ways. Either the senior creditor could be compelled to realise on particular collateral to the advantage of the junior creditor or the junior creditor could be subrogated to the rights of the senior creditor to the collateral that the senior creditor did not realise on after the senior creditor has taken its action. These can be referred to as marshalling by compulsion or injunction and marshalling by subrogation.[132]

Justice Story saw the doctrine of marshalling as being able to compel the senior creditor and this distinguished the common law from Roman law. He wrote:

> The principal difference between the Roman system and ours is, that our courts of equity arrive directly at the same result, by compelling the first creditor to resort to the fund, over which he has a complete control, for the satisfaction of his debt; and the Roman system substituted the second creditor to the rights of the first, by a cession thereof upon his payment of the debt.[133]

Bispham saw a similar choice, but he went on to say:

> In practice, however, the latter of these two methods [subrogation] is the one most usually employed; and the sounder doctrine seems to be that the first of the two ought not to be resorted to except under very peculiar circumstances. It is true that there are very many dicta to the effect that a creditor will be restrained from resorting to one of the two sources of payment, and compelled to look to the other; but in practice the rule has been seldom applied (except under peculiar circumstances), because it would appear to be unjust that a creditor who has taken pains to obtain ample security should be limited in his right of enforcement, and exposed to delay; more especially as the ends of justice can in general be completely attained by the application of the doctrine of subrogation. A paramount encumbrancer ought to be allowed to choose the method of collecting his debt, and all that a junior creditor can fairly ask is that he shall have liberty to resort to another source

132 "Subrogation" in the context of marshalling is used with the general meaning of substituting one creditor into the position of another, and not with the more specific meaning of one creditor paying off the obligation owed to another and then standing in that other's place.

133 *Story's Commentaries on Equity Jurisprudence, supra* note 4 at 419.

of payment in the place of the one of which he has been deprived. Of course, where both funds are in court, or under its immediate control, the case is different. The rights of every one can be protected, and there is no harm in throwing the paramount creditor at once on the singly charged fund.[134]

Tied to the issue of the method of implementing marshalling is the question of whether marshalling is something exercised against the senior creditor or against the debtor. If marshalling relates to the equitable rights of the junior creditor against the senior creditor, then there should be room for marshalling by compulsion. However, if marshalling is an equitable right the junior creditor has against the debtor, then compelling or enjoining the senior creditor would seem to be unavailable. There is some authority for both views.[135]

The issue has been dealt with differently by different jurisdictions.

A. United States

American jurisprudence is quite clear that, in theory at least, marshalling by compulsion of the senior creditor is available.[136] The U.S. approach is justified on the basis that it does not result in any actual or practical disadvantage to the senior creditor. The U.S. approach is designed to prevent the junior creditor from being adversely affected by the whims of the senior creditor. U.S. courts repeatedly assert that the senior creditor cannot be impaired in terms of its rights to have access to collateral.[137]

Thus, in the U.S., marshalling by compulsion can be ordered, even where the senior creditor does not yet want to realise on its security. The court used very strong language to this effect in *Shedoudy* v. *Beverly Surgical Supply Co.*:[138]

> We decide the equitable powers of the court are properly used to remove the security interest of a senior lienholder even in the absence of a pending

134 G. T. Bispham, *The Principles of Equity*, 2nd ed. (Philadelphia: Kay & Bro., 1878) at 399-400.

135 See *e.g.* J. Adams, *The Doctrine of Equity* (Philadelphia: Johnson, 1859) at 583-86; and *Webb* v. *Smith, supra* note 57 at 200.

136 *Broadway National Bank of Chelsea* v. *Hayward, supra* note 35; *Community Bank* v. *Jones* 566 P. 2d 470 (Ore. S.C. 1977); *Enloe* v. *Franklin Bank and Trust Co., supra* note 5; *Greenwich Trust Co.* v. *Tyson, supra* note 35; *Harris* v. *Cheshire* 126 S.E. 593 (N.C. S.C. 1925); *In re Jack Green's Fashions for Men—Big and Tall, supra* note 71; *Monarch Cycle Co.* v. *Waggener* 52 P. 873 (Kan. S.C. 1898); *In re Penn Central Transp. Co.* 346 F. Supp. 1323 (U.S. D.C., E.D. Penn. 1972); *Savings and Loan Assn of Kingston* v. *Berberich* 264 N.Y.S. 2d 989 (S.C. App. Div. 3rd Dept. 1965); *Sowell* v. *Federal Reserve Bank* 268 U.S. 449 (1925); *Speer* v. *Home Bank of Forest City* 206 S.W. 405 (Kansas City Ct. Apps. 1918); *Vandever Invest. Co. Ltd.* v. *H. E. Leonhardt Lumber Co., supra* note 120; Marshaling Assets, *supra* note 5; Meagher, Gummow and Lehane, *supra* note 10.

