SASKATCHEWAN
LAW REVIEW

Deposit Account Set-Off Under the *PPSA*

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> And the most annoying thought is that a little money, judiciously applied, would relieve the burdens and anxieties of most of these people; but affairs seem to be so arranged that money is most difficult to get when people need it most.
> ~ Mark Twain & Charles Dudley Warner, *The Gilded Age: A Tale of Today*[1]

I. INTRODUCTION

The focus of this paper is "deposit account set-off"—that is, a depository bank's eligible set off of a customer's debt balance against his or her reciprocal deposit account balance. Between a depository bank asserting a right of deposit account set-off, and a secured party claiming priority to the deposit account balance pursuant to a Personal Property Security Act ("*PPSA*")[2] security interest, who prevails? On what analytical grounds? Answers to these questions require considerable elucidation. My chief object, in this paper, is to explore and explain the interaction between *PPSA* security and deposit account set-off. In doing so, I demonstrate that a bank's right of deposit

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1 Mark Twain & Charles D Warner, *The Gilded Age: A Tale of Today*, Volume I in *The Complete Works of Mark Twain*, vol 10 (New York: Harper & Brothers, 1915) at 190 [Twain & Warner, *The Gilded Age*]. Numerous characters from *The Gilded Age* are introduced as players in this paper's illustrative fact patterns. For those interested in the literary aspect, a number of footnotes throughout the piece furnish brief biographical accounts of the characters (not the players).

2 *The Personal Property Security Act, 1993*, SS 1993, c P-6.2 [*SPPSA*]. In this paper, the *SPPSA* acts as a general proxy for the "*PPSA*"; unless otherwise specified, all statutory references to the *PPSA* are to the provisions of the *SPPSA*. Citations for the other personal property security statutes in common law Canada are as follows: RSA 2000, c P-7 [*APPSA*]; RSBC 1996, c 359 [*BCPPSA*]; CCSM c P35 [*MPPSA*]; SNB 1993, c P-7.1 [*NBPPSA*]; SNL 1998, c P-7.1 [*NFPPSA*]; SNWT 1994, c 8 [*NWTPPSA*]; SNS 1995-96, c 13 [*NSPPSA*]; SNWT 1994, c 8, as duplicated for Nunavut by s 29 of the *Nunavut Act*, SC 1993, c 28 [*NPPSA*]; RSO 1990, c P.10 [*OPPSA*]; RSPEI 1988, c P- 3.1 [*PEIPPSA*]; RSY 2002, c 169 [*YPPSA*].

account set-off is statutorily recognized by the *PPSA*, and typically holds a superior position vis-à-vis competing security interests. I also demonstrate that both contractual set-off and equitable set-off tenets are constitutive of a bank's powerful right of deposit account set-off.

Set-off applies in and across a broad array of legal arenas. In the banking arena, its potency is accentuated since reciprocal debt obligations are endemic to the bank-customer relationship. A bank with a right of deposit account set-off wields an enormously powerful realization tool.[3] It is therefore important to understand, as clearly as possible, the juridical nature of deposit account set-off and its relative power under the *PPSA*. Indeed, this power bears directly on the question whether Canadian common law provinces and territories ought to adopt a control paradigm for deposit account perfection and priority ordering.[4]

Before exploring the contours of deposit account set-off under the *PPSA*, I must furnish a basic account of the judge-made principles of legal, equitable, and contractual set-off. Lothian and I have written elsewhere about these principles in considerable detail,[5] so here I present a mere synopsis. My aim, in Part II, is to equip the reader with a basic understanding of set-off doctrine and its attendant lexicon. This enables the reader to follow the subsequent analyses, undertaken in Part III, in which I explore and explain the interaction between deposit account set-off and conventional *PPSA* security.

II. SET-OFF BASICS

Set-off is broadly defined as the "discharge of reciprocal [monetary] obligations to the extent of the smaller obligation."[6] Suppose that

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3 See Clayton Bangsund, "Set-Off & Security Interests" (2017) 50:1 UBC L Rev 1 [Bangsund, "Set-Off & Security Interests"].

4 See e.g. Ontario Bar Association, Personal Property Security Law Subcommittee, *Perfecting Security Interests in Cash Collateral* (6 February 2012), online: <http://www.oba.org/CMSPages/GetFile.aspx?guid=c020380c-6c0a-496f-b4b1-b44d6ac07eb5>, archived: <https://perma.cc/8XRC-CQ58>; Robert M Scavone, "Cash Collateral Under the PPSA: The Case for Control" (2012) 53:2 Can Bus LJ 263; Jennifer Babe et al, *Business Law Agenda: Priority Findings & Recommendations Report* (June 2015), online: <http://www.ontariocanada.com/registry/showAttachment.do?postingId=18942&attachmentId=33251>, archived: <https://perma.cc/2P4G-QX6E>; Margaret Grottenthaler, "Cash collateral amendments for Ontario recommended by expert panel", (4 August 2015), *Canadian Structured Finance Law* (blog), online: <http://www.canadianstructuredfinancelaw.com/2015/08/articles/derivatives/cash-collateral-amendments-for-ontario-recommended-by-expert-panel>, archived: <https://perma.cc/4NBU-663K>.

5 Clayton Bangsund & Jasmine Lothian, "Inequity in Equitable Set-Off: *Telford v Holt* Revisited" (2016) 94:1 Can Bar Rev 149; Bangsund, "Set-Off & Security Interests", *supra* note 3.

6 Philip R Wood, *English and International Set-Off* (London: Sweet & Maxwell, 1989) at paras 1-1, 1-91.

Eschol owes Si[7] $100, and that Si owes Eschol $60 in a related or unrelated transaction. Under set-off principles, Si is entitled to extinguish his indebtedness to Eschol; he does so by using his property (that is, his monetary claim against Eschol) to reduce or retire Eschol's reciprocal monetary claim. In technical set-off parlance, Si may "*set off*" his property against—or assert his right of "*set-off*" against—Eschol's property.

Set-off, in the Canadian common law tradition, is comprised of three general divisions: legal, equitable, and contractual. First, there is legal set-off, which requires (i) mutuality between the party asserting set-off and the party against whom it is asserted, and (ii) that the cross-obligations constitute debts both existing and payable at the time set-off is asserted. Legal set-off arises between two parties holding mutual cross-debts, regardless of whether such debts arose under connected contracts. In the above example, both Eschol and Si enjoy a right of legal set-off against each other.

When one of the cross-claims is assigned—from Eschol to Clay[8] (continuing our example)—legal set-off is unavailable to the account debtor (Si) as against the assignee (Clay) due to the loss of mutuality.[9] Nevertheless, the principles of equitable set-off may apply to enable the account debtor to set off his claim against the account balance in priority to the assignee. Equitable set-off can be conceptualized as a *relaxation* of the strict rules of legal set-off. Unlike legal set-off, equitable set-off does not require mutuality, but may require a close connection between the obligations being set off. Where there has been an assignment, either or both of two rules of equitable set-off may apply in favour of an account debtor who becomes embroiled in a dispute with the assignee: the unconnected claims notification rule and the close connection rule.[10]

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7 "Colonel" Eschol Sellers and "Squire" Si Hawkins (Mark Twain & Charles Dudley Warner, *The Gilded Age & Later Novels—The Gilded Age: A Tale of Today* (New York: Penguin Books)). James Lampton, a cousin of Twain's mother, inspired the Colonel's personality (see Harriet Elinor Smith et al, eds, *Autobiography of Mark Twain*, vol 1 (Berkeley: University of California Press, 2010) at 206). In the first edition of *The Gilded Age*, the Colonel's name was Eschol Sellers. The authors appropriated his name from an elderly gentleman whom Warner had encountered years earlier. The Colonel's given name was changed to Beriah, then Mulberry, in later editions and works (see *infra* notes 80 and 101).

8 Clay Hawkins, adopted orphan son of Si and Nancy Hawkins (Twain & Warner, *The Gilded Age*, *supra* note 1).

9 *Telford v Holt*, [1987] 2 SCR 193 at 205, 41 DLR (4th) 385 [*Telford*]; Ronald CC Cuming, "Security Interests in Accounts and the Right of Set-Off" (1991) 6:3 BFLR 299 at 304.

