



# A Guide to Agricultural Security Agreements

## In Alberta



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# A GUIDE TO AGRICULTURAL SECURITY AGREEMENTS IN ALBERTA

## Table of Contents

<b>Introduction</b>	-	1
<b>1. Basics of Security Agreements</b>	-	2
a. What is Security?	-	2
b. Why use Security?	-	2
c. Granting Security Agreements	-	3
d. Knowing what Security Exists	-	4
e. “Term” or “Demand” Debt?	-	4
f. Default	-	4
<b>2. Land Mortgages</b>	-	5
a. Nature of Mortgages	-	5
b. Registration	-	5
c. Priorities	-	5
d. Usual Terms	-	5
e. Fixtures	-	6
f. Extent of Liabilities	-	6
<b>3. Grazing Lease Security</b>	-	7
<b>4. Personal Property Security</b>	-	7
a. Personal Property Security Act (“PPSA”)	-	7
b. When does PPSA apply?	-	7
c. General Security Agreement (“GSA”)	-	8
d. “Serial Number Goods” or “General Collateral”	-	8
e. Assignment of Accounts	-	9
f. Purchase Money Security Interest (“PMSI”)	-	9
g. Inventory Interests	-	9
h. “Input” Interests – Crops and Livestock	-	10
i. Searches	-	10
j. Registrations	-	10
k. Default and Recovery	-	11

<b>5.</b>	<b>Bank Act Security</b>	-	12
	a. Who can use it?	-	12
	b. Registration and Searches	-	12
	c. Advantages over PPSA (?)	-	12
<b>6.</b>	<b>Promissory Notes and Guarantees</b>	-	13
	a. Promissory Notes	-	13
	b. Guarantee	-	13
	c. Co-signed Loans	-	14
	d. Accommodating Security	-	14
<b>7.</b>	<b>Assignments and Directions</b>	-	15
	a. Priority Agreements	-	15
	b. Assignments	-	15
<b>8.</b>	<b>Agricultural Quotas</b>	-	15
	a. Legal nature of a "Quota"	-	15
	b. Security Interest in Quota	-	15
<b>9.</b>	<b>Statutory Liens</b>	-	16
	a. Builders' Lien Act	-	16
	b. Animal Keepers Act	-	17
	c. Garage Keepers' Lien Act	-	17
<b>10.</b>	<b>Summary</b>	-	18
<b>11.</b>	<b>Appendix</b>	-	19
<b>12.</b>	<b>Acknowledgement</b>	-	19

## **Introduction – Purpose of this Publication**

The topic of security and the laws affecting debtors and creditors is complex. This is perhaps why it is easy for business owners, when the business is running smoothly, to fall into a pattern of simply signing documents. This guide provides a general overview of security and security agreements, and should give farmers and their advisors a better understanding what they are signing and enable them to negotiate the extent of the security they give where it is possible and appropriate. Terms “debtor” and “borrower” are used interchangeably as are “creditor” and “lender”.

# **1. Basics of Security Agreements**

## **a. What is Security?**

Security is an interest a debtor gives a secured creditor in the debtor's property. Its purpose is to protect the creditor if the debtor does not pay what they owe or if they commit some other default under their agreements with the lender.

A debtor who has given one creditor security in a certain property can give more security in the same property to others, although it might be a default under the debtor's agreement with the first secured creditor to do that. Secured creditors with security in the same property generally do not share it equally if the debtor defaults.

Instead, each creditor's rights over the property depend on the rank ("priority") of their particular security. Priority among secured creditors depends on such circumstances as when their security was obtained, when and how it was registered and the type of security.

## **b. Why use Security?**

At the time debtors are borrowing money or acquiring goods or services on credit, most fully intend to pay what is owed when due. Unfortunately, good intentions may not be accomplished. The market for products may shrink, weather may destroy crops, disease may strike livestock, interest rates, inflation, or the cost of supplies may rise dramatically.

Prudent creditors try to protect themselves against such uncertainties by taking security. When a debtor defaults, the ability to seize or foreclose and sell property will generally result in quicker and better recovery than seeking and collecting on a money judgement.

In certain cases, it may be beneficial for the debtor to agree to give security. Sometimes a debtor cannot obtain credit at all without giving security. Or, providing security may mean a more favourable interest rate, since the creditor's risk is lessened.

When it makes good business sense, any creditor – whether a farmer, a banker, or a supplier – should take security from a debtor. Some factors for debtors and creditors to consider include:

- Can the creditor afford to lose the amount of the loan if the debtor does not or cannot pay?
- Is this the sort of credit for which other creditors would normally seek security?
- Which property should the security cover? The creditor should conduct a search against the debtor and relevant property to determine if anyone else is registered as owner or secured creditor.
- How much property should security cover? There should be a sensible balance between the amount of the credit and the amount and type of property the security covers.

It is important to ensure that the security documents are properly prepared, signed, and registered. Having security that does not work against the debtor and other creditors is worse than not taking security at all as the creditor is lulled into the false belief that they are protected.