137 See Shalhoub, *supra* note 35 at 289-90.

138 *Supra* note 26.

foreclosure by that creditor where necessary to permit a judgment creditor as junior claimant to satisfy its judgment when in doing so, no risk of loss is imposed on the senior creditor.[139]

B. ANTIPODES

Australian courts in particular have taken a narrow view of touching upon the senior creditor's flexibility.[140] In *Commonwealth Trading Bank* v. *Colonial Mutual Life Assurance Society Ltd.*,[141] Neasey J. said:

> . . . I think there is difficulty in any concept of enforcing an equity to marshall against the first mortgagee, because it is basic to the principle that he has been paid off. The equity to marshall is "enforced" against the person who is disadvantaged or dispossessed by its operation. The court does not even interfere with the first mortgagee's choice as to which security he shall realize.[142]

There is no reason why it is "basic" to the doctrine of marshalling that the senior creditor has been paid off. Marshalling could well be sought just before or at the time the senior creditor proposes to take action.

One Antipodean author has criticised the U.S. position for affording the junior creditor too much power:

> The purpose of having a "prior" claim to "multiple" securities is both to ensure repayment if each property, by itself, is insufficient and to have priority over those properties in satisfying its debt. This entitlement of the multiple chargee should not then be subjected to the subsequent claim of the single chargee. In the author's opinion, marshalling as a remedy akin to subrogation is the most "equitable" analysis of the doctrine. The multiple chargee's rights remain paramount and at the same time the single chargee is granted access to alternative property to satisfy its debt.[143]

This misconstrues the U.S. position. It does not prejudice the multiple chargee (the senior creditor) in any way; it just prevents the senior creditor's capriciousness from destroying the benefit of the junior creditor's security. The U.S. position may also allow the problems of using subrogation to be avoided. Marshalling by compulsion may operate only infrequently. Why not at least have it available?

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139 *Ibid.* at 166.

140 *Bank of NSW* v. *City Mutual Life Assurance Society Ltd and Steed*, [1969] V.R. 556 (S.C.); *Jenkins* v. *Brahe & Gair*, *supra* note 47; *Miles* v. *Official Receiver*, *supra* note 47. New Zealand courts seem to draw the same conclusion: *Bissett* v. *Australia and New Zealand Bank Ltd.*, *supra* note 90 (inference); *Re Taylor*, [1934] N.Z.L.R. 117 (S.C.) (inference only).

141 *Supra* note 6.

142 *Ibid.* at 130-31. See also *Mir Bros. Projects Pty Ltd.* v. *Lyons*, [1977] 2 N.S.W.L.R. 192 (S.C.); *Re Crothers*, [1930] V.L.R. 49 (S.C.); Meagher, Gummow & Lehane, *supra* note 10; E. Sykes, *The Law of Securities*, 4th ed. (Sydney: Law Book Co., 1986).

143 Cleaver, *supra* note 53 at 280-81.

C. England and Canada

English courts are somewhat more equivocal than the U.S. or Australian courts on the issue.[144] Bispham notes[145] that a problem in English law is that when the senior creditor acts on one security, it may extinguish the debt, making subrogation difficult. This possibility makes compulsion of the senior creditor a more attractive solution.

As in England, the Canadian position appears to be equivocal. *Falconbridge on Mortgages* sees no difficulty in a court's compelling the senior creditor to take particular action:

> It would appear that there are cases in which a court would be justified, for the protection of the interests of the respective owners or mortgagees of separate parcels of land, in interfering with the freedom of action of the holder of the common mortgage, provided it can do so without substantially delaying or inconveniencing such mortgagee, or preventing him from obtaining payment in full of his claim or rendering his proceedings more onerous.[146]

The issue was addressed in *First Investors Corp. Ltd.* v. *Butler Engineering Ltd.*,[147] where Berger J. said, "In the result, the real question to be decided is whether the doctrine of marshalling may, in certain circumstances, *compel* a plaintiff to purchase."[148] The court said the question was to be answered in the affirmative. However, in *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp.*,[149] Orde J. said that the right to marshall is subject to two important qualifications, the first of which is "that nothing will be done to interfere with the paramount right of the first mortgagee to pursue his remedy against either of the two estates."[150]