10 For a detailed discussion of the contours of equitable set-off, see Bangsund & Lothian, *supra* note 5 at 154. In *Telford* Justice Wilson refers to the unconnected claims notification rule as the "general rule," and the close connection rule as the "exception" (*Telford*, *ibid* at 211).

Pursuant to the unconnected claims notification rule of equitable set-off, an account debtor can set off against the assignee a money sum which accrued and became due (that is, was existing and payable) prior to the notice of assignment. Stated alternatively, an account debtor (Si) is entitled to assert equitable set-off against an assignee (Clay) to the same extent that he would have been able to assert legal set-off against the assignor (Eschol) immediately prior to receiving notice of the assignment.

The close connection rule of equitable set-off is more liberal than the unconnected claims notification rule. Under the close connection rule, debts accrued but not due at the time of notice of the assignment (that is, debts existing but not yet payable) can nonetheless be set off by the account debtor (Si) against the assignee (Clay) if (i) the contracts, from which the reciprocal debts emanate, are closely connected, and (ii) it would be manifestly unjust to refuse set-off in the circumstances. Thus, unlike the unconnected claims notification rule, the close connection rule incorporates the *debitum in praesenti solvendum in futuro* principle, allowing for the immediate set-off of an existing debt that becomes payable at a future date due to the effluxion of time. The close connection rule additionally applies, not only where the account debtor's claim is for a liquidated debt, but also where the account debtor's claim is unliquidated.

Finally, in addition to any legal or equitable set-off rights that may exist in favour of the account debtor, the debtor may bargain with their contractual counterparty for, or against, set-off rights, in which case the extent of such rights can be tailored to the parties' specifications. A contractual set-off clause is typically used to expand set-off rights,[11] not narrow or negate them.[12] In the banking industry, a prominent form of deposit account set-off, commonly referred to as "account combination,"[13] gives a depository bank an implied contractual right, with or without advance notice, to set off the customer's current debt balances against reciprocal deposit account balances.[14] Account combination can be conceptualized as a *reaffirmation* of existing legal set-off principles, with a self-help feature. Account combination is a major facet of deposit account set-off.

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11 See Ewan McKendrick, ed, *Goode on Commercial Law*, 4th ed (London: Penguin Books, 2010) at 650; Louise Gullifer, ed, *Goode on Legal Problems of Credit and Security*, 4th ed (London: Sweet & Maxwell, 2008) at para 7.26.

12 See MH Ogilvie, *Bank and Customer Law in Canada* (Toronto: Irwin Law, 2007) at 24.

13 This form of set-off takes a variety of names: "combining accounts," "account consolidation," "consolidation of accounts," "netting," and "blending." See NW Caldwell, "Security Interests in Proceeds: Account Consolidation and the *PPSA*" (1995) 59:1 Sask L Rev 165 at 172.

14 See Benjamin Geva, "Rights in Bank Deposits and Account Balances in Common Law Canada" (2012) 28:1 BFLR 1 [Geva, "Rights in Bank Deposits"].

III. *PPSA* FRAMEWORK

A. COMMON LAW, EQUITY & THE LAW MERCHANT

Having briefly recounted the basic principles of set-off, I now begin my explication of deposit account set-off under the *PPSA*. A natural starting point for a discussion of the interplay between deposit account set-off rights and conventional security is *PPSA* s. 65(2):

> The principles of the common law, equity and the law merchant, except to the extent they are inconsistent with this Act, supplement this Act and continue to apply.[15]

The principles of legal, equitable, and contractual set-off collectively constitute "principles of the common law, equity and the law merchant." For example, equitable set-off is clearly a "principle of equity." It belongs to that "body of rules or principles which form an appendage to the general rules of law, or a gloss upon them."[16]

In the specific context of deposit account set-off, s. 65(2) therefore provides that the principles of legal, equitable, and contractual set-off, "except to the extent they are inconsistent with" the express provisions of the *PPSA*, supplement the *PPSA* and continue to apply. To what extent, if at all, are the principles of set-off *inconsistent with* the express provisions of the *PPSA*? To what extent are set-off principles *embodied in*, or *statutorily recognized by*, the *PPSA*? Subsection 41(2) is clearly implicated. A series of illustrative scenarios helps elucidate this provision and the *PPSA* framework for governance of deposit account set-off rights.

B. DEPOSIT ACCOUNT SET-OFF V. TRUE SECURITY INTEREST

1. Deposit Account Set-Off v. Security Interest in Deposit Account as Original Collateral

(a) Henry, Philip[17] & Bank: Scenario 1

Suppose, in Scenario 1,[18] that Henry opens a deposit account with the Bank on day 1; $100 is deposited into the account. On day 2, the Bank

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15 *SPPSA*, *supra* note 2, s 65(2).

16 John McGhee, ed, *Snell's Equity*, 30th ed (London: Sweet & Maxwell, 2000) at para 1-03. As Lothian and I have indicated, "*Telford v Holt* is a textbook example of equity in action. While legal set-off was unavailable to Telford, the Supreme Court of Canada, on grounds of fairness and to mitigate the perceived severity of the strict legal rule, allowed Telford an equitable set-off against Holt" (Bangsund & Lothian, *supra* note 5 at 166, n 67).

17 Henry Brierly and Philip Sterling (Twain & Warner, *The Gilded Age*, *supra* note 1).

18 Admittedly, this simple scenario is contrived and, in the real world, is unlikely to occur in this specific fashion. A secured party is more likely to take a security interest in a commercial debtor's inventory (see Scenario 2, below) or general accounts receivable, both forms of collateral which generate proceeds that ultimately get deposited into the debtor's deposit account. However, to clarify, it

grants Henry an unsecured revolving operating line of credit, payable on demand, with a borrowing limit of $100. Henry immediately draws down the operating line to the $100 limit, spending the borrowed funds on ephemeral luxuries. On day 3, Henry grants Philip a security interest in his deposit account to secure payment of by registering a financing statement. On day 4, Philip notifies the Bank of his security interest in Henry's deposit account.[19] On day 5, Henry defaults on his payment obligation to Philip. Consequently, Philip serves written notice on the Bank demanding that the Bank make payment of the $100 deposit account balance to him.[20]

In a subsequent dispute over the deposit account balance, how do the principles of legal, equitable and contractual set-off interact with the *PPSA*'s rules governing conventional security? Between Philip and the Bank, who holds the superior position?

(b) Outcome in the Absence of the *PPSA*

Before embarking on the statutory analysis, first consider the outcome of such a dispute in the absence of a statutory framework, that is, on the assumption that judge-made rules and principles govern. On this assumption, the Bank is entitled to set off the operating line balance against the deposit account balance by virtue of both equitable set-off and contractual set-off principles.

Pursuant to the unconnected claims notification rule, the Bank is entitled to assert equitable set-off against Philip to the same extent that it would have been entitled to assert legal set-off against Henry prior to receiving notice of Philip's interest. On day 4, at the moment before the Bank was notified of Philip's interest, the Bank was entitled to assert legal set-off against Henry based on the presence of the dual elements of "mutuality" and "current liquidated debts." It follows that the Bank is entitled to assert equitable set-off against Philip under the unconnected claims notification rule. Moreover, the close connection rule may be satisfied if it is determined that the contracts to which the cross-debts relate are closely connected and that it would be manifestly unjust to refuse the Bank set-off. Finally, the

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is not unusual for a secured party to acquire a security interest in a deposit account as original collateral. Indeed, a standard general security agreement provides for such a security interest. See Jacob S Ziegel, "Canadian Perspectives on the Law Lords' Rejection of the Objection to Chargebacks" (1998) 14:1 BFLR 131 at 141. What is unusual about Scenario 1 is that the secured party is acquiring an isolated security interest in *only* the deposit account. See Roderick J Wood, "Acquisition Financing of Inventory: Explaining the Diversity" (2014) 13:1 OUCLJ 49 at 69.

19 Note that Philip's previous registration of a financing statement with the Personal Property Registry does not constitute constructive notice to the Bank (*SPPSA*, *supra* note 2, s 47). The applicable knowledge requirements are set out in s. 2(2) of the *SPPSA* (*ibid*).

20 *Ibid*, s 57(2)(a).