### **c. Granting Security Agreements**

It is important to understand any agreement you sign. Agreements you think provide the lender with limited security may in fact contain clauses giving the lender security over all your assets, similar to a general security agreement. Recognising this before signing any agreement permits you to negotiate with your lender about reducing the amount of security required. Before signing any agreement a borrower should know the answer to the following questions:

- What must I do under this agreement? What can I not do?
- What can happen to my property and me if I can't live up to my promises in the agreement?
- Are there any practical cost effective changes that are likely to be acceptable to my creditor that will make the deal or the documents better for me?

Most security agreements now in use by institutional lenders are standard forms, many being in "plain language" which debtors can understand if they actually read the agreement they are presented with. They will vary to some extent in internal content, but all of them will contain the following:

- Names and addresses of debtor and creditor.
- Either an amount that is the maximum amount owed for which the security is given or a statement that it is given for all sums and debts owing at any time by the debtor to the creditor.
- Obligations of each of the debtor and the creditor.
- What things are "default".
- What rights the creditor will have upon default.
- Provisions for signing and certification of signing by the debtor (and the creditor in limited cases).

Many creditors, especially large institutions, will be unlikely to change their standard security agreements at the request of one customer. However, they may be willing to reduce the amount of property the security will affect, or to restrict the part of the indebtedness for which security is required.

If you do decide to give your creditor security, make sure you get an exact copy of every security agreement and other documents you sign. Keep these copies in your farm records. These will act as a reminder for you to contact your creditor about discharging security when you've paid everything you owe, and a cross-check on what discharges must be obtained, or to whom proceeds must be paid, when you dispose of affected property.

## **d. Knowing what Security Exists**

It can be challenging for business owners to keep track of all agreements signed in the course of business and their specific effects. The common types of security agreements depend to some extent on the nature of the creditor involved. A list of some common security agreements based on the creditor follows – it is not a complete list nor does it suggest that all these agreements are used in each case.

- Banks, credit unions, Farm Credit Canada (“FCC” – a federal crown corporation), Agriculture Financial Services Corporation (“AFSC” – a provincial crown corporation): can use the full range of agreements including mortgages, general security agreements, purchase money security interests, assignments, and guarantees.
- Livestock feeder co-operatives: Purchase Money Security Interest (“PMSI”) and Inventory interests.
- Vehicle and equipment dealers: PMSI.
- Agricultural Suppliers: Input interests.

## **e. “Term” or “Demand” Debt**

Examples of demand debt are usually found with operating loans or lines of credit. Demand debt has no fixed due date for full repayment but must be repaid when the lender makes such a demand. When the lender decides to “call” the loan, borrowers are sometimes surprised that this can happen.

Term debt is repaid on a schedule with a fixed date at which total repayment is due. This is typical of mortgage loans or equipment loans. A lender cannot seek full repayment by calling the loan before the fixed term date, unless the debtor defaults.

## **f. Default**

“Default” most commonly means that payments are missed, but there are almost always other events set out in the loan or security agreement that are considered to be defaults. Some examples are:

- Failure to maintain insurance or adequate insurance;
- Failure to pay property taxes;
- Failure to maintain or repair collateral;
- Judgements or enforcement action by other creditors;
- Failure to maintain value to loan ratios; and
- Dispose of collateral without payment to or consent of the lender.

In any circumstance of default, the lender can proceed with all, or any, of the enforcement actions which are outlined in the security agreement or generally available in law. It is important for the borrower to read and understand all of their obligations. If some items seem impossible to honor or unreasonable in the circumstances it may be possible to negotiate some alterations before the agreements are signed.

Formal demand in writing before acting on a default may or may not be required. In the case of any debtor who is a “farmer”, as defined in the *Farm Debt Mediation Act*, a secured lender must

serve a prescribed form of notice of intention to enforce security on the debtor and wait 15 business days after doing so before any enforcement action can be taken. This requirement cannot be avoided by the lender or waived by the debtor.

## **2. Land Mortgages**

### **a. Nature of Mortgages**

Any agreement that gives a creditor a security interest in land is treated by Alberta law as a mortgage in terms of registration priorities and rights of enforcement. The “mortgagor” is the land owner who gives the mortgage, and the “mortgagee” is the creditor to whom the mortgage is given. Such financial encumbrances are not always labelled “mortgage” – a debtor may sign an agreement labelled “Encumbrance Agreement” or “Agreement Charging Land”, and these may be registered as such or by caveat. There is a common misconception amongst debtors that these equivalent forms of land charge are somehow inferior as security to a mortgage registered as such – this is simply not the case.

### **b. Registration**

In order for a mortgage to affect and obtain rights as between the mortgagee and third parties with interests in the land, or who may wish to acquire interests, it must be registered against the title to the mortgaged lands, in the Land Titles Office, pursuant to the *Land Titles Act*. The notation of registration on the Certificate of Title tells anyone who searches the title of the existence, date of registration, name and address of the lender, and the original or maximum amount secured. A copy of any current title, historical title, and copies of all registered documents affecting such title are publicly available for a fee from registry agents, lawyers, or the Land Titles Office.