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144 On the English position, see inferentially in favour of compulsion: *Aldridge* v. *Forbes* (1858), 4 Jur. (N.S.) 20; *The Chioggia*, *supra* note 104; *Gregg* v. *Arrott* (1835), L. & G. *temp.* Sugd. 246; *Aldridge* v. *Cooper*, 8 Ves. Jun. 382; *Webb* v. *Smith*, *supra* note 57; *Lawrance* v. *Galsworthy*, *supra* note 25; *Lanoy* v. *Athol*, *supra* note 1; Ambivalent or opposed: *Gibson* v. *Seagrim*, *supra* note 10; *Hanby* v. *Roberts* (1751), Amb. 127; 27 E.R. 83; *Selco Salvage*, *supra* note 22; *Trimmer* v. *Bayne* (1803), 9 Ves. Jun. 209; 32 E.R. 582.

145 Bispham, *supra* note 134 at 400.

146 W. B. Rayner and R. H. McLaren, *Falconbridge on Mortgages*, 4th ed. (Agincourt, Ont.: Canada Law Book, 1977) at 314. Note *Falconbridge* cites U.S. authority for this proposition—*i.e.* the *Cor Jur.*

147 *First Investors Corp. Ltd.* v. *Butler Engineering Ltd.*, *supra* note 35.

148 *Ibid.* at 364.

149 *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp.*, *supra* note 67.

150 *Ibid.* at 368; Other support for not interfering with the senior creditor's rights: *Re Bread Man Inc.*, *supra* note 21; *Canada Trustco Mortgage Co.* v. *Wenngatz Construction and Holdings Ltd.*, *supra* note 58; *Fiatallis North America Ltd.* v. *Pigott Construction Ltd.*, *supra* note 80; *Seel Investments Ltd.* v. *Greater Canadian Securities Corp. Ltd.*, *supra* note 35.

There is no reason why marshalling by compulsion should not be available. There is no reason why in some circumstances it should not be available even before the senior creditor takes action. The U.S. position has much to recommend it. The basis of marshalling is to prevent the capriciousness of the senior creditor from destroying the junior creditor's security. This can best be achieved if the court at least has the option to compel the senior creditor. The junior creditor will be responsible for proving there is no potential injury to the senior creditor's position. Allowing marshalling by compulsion does not destroy any of the effectiveness of the PPSA. Marshalling has too much uncertainty and too many obstacles to cause a creditor to ignore the rules of the PPSA.

D. Compulsion and Subrogation

If marshalling by compulsion is available, it will be implemented by injunction against the senior creditor. There is no section of the PPSAs that specifically authorises this action, although the PPSAs do allow a court to make orders respecting rights to collateral.[151] The junior creditor should act as soon as it gets notice of the realisation by the senior creditor. Delay may mean that the senior creditor will already have realised before a court can marshall. Delay might also be interpreted by the court as a detriment to the senior creditor which could prevent marshalling.

Because of problems of timing, marshalling will often be by subrogation.[152] If the senior creditor has taken action against the collateral in which the junior creditor had an interest, it will be too late to enjoin the senior creditor. All the court can do is to subrogate the junior creditor to the rights the senior creditor had in the collateral it did not act against. The relationship between marshalling and subrogation was illuminated by Lummus J. in *Broadway National Bank of Chelsea* v. *Hayward*:[153]

> Subrogation and marshaling are often different manifestations of the same equity, but where subrogation remedies injustice . . . , marshaling prevents

151 Alberta, s. 64; British Columbia, s. 63; Ontario, s. 67; Saskatchewan, s. 63; Yukon, s. 61. Manitoba's s. 64 is not as generously worded.

152 See *CJS* Creditor and Debtor, *supra* note 2 at 608; B. Weintraub and A. N. Resnick, "Subordination of the Guarantor's Subrogation Rights: The Marshaling Doctrine Revisited" (1986) 18 U.C.C. L. J. 364; *Re O'Leary*, *supra* note 66; *Congresbury Motors Ltd.* v. *Anglo-Belge Finance Co. Ltd.*, [1970] 3 All E.R. 385 (C.A.); Bispham, *supra* note 134. In *Commonwealth Trading Bank* v. *Colonial Mutual Life Assurance Society Ltd.*, *supra* note 6, the argument was made that the double claimant acted as a sort of trustee for the single claimant. This view was rejected. Subrogation rights should not be viewed as security interests because they do not come into existence by agreement but by operation of the law: Cuming and Wood, *supra* note 119, sec. 2[4]; see also sec. 34[4].

