Canadian Bar Association - Ontario

l'Association du Barreau canadien - Ontario

SUBMISSION TO

THE MINISTER OF CONSUMER AND COMMERCIAL RELATIONS

CONCERNING THE

PERSONAL PROPERTY SECURITY ACT

)0-20 rue Toronto St.
Toronto, ON
M5C 2B8
TDX Box 104
tel. (416) 869-1047
fax (416) 869-1390
free 1-800-668-8900

THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN
ONTARIO

Approved by CBAO Executive on October 21st, 1998

CANADIAN BAR ASSOCIATION - ONTARIO

Canadian Bar Association - Ontario (CBAO), an autonomous provincial branch of the Canadian Bar Association, was founded in 1896. A voluntary membership organization, it represents over 16,000 Ontario lawyers, judges and law students. CBAO has the following objectives:

(a) to promote and encourage law reform throughout the Province;

(b) to improve the availability, accessibility and quality of legal services to all residents of Ontario;

(c) to uphold the standards of the profession of law;

(d) to encourage high standards of legal education, training and ethics; and

(e) to preserve the independence and integrity of the judiciary.

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This Submission constitutes the comments and recommendations of the Canadian Bar Association - Ontario ("**CBAO**") with respect to the *Personal Property Security Act*, R.S.O., 1990, c.P.10, as amended (the "**OPPSA**" or the "**Act**"). It has been prepared by the Personal Property Security Law Subcommittee (the "**PPSL Committee**" or "**Committee**") of the Business Law Section of the CBAO and approved by the CBAO Executive on October 21, 1998.

PPSL COMMITTEE

The PPSL Committee has been actively engaged for over fifteen years in a variety of matters pertaining to the OPPSA and related commercial law legislation. Over the years, the Committee has worked closely with representatives of the Ontario Ministry of Consumer and Commercial Relations (the "**Ministry**") with a view to the development and improvement of the OPPSA and the enhancement of the day-to-day functioning of the Personal Property Security Registry (the "**PPS Registry**"). The Committee has made a number of submissions to the Ministry. Our most recent submission was made in 1993 (the "**1993 Submission**") pertaining to the OPPSA and the *Repair and Storage Liens Act* (Ontario). A copy of that Submission is attached as Appendix A. Perhaps most notably, the Committee worked closely with the Ministry in 1995 to achieve a quick and appropriate legislative response to the serious problems about to emerge as a result of the OPSEU strike and the extended shut-down of the PPS Registry.

One of the key roles of the Committee is to alert the practising bar to case law and other developments concerning the OPPSA and related legislation and to provide practice tips and other educational assistance to practising lawyers. This is done primarily through a newsletter called *Imperfections* - which has been published regularly since 1982 - and through conference and seminar presentations by the Committee and individual members.

The Committee has invited comments from the practising bar, academics and others with respect to problems experienced under the OPPSA and with respect to amendments to the current legislation which might be necessary or desirable. In response, the Committee has received many letters and comments highlighting shortcomings or vagaries in the legislation. Based on such communications and our continuing study of the OPPSA, we have concluded that it is necessary to make some substantive amendments to the OPPSA.

A list of the current members of the Committee, together with a list of the Ministry representatives who are Observers, is attached as Appendix B. The Committee is a volunteer committee. While members of the Committee bring to bear considerable expertise and many years of experience in matters pertaining to the OPPSA, the Committee does not have financial resources to undertake significant legal research or empirical studies concerning the points which have been brought to its attention.

The comments and recommendations in this Submission reflect the views of the Committee as a whole but they do not necessarily reflect in all cases the views of each individual member of the Committee.

THE LEGISLATIVE AND COMMERCIAL CONTEXT

Ontario was the first jurisdiction in Canada to enact modern personal property security legislation (in 1967) and the first jurisdiction in North America - if not the world - to implement (in 1976) a computerized central registry for security interests in personal property. The pioneering 1967 legislation was based on reform proposals made by the CBAO's Catzman Committee and was substantially modelled on Article 9 of the United States Uniform Commercial Code ("**UCC**") which is in force in all the American states and in the District of Columbia. The 1967 legislation was substantially revised in 1989, largely as a result of the work of the Minister's Advisory Committee (which replaced the Catzman Committee). It is this Act, with subsequent amendments, which is currently in force in Ontario.

Since Ontario's ground-breaking initiative, most of the other jurisdictions in Canada have enacted some form of PPSA-type legislation. The OPPSA is thus a part of an (almost) national rubric of similar commercial legislation. While all such enactments are rooted in the principles of Article 9 of the UCC, the other Canadian jurisdictions have chosen to pattern their legislation along the lines of a version of legislation which is sometimes referred to as the "western model" (since its genesis is legislation enacted in Western Canada). The western model is similar in most substantive respects to the OPPSA. However, there are some significant differences of substance and a great number of differences in points of detail. Generally, the western model is more complex and detailed than the OPPSA. One of the important differences between the OPPSA and the western model is that, except in the case of consumer motor vehicles, the financing statement prescribed under the Ontario Regulations only requires the collateral covered by the existing or prospective security agreement to be indicated by means of inserting an "X" into a "box" whereas the legislation in the other provinces requires a more detailed description.