### **c. Priorities**

The priority of any valid claim or interest in any property, including land, is a measure of who has first, second, etc. claim on the property and its repossession or proceeds of its sale, as between competing claimants. For most purposes, the Alberta Land Titles System is relatively simple in this regard. Whoever registered first, as between any two competing claims, has priority and this applies to all mortgages. There are a limited number of claims that have priority without registration, such as unpaid property taxes. Claimants may, as between themselves, agree to different priorities by entering into priority agreements, and you may see these registered on a title.

### **d. Usual Terms**

While more conventional forms for one loan, term loan, mortgages remain common, increasingly the loans secured by farm land in common use by lenders are framed in “revolving credit” terms. These express a maximum amount of money and a maximum interest rate chargeable on any components that are secured by the mortgage. This serves to have the mortgage secure different types of loans and financing, for example:

- Loans for purchase of land;
- Operating lines of credit; and

- Loans for construction of buildings, in one registration. It also allows new loans or re-advances of repaid principle on existing loans to occur and be secured, up to the expressed amount, without the need for new registration or amendment of the mortgage.

Typically each lender will have a section in their standard forms for the variable items such as mortgagor name and address, legal description of lands, amount, interest rate a method of calculation and, in the case of fixed term loans, the instalment payment amount. The balances of standard terms are then appended or by reference to a set of standard terms separately registered with the Land Titles Office for such purposes. These standard terms must often consist of a fair volume of text and pages. Some lenders now produce these in plainer language that is easier for non-lawyers to read and understand.

As any significant failure to honour any of the numerous mortgagor obligations and representations that are included will be a default, it is obviously important for a debtor to ensure that they entirely understand and can consent to all of it before it is signed. Lenders are usually very reluctant to alter any of their standard terms, but there are situations where the necessity of a doing so can be successfully raised.

## **e. Fixtures**

A “Fixture” is an item of personal property that has become part of land by virtue of its degree of attachment to the land or its placement on the land to benefit utility of the land. The importance of this to the present discussion is that mortgage security includes all fixtures. A mortgagor who, for any reason, removes, damages, or fails to maintain fixtures (unless one has consent of the mortgagee for same) commits default under the mortgage and civil “waste” at common law. They may be found personally liable for money damages or even ordered by a court to return or replace the relevant item. In some cases this “waste” is also a criminal offence. For example, before a debtor demolishes a building or decides to detach and sell an affixed bin or silo they should seek the consent of the mortgagee.

A lender who finances the purchase of an item that will or may become a fixture (common example, mobile home) may register a Notice of Security Interest (“NOSI”) against title to land on which it is to be located, as a supplement to their registration under the *Personal Property Security Act*. If it is registered prior to the item becoming a fixture it will have priority to the claims of mortgagees of the same land.

## **f. Extent of Liabilities**

The *Law of Property Act* restricts enforcement right of mortgagees in Alberta. Basically, regardless of what the mortgage terms may say, in respect to a conventional mortgage loan to one or more individuals (not a corporation), where the mortgage is the only security taken, the lender’s rights are restricted to foreclosure and sale action against the land and the mortgagor cannot be personally sued for the money owing, even in the case where the mortgagee does not recover all the money owing from the sale of the land. Also, when an application for judgment is made in the court action, the court will, in the case of farm land, unless a prescribed exception applies, allow a one year “redemption period” to give time to the mortgagor to repay, sell in order to repay, or refinance with another lender, or bring the loan account (if it is a term loan with an unexpired term) into good standing.

These restrictions of mortgagee's rights make it important for any lender taking mortgage security on farm land in Alberta to understand them in assessing the risk. Whether one is the mortgagor or mortgagee, there is a complex set of rules and exceptions, process rules and issues and a vast body of common law which apply and questions should be directed to a knowledgeable lawyer.

### **3. Grazing Lease Security**

The *Public Lands Act* and regulations under the Act permit the leasing of land owned by the Provincial Crown as (among other things) "Grazing Leases". These may be held by a grazing association of ranchers, who hold unit factors, or by one or more individuals, or by a corporation. They will allow exclusive use of certain public lands for grazing specified numbers of livestock (most for cattle, some for sheep or bison). They are often a feature connected to farms which also have titled land and can be part of security taken by lenders, together with the titled land or separately.

These leases, in some cases, particularly where there are surface leases, can have very substantial value in "sale" terms – really assignment of the balance of the term to a purchaser. Any assignment must be to a qualified assignee and consented to by the director (administrator on behalf of the government).

The director maintains a paper registry of leases, assignments, mortgages, and other forms of security interests. Leases can be mortgaged with consent of the director, for what the charge is worth in the context that a termination results in zero value. A common form of security is a "Conditional Surrender of Lease" to the lender, whereby if the borrower defaults the lender can "sell" the lease to a qualified and approved purchaser to whom the lease is assigned.