Bank is entitled to set-off under contractual principles, including the implied right of account combination, since the deposit account and the operating line are both "current accounts."

In short, absent a statutory framework, in common law Canada the Bank would be successful in a Scenario 1 dispute with Philip.

(c) Outcome under the *PPSA*

(i) PPSA *s. 41*

Next, consider the outcome under *PPSA* governance. Subsections 41(1) and (2) of Saskatchewan's *PPSA* are reproduced below:

> (1) In this section:
>
> (a) "account debtor" means a person who is obligated pursuant to an intangible or chattel paper;
>
> (b) "assignee" includes a secured party and a receiver.
>
> (2) Unless the account debtor on an intangible or chattel paper has made an enforceable agreement not to assert defences to claims arising out of a contract, the rights of an assignee of the intangible or chattel paper are subject to:
>
> (a) the terms of the contract between the account debtor and the assignor and any defence or claim arising from the contract or a closely connected contract; and
>
> (b) any other defence or claim of the account debtor against the assignor that accrues before the account debtor acquires knowledge of the assignment.[21]

Subsection 41(1) clarifies the scope of s. 41 and its various subsections. For the purposes of s. 41, the Bank is an "account debtor"[22] and Philip, a "secured party,"[23] constitutes an "assignee."[24] With reference to Scenario 1, *PPSA* s. 41(2) therefore provides that Philip's rights in Henry's deposit account (an "account"[25] and an "intangible"[26] under the *PPSA*[27]) are subject to (a) the Bank's contractual rights under the customer account agreement or a closely connected contract, and (b) any other defence or claim the Bank has against Henry that accrues before the Bank acquires knowledge of the assignment to Philip. In short, *PPSA* s. 41(2) *recognizes* the Bank's contractual and equitable

21 *Ibid*, s 41.
22 *Ibid*, s 41(1)(a), "account debtor".
23 *Ibid*, s 2(1)(nn), "secured party".
24 *Ibid*, s 41(1)(b), "assignee".
25 *Ibid*, s 2(1)(a), "account".
26 *Ibid*, s 2(1)(w), "intangible".
27 For a detailed account of the *PPSA* taxonomy, see Clayton Bangsund, "The Deposit Account & Chose in Action at Common Law & Under the PPSA: A Historical Review" (2014) 30:1 BFLR 1 [Bangsund, "Historical Review"].

set-off rights against the deposit account balance, and affords them superiority[28] over competing *PPSA* security.[29]

(ii) PPSA *s. 41(2)(a)*

Pursuant to *PPSA* s. 41(2)(a), the Bank is entitled to set off the operating line balance against the deposit account balance because Philip takes his assignment subject to the Bank's contractual rights. The Bank's implied contractual right of account combination entitles it to set off because the accounts are both current. Thus, pursuant to s. 41(2)(a), Philip's claim to Henry's deposit account balance is subject to the Bank's contractual right to set off the operating line balance against the deposit account balance.[30]

Additionally, the Bank may assert the close connection rule of equitable set-off, which, like account combination, is embodied in the statutory language of *PPSA* s. 41(2)(a).[31] A revolving line of credit commonly operates in close connection with a deposit account balance, which suggests that the Bank may be entitled to assert the close connection rule of equitable set-off in priority to Philip's security interest.[32]

(iii) PPSA *s. 41(2)(b)*

Under *PPSA* s. 41(2)(b), Philip takes his security interest subject to "any other defence or claim" that the Bank has against Henry that accrues before the Bank acquired knowledge of the assignment. The Bank's "defences and claims" against Henry include, at a minimum,

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28 The better term may be "superiority dispute" when the competition is between a secured party asserting a proprietary claim in a deposit account and the bank asserting set-off against such account. See Cuming, *supra* note 9 at 301, n 4, where the author, mindful of this distinction, describes the manner in which he uses the term "priority": "In this paper, the term 'priority' is used to refer to 'a prior right' to the money. It is not used to indicate a ranking of two proprietary interests in the money."

29 *Scanwood Canada Ltd. (Re)*, 2011 NSSC 468 at para 90, 311 NSR (2d) 173; *Western Surety Co. v National Bank of Canada*, 2001 NBCA 15 at para 74, 237 NBR (2d) 346. In *Greenview (Municipal District No. 16) v Bank of Nova Scotia* (2013 ABCA 302 at para 28, 5 CBR (6th) 69), this interpretive theory was advanced by an account debtor, Western Surety, claiming a right of set-off. The Alberta Court of Appeal did not ultimately decide the issue because the assignee was not able to establish that an account was actually owing. See also *Kari Holdings Inc. v HSBC Bank Canada*, 2017 ONSC 437 at para 40.

30 See Geva, "Rights in Bank Deposits", *supra* note 14 at 38.

31 See Cuming, *supra* note 9 at 306.

32 A current account and a revolving operating line often work in conjunction. For two concise descriptions of the daily interaction between a current account and a revolving operating line, see *Agricultural Credit Corp. of Saskatchewan v Pettyjohn* (1991), 79 DLR (4th) 22 at 32, [1991] 3 WWR 689 (Sask CA), Sherstibitoff JA; *Flexi-Coil Ltd. v Kindersley District Credit Union Ltd.* (1993), 107 DLR (4th) 129 at 147, [1994] 1 WWR 1 (Sask CA), Jackson JA [*Flexi-Coil*].

legal set-off since the dual elements of "mutuality" and "current liquidated debt" were present, as between the Bank and Henry, immediately prior to the Bank receiving notice of Philip's security interest.[33] Consequently, the Bank is entitled to assert equitable set-off against Philip under *PPSA* s. 41(2)(b).

(d) Reinforcement under *The Choses in Action Act*

The Choses in Action Act[34] reinforces the outcome described above. Section 5 of the *Choses in Action Act*, reproduced below, grants similar protection to the Bank to that which it enjoys under *PPSA* s. 41(2):

> In case of an assignment of a debt or chose in action arising out of contract and not assignable by delivery, the assignment shall be subject to any defence or set-off in respect of the whole or any part of the debt or chose in action existing at the time of the notice of assignment to the debtor or person sought to be made liable, in the same manner and to the same extent as such defence or set-off would be effectual if there had been no assignment thereof,

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33 One might criticize this assertion on the basis that it assumes, without grounds, that set-off principles are among the "defences or claims" available to an account debtor under *PPSA* s. 41(2)(b). I recognize the circularity, but suggest that this is the very nature of the interplay between *PPSA* ss. 65(2) and 41(2)(b). Subsection 65(2) provides that set-off principles continue to apply to the extent not inconsistent with the express provisions of the *PPSA*. In turn, s. 41(2)(b), an express provision, makes generic reference to the availability of an account debtor's "defences and claims." Set-off principles certainly constitute "defences and claims." If one contends that they do not, then he must furnish a plausible alternative interpretation of the subsection. What else could be intended under s. 41(2)(b) that is exclusive of set-off principles?

34 RSS 1978, c C-11 [*Choses in Action Act*]. The lineage of Saskatchewan's *Choses in Actions Act* is unique. Originally enacted as an Ordinance of the Northwest Territories in 1898 (*An Ordinance respecting Choses in Action*, CO 1898, c 41), the statute is modeled on Ontario legislation dating back to 1872 (*An Act to make Debts and Choses in action assignable at Law*, SO 1871-72, c 12), which was later amended and consolidated under *The Mercantile Amendment Act* (RSO 1877, c 116, ss 6-12), then under *The Mercantile Amendment Act* (RSO 1887, c 122, ss 6-13 [*Mercantile Amendment Act*]). The language in ss. 2 and 3 of Saskatchewan's *Choses in Action Act* closely tracks the language of ss. 7 and 6 (respectively) of Ontario's *Mercantile Amendment Act*. The *Mercantile Amendment Act* provisions pertaining to assignments of choses in action were repealed in 1897, under *The Statutes Amendment Act, 1897* (SO 1897, c 15, s 5), and in their stead more conventional statutory language was adopted, mirroring the English formulation set out in the *Supreme Court of Judicature Act, 1873* ((UK), 36 & 37 Vict, c 66, s 25(6)): *The Judicature Act* (RSO 1897, c 51, s 58). The Ontario provisions are now housed in the *Conveyancing and Law of Property Act* (RSO 1990, c C.34, s 53). For an interesting late nineteenth-century discussion of Ontario's *Mercantile Amendment Act*, see J James Kehoe, *A Treatise on the Law of Choses in Action* (Toronto: Carswell & Co, 1881).