It is universally agreed that the OPPSA is a major piece of commercial legislation which has a profound impact on commercial transactions in Ontario. It is legislation

which impacts directly on access to and the cost of credit. On a daily basis, tens of thousands of transactions are conducted in the context of this legislation and are governed by it. The OPPSA directly affects a huge range of consumer and business transactions ranging from the financing of a vehicle purchase by an individual and loans to small businesses to lease financing of equipment to multi-million dollar corporate borrowings. The legislation impacts not only on borrowers and lenders but also on suppliers of goods and services, buyers, persons with an interest in real property (including landlords and tenants), employees and other persons claiming the benefit of liens on property, and many others.

The commercial world is dynamic. It is constantly evolving. Over the past 20 years, there has been a rapid expansion in the use of equipment leasing as an alternative to purchase money financing and the advent (and explosive growth) of innovative financing techniques such as the securitization of assets, and the beginnings of electronic commerce. There has been a commensurate growth in the volume and value of interprovincial and international sales and financing transactions and the globalization of securities markets. Commercial legislation - such as the OPPSA - cannot remain static. It must keep pace with such changing circumstances and provide stability and support so that transactions can be conducted safely, expeditiously and cost-effectively.

Recent developments in the United States reflect the fact that modern commercial practices dictate legislative change. A major project to revise Article 9 of the UCC was initiated in the early 1990's and is now nearing completion. The project has resulted in an extensively revised Article 9 which embodies many fundamental changes, and most states in the United States will likely implement this new legislation by the contemplated effective date of July 1, 2001. Given the close and substantial economic relationships which exist on a north-south axis between persons in Ontario and lenders, borrowers and trading partners in the United States, it is especially important that a process for updating the OPPSA be initiated bearing in mind the changes to Article 9 of the UCC.

PURPOSE AND SCOPE OF THIS SUBMISSION

Ontario has an established tradition of reforming personal property security law, as is evidenced by its implementation of the recommendations of the Catzman Committee and, more recently, its implementation in 1989 of most of the recommendations of the Minister's Advisory Committee.

Almost a decade has passed since the adoption of those recommendations and the Committee is of the view that it is now time for Ontario to take cognizance of the legislative and commercial developments in the past decade and to begin an organized and disciplined process of reforming the OPPSA with a view to the future. The OPPSA

must continue to provide a fair and efficient legislative framework in which debtors, secured parties and other stakeholders can know their rights and duties, and operate cost-effectively. It must be conducive to business transactions, not an impediment to them.

In preparing this Submission, the Committee has carefully considered the western model and the desirability of the greatest possible harmonization between the OPPSA and the *Personal Property Security Acts* of other jurisdictions. We strongly favour uniformity wherever possible. However, we do not favour repeal of the OPPSA and its replacement by the western model or any variation thereof. Specifically, we point out that the current OPPSA has now been in force for nearly ten years (much longer than many of the PPSAs of other provinces) and that many Ontario users - not only lawyers and members of the judiciary but also a great number of other persons - are familiar with its provisions. In our view, most of its provisions work satisfactorily. Change merely for the sake of uniformity could well be counter-productive. It could create much uncertainty and confusion as well as requiring basic - and costly - changes in the structure of the registration system. Apart from these difficulties, as stated previously, the western model is generally much more detailed and complex than the OPPSA. While detail in statutory provisions is sometimes laudable, this is not always true and it is never the case where detail results in vagueness or ambiguity. The Committee is concerned that, in some instances, the detailed provisions of the western model could in fact result in more litigation, not less, once put under the microscope in the Ontario commercial marketplace. In short, like the Minister's Advisory Committee, we favour a process of selectively revising the OPPSA to harmonize its provisions with those of the western model wherever practicable and consistent with Ontario policy.

The purpose of this Submission is twofold. First, it is to recommend certain specific amendments to the OPPSA. Amendments to the OPPSA are needed now for the following reasons:

(a) to clarify certain provisions with a view to reducing disputes and litigation; we are concerned that, in some instances, court time is unnecessarily being taken up with issues which might be resolved outside court if the OPPSA provisions were clearer;

(b) to address some judicial glosses that have been added to the OPPSA; unfortunately, there are a few areas where judicial interpretations have resulted in significant uncertainties; such uncertainties are impediments for business because they make planning difficult and because they result in increased costs (which are frequently passed along to consumers and other debtors); and

(c) to rationalize and increase the use of the computer-based PPS Registry for the recording of additional interests in personal property (as is done in

several other provinces); centralized "one stop shopping" would enhance the efficiency and cost-effectiveness of the public registry and search systems; in addition, centralization would likely over time reduce government record-keeping expenses.

The second purpose of this Submission is to remind the Minister of emerging issues which merit attention and to recommend the establishment of a structure to facilitate an ongoing process of reform of the Act.

We believe this Submission is a fair and objective presentation concerning changes to the OPPSA and initiatives which are desirable for the Ontario business community as a whole, not merely for the legal profession, in order to improve the quality and performance of the Act.