### **4. Personal Property Security**

#### **a. Personal Property Security Act ("PPSA")**

Personal property is the term used to describe all property that is not land. *The Personal Property Security Act* of Alberta is the provincial statute governing most forms of the security over personal property. Its registry system is almost purely a system of electronic registration through registry agents, lenders (including vehicle and equipment dealers) and lawyers who qualify for access. There are a variety of categories of registration – the vast majority fall under the term "security interest". Very generally, once a valid security interest is registered, it takes priority from date of registration over subsequent registered interests in the same property.

For a valid security interest to exist, the debtor must sign a document that expressly grants an interest or charge in described personal property. The terms of the contract outline the type of security provided, the property which is affected, and all other terms of the relationship between the debtor and the creditor.

#### **b. When does PPSA apply?**

The PPSA applies to every transaction that in substance creates a security interest, no matter what name or label is given to the agreement, with some specific exceptions such as statutory liens or interests which are not expressly included. A debtor should be aware that a document

that creates a registerable security interest may not have a title that indicates this – for example a document titled simply “Loan Agreement” may include provisions granting security over personal property.

Even pure leases of personal property, which only grant possession to the debtor, with title remaining with the creditor, are treated by the PPSA as grants of a security interest and must be registered to obtain priority of the lessor’s interests in the property as against claims of other creditors.

The types of security agreements discussed here are just a few of the most common ones.

### **c. General Security Agreement (“GSA”)**

Except to the extent that specific personal property is expressly excluded in a GSA, it creates a security interest in all present and after acquired personal property of the debtor. Thus, it affects all personal property the debtor has at the time of the signing, all other personal property the debtor later acquires (automatically as soon as acquired), and all proceeds of any disposal of any personal property. It will usually define property to include inventory, equipment, accounts, book debts, cash, contractual rights, and a variety of other forms.

In the case of farmers as debtors, it is common for a GSA to also list and grant specific security in some or all of the significant vehicles, equipment, non-fixture structures, etc. currently owned by the farmers. A GSA registration, to be valid, must contain the statement “all present and after acquired personal property” as an item of “general collateral” and will also list the specific items in the required collateral categories.

A GSA may be used as a first charge over property, or as a blanket charge that affects all equity (value less prior amounts owing to other secured creditors) in the property. In terms of enforcement due to default, it gives the lender the ability to seize and sell all the farmer’s assets. If the lender has first priority as to an asset, the lender applies all proceeds to the debt. If the lender sells property as to which there is a prior charge, the prior charge is paid in full before the lender can apply remaining proceeds to its debt.

It is of the utmost importance to a debtor to understand all terms of a GSA, most particularly the terms that deal with how the debtor can or cannot deal with their property. It is common for a GSA to permit the debtor to sell or exchange inventory, finance new property acquisitions with security granted to the other lender as to that property, or to sell general property for replacement, in the ordinary course of business, without the lender’s consent. If this will be necessary for your business you should ensure that the appropriate terms exist. Otherwise, and generally, it will be a default for the debtor to dispose of any personal property without the consent of the lender or paying fair value of the security to the lender.

### **d. “Serial Number Goods” or “General Collateral”**

The PPSA divides personal property into two broad categories for registration and search purposes. “Serial number goods” in the context of farming include motor vehicles, combines, tractors, and some other farm vehicles, but not those items of machinery designed only for use in farming. Trailers are also included. “General Collateral” is everything that is not serial number goods.

The significance of this, on the lender side, is that in order to have priority over other claims as to serial number goods, they must be registered in that category by make, model, year and serial number. Since it is not always clear whether a self-propelled or towed piece of equipment may be a motor vehicle or trailer in definition it is prudent for a lender to simply register all such things as serial number goods. That way they will show up in accurate searches of either name or serial number. As to general collateral, the regulations under PPSA require certain forms of description – inadequate forms will not preserve the lender’s priority.

## **e. Assignment of Accounts**

This is also often labelled as an Assignment of Book Debts (“ABD”). Like a GSA an ABD covers the debtor’s present and future property, but only the debts that others owe to the debtor and other property that relates to those debts, such as the actual records of the debts. An ABD gives the creditor access to whatever a debtor is owed, including payments a farmer may not normally think of as accounts receivable, such as the sale price of livestock. Thus, a borrower must consider whether to request exclusion of certain accounts before signing an ABD. As a sub-category, a lender may take an assignment of specific accounts, such as cash deposits with a bank.

## **f. Purchase Money Security Interest (“PMSI”)**

A PMSI (pronounced “pim-see”) is a security interest taken by a lender as a supplier of financed property or to finance purchase of specific property from a supplier. If a PMSI is properly registered within the specific time period to do so, it has super priority over other security interests that would otherwise affect the property in question. The reasoning is that since the lender enables the debtor to obtain a new asset the lender deserves first priority against it.