> and the defence or set-off shall apply as between the debtor and any assignee of the debt or chose in action.[35]

The *Choses in Action Act* is primarily aimed at furnishing the assignee of a chose in action with statutory authority, and a clear procedural path, to pursue payment from the account debtor.[36] I do not place emphasis on the *Choses in Action Act* because it is subordinate to the *PPSA*. To the extent of any inconsistency or conflict between the provisions of the two statutes, the *PPSA* provisions prevail.[37] There is considerable overlap between the *PPSA* and the *Choses in Action Act*, and not a great deal of inconsistency or conflict. In Scenario 1, for instance, both *PPSA* s. 41(2) and s. 5 of the *Choses in Action Act* clearly permit the Bank to set off the operating line balance against the deposit account balance in priority to Philip's security interest.

2. Deposit Account Set-Off v. Security Interest in Deposit Account as Proceeds

(a) Laura, Ruth[38] & Bank: Scenario 2

In Scenario 2, Ruth asserts a security interest in Laura's deposit account balance as proceeds of her original collateral. Events occur in the following sequence. On day 1, Laura opens a deposit account with the Bank; no initial deposit is made. On day 2, the Bank grants Laura an unsecured revolving operating line of credit (payable on demand), with a borrowing limit of $100. Laura immediately draws down the operating line to the $100 limit, spending the funds on

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35 *Choses in Action Act*, *ibid*, s 5.

36 *Ibid*, ss 2, 4. As observed in note 34, *supra*, Saskatchewan's *Choses in Action Act*, which applies to both absolute assignments and security assignments, is distinctive from similar legislation in other provinces. Consider, for example, Alberta's *Judicature Act* (RSA 2000, c J-2). Section 20 of the *Judicature Act* purports to apply to "a debt or other legal chose in action…made in writing under the hand of the assignor and not purporting to be by way of charge only" (*ibid*, s 20). I discuss this statutory provision in Bangsund, "Historical Review" (*supra* note 27 at 26, n 104): "At first glance, the requirement that the assignment be absolute (and not by way of charge only) appears self-explanatory. However, courts have interpreted the term 'absolute assignment' rather liberally, holding that it includes, within its meaning, devices that act as 'continuing security.'" See also Douglas R Johnson, "Accounts Receivable Financing in Canada: Nature of the Charge and Rights of Priority" (1981) 15:1 UBC L Rev 87 at 121-23.

37 *SPPSA*, *supra* note 2, s 69(2): "Except as otherwise provided in this or any other Act, where there is a conflict between a provision of this Act and a provision of any Act other than those mentioned in subsection (1), the provision of this Act prevails."

38 Laura Hawkins and Ruth Bolton (Twain & Warner, *The Gilded Age*, *supra* note 1). Laura, also an orphan, is the adopted daughter of Si and Nancy Hawkins, and one of the story's tragic characters. In contrast, Ruth Bolton is one of the tale's heroes, pursuing a career in medicine and finding love with Philip Sterling.

evanescence. On day 3, Laura purchases, on credit terms, $100 worth of inventory from one of her suppliers, Ruth, and grants Ruth a purchase money security interest in the inventory to secure payment of the purchase price. Ruth immediately perfects her security interest by registering a financing statement. On day 4, Laura sells the inventory and deposits sale proceeds of $100 into the deposit account. On day 5, Laura defaults on her obligations to Ruth. Ruth notifies the Bank of her proceeds security interest in Laura's deposit account, and demands the Bank make payment to Ruth of the $100 balance. The Bank refuses to comply with this demand. Litigation ensues. Between Ruth and the Bank, who prevails in a dispute over the deposit account balance?

(b) Outcome under the *PPSA*

(i) *Narrow Interpretive Approach: Non-Assignee*

PPSA s. 41(2) applies to resolve the dispute in Scenario 2 only if Ruth constitutes an "assignee" for the purposes of s. 41. According to Cuming, Walsh, and Wood, s. 41 does not apply because Ruth's rights arise, not by assignment, but automatically by operation of statute:[39]

> The PPSA provides a statutory right of set-off in relation to assignments of intangibles and chattel paper. However, this provision only applies where these rights have been transferred through an assignment of the intangible or chattel paper. The inventory financer's right to the account as proceeds does not arise by virtue of an assignment between the debtor and the inventory financer. Rather, the right arises automatically by virtue of its statutory right to the proceeds.[40]

The professors' stance rests on a narrow, technical interpretation of the term "assignee." The term "assignee" typically refers to a person who has received a transfer of rights or property—that is, a *first-order* recipient of an "assignment."[41] Since Ruth, a proceeds claimant, is not a first-order recipient of a deposit account assignment, she does not constitute an assignee for the purposes of s. 41. Accordingly, *PPSA*

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39 *SPPSA*, *supra* note 2, s 28(1)(b).

40 Ronald CC Cuming, Catherine Walsh & Roderick J Wood, *Personal Property Security Law*, 2nd ed (Toronto: Irwin Law, 2012) at 668. See also Cuming, *supra* note 9 at 315: "A literal interpretation of section 41 of the Alberta Act and its equivalent leads to the conclusion that these provisions do not apply to such situations since the interest of the secured party in the proceeds does not arise out of a contractual or voluntary assignment by the assignor, but arises by operation of the Act."

41 *Black's Law Dictionary*, 7th ed, *sub verbo* "assignment": "The transfer of rights or property."

s. 41(2) does not apply to resolve the dispute. On this narrow view, only a first-order assignee is subject to the account debtor's equitable and contractual set-off rights pursuant to *PPSA* s. 41(2).[42] One must turn to some other authority or line of analysis to resolve the priority dispute between Ruth and the Bank. I will return, below, to this narrow interpretive approach, and how it affects the analysis in Scenario 2. I prefer an alternate interpretive approach, which I will explain next.

(ii) *Broad Interpretive Approach: Assignee*

Note that *PPSA* s. 41(1) does not actually *define* the term "assignee." For a definition, one must consult another source, such as *Black's Law Dictionary*:

> [A]ssignee…One to whom property rights or powers are transferred by another. Use of the term is so widespread that it is difficult to ascribe positive meaning to it with any specificity. Courts recognize the protean nature of the term and are, therefore, the often forced to look to the intent of the assignor and assignee in making the assignment — rather than to the formality of the use of the term *assignee* — in defining rights and responsibilities.[43]

Black's recognizes the broad usage and protean nature of the term "assignee."[44] There are good reasons to believe the term "assignee" carries a broad meaning for the purposes of *PPSA* s. 41. First, *PPSA* s. 41(1)(b) is drafted inclusively, without description or enumeration, connotative of a broad meaning.[45] Second, while *PPSA* s. 41(1)(b) may not define the term "assignee," it does clarify that for the purposes of s. 41 the term "includes a secured party."[46] In Scenario 2, Ruth undoubtedly falls within the *PPSA*'s definition of "secured party."[47]

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42 The narrow interpretive approach is palatable in jurisdictions where the *PPSA* is silent on the meaning of the term "assignee" in its concordant provision to *SPPSA* s. 41(1)(b). These jurisdictions include Alberta (*APPSA*, *supra* note 2, s 41), British Columbia (*BCPPSA*, *supra* note 2, s 41), Ontario (*OPPSA*, *supra* note 2, s 40), and Yukon (*YPPSA*, *supra* note 2, s 39).

43 *Supra* note 41, *sub verbo* "assignee".

44 See also UCC, §9-102 (2010), Comment 26, reproduced *infra* note 102.

45 Consider, also, the *Choses in Action Act* (*supra* note 34, s 3), which provides that the term "assignee" includes "a person now being…entitled by a first or subsequent assignment or transfer or a derivative title to a debt or chose in action." Does Ruth hold her entitlement through a "derivative title"? Or is "derivative title" a limited reference to the acquisition of title *through another person*, rather than *through the disposition of another form of personal property*? If Ruth does constitute an "assignee" within the meaning of s. 2 of the *Choses in Action Act*, what impact, if any, does this have on whether she is an assignee for the purposes of *PPSA* s. 41?