At the same time it also needs to be stressed that we consider this to be a very modest Submission. It does not purport to be exhaustive of all significant amendments which the Committee believes are necessary or desirable. The Committee has views concerning several other important matters. We are prepared to comment on these matters at a later date.

SPECIFIC RECOMMENDATIONS

We begin with some specific recommendations. These are ordered according to the section in the OPPSA to which they pertain and not in order of importance. In most instances, we suggest appropriate statutory language for the legislative drafters' consideration.

1. Subsection 1(1): Definition of "debtor"

The definition of debtor in the OPPSA has given rise to considerable difference of opinion among legal practitioners because it is not clear that it includes an owner of collateral who makes the collateral available as security without itself assuming any personal obligation under the security agreement: see The Canadian Bar Association - Ontario, *Personal Property Security Opinion Report* at pp. 44-46. Such types of arrangements are very common in business transactions where a parent company may be asked to provide collateral for a loan to a subsidiary and *vice versa*. There is no doubt that the Minister's Advisory Committee intended the definition of debtor to include such dual arrangements, as appears from the amended definition of debtor in its *Supplementary Report* of 1985, at pp. 2-3. Unfortunately, the amendment was omitted in the enacted legislation, thus giving rise to the ambiguity. For reasons of principle and uniformity, we favour a definition of debtor that is similar to that in the western model.

We recommend that subsection 1(1) of the OPPSA ("Definitions") be amended by deleting the definition of "debtor" and substituting the following:

" 'debtor' means

(a) a person who owes payment or performance of an obligation secured, whether or not that person owns or has rights in the collateral,

(b) a lessee under a lease for a term of more than one year,

(c) a transferor of an account or chattel paper,

(d) a transferee of or a successor to a debtor's interest in collateral, and

(e) if the person referred to in clause (a) and the owner of the collateral are not the same person,

(i) where the word 'debtor' is used in a provision dealing with the collateral, the owner of the collateral,

(ii) where the word 'debtor' is used in a provision dealing with the obligation, the obligor, and

(iii) where the context permits, both the owner and the obligor."

2. Subsection 1(1): Application of the OPPSA to licenses

One of the most pressing issues under the OPPSA at the present time concerns the status of regulated licenses and quotas. In *Re National Trust Co. and Bouckhuyt* (1987), 61 O.R. (2d) 640, the Ontario Court of Appeal held that a "basic production quota" to grow tobacco granted under the *Farm Products Marketing Act* (Ontario) does not create a property right and, therefore, could not be the subject of a security interest under the OPPSA. The decision has caused much consternation among lawyers and their clients since various types of regulated licenses (such as taxicab and nursing home licenses), as well as tobacco and milk production quotas (in this Submission, called "licenses") are a common and important form of collateral. It is frequently impossible for a debtor to raise money on the security of a business basically resting on the

existence of such a license unless the license itself is available as a valid form of collateral.

Subsequently, lower courts have wrestled with the reasoning in *Bouckhuyt* and have sought to distinguish it from the regulatory regime governing the type of license before the court, but with very mixed results. Sometimes judges have reached different conclusions involving the same type of license.

The Ontario Court of Appeal has been invited on a couple of occasions to reconsider its earlier decision but has so far declined to do so. In *Canadian Imperial Bank of Commerce v. Hallahan* (1990), 69 D.L.R. (4th) 449 (Ont. C.A.), leave to appeal refused (1991), 74 D.L.R. (4th) viii (S.C.C.), the Court of Appeal indicated that the decision in *Bouckhuyt* had placed too much emphasis on traditional definitions of personal property, and that it would be useful to have that decision reconsidered. However, in *Bank of Montreal v. Bale* (1991), 5 O.R. (3d) 155, the Court of Appeal, after referring to *Hallahan*, expressly declined to overrule or revisit the decision in *Bouckhuyt*.

It seems to us therefore that the most appropriate solution is to amend the definition of "intangible" to include licenses so that, when that definition is read together with the definition of "personal property" in the OPPSA, it will be clear that the OPPSA applies to security interests therein. We are also of the view that it is desirable that a definition of "license" be added to the OPPSA and that it be inclusive rather than exhaustive, with a view to ensuring that courts will understand that all security interests in licenses, however denominated, should be under the umbrella of the OPPSA. At the same time, the explicit inclusion of licenses in the definition of "intangible" is not intended to override statutory or other provisions governing the grant of the license. Whatever restrictions exist in the terms of the license or in the relevant legislation imposing regulatory requirements will continue to apply. The explicit inclusion of licenses simply means that the OPPSA applies to a security interest in a license. It leaves it up to the secured party, as a matter of commercial judgment, to decide whether the license is suitable collateral having regard to the contractual or statutory restrictions in the grant of the license.

We have considered whether it would be appropriate to add statutory language overriding contractual or statutory restrictions on the creation of a security interest in a license. We do not make any recommendations in this regard at this time because we believe such a step requires much more careful consideration than we have been able to give the issue.