Most commonly, PMSI’s are related to purchase of vehicles or equipment. From the lender side it is important to effect a valid registration in a timely manner (generally within 15 days of the date the debtor takes possession of the goods). Otherwise a GSA holder, if one exists, will have priority. It is also important to realize that leases, lease options, and conditional sale contracts are PMSI’s – even though the lessor or seller retain legal title, PPSA regards their interest only as a security interest, which can be lost due to failure to properly register.

On the debtor side, this permits wider options for financing the purchase of new assets, without the necessity to obtain consent of, or releases from, existing creditors. But the debtor must realize that a GSA holder will obtain a general second charge on all PMSI-financed assets, as a claim on any equity.

## **g. Inventory Interests**

The financing of a debtor’s inventory is a special category of PMSI. In a farming context, a common example is financing of livestock inventory through a feeder co-operative. The lender or supplier of inventory on credit who wants the special PMSI priority over that inventory must give written notice of such claim in proper form to all other registered secured parties who may have any claim to the same property (such as any GSA’s). The lender or supplier will only have priority over inventory supplied after the date such notice is given.

## **h. “Input” Interests – Crops and Livestock**

Another special category of PMSI’s is lender or supplier credit for the purchase of “inputs”, such as seed, fertilizer and pesticides for crops, or feed for livestock.

As to livestock feed, drug, and hormone supplies, the PPSA is pretty straightforward. The lender or supplier obtains first priority of claim to the related livestock as to unpaid sums due for supplies delivered after the date of registration of the security interest.

As to crops, priority issues can be complicated. Generally the registered interest in the specific year’s crops that were the subject of the inputs has priority over other security interests registered as to crops. Other PPSA provisions govern priority issues between persons who become owners of the land before harvest and the lender, and competing claims to a crop between different input lenders as to the same crop.

On the lender side this kind of security is subject to many contingencies which must be considered in assessing real value. On the debtor side it is important to recognize when such security has been granted (it is often “buried” in the loan or credit agreement) and to direct crop or livestock sale proceeds to payment of such loans as a priority, to avoid default.

## **i. Searches**

The PPSA registry system is public. Anyone who has direct access to the system, or who utilizes a registry agent can, upon payment of a fee, search the system for registrations against any debtor name, or any serial number related to any serial number goods.

If a person searches the registry under the correct debtor name (it is important to ensure exactness and review any “inexact matches” that are provided) that person can rely on the information produced for the purposes for which the search was done.

However, if the question is whether there are any outstanding secured claims against something that is “serial number goods” only a search by the exact, correct, complete serial number will protect against undisclosed claims.

This illustrates the importance, for lenders, of very clinical attention to exact and complete registrations being made, with exact full debtor names and proper forms of collateral description, and with precise and correct full descriptions of any relevant serial number goods. An innocent purchaser of goods, or registrant of a valid security interest in the same goods, who has completed a full and correct search which does not disclose the lenders registration will obtain their interest clear of or in priority to the deficiently registered claim.

## **j. Registrations**

This guide has already addressed, generally the nature, process, and value of registration under PPSA. This section addresses some collateral matters of importance.

Registration protects the validity and priority of the security interest against claims and interests of people other than the secured party who deal with the debtor. It is not relevant as between debtor and secured party. If a secured party is not properly registered this does not let the debtor out of their obligations. A debtor who represents property to be free of claims because

the claims are not registered commits a default and breach of trust and, in some cases, criminal fraud.

It is common in a farming context for farmers, innocently or just negligently, to sell items of personal property to a purchaser who trusts their representation of clear title without completing a registry search. The purchaser can be quite surprised and upset and suffer significant financial loss if the secured creditor who has valid priority of interest later seizes the item from the purchaser due to default by the debtor.

Registrations have a term of effect between one to twenty-five years or “infinity” as elected by the registrant (fees increase for longer terms). If the term expires without being renewed by the registrant, the registration disappears from the registry and the creditor may lose their relative priority position. Keeping track of each registration to ensure it is renewed when due, if the claim has not been terminated, is critical.

Registration of an interest does not usually disclose the amount owing or any terms of the security agreement. PPSA provides for any third party who has an interest in the same property to compel a registrant to provide details and documentation of certain kinds by written demand.

## **k. Default and Recovery**

The PPSA contains extensive provisions relating to the processes and manner in which the secured creditor can enforce its claim against the affected property in the event of default by the debtor. These vary for a variety of circumstances and types of property. This guide will just provide the “typical” example of the security being a piece of farm equipment, very generally. This relates to a situation where there is not a voluntary liquidation between the parties, and aside from the option of formal receivership of the debtor.