46 *SPPSA*, *supra* note 2, s 41(1)(b).

47 *Ibid*, s 2(1)(nn): "'secured party' means: (i) a person who has a security interest."

By virtue of her proceeds claim, she is "a person who has a security interest"[48] in the deposit account.[49] Though not a first-order recipient of an assignment, Ruth is a "secured party" and is therefore captured within the meaning of "assignee" for the purposes of s. 41.[50]

I prefer the broad interpretive approach because it renders unnecessary a separate, yet parallel, branch of analysis in Scenario 2. Under the broad interpretive approach, Ruth's rights as a proceeds claimant are subject to the Bank's deposit account set-off rights pursuant to *PPSA* s. 41(2) for precisely the same reasons that Philip's rights, as an original collateral claimant, were subject to the Bank's deposit account set-off rights in Scenario 1.[51] In other words, *PPSA* s. 41(2) directly applies to resolve the dispute in favour of the Bank.

In contrast, further analysis is required to resolve Scenario 2 under the narrow interpretive approach. I do not lightly dismiss this possibility. Suppose that Cuming, Walsh, and Wood are correct in concluding that *PPSA* s. 41(2) is not squarely engaged in Scenario 2 on the basis that Ruth is not an assignee of the deposit account. What, then, is the appropriate analytical path?

(iii) *Analytical Subtheories under the Narrow Interpretive Approach*

Professor Cuming's Consideration of Two Competing Interpretive Theories

If *PPSA* s. 41(2) is inapplicable to Scenario 2, how is the matter resolved? In 1991, Cuming examined this question in considerable detail.[52] In doing so, he identified and assessed two divergent interpretive theories.[53] Bear in mind that Cuming offered his analysis based on earlier personal property security legislation which did not contain concordant provisions to *PPSA* ss. 41(1)(a) and (b).[54] Also keep in mind that, at present day, Alberta's *APPSA*, British Columbia's *BCPPSA*, Ontario's *OPPSA*, and Yukon's *YPPSA*, do not contain a concordant provision to Saskatchewan's *PPSA* s. 41(1)(b).

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48 *Ibid*.

49 *Ibid*, s 28(1): "Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest…(b) extends to the proceeds."

50 Other jurisdictions with personal property security statutes containing concordant provisions to *SPPSA* s. 41(1)(b), clarifying the meaning of the term "assignee" for the purposes of the section, include New Brunswick (*NBPPSA*, *supra* note 2, s 41(1)), Newfoundland (*NFPPSA*, *supra* note 2, s 42(1)(b)), Nova Scotia (*NSPPSA*, *supra* note 2, s 42(1)), the Northwest Territories (*NWTPPSA*, *supra* note 2, s 41(1)), Nunavut (*NPPSA*, *supra* note 2, s 41(1)), and Prince Edward Island (*PEIPPSA*, *supra* note 2, s 41(1)(b)).

51 See Geva, "Rights in Bank Deposits", *supra* note 14 at 39.

52 *Supra* note 9.

53 *Ibid* at 318.

54 *The Personal Property Security Act*, SS 1979-80, c P-6.1, s 41.

Implicit Priority Rule Theory

Under the first interpretive theory, *PPSA* s. 28[55] embodies an implicit priority rule in favour of the proceeds claimant over the set-off claimant (the "implicit priority rule theory").[56] Cuming articulates the implicit priority rule theory in simple terms (for ease of reference, I have identified the Scenario 2 parties in square brackets): "The secured party [Ruth] has a perfected security interest in the proceeds [Laura's deposit account balance] and this is sufficient to defeat the unsecured claim of the depositary institution [the Bank]."[57]

Cuming dismisses the implicit priority rule theory on several grounds. First, *PPSA* s. 28 does not expressly speak to priority, but "merely provide[s] for the creation and perfection of a statutory security interest in proceeds."[58] Second, to interpret s. 28 in such a fashion is to disregard the fundamental nature of the deposit account as part of a larger contractual relationship between the assignor and the Bank.[59] Finally, the implicit priority rule theory creates *asymmetry* in the rules of deposit account set-off. Whereas deposit account set-off is available to the Bank pursuant to *PPSA* s. 41(2) where Philip claims the deposit account as original collateral, it is unavailable (pursuant to the implicit priority rule theory) where Ruth claims the deposit account as proceeds. "Why the distinction?", Cuming asks. On what grounds can this interpretation, which artificially bifurcates the rules of deposit account set-off, be rationalized? Is it not more sensible to adopt the same sort of analytical approach as that set out in *PPSA* s. 41(2)? Why should the Bank's power to assert deposit account set-off hinge on whether its competitor stakes its claim against the deposit account as original collateral or as proceeds? Should the *PPSA* not produce consistent outcomes? In any case, despite serious questions about its sensibleness, application of the implicit priority rule theory in Scenario 2 gives Ruth priority over the Bank in relation to Laura's deposit account balance.[60]

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55 *SPPSA*, *supra* note 2, s 28(1).

56 Cuming, *supra* note 9 at 316.

57 *Ibid*.

58 *Ibid*.

59 *Ibid* at 316-17, where Cuming acknowledges the bank's inherent rights: "The effect of section 28 is to create a statutory charge (a security interest) against that account. It does not change the underlying relationship between the account debtor and the assignor that is endemic to any debtor/creditor relationship."

60 In the following statement, Justice Vancise of the Saskatchewan Court of Appeal appears to endorse the implicit priority rule approach:

> In its argument before us the bank properly categorized the issue as one of competing interests under the Act. Namely, did the bank hold the term deposit free from the interest of the credit union. It contends that if it did, then it properly exercised its right of set-off. It did not contend that its common law right of set-off gave it priority over the perfected security interest of the credit union in the term deposit.

Uniform Equitable Set-Off Theory

Cuming rejects the implicit priority rule theory. He instead embraces a purposive interpretive theory under which the principles of equitable set-off apply in Scenario 2, just as they applied in Scenario 1 (the "uniform equitable set-off theory"). Based on *PPSA* s. 65(2), Cuming reasons that the principles of equitable set-off are "not inconsistent" with the express provisions of the *PPSA*.[61] Indeed, as demonstrated above, the principles of equitable set-off are recognized in *PPSA* s. 41(2). Additionally, Cuming asserts that the uniform equitable set-off theory creates *symmetry* in the rules of deposit account set-off, which is preferable to the asymmetrical bifurcation created by the adoption of the implicit priority rule theory.[62] Thus, while Cuming recognizes the distinction between an assignee (like Philip) and a non-assignee (like Ruth), he nonetheless favours an analytical approach under which Philip and Ruth are afforded equivalent treatment vis-à-vis the Bank.[63]

Cuming's logic is persuasive. In my view, the uniform equitable set-off theory is preferable to the implicit priority rule theory because it renders the *PPSA* more coherent.[64] In Scenario 2, application of the uniform equitable set-off theory under the narrow interpretive approach gives the Bank a superior claim to Ruth with respect to Laura's deposit account balance, thereby mirroring the outcome of Scenario 1 through an analogous analytical framework involving the conjunctive operation and purposive interpretation of *PPSA* ss. 65(2) and 41(2).[65]

Professor Geva's Perspective

Account Combination Theory

In his article, Cuming focused on deposit account set-off through an equitable set-off lens, and favoured an interpretation that recognizes

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> *Given my conclusion that the credit union has a perfected security interest in the term deposit, it is not necessary to deal with the matter further.*

Indian Head Credit Union v Andrew (1992), 97 DLR (4th) 462 at 468, [1993] 1 WWR 673 [*Indian Head Credit Union*] [emphasis added].

Vancise J.A. seems to assume that a perfected security interest *per se* defeats a right of set-off. Other courts have rejected this view, at least implicitly. See e.g. *Flexi-Coil*, *supra* note 32; *Belarus Equipment of Canada Ltd. v C & M Equipment (Brooks) Ltd. (Receiver of)* (1994), [1995] 1 WWR 429, 24 Alta LR (3d) 125 (specifically adopting *Flexi-Coil* over *Indian Head Credit Union)*; *GE Capital Canada Equipment Financing Inc. v HSBC Bank Canada*, 2002 SKQB 406, 4 PPSAC (3d) 145.