We recommend that subsection 1(1) of the OPPSA ("Definitions") be amended as follows:

Add the words "and includes a license" to the definition of "intangible" so that the definition, as amended, would read:

> **" 'intangible' means all personal property, including choses in action, that is not goods, chattel paper, documents of title, instruments, money or securities, and includes a license."**

Add the following new definition:

> **" 'license' includes a right or permission to do an act or conduct an activity, whether pursuant to contract or statute or both, and includes a quota; provided however that nothing in this Act shall abrogate or override any restriction in the terms of the license or the statutory provisions governing the license."**

3. Section 2: Application of the OPPSA to leases

As we stated in our 1993 Submission, since the introduction of personal property security legislation in Ontario, no single issue has generated more litigation and controversy than the question of whether a particular lease is one to which the OPPSA applies. This question has not only been the subject of much litigation but has also been the subject of numerous articles in Canadian legal publications. A great amount of court time has been spent attempting to come to grips with this problem and, for every court case which has been reported, there are undoubtedly many other disputes which have been settled one way or another outside the court. Disputes as to whether a lease is one governed by the OPPSA continue to be a source of costly litigation.

This issue was previously considered by the Minister's Advisory Committee in its *Report* of 1984 and in its *Supplementary Report* of 1985. That Committee recommended that the OPPSA apply to all leases of more than a year, whether or not such leases amounted to security leases. Despite such recommendation, the proposed change was not included in the 1989 version of the OPPSA.

In our view, it is now time to clarify the law and to move toward uniformity with *Personal Property Security Acts* in other provinces. To this end, we recommend that Ontario follow the western model, and adopt the definition of "lease for a term of more than one year," with all necessary related changes. While the OPPSA should thus apply to all leases, the default provisions set out in Part V of the OPPSA should only apply to those leases which in substance create a security interest. In other words, where there is a "true" lease, the rights and remedies of the parties after default should continue to lie outside the OPPSA.

With such amendments, it is hoped that certainty and predictability will be brought into this area and we will no longer need to focus on the identity of the lessor, the value of purchase options, intentions of parties, and so on, in determining whether registration of a financing statement or other perfection step is necessary to protect the interest of the lessor.

We have also considered whether the OPPSA should be amended to apply also to commercial consignments, as is the case with the western model, and as was previously recommended by the Minister's Advisory Committee. While it would be logically consistent to include such consignments, on balance the Committee is of the view that this is not a pressing issue. We are also concerned that such a change could be a trap for unwary individuals such as artisans or craftspersons who consign goods on a regular basis to retail merchants, and who would not likely be aware of the perfection requirements.

We recommend that section 2 of the OPPSA ("Application of Act") be amended by deleting the word "and" at the end of paragraph (a), by replacing the period at the end of paragraph (b) with "; and" and by adding the following new paragraph:

"(c) a lease for a term of more than one year, even though the lease may not secure payment or performance of an obligation."

To give effect to the extension of the OPPSA to such leases, it is necessary to make a number of complementary changes to other provisions in the OPPSA. One of these changes relates to the definition of "debtor" which, in paragraph 1 of this Submission, we have already recommended be changed so as to include, among other things, a lessee under a lease for a term of more than one year. The following are the other required complementary changes, the wording of which has substantially followed the wording of some of the related provisions of the British Columbia *Personal Property Security Act*.

We recommend that subsection 1(1) of the OPPSA ("Definitions") be amended as follows:

Add the following new definition:

" 'lease for a term of more than one year' includes

(a) a lease for an indefinite term including a lease that is determinable by one or both of the parties within one year from its execution,

(b) a lease initially for a term of one year or less than one year where the lessee, with the consent of the lessor, retains uninterrupted or substantially uninterrupted possession of the leased goods for a period in excess of one year after the date the lessee acquired possession of the goods but the lease does not become a lease for a term of more than one year until the lessee's possession extends for more than one year, and

(c) a lease for a term of one year or less if

(i) the lease provides that it is renewable for one or more terms automatically, at the option of one of the parties or by agreement of all the parties, and

(ii) the total terms, including the original term, may exceed one year

but does not include

(d) a lease involving a lessor who is not regularly engaged in the business of leasing goods, or

(e) a lease of household furnishings or appliances as part of a lease of land if the goods are incidental to the use and enjoyment of the land."

Amend the definition of "purchase-money security interest" by deleting the word "or" at the end of clause (a), by adding the word "and" at the end of clause (b) and by adding the following new clause:

"(c) the interest of a lessor of goods under a lease for a term of more than one year,"

Add the words "the interest of a lessor under a lease for a term of more than one year" as a new clause to the definition of "security interest" so that the definition, as amended, would read:

"security interest" means an interest in personal property that secures payment or performance of an obligation, and includes, whether or not the interest secures payment or performance of an obligation,

(a) the interest of a transferee of an account or chattel paper, and

(b) the interest of a lessor under a lease for a term of more than one year;"

We recommend that section 58 of the OPPSA ("Default") be deleted and replaced by the following sections:

"58. Unless otherwise provided in this Part, this Part applies only to a security interest that secures payment or performance of an obligation.

58.1. The rights and remedies mentioned in this Part are cumulative."

4. Subsection 9(2): Non-misleading errors in agreement

Subsection 9(2) of the Act provides that a security agreement is not unenforceable against a third party by reason only of a defect, irregularity, omission or error therein or in the execution thereof unless the third party is actually misled by the defect, irregularity, omission or error. In our opinion, the subsection is seriously defective and we recommend its deletion. The same recommendation was made by the Minister's Advisory Committee at p. 63 in its *Supplementary Report* of 1985.