The creditor instructs a Civil Enforcement Agent (a licensed private bailiff company) to place formal seizures on the equipment with or without it being removed at the time. Whether it is removed depends on a number of factors. The creditor or bailiff then serves a “Notice of Disposition” on the debtor (who also received a Notice of Seizure and related documents) and on any other persons who appear to have any interest in the same property (normally other PPSA registrants). If the debtor does not settle the claim, and if no other creditor claims priority, within 20 days, the creditor or the agent then removes and sells (or just sells, if the item was removed upon seizure) the property. This may be by private sale, auction, or consignment to a dealer. After payment of all agent and other costs, the net proceeds, up to the amount required to pay out the creditor, is paid to the creditor. If there is a surplus, this is paid to the debtor or to any creditor with a proven secondary claim, as determined by the regulated process, along with an accounting. If there is a shortfall, the creditor may seek a money judgment for the amount, plus costs, in court.

If the security cannot be found (disposed of or hidden), or is not worth the costs of formal seizure and sale, the creditor can obtain a money judgement against the debtor for the full amount owing. There is a common misconception amongst farmers that a creditor under a “time-sale” agreement can only either “seize or sue” and not both. In Alberta this only applies to “consumer goods”, and the relevant property of a farmer is seldom in the category. The creditor will then try to enforce this judgment via a “writ of enforcement” against other land or personal property of the debtor.

## **5. Bank Act Security**

### **a. Who can use it?**

Generally, personal property is the jurisdiction of provincial governments, and in Alberta is governed for our purposes by PPSA. However, as banks are regulated by the *Bank Act* of Canada, they utilize and enforce certain forms of security created by that Act. This includes “Section 427 Security” upon farmer’s assets, which authorizes and secures lending with the security including crops, livestock, and implements.

This type of security is seldom taken any more for new loans in Alberta, due to the advent of PPSA, but it is still available and in existence in some cases.

### **b. Registration and Searches**

When Bank Act Security is signed by a farmer in favour of a bank it is registered by way of paper notice with the Bank of Canada whose registry office in Alberta is located in Calgary. A search can be conducted directly to the office or via registry agent with payment of a fee. The search only tells one whether a named farmer (individual or corporate) has granted security, and to which bank. To find out the exact terms and extent it is necessary to obtain documentation copies from the registry or the bank.

This form of security at one time had legal priority over almost all PPSA security regardless of when it arose or was registered. In most situations that is no longer the case. But as it will have priority over PPSA registrations (other than PMSI’s) which are later in registration, it is important for any lender to determine its existence and extent, in order to assess what is available under their security.

### **c. Advantages over PPSA?**

Often a bank lender will have both *Bank Act* and PPSA security, and the *Bank Act* security will be elected for enforcement against affected property because:

- It has better actual or potential priority status;
- In the case of crops, there are less limitations on effect and enforcement options; and/or
- There is a desire to move to very quick sale with no or less prior requirements as to debtor or other creditor rights observance.

## **6. Promissory Notes and Guarantees**

Although these two kinds of documents are often called “security” they are not, as they do not give the creditor any interest in the property of the person who signs them.

### **a. Promissory Note**

A promissory note is a written promise by the person signing it to pay another person a specific amount of money. The note can either be:

- A demand note, where the person who owes money must pay it whenever the person named in the note demands to be paid; or
- A term or instalment note, where money is paid at the particular time or times.

A note is only evidence of the debt it refers to, not security for that debt. If the person who signed the note does not pay on time, the person who then holds the note must sue in court to collect. A promissory note is a negotiable instrument. This means the person to whom it is given can sell it to someone else rather than keeping it until paid. That buyer can sell it again or collect under it, and so on.

Although promissory notes do not provide security in any property to a lender, they are often used with security instruments as part of a financing package. One or more promissory notes will outline the size of the debt at any given time, while a GSA, Bank Act Security, mortgage or other security instrument will provide the lender with security over farm property.

More than one person can sign a promissory note. If they sign “Jointly and Severally”, the creditor is not forced to sue each of them for that person’s share of the debt. Instead, the creditor can choose to collect the whole amount from any of them. Naturally, the creditor will choose the one who appears to have assets that can easily be taken to pay the judgment. It will be up to that person to try to extract from the other debtors the shares they should pay.

### **b. Guarantee**

A guarantee is a promise by a person who is not the borrower to accept responsibility for the indebtedness of the borrower. It is not “security”. It is an agreement between a guarantor and a creditor in which the guarantor promises to pay the money that a particular debtor owes to the creditor if the debtor defaults.

Lenders often use guarantees when farm property is in the name of one spouse or a corporation and the lender wants to ensure the other spouse or the corporation’s principals are legally bound to repay the indebtedness.

There are several issues concerning the extent of liability, the order of collection and the cancellation of a guarantee that the guarantor should understand.

The liability granted in a guarantee can either be limited or unlimited in nature. A limited guarantee means the guarantor is liable only for the stated amount in the guarantee. The unlimited guarantee means the guarantor is liable for the entire indebtedness of the borrower. Obviously, it is very important to know which type is being signed. As a guarantor, always attempt to negotiate a limit on the guarantee.