61 *Supra* note 9 at 321.

62 *Ibid*.

63 See Geva, "Rights in Bank Deposits", *supra* note 14 at 39.

64 This is essentially the same reason I prefer the broad interpretive approach to the narrow interpretive approach.

65 Note that this would not be the case if Ruth notified the Bank of her interest in the sale proceeds prior to their deposit in Laura's deposit account. See Bangsund, "Set-Off & Security Interests", *supra* note 3 at 9.

the supremacy of equitable set-off rights vis-à-vis competing *PPSA* security, whether original collateral or proceeds. In 2011, Geva also examined deposit account set-off.[66] Near the end of his article, Geva outlined his view of the appropriate analytical framework (the "account combination theory"):

> I thus argue that as long as it is treated as a *right of set-off operating like a legal set-off*, and other than where it could benefit from the authority given by the secured party to the customer to dispose of the collateral free of the security interest, *the bank's right to combine accounts* is defeated by a security interest. At the same time, where it is characterized as a *current account set-off*, the banker's *right to combine accounts* defeats a competing security interest. I suppose that the result does not depend on whether the security interest is perfected. It is only as a *current account set-off* the right to combine accounts is "inherent in the banker-customer relation" so as to prevail over all adverse claims.[67]

Geva's account combination theory appears quite sound. It is consistent with the express language of the *PPSA*, and produces outcomes similar to that of the uniform equitable set-off theory. In Scenario 2, for example, the account combination theory, like the uniform equitable set-off theory, provides that the Bank's implied right of contractual set-off defeats Ruth's proceeds security interest.[68]

(iv) *Synopsis*

I will briefly recount the analytical framework for Scenario 2. If the broad interpretive approach is adopted, then the Bank is entitled to assert its right of deposit account set-off in priority to Ruth pursuant to *PPSA* s. 41(2). Yet even if the broad interpretive approach is rejected, and the narrow interpretive approach is adopted in its stead, the prevailing view is that the Bank is nevertheless entitled, under a

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66 "Rights in Bank Deposits", *supra* note 14.

67 *Ibid* at 44 [emphasis in original; footnotes omitted].

68 Geva appears to draw a distinction between (i) a scenario in which the deposit account and current credit account(s) operate in conjunction, and (ii) one in which the deposit account and current credit account operate independently (i.e., are treated as completely separate items of intangible personal property). In the former scenario, account combination is automatic and self-asserting, and trumps a competing security interest; in the latter, the bank must positively assert set-off in order to claim priority over the secured party, and may be thwarted if this assertion comes too late. The former state of affairs is presumed (*ibid* at 16). Neither Scenario 1 nor Scenario 2 present facts that tend to rebut this presumptive state of affairs.

purposive reading of *PPSA* ss. 65(2) and 41(2), to assert deposit account set-off in priority to Ruth pursuant to equitable set-off or account combination. In other words, irrespective of one's preferred interpretive approach, the operative analysis in Scenario 2 is either identical to, or wholly analogous with, that in Scenario 1. In Scenario 2, the Bank's deposit account set-off rights, comprising contractual and equitable set-off principles, again reign supreme vis-à-vis competing *PPSA* security.

3. Deposit Account Set-Off (Term Loan) v. Security Interest

(a) Equitable Set-Off: Relevant or Irrelevant?

Immediately preceding his articulation of the account combination theory, Geva assessed the analytical approaches of Cuming and Crawford on the subject of deposit account set-off:[69]

> There is no unanimity in the scholarly view in Canada on the priority of the bank's set-off right. At one end of the spectrum, Cuming asserts that "the rules of equitable set-off provide the most consistent and practical" solution so as to protect the bank combining accounts only when it acts without knowledge. At the other end of the spectrum, Crawford is of the view that the bank's right to combine accounts, being "inherent in the banker-customer relation in the common law" necessarily prevails regardless of other considerations.
>
> *I find "equitable set-off" to be irrelevant.* At the same time I am persuaded neither by the "inherent nature" of the bank's right nor by its alleged reach. In my mind the resolution of the issue depends on the nature of the banker's right to combine accounts along the lines discussed above in Part 4. I thus argue…[see the text accompanying note 67].[70]

Geva prefers to view the matter purely through a contractual lens—one in which a tempered version of account combination applies to resolve the matter.[71] He thus finds equitable set-off irrelevant. This

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69 I do not have basis to address Geva's assessment of Crawford's view. The looseleaf source Geva cited is updated beyond that of the looseleaf version I consulted. Based on my brief review of Crawford's work (Bradley Crawford, *The Law of Banking and Payment in Canada*, vol 2 (Toronto: Canada Law Book, 2008) (looseleaf November 2008 supplement)), it appears that Crawford favours the account combination approach, or something close to it.

70 Geva, "Rights in Bank Deposits", *supra* note 14 at 44 [emphasis added; footnotes omitted].

71 Geva speaks more broadly to the bank's right of deposit account set-off as against a competing security interest in the deposit account, whether as original collateral or as proceeds (see *ibid* at 38-45). This leads me to believe that he, too, prefers the

position deserves attention, particularly since equitable set-off is embodied in the language of *PPSA* s. 41(2), and expressly named as a defence or claim available to the Bank under concordant provisions in the personal property security statutes of Manitoba,[72] the Northwest Territories,[73] Nunavut,[74] and Ontario.[75] Indeed, Geva acknowledges this express language in his article.[76] On what basis, then, can he dismiss equitable set-off as irrelevant to deposit account set-off analysis under the *PPSA*? He makes the same assertion elsewhere, this time with an attendant explanation:

> Equitable set-off is exercised by the assertion "as a defence to [an] action" of "grounds... which (prior to the *Judicature Act*) would have entitled a defendant to file a bill in Chancery to restrain the plaintiff from proceeding with his action..." Such grounds are based on the breach of a duty arising from a contract sued upon or a matter closely related to it. Hence, I find 'equitable set-off' to be irrelevant.[77]

I do not agree that a narrow historical description of equitable set-off renders the doctrine of equitable set-off irrelevant to deposit account set-off. For instance, in *Telford v. Holt*,[78] Canada's seminal decision on equitable set-off, the Supreme Court of Canada allowed equitable set-off to Telford,[79] but not on the basis of any "breach of a duty." Geva's historical explanation for dismissing Cuming's uniform equitable set-off theory is inadequate. The matter requires further investigation, and another illustrative scenario.

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broad interpretive approach over the narrow interpretive approach. This is not to say, however, that he necessarily agrees with my understanding of the internal parameters of the broad interpretive approach (i.e., its substantive content).

72 *MPPSA*, *supra* note 2, s 41(2)(a)(ii).

73 *NWTPPSA*, *supra* note 2, s 41(2)(a)(ii).

74 *NPPSA*, *supra* note 2, s 41(2)(a)(ii).

75 *OPPSA*, *supra* note 2, s 40(1.1)(a).

76 "Rights in Bank Deposits", *supra* note 14 at 41.

77 Benjamin Geva, "Security Interests in Bank Deposits Under UCC Article 9: A Perspective" in Elvia Arcelia Quintana Adriano, ed, *The Evolution of Global Trade over the Last Thirty Years* (Mexico: Universidad Nacional Autónoma de México, Instituto de Investigaciones Jurídicas, 2013) 31 at 39 [footnotes omitted], online: <https://archivos.juridicas.unam.mx/www/bjv/libros/8/3581/6.pdf>, archived: <https://perma.cc/TJN8-24UH>.

78 *Supra* note 9.

79 *Ibid* at 218.

(b) Beriah, Alice[80] & Bank: Scenario 3

Suppose, in Scenario 3, that Beriah opens a deposit account with the Bank and makes an initial $100 deposit. The Bank then advances $100 of credit to Beriah pursuant to an unsecured term loan, maturing three years in the future. Beriah spends the borrowed funds on extravagancies. He then grants Alice a security interest in his deposit account to secure payment of another $100 debt obligation. Alice registers notice of her security interest. Beriah later defaults on his debt to Alice. Alice notifies the Bank of her security interest in Beriah's deposit account and demands that the Bank make payment of the $100 deposit account balance to her. The Bank refuses to comply with Alice's demand and asserts set-off. Between Alice and the Bank, who prevails in a subsequent dispute over the deposit account balance? In Scenario 3, how do the principles of contractual set-off and equitable set-off interact with conventional *PPSA* security?