Subsection 9(2) suffers from the following defects. First, it is a relic from the pre-PPSA era where it was intended to deal with errors in the statutorily-required affidavits of bona fides and execution which were included as part of the registered security agreement. Affidavit requirements were abolished with the adoption of PPSA legislation. Subsection 9(2) has therefore lost its rationale. Secondly, clause 11(2)(a) of the OPPSA imposes a writing requirement for security agreements for the benefit of third parties to ensure that there is satisfactory evidence of the conclusion of a security agreement. That requirement serves a purely evidentiary purpose. It has nothing to do with whether or not a third party was actually misled by any error. Subsection 9(2) seems to almost totally undermine that purpose by excusing errors or omissions however substantial in character. Requiring a third party to prove that it was actually misled by an error or omission is meaningless because, in practice, under the PPSA

system, a third party usually does not see the written security agreement until a dispute has already arisen between the objecting party (often a trustee in bankruptcy) and the secured party relying on the security agreement.

In our view, deleting subsection 9(2) will clarify the effect of the writing requirements in clause 11(2)(a) by removing an apparently contradictory provision.

We recommend that subsection 9(2) of the OPPSA be deleted.

5. Subsection 9(3): Incomplete collateral descriptions

A court, exercising its power under section 67 of the OPPSA or its general powers, would likely preserve a security agreement with respect to collateral properly described by severing collateral that is the subject of a deficient description. Consequently, subsection 9(3) can be regarded as unnecessary surplusage. Its deletion would not constitute a substantive change in the law but, rather, merely the elimination of a redundancy.

We recommend that subsection 9(3) of the OPPSA be deleted and that subsection 9(1) be renumbered as section 9.

6. Paragraph 15(a): Application of sales law

Given the enactment of the *International Sale of Goods Act* (Ontario) subsequent to the enactment of paragraph 15(a) of the OPPSA, it is not entirely appropriate to state that the *Sale of Goods Act* (Ontario) governs the sale and any disclaimer, limitation and modification of the seller's conditions and warranties.

We recommend that paragraph 15(a) of the OPPSA be amended by deleting the words "the *Sale of Goods Act*" and by substituting therefor the words "the law relating to the contract of sale".

7. Section 22: Possession of collateral by persons licensed to carry on a fiduciary business

In some forms of secured transactions - particularly those involving security interests in securities such as instalment receipts - additional transaction costs are often incurred because of the stipulation in section 22 of the OPPSA that possession of

collateral will not perfect a security interest where the possession is by a person who is the "debtor's agent". These transactions typically involve possession of such collateral being taken by a trust company or other person licensed to carry on a fiduciary business in circumstances where the debtor does not have authority to give instructions to the person in possession concerning the collateral (that is, the debtor does not control the collateral) even though the person in possession might be said to be the "debtor's agent" because it is providing custodial, trust or other services for the debtor. Concerns in this regard have not been allayed by jurisprudence to date. It would seem appropriate to provide an exception in the case of such persons licensed to carry on a fiduciary business, the basis for such exception being the high degree of trust and reliability of such persons.

While we recognize that concerns about this issue might ultimately be addressed as part of the much broader reform concerning investment securities to be encompassed by the Tiered Holding System project (see paragraph 31 below), we are of the view that this issue merits attention at this time.

We recommend that section 22 of the OPPSA ("Perfection by possession or repossession") be amended by adding the subsection number (1) before the word "Possession" and by adding the following new subsection:

"(2) Despite subsection (1), where a security is in the possession of a person licensed to carry on a fiduciary business in Ontario who is maintaining such possession on behalf of a secured party for the purpose of perfecting a security interest in such security and that person is at the same time acting as the debtor's agent, that person shall not be considered to be acting as the debtor's agent for the purposes of subsection (1) if the actual authority conferred on that person by the debtor does not extend to such security or such security interest and that person is not otherwise subject to the debtor's direction or control with respect to such security or security interest."

8. Subsection 25(1): Perfecting as to proceeds

The difference between an "authorized" dealing referred to in this subsection and transfers with "consent" under subsection 48(1) of the OPPSA is often misunderstood. Many practitioners have difficulty in reconciling the two sections. The difference is significant because the consequence of the "authorized" dealing referred to in this subsection is that the collateral in question can be transferred *free of the security interest* whereas the consequence of the transfer with "consent" referred to in subsection 48(1) is

that the collateral transferred *remains subject to the security interest*. Clarification in the OPPSA is in order.

We recommend that clause 25(1)(a) of the OPPSA ("Perfecting as to proceeds") be amended by inserting the words "free of the security interest" immediately after the words "expressly or impliedly authorized the dealing with the collateral".