Some guarantees state that the assets of the borrower must be liquidated in full before the lender may demand payment from the guarantor, while other guarantee contracts state that the lender shall not have to exhaust its remedies against the borrower before suing the guarantor. In the second case, the creditor can bypass the original debtor and proceed to collect from the guarantor right away.

Sometimes a guarantee also involves a collateral security agreement. This means the guarantor gives the creditor security over the guarantor's property for the money owing if the creditor has to call on the guarantee. Commonly, the security is an assignment of all debts the original debtor owes the guarantor then or later and a promise that the guarantor will not collect anything the debtor owes him or her until everything the debtor owes the creditor is paid in full. It could also be a mortgage on land or security in the guarantor's personal property.

Guarantee agreements should contain a clause outlining how to cancel the guarantee. A guarantee is not cancelled automatically upon death. Most guarantees bind estates, so that cancelling the guarantee may mean the creditor can declare the debtor in default, or can cut back the amount of credit. The cancellation usually goes into effect within a set period of time. You, or your estate, remain liable for all obligations the debtor takes on prior to that effective date. Be sure to get the cancellation in writing from the creditor. As soon as the debtor carries out the particular obligations you agreed to guarantee, contact the creditor for written confirmation that your guarantee has ended and you owe nothing under it. If you do not, you may find the creditor will make a claim against you or your estate for some new obligation the debtor incurs, for which you may not have intended to provide a guarantee.

A guarantee made by an individual in Alberta is not valid or binding on the guarantor unless it contains or appends a prescribed form of acknowledgement certified in writing by a lawyer, pursuant to the *Guarantees Acknowledgement Act*. This is a certification that the lawyer has explained the terms and effect of the guarantee and that the guarantor understands their obligations. Additionally, if the guarantor is not a person who is receiving any consideration for, or direct benefit from, the guarantee (i.e. is not a shareholder of the corporate debtor, or is just a relative of the debtor with no ownership interest in the debtor property) a Certificate of Independent Legal Advice may be necessary or advisable from the lender point of view, in order for the guarantee to be enforceable.

### **c. Co-Signed Loans**

A loan is co-signed when a person who is not receiving the money agrees to sign the loan documents as a debtor (not as a guarantor). A typical example of a co-signed loan is if a parent signs a promissory note to help a young farmer obtain funds. The signature makes the parent responsible for the loan.

A co-signer is liable to repay the debt in the same fashion as the person who actually borrowed the money.

### **d. Accommodating Security**

An alternative to the guarantee may be "accommodating security". Accommodating security describes property given as security by one person to a lender as part of the debt structure between another person and the lender. Usually, accommodating security occurs when a

farmer's child begins farming but does not have sufficient equity to obtain credit; their parents may be asked to provide their property as security for their child's loans.

The benefit of pledging a specific asset, instead of signing a guarantee, is that the individual giving the accommodating security knows that their liability is limited to the value of the pledged asset. Be careful that the terms of the agreement outlining the accommodating security are accurate and the liability in this respect is limited to the specific security given.

## **7. Assignments and Directions**

### **a. Priority Agreements**

Secured parties can agree to let other secured parties, whose security would normally come after their claim, have priority ahead of them. This is done by deliberately signing a subordination or postponement agreement, or adding a clause in their own security agreement that says certain kinds of security interests can go ahead of theirs.

For example, a child has given security to their parents as well as to a bank for money borrowed from each of them. The bank will usually require the parents to subordinate their security to the banks.

### **b. Assignments**

Creditors use an assortment of assignments and directions to intercept a farmer's income. The documents permit the creditor to obtain payment for loans before the farmer is given access to the income. Assignments can deal with any form of income. Some common examples are: assignments used by lenders to obtain payment of income directly from marketing boards to the lender, or directions to elevators instructing them to pay funds generated from the sale of crops to the holder of PMSI security.

## **8. Agricultural Quotas**

In Alberta the *Marketing of Agricultural Products Act* and some of its regulations govern the administration of "supply management" systems which apply to milk, cheese, poultry, and eggs. For example, the quota system for milk is administered by "Alberta Milk" as the designated board.

### **a. Legal Nature of a "Quota"**

Quotas are not "property" of the farmers who hold the quota but rather licences to produce the commodity. Therefore a lender cannot obtain a binding security interest in quotas, as such. This is problematic in terms of financing what is generally the most valuable single asset of, for example, a dairy farmer.

### **b. Security Interest in Quota**

The way that lenders have devised to be able to assign value to this asset as "security", and ensure something similar to a security interest is created, is the use of Power of Attorney. This

has been recognized and endorsed by the marketing boards in the prescribed manner and terms set out by regulations. In the case of Alberta Milk, only one “appointment of attorney” per farmer can be registered with them and it is limited to giving the lender authority to “apply to transfer” and receive proceeds from sale, an assignment of sale proceeds, and an agreement by the producer not to request any transfer without provision of written consent of the lender as attorney. The lender is required to agree not to offer quota for sale unless there is an abandonment or cessation of the producer’s business.