(c) Outcome under the *PPSA*

In Scenario 3, the Bank is disentitled to account combination under *PPSA* s. 41(2)(a) because the amount payable under Beriah's term loan is not presently payable; it does not constitute a "current account."[81] The Bank is also disentitled to set-off under *PPSA* s. 41(2)(b)—the unconnected claims notification rule—because the Bank did not have an extant right of legal set-off against Beriah at the time it acquired knowledge of Alice's security interest. However, pursuant to the operative language of *PPSA* s. 41(2)(a) referable to the close connection rule, the Bank may be entitled to equitable set-off if it can demonstrate (i) that there is a close connection between the term loan and reciprocal deposit account balance, and (ii) that it would be manifestly unjust to refuse the Bank set-off in the circumstances.

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80 Beriah Sellers and Alice Montague (Twain & Warner, *The Gilded Age*, *supra* note 1). Shortly after the first printing of *The Gilded Age*, a real-life Eschol Sellers, whom Twain described as "a college-bred gentleman of courtly manners and ducal upholstery," appeared and threatened a libel suit, prompting the publisher to change the Colonel's given name to Beriah in later printings (Smith et al, *supra* note 7 at 207, 529, n 207.23-28). Alice Montague is a friend and confidante of both Ruth Bolton and Philip Sterling. Ruth and Philip each boarded with her family at different stages of the tale.

81 But what if contractual documentation governing the term loan contains a carefully drafted clause providing that Beriah is in default upon the Bank's receipt of notice of assignment of the deposit account, and that the Bank is entitled to accelerate and demand payment immediately upon receipt of notice? Would such a clause make the term loan account "current" for the purposes of account combination, and thus entitle the Bank to set off the term loan against the deposit account? For discussion of this issue in the U.S. context, see Barkley Clark, "Bank Exercise of Set-off: Avoiding the Pitfalls" (1981) 98:3 Banking LJ 196 at 207-208. In the Canadian context, where a promissory note is involved, see *Belows v Dalmyn and Dalco Contractors Ltd.*, [1978] 4 WWR 630, 4 BLR 205 (Man QB).

Regarding the first branch of analysis, Justice Jackson of the Saskatchewan Court of Appeal observes that whether a close connection exists between impugned claims is a highly contextual determination, and past case law offers limited guidance.[82] Still, some generalization is possible. For instance, Lothian and I observed that "both the timing and purpose of the contracts giving rise to the cross-claims are relevant considerations in determining whether a close connection exists."[83] In Scenario 3, it is arguable that Beriah's term loan and deposit account balance are not closely connected given their divergent timing and purposes.[84] On the other hand, some courts have characterized seemingly independent cross-claims as "closely connected," thereby suggesting that the close connection threshold is relatively low.[85] Relying on these precedents, the Bank may be able to establish a close connection, and thus satisfy the first branch of analysis under the close connection rule of equitable set-off.

The question that remains under the second branch of analysis is whether it would be manifestly unjust to deprive the Bank of equitable set-off in the circumstances. Here, the Bank faces a significant challenge since, pursuant to the term loan, it explicitly agreed to receive repayment of Beriah's account debt at a future date which has not yet arrived. Alice might, therefore, successfully argue that the Bank has implicitly contracted out of its right of set-off until loan maturity. To allow equitable set-off would be to override the Bank's consensual arrangement with Beriah, effectively permitting it to unilaterally accelerate a debt that would otherwise mature in the future.[86] For this reason, Alice might convincingly argue that it would not be manifestly unjust to refuse the Bank equitable relief in the

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82 *Saskatchewan Wheat Pool v Feduk*, 2003 SKCA 46 at para 84, [2004] 2 WWR 69.

83 *Supra* note 5 at 159.

84 *Citibank Canada v Confederation Life Insurance Co*. (1996), 42 CBR (3d) 288 at para 40, 15 OTC 26 (Ct J (Gen Div)): "The Term Deposit transaction was entered into between Citibank and Confederation Life on May 23, 1984, at a different time, and for entirely different purposes than the bond agreement and swap agreement transactions later and separately agreed to between the parties." See also *Baxter v West Coast Air Ltd*., 2012 BCSC 1097 at para 37.

85 See *Commercial Factors of Seattle LP v Canadian Imperial Bank of Commerce*, 2010 ONSC 3516 at para 52, 16 PPSAC (3d) 181, where the Ontario Superior Court of Justice concluded, in the accounts factoring context, that a bank's monetary claims against a subcontractor service provider under assigned consultant claims were closely connected to the subcontractor's monetary claim against the bank on account of services provided (assigned to a factoring company). In *Nicolou v McLennan & Associates* (2013 ONSC 1622, 307 OAC 56), the same court concluded, in the professional services context, that a lawyer's monetary claim against his client for legal services rendered was closely connected to the client's reciprocal monetary claim against the lawyer on account of monies advanced for investment in an ultimately unsuccessful business venture (*ibid* at para 17).

86 Bangsund & Lothian, *supra* note 5 at 165.

circumstances. Indeed, case law exists, pre-dating the *PPSA*, consistent with this view.[87] However, in the modern *PPSA* era, there is no Canadian case law directly on point, leaving the matter unsettled.

In any event, Scenario 3 aptly demonstrates the relevance of equitable set-off doctrine to deposit account set-off analysis. Equitable set-off is critical where deposit account set-off is unavailable to the Bank under account combination principles, but potentially available under equitable set-off principles. The relevance proposition is strong in Alberta,[88] British Columbia,[89] New Brunswick,[90] Newfoundland,[91] Nova Scotia,[92] Prince Edward Island,[93] Saskatchewan,[94] and Yukon,[95] given the operative language of *PPSA* s. 41(2) (or its equivalent) in these jurisdictions. It is incontestable in Manitoba,[96] the Northwest Territories,[97] Nunavut,[98] and Ontario[99] since, in these jurisdictions, the

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87 See *The James McCready Co. Ltd. v The Alberta Clothing Co.* (1910), 3 Alta LR 67, 13 WLR 680 (SC); *Bradford Old Bank Ltd. v Sutcliffe*, [1918] 2 KB 833 at 847 (CA); Cuming, *supra* note 9 at 308, n 31:

> The source of this exception arises out of the special relationship between a bank amd [sic] its customer. If a bank were allowed to set off the amount of an unmatured term loan against a deposit, it would be placed in the position of being able to disregard its contractual obligation under the loan agreement and exact premature repayment on the loan. Further, it would place the customer in the impossible position of not knowing whether or not his or her cheques drawn on the deposit account would be honuoured. A similar position has been taken with respect to the right of a bank to consolidate a loan and a current account. See *Bradford Old Bank Ltd. v. Sutcliffe*, in which Scrutton L.J. noted that if a bank were allowed to set off a loan against a current account without the customer's consent, no customer could feel any security in drawing a cheque on his or her account.

[citations omitted]

88 *APPSA*, *supra* note 2, s 41(2).

89 *BCPPSA*, *supra* note 2, s 41(2).

90 *NBPPSA*, *supra* note 2, s 41(2).

91 *NFPPSA*, *supra* note 2, s 42(2).

92 *NSPPSA*, *supra* note 2, s 42(2).

93 *PEIPPSA*, *supra* note 2, s 41(2).

94 *SPPSA*, *supra* note 2, s 41(2).

95 *YPPSA*, *supra* note 2, s 39(1).

96 *MPPSA*, *supra* note 2, s 41(2)(a)(ii).

97 *NWTPPSA*, *supra* note 2, s 41(2)(a)(ii).

98 *NPPSA*, *supra* note 2, s 41(2)(a)(ii).