9. Subsection 28(1): Sales in the ordinary course of business

Subsection 28(1) protects a buyer when a seller sells goods in the ordinary course of business. Such a buyer takes the goods free from any security interest therein given by the seller, even a perfected security interest, provided the buyer did not know that the sale was in breach of the security agreement. Subsection 28(1) is thus an exception to clause 25(1)(a) which provides for the continuation of a security interest unless the secured party authorized the disposition free of the security interest. Its function is similar to that of subsection 2(1) of the *Factors Act* (Ontario) which protects a buyer of goods from a mercantile agent acting outside the agent's authority. These provisions protect the buyer only from a security interest given by the seller, not from any other interest such as a security interest given by a predecessor in title. The Committee is of the view that there are three aspects to this provision which require clarification:

1. To be protected, the buyer need not take possession of the goods nor must the seller have been in possession of the goods at any point. Possession may be in the hands of a third person. However, in our view, a secured party who has perfected its security interest *by possession* of the goods at the time of the sale to the buyer should prevail over the buyer irrespective of the buyer's good faith purchase in the ordinary course of the seller's business.

2. The buyer ought not to be required to obtain the ownership or general property in the goods in order to be protected. It ought to be sufficient that the goods were "identified" to the sale contract. "Identification" is an established concept in the law of sale of goods. This clarification seeks to obviate an unduly strict application of some of the rules set out in section 19 of the *Sale of Goods Act* (Ontario) with respect to ascertaining the intention of the parties as to the passage of property.

3. It is equally irrelevant whether the seller retained a security interest in the goods. This codifies *Spittlehouse v. Northshore Marine* (1994), 18 O.R. (3d) 60 (C.A.) and rejects any implication to the contrary from *Royal Bank of Canada v. 216200 Alberta* (1987), 51 Sask. R. 147 (C.A.).

Finally, it should be noted that the provisions recommended below do not protect a pre-paying buyer to whose contract goods have not been identified, even though goods of the same contract description are owned by the seller and available in the seller's inventory. The law could create a lien for such goods in favour of the prepaying buyer, and such a lien could be made subject to the rights of competing buyers to whom specific goods have unconditionally been appropriated. However, we believe that the *Sale of Goods Act* (Ontario) is a more appropriate framework for addressing this question.

We recommend that section 28 of the OPPSA ("Transactions in ordinary course of business") be amended by adding the following new subsection:

"(1.1) (a) Subsection (1) applies whether or not:

(i) the buyer took possession of the goods,

(ii) the seller has been in possession of the goods at any time,

(iii) the property in the goods passed to the buyer, or

(iv) the seller retained or took a security interest in the goods.

(b) Despite clause (1.1)(a), subsection (1) does not apply where

(i) the security interest given by the seller was perfected by possession and the buyer did not take possession of the goods, or

(ii) the goods were not identified to the contract of sale.

(c) Goods are identified to the contract of sale when they are either:

(i) identified and agreed upon by the parties at the time the contract is made, or

(ii) marked or designated to the contract, either by the seller, or by the buyer with the seller's consent or authorization."

10. Subsection 28(2): Leases in the ordinary course of business

While it is recognized that prevailing leasing practices have not given rise to the issues addressed above in paragraph 9 of this Submission, nevertheless, for reasons of consistency, the recommended amendments concerning ordinary course sales should apply to ordinary course leases as well, with necessary modifications.

We recommend that Section 28 of the OPPSA ("Transactions in ordinary course of business") be amended by adding the following new subsection:

"(2.1) (a) Subsection (2) applies whether or not:

(i) the lessee took possession of the goods, or

(ii) the lessor has been in possession of the goods at any time.

(b) Despite clause (2.1)(a), subsection (2) does not apply where

(i) the security interest given by the lessor was perfected by possession and the lessee did not take possession of the goods, or

(ii) the goods were not identified to the contract of lease.

(c) Goods are identified to the contract of lease when they are either:

(i) identified and agreed upon by the parties at the time the contract of lease is made, or

(ii) marked or designated to the contract of lease, either by the lessor, or by the lessee with the lessor's consent or authorization."

11. Subsection 28(3): Purchasers of chattel paper

Chattel paper (which includes conditional sale contracts and chattel mortgages) is an important class of collateral in financing arrangements in certain industries (motor vehicles, computers and furniture, to name only a few). It is possible to perfect a security interest in chattel paper by registration under the OPPSA (section 23) or by taking possession of the chattel paper (section 22). Taking possession of the chattel paper can provide a secured party with a security interest in it with greater protection than simply doing a registration.

A subsequent purchaser of chattel paper will defeat a prior secured party's security interest in chattel paper in two instances. The first is where the prior security interest was perfected by registration and the subsequent purchaser did not know of the prior security interest at the time of taking possession of the chattel paper. The second is where the chattel paper is the proceeds of inventory, irrespective of the subsequent purchaser's knowledge. Because subsection 28(3) uses the term "purchaser", these priority rules are available to a buyer of chattel paper as well as to a lender who is granted security in chattel paper. In order to take advantage of these special priority rules, a purchaser of chattel paper must take possession of the chattel paper in the ordinary course of its business and must give new value.