Thus, on the lender side, listing a quota as an item of property in a security agreement, and registering it as an item under general collateral, is a purely symbolic exercise.

## **9. Statutory Liens**

The liens dealt with here are just the ones of most common application to farming, and are examples of a number of such liens.

### **a. Builders’ Lien Act**

The *Builders’ Lien Act* permits anyone who performs work or services or supplies material in respect to almost any “improvement” to land, and has not been paid, to register a builders’ lien against the title. If the owner does not pay their contractor, or a contractor does not pay its subcontractors or labourers, and such a lien is registered within the prescribed time period, the lien can be enforced by court action, which can include sale of land or materials. So long as court action is commenced within 180 days after registering the lien, and pursued at the required pace, it remains registered on title until:

- The lien claimant is paid in full and discharges the lien;
- The owner (or contractor where the lien is by a subcontractor) places money in court as alternate security pursuant to a court order;
- A court orders the discharge in the court action at any stage; or,
- The land is sold to pay the lien.

A builders’ lien has priority over any claims or interests that are registered after its registration, and in terms of registration it “jumps the line” at the Land titles Office – even if another registration was submitted before the statement of lien and has not yet achieved actual registration. The builders’ lien will go first in line the minute it arrives for registration. Also, it takes priority over prior registered mortgages as to money advanced on the mortgage loan after the date of registration of the lien.

Thus, a prudent lender (this usually involves a construction mortgage loan being given out in segments as construction progresses), will search title on the day any money is received and will not advance until the lien has been removed.

Careful planning and monitoring of the construction process, with careful analysis of costs and potential costs, overruns or extras, and of cash flow requirements, and timing, along with appropriate monitoring of contractor payment of subcontractors, is the key to avoiding builders’ liens. There can be very significant costs, delays, and damages resulting from failure to do so.

## **b. Animal Keepers Act**

The *Animal Keepers Act* grants a lien to any animal keeper (a person who boards, feeds, or cares for animals owned by others for compensation) on animals (cattle, horses, swine, sheep, bison, deer, elk, goats, mules, and asses) and related gear (tack, stock trailers, etc.) for any debt owed by an owner in relation to the animals and gear. The lien is a right to retain the animals and gear in possession and to sell them to pay the unpaid debt.

This lien does not require any registration, and it has priority over all other security interests of any kind in the subject animals and gear. If the debt is not paid within 14 days after it is incurred, the animal keeper can give 14 days' notice of proposed sale, with the required contents, and apply the proceeds to the debt and related expenses.

There is no requirement to notify registered secured claimants of the lien claim or of a sale, and a lender who has animals as part of all of its security may not even find out that this has occurred to some or all of them until well after the event. Thus, it is prudent for such a lender to monitor the location and means of care or feeding of the relevant animals, and to consider paying the animal keeper itself, if necessary, to prevent such losses.

## **c. Garage Keepers' Lien Act**

The *Garage Keepers' Lien Act* gives a lien to any person who is in the business of housing, storage, or repair of motor vehicles or "farm vehicles" for unpaid charges relating to storage, repair, maintenance, accessories, and parts furnished to such vehicles. The lien exists so long as the garage keeper retains possession, or obtains written acknowledgment of the debt signed by the debtor and registers the lien pursuant to PPSA within 21 days after releasing possession to the debtor.

With the exception of new interests that arise after possession is released and before the lien is registered, a garage keepers' lien generally has priority over other security interests. The lien expires 6 months after it is registered unless, before then, the lien claimant seizes the vehicle through a civil enforcement agent, or has obtained a court order extending the existence of the lien for up to 6 further months and registered the extension under PPSA.

A "farm vehicle" is any machinery or equipment that has a manufacturer's serial number, is intended for use in any type of farming operations, and is not a motor vehicle. Thus, the Act and its lien apply to virtually all major farm equipment. The lien is enforced after seizure by the same processes as a security interest under PPSA.

On the debtor side, registration of such a lien will invariably be a default under security agreements affecting the same property. On the lender side, it may be wise to pay out any such lien that arises and effect one's own seizure and sale, rather than to let more expenses and charges mount before the lien is paid from sale proceeds.

## **10. Summary**

There is no doubt that the issues around security can be complex. Nor is there any doubt that security arrangements are necessary in obtaining the significant financing agricultural operations need. Because of these realities it is important that farm business owners manage and monitor their credit arrangements. One component of good management is reviewing and understanding in advance the security documents they sign.

This publication is intended as general information and not as specific advice concerning individual situations. Though it outlines some of the legal considerations of security agreements, it should not be considered as either an interpretation or complete coverage of any of the various statutes and regulations or common law affecting security agreements. The Government of Alberta neither accepts nor assumes any responsibility towards persons using it as such. All security agreements should be reviewed and discussed with a qualified lawyer before they are signed.

## **11. Appendix**

Queen's Printers – Laws on Line <http://www.qp.alberta.ca/570.cfm>

## **12. Acknowledgement**

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