99 *OPPSA*, *supra* note 2, s 40(1.1):

> An account debtor who has not made an enforceable agreement not to assert defences arising out of the contract between the account debtor and the assignor may set up by way of defence against the assignee, (a) all defences available to the account debtor against the assignor arising out of the terms of the contract or a related contract, including equitable set-off and misrepresentation; and (b) the right to set off any debt owing to the account debtor by the assignor that was payable to the account debtor before the account debtor received notice of the assignment.

concordant provision to *PPSA* s. 41(2) explicitly identifies equitable set-off by name. For example, Manitoba's provision reads as follows:

> (2) Unless an account debtor makes an enforceable agreement not to assert any defence or claim arising out of a contract, the rights of an assignee of an intangible or chattel paper are subject to
>
> (a) the terms of the contract between the account debtor and the assignor and any defence or claim arising from
>
> (i) the contract, or
>
> (ii) a contract closely connected to the contract, where the account debtor meets the requirements for an *equitable set -off*; and
>
> (b) any other defence or claim of the account debtor against the assignor that accrues before the account debtor acquires knowledge of the assignment.[100]

In short, deposit account set-off is best conceptualized as an amalgam of contractual and equitable tenets. The implied contractual right of account combination is a prominent component of deposit account set-off, but it is not the only one. If account combination is unavailable, a depository bank may resort to the principles of equitable set-off in an attempt to defeat competing *PPSA* security.

C. DEPOSIT ACCOUNT SET-OFF V. DEEMED SECURITY INTEREST

1. Deposit Account Set-Off v. Absolute Transfer

(a) Mulberry, Washington[101] & Bank: Scenario 4

Contemplate a final variation on the facts. Suppose, in Scenario 4, that Mulberry opens a deposit account with the Bank and initially deposits $100. The Bank subsequently grants Mulberry an unsecured revolving operating line of credit (payable on demand) with a borrowing limit of $100. Mulberry immediately draws down the operating line in its entirety and squanders the borrowed funds on penny stocks. Mulberry then effects, or purports to effect, an absolute transfer of his deposit account to Washington. Washington registers his interest in the Personal Property Registry, then furnishes the Bank with notice demanding that the Bank pay the deposit account balance to him.

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100 *MPPSA*, *supra* note 2, s 41(2) [emphasis added].

101 Mulberry Sellers and Washington Hawkins (Mark Twain, *The American Claimant in The Complete Works of Mark Twain*, vol 4 (New York: Harper & Brothers, 1924)). The Colonel bears the name Mulberry Sellers in this later work of Twain's, presumably because a real-life Beriah Sellers objected to the use of his name in later editions of *The Gilded Age* (see *supra* note 80).

The Bank refuses to comply with Washington's demand. Between Washington and the Bank, who prevails in a dispute over the deposit account balance?

(b) Outcome under the *PPSA*

Again, the threshold question is whether *PPSA* s. 41(2) applies to resolve the dispute between Washington and the Bank. The express language in *PPSA* s. 41(1)(b) does not allude to an "absolute transferee." Does this suggest that Washington is not an "assignee" for the purposes of s. 41?

Clearly, the answer is no. Washington, an absolute transferee, is an "assignee" for the purposes of *PPSA* s. 41. Indeed, the term "assignee," in colloquial usage, ordinarily refers to an absolute transferee.[102] Subsection 41(1)(b) of the *PPSA* further clarifies that the term "includes a secured party."[103] This language in no way implies that the term "assignee" is to be interpreted in a narrow manner, inconsistent with its general usage (that is, in a manner excluding an absolute transferee from its scope). Rather, this inclusive language suggests the very opposite; that the term "assignee" should be given a broad interpretation. While perhaps not a secured party in the conventional sense, Washington is clearly a "secured party" for the purposes of the *PPSA*. The absolute transfer of Mulberry's deposit account balance to Washington created a deemed security interest[104] in the deposit account, thereby constituting Washington a "secured party"[105] for the purposes of the *PPSA*. Again, *PPSA* s. 41(1)(b) makes clear that an "assignee" includes a "secured party." Thus, Washington, an absolute transferee *cum* secured party, falls squarely within the purview of *PPSA* s. 41(2). As Cuming observes, "the Acts do not draw a distinction between an 'assignment' or 'transfer' of a chose and the creation of a security interest in it."[106] The absolute transfer creates a "deemed" security interest under the *PPSA* and attracts the statute's perfection rules and priority structure, including *PPSA* s. 41(2). In Scenario 4, the Bank prevails over Washington pursuant to *PPSA* s. 41(2).

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102 See UCC §9-102 (2010), Comment 26:

> This article generally follows common usage by using the terms "assignment" and "assign" to refer to transfers of rights to payment, claims, and liens and other security interests. It generally uses the term "transfer" to refer to other transfers of interests in property…Depending on the context, each term may refer to the assignment or transfer of an outright ownership interest or to the assignment or transfer of a limited interest, such as a security interest.

103 *SPPSA*, *supra* note 2, s 41(1)(b).

104 *Ibid*, ss 2(1)(qq)(ii)(A), 3(2).

105 *Ibid*, s 2(1)(nn).

106 *Supra* note 9 at 303.

(c) Differentiation Between Absolute Transfer and Actual Transfer

Note that the absolute transfer described in Scenario 4 is quite different from a scenario in which funds from Mulberry's deposit account are transferred to Washington's deposit account via electronic funds transfer, or some other similar method of funds transfer. Upon effectuation of the latter type of transaction, the impugned funds become Washington's, and Mulberry's deposit account balance is no longer available to be set off against by the Bank. The difference can be described as follows: In Scenario 4 (an absolute transfer scenario), there is an absolute transfer *of* a deposit account from Mulberry to Washington. Meanwhile, in an actual transfer scenario, the transfer of funds is actually effectuated *from* the deposit account of one (Mulberry) *to* the deposit account of another (Washington). In the latter scenario, the Bank has no right of set-off against Mulberry's deposit account because the account balance has been depleted. The funds are now constitutive of Washington's deposit account, whether maintained at the Bank or at some other depository institution, and the Bank's deposit account set-off rights do not extend to that account balance.

IV. CONCLUSION

Though the basic idea of set-off may be simple, its application is not. Indeed, the interaction between deposit account set-off and conventional *PPSA* security can be complicated and extremely nuanced. However, a careful review of this interplay reveals that banks hold an extraordinarily powerful realization tool in deposit account set-off. When a deposit account balance is claimed by a secured party asserting a proprietary right under the *PPSA* on one hand, and by the depository bank asserting a right of deposit account set-off on the other, the contest is often resolved in favour of the bank.[107]

Rules of deposit account set-off necessarily impact the *PPSA*'s deposit account priority rules because both sets of rules pertain to deposit account entitlements. It thus appears that deposit account set-off must be considered, and possibly reformed, as part of any legislative reform effort concerning the *PPSA* deposit account perfection and priority rules. Cuming was prescient in this regard, identifying over a

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107 Bear in mind, also, that the depository bank always has the option of taking a security interest in its customer's deposit account, thereby giving it another line of defence against competing *PPSA* security. See *SPPSA*, *supra* note 2, s 9(4): "An account debtor as defined in clause 41(1)(a) may take a security interest in the account or chattel paper under which the account debtor is obligated."

quarter century ago the potential need for legislative reform in this area:

> [I]t may be necessary to amend the PPSAs in order to provide a set of more refined rules built around the registry systems of the Acts. These rules may provide that an unperfected security interest in accounts is subordinate to the account debtor's right of set-off. Alternatively, they might involve abolition of the right of set-off in this context thereby forcing account debtors to seek to establish priority on the basis of security interest in accounts owing to debtors.[108]

Geva also emphasizes the need for legislative reform given the uncertainty in the "priority scheme among competing claims to a deposit account."[109] I agree with the learned professors. As I have stated elsewhere, if there is a deficiency in *PPSA* s. 41(2), "it is in the opacity of the language governing the interaction between deposit account set-off rights and competing" *PPSA* security.[110] In my view, legislative clarification of deposit account set-off rights is worthy of consideration as a plausible alternative to, or a component part of a larger integrated alternative to, the *PPSA*'s adoption of a control paradigm for deposit account perfection and priority ordering.

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108 *Supra* note 9 at 322.
109 "Rights in Bank Deposits", *supra* note 14 at 46.
110 Clayton Bangsund, "PPSL Values" (2015) 57:2 Can Bus LJ 184 at 215.