Unfortunately, subsection 28(3) gives the purchaser priority only "to the extent that" the purchaser gives new value. It is, therefore, uncertain whether a buyer who purchases chattel paper at a discount will have priority with respect to the full amount of the monetary obligation evidenced by the chattel paper including the amount that is in excess of the discounted amount paid by the buyer. Similarly, although the principal amount of a loan would clearly fall within the new value qualification, it is less clear whether the other amounts which are often secured by such a loan (for example, interest and fees) would benefit from the chattel paper priority rules. A purchaser of chattel paper wishing to eliminate this uncertainty would need to obtain a subordination or a release from every prior secured party, which is costly and time-consuming, even where prior secured parties cooperate. Thus, one of the consequences of the qualifying words "to the extent that" is to hinder originators of chattel paper from fully utilizing chattel paper as a source of financing.

We recommend that a purchaser's expectation interest be protected and that the "to the extent of value" qualification be deleted from the OPPSA. We note that none of the PPSAs based on the western model contains this qualification. The qualifying words are a holdover from the former Ontario PPSA and, apparently, the retention of such qualifying words in subsection 28(3) was an oversight: see J.S. Ziegel and D. Denomme, *The Ontario Personal Property Security Act - Commentary and Analysis*, at p. 219.

We recommend that subsection 28(3) of the OPPSA ("Purchaser of chattel paper") be amended by deleting the words "has, to the extent that the purchaser gives new value," and by substituting therefor the words "and who gives new value has".

12. Subsection 40(1): Person obligated on an account or on chattel paper

This subsection, and the corresponding provisions in other PPSAs, for the most part follow Article 9 of the UCC without any explicit explanation of the reason for doing so. That model may leave uncertainty in the context of our common law. The common law position is that the assignee of a debt acquires the assignor's rights, subject to the account debtor's defences and rights of set-off vis-à-vis the assignor, but the assignee is not affirmatively liable for the assignor's breaches. The assignment of the debt operates neither to diminish nor to improve the account debtor's position. The purpose of the recommended amendments is two-fold:

1. To clarify in clause 40(1)(a) that the assignee is not affirmatively liable on the assigned contract and that any breach of the assigned contract by the assignor may be set up against the assignee only by way of defence to the assignee's action. No counterclaim may be submitted by the account debtor against the assignee. This will preclude any implication to the contrary from the current language of clause 40(1)(a). At the same time, the proposed revision retains and stresses the broad scope of defences arising from the assigned contract which may be raised against the assignee. It precludes any implication, which may emerge from the current provision, that only defences arising from the "terms" of the contract - as opposed, for example, to remedies for misrepresentation or equitable set-off - are available against the assignee.

2. To reiterate in clause 40(1)(b) the common law position that an assignee is not subject to defences (not to mention claims) arising outside the assigned contract and related matters other than those which qualify for statutory set-off. The latter is limited to mutual debts. While arising outside the assigned contract, statutory set-off may be asserted by the debtor against the original creditor, as of right, by way of defence to the action on the assigned contract: see section 111 of the *Courts of Justice Act* (Ontario).

We recommend that subsection 40(1) of the OPPSA ("Person obligated on an account or on chattel paper") be deleted and the following substituted therefor:

"(1) An account debtor who has not made an enforceable agreement not to assert defences arising out of a contract may set up against an assignee by way of defence:

(a) all defences arising out of the terms of the assigned contract and related breaches by the assignor including any equitable set-off or remedy for misrepresentation available against the assignor's action; and

(b) the right to set off any debt owed to the account debtor by the assignor which was payable before the receipt of notice of the assignment by the account debtor.

In this subsection, 'account debtor' means a person obligated on an account or on chattel paper."

13. (New) subsection 40(4): Anti-assignment clauses

The common law has traditionally opposed restraints on the alienability of personal property. Anti-assignment clauses seek to overcome this common law position. The effect of an anti-assignment clause is unclear under Canadian law. In some cases, the assignment has been held void. In other cases, the assignment is valid as between the assignor and the assignee, even though the assignee cannot sue the account debtor.

The arguments in favour of enforcing such clauses centre largely around the theory that contracting parties should be free to strike whatever bargain they please and their agreement should be respected. An additional concern is that once the owner of a debt has assigned it and the account debtor has received notice of the assignment, the account debtor can no longer set off any amounts owed to the account debtor by the assignor against the debt now owed to the assignee. This right of set-off can be particularly important if there is a continuing business relationship between the account debtor and the assignor out of which a claim by the account debtor against the assignor may arise.

Despite the arguments in favour of enforcing such clauses, however, the policy arguments against enforcement appear to us to be more persuasive. The freedom of contract theory assumes equal bargaining power between the parties, which is rarely a reality. In addition, the right of an account debtor to restrict a transfer in order to protect its right of set-off must be weighed against the consequences of enforcing such clauses. A clause prohibiting the assignment of payment rights could severely restrict sources of financing that would otherwise be available to assignors if the law did not give effect to such clauses. Anti-assignment clauses which restrict the right of a

business to assign by way of security the money due under accounts or chattel paper or to sell or securitize the money due under accounts or chattel paper may place such business in financial jeopardy.

On balance, it would appear to be preferable to depart from the traditional common law view in favour of a policy favouring the assignability of accounts and chattel paper and the granting of security interests therein. A similar policy choice has been made in each other PPSA jurisdiction in Canada and in Article 9 of the UCC.