153 *Supra* note 134.

it. Marshaling gives the junior creditor the right of compelling the senior creditor to resort in the first place to the fund which he alone holds.[154]

Subrogation cannot give the junior creditor a greater right than it would have had before subrogation. Furthermore, the right to be subrogated can disappear upon either the *bona fide* transfer of the surplus security to a third party or upon the discharge of the senior creditor's security agreement. In either case, there is nothing left to be subrogated to. As mentioned, this possibility is a reason why the option of using compulsion should remain available to effect marshalling.[155]

The dangers of relying exclusively on the doctrine of subrogation to effect marshalling are illustrated by the case of *Bank of Nova Scotia* v. *Adriatic Developments Ltd.*[156] In that case, the Bank had mortgages on three properties: the Nanaimo property, the Victoria property and the Victoria Residence property. Anderson had a second mortgage over the Nanaimo property. The Bank foreclosed on and sold the Nanaimo and Victoria properties. Anderson argued that marshalling should apply.

The court refused to marshall for a number of reasons. One of the reasons was that it was too late for Anderson to be subrogated to the claim of the Bank against the Victoria Residence property. Murphy L.J. said:

> The mortgage debt to the Bank of Nova Scotia was not in any way realized out of the Victoria residence property. Since the bank's debt has been fully satisfied out of the sale proceeds of the Nanaimo and Victoria properties, the bank has no further claim against the Victoria residence property. . . . It is obligated to discharge that mortgage. As mentioned previously . . . the singly-secured creditor (Anderson) cannot interfere with the right of the doubly-secured creditor (the Bank of Nova Scotia) to resort to any specific parcel or parcels upon which it has security. Since the doubly-secured creditor has realized its claim out of the Nanaimo and Victoria parcels only, the singly-secured creditor would be entitled to be subrogated to the place of the former with respect to the Victoria residence proprerty. However, to subrogate Anderson to the place of the Bank of Nova Scotia would give him nothing as the bank no longer has any claim against the Victoria residence property.[157]

Other cases, inferentially at least, assume the contrary. In *Re Bread Man Inc.*,[158] the court noted that, "there is some authority for the proposition

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154 *Ibid.* at 202.

155 Derham deals with the problems of set-off and assignment and marshalling, *supra* note 9. Some of the problems he sees for marshalling in that context arise from his assumption that marshalling works by subrogation.

156 *Bank of Nova Scotia* v. *Adriatic Developments Ltd.*, *supra* note 35.

157 *Ibid.* at 633.

158 *Re Bread Man Inc.*, *supra* note 21.

that if a first mortgagee has already been paid out of a fund then the Court may apply the marshalling doctrine and allow the second mortgagee to stand in his place with respect to the other fund. . . ."[159] Austin J. in *Fiatallis North America Inc.* v. *Pigott Construction Ltd.*[160] said, "[t]he Court will not interfere with the right of Creditor X against any or all of the funds, but if X resorts to the one fund against which Y has rights, then in appropriate circumstances, the court will subrogate Y to the rights of X in the other funds."[161]

A court should not be too quick to conclude that a debt of the senior creditor is extinguished for the purposes of subrogation as soon as the senior creditor realises on its security. The debtor could in a sense be getting a windfall because of the whim of the senior creditor. The debtor (and in most cases the debtor's unsecured creditors) should expect to be left with only what remains after as many secured creditors as possible have been satisfied. Marshalling, properly employed, can satisfy as many secured creditors as possible, without defeating the rights of the senior creditor, without depriving the debtor and general creditors of what they legitimately expect to be left remaining after satisfaction of the secured creditors, and without frustrating the design of the PPSA. Marshalling is one old piece of the law that deserves a place in modern secured transactions law.

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159 *Ibid.* at 62.

160 *Supra* note 80.

161 *Ibid.* at 34, citing *Falconbridge on Mortgages, supra* note 146 at 312-16. See also *Goodman* v. *Parkhurst, supra* note 130 at 603; and *Ernst Bros. Co.* v. *Canada Permanent Mortgage Corp., supra* note 67.