The recommended provision does not address the enforceability of prohibitions on *partial* assignments. Partial assignments have become an important practical issue in securitization transactions. A majority of the Committee was concerned that allowing partial assignments could impose undue hardship on account debtors. We recommend that the enforceability of prohibitions on partial assignments be given careful study in the context of considering Ontario's response to the forthcoming changes to Article 9 of the UCC.

We recommend that section 40 of the OPPSA ("Person obligated on an account or on chattel paper") be amended by adding the following new subsection:

"(4) Without affecting the defences and claims available to a person obligated on an account or on chattel paper as provided for in subsection (1), a term in a contract between a person obligated on an account or on chattel paper and an assignor that prohibits or restricts assignment of, or the creation of a security interest in, the whole of the account or chattel paper for money due or to become due or that requires the person's consent to such assignment or creation of a security interest:

(a) is binding on the assignor, but only to the extent of making the assignor liable for breach of contract; and

(b) is unenforceable against third parties."

14. Subsection 41(1): Use of PPS Registry

The registration system under the OPPSA is stated to be maintained "for the purposes of this Act and the *Repair and Storage Liens Act*". The PPS Registry is also used with respect to other Ontario legislation (for example, that relating to retail sales tax and other provincial taxes) to record interests in the personal property of tax debtors. The computerized registries of other provinces are used for a wide variety of disparate

registrations ranging from seizures (writs of execution) to sale of goods notices to unpaid fines under provincial offences legislation to unpaid family support, to name just a few. The Committee believes that the trend toward increased use of the PPS Registry for purposes unrelated to consensual security interests in personal property will continue. The Committee generally favours such broader use of the PPS Registry because this centralized, computer-based registry will facilitate "one stop shopping" and considerably enhance efficiency and cost effectiveness with respect to public searches.

However, such multi-purpose use should be carefully planned. Specifically, we believe it is important that results of searches of the PPS Registry clearly separate the registrations made under different Acts to avoid misleading searchers. Presently, all families of registrations (that is, originating registrations such as financing statements together with their amending registrations such as financing change statements) are reported in reverse chronological order regardless of the legislation under which those registrations were made. This blending together of unrelated matters is unsatisfactory because it tends to confuse the searcher and generally results in additional time having to be spent to review a search report. This problem will be greatly exacerbated if the PPS Registry is used for more and more registrations under "non-PPSA" legislation. In addition, such legislation mandating the use of the PPS Registry must make clear what the *effect* of registration under that legislation is on the regime created by the OPPSA. For example, it should be made clear whether the interest registered against the "debtor" is a security interest and the registrant a "secured party" for the purposes of the OPPSA, or whether some other effect is intended.

We recommend that subsection 41(1) of the OPPSA ("Registration system") be amended by deleting the words "*Repair and Storage Liens Act*" and by substituting therefor the words "such other Acts as make reference to the registration system maintained under this Act".

We recommend that the PPS Registry not be used for other types of registrations until such time as the computer system can be revised to provide search reports which are organized to allow searchers to discern easily the different types of registrations.

15. Subsection 43(1): Search criteria

The Committee has considered "similar match" search criteria embodied in the registration and search systems of most other PPSA provinces. In essence, such criteria result in a report to a searcher which reveals not only those registrations exactly matching the name submitted by the searcher but also those which are "close" to that name. In some instances, the searcher can choose the degree of "closeness".

The current Ontario system is essentially an "exact match" system except where a search is conducted against motor vehicles by vehicle identification number. In the case of a search by vehicle identification number, the searcher is able to specify whether only exact matches are to be reported or whether registrations considered "close" by the Ministry's search algorithm should be reported as well. In practice, this option is seldom selected by searchers. It needs to be emphasized that, while there are also two types of searches that can be made relating to individual debtors (an "individual non-specific" search and an "individual specific" search), both are "exact match" searches. The difference is simply that fewer criteria are used for the "individual non-specific search" in that it reports all registrations matching a first name and surname supplied by the searcher, as opposed to the "individual specific" search in which the searcher provides a first name, initial of second given name, surname and date of birth and all must be matched exactly.

The Committee is of the view that a "similar match" concept should not be adopted in Ontario. We have two reasons. First, we believe that the much greater volume of registrations in Ontario, as compared to other provinces, would lead to search results of unmanageable size being reported in many instances. The effect would be to increase significantly the time which would have to be spent in reviewing the search report and in reacting to its contents. This would necessarily increase the transaction costs for secured parties and, in turn, would likely increase the costs to consumers and other debtors.

Secondly, since the degree of "closeness" in the search match will always be arbitrary to some extent, the legal effect of including close matches on a search report is not certain. For example, if a searcher discovers a registration in the search process which is "close" but does not match the search criteria exactly, what obligations are imposed on the searcher? It is now well established that strict compliance with the requirements of the OPPSA, and particularly those requirements which are potential search criteria, is necessary for a registration to be effective. A searcher should not have to consider non-complying registrations where the effect of the non-compliance is the failure of the registration to be revealed by a search using criteria which would have been the basis for a valid registration. In short, the disruption and other disadvantages in changing from an "exact match" system to a "similar match" system would appear to greatly outweigh the advantages (if any).

We recommend that the present system of reporting "exact matches" be continued.

16. Subsection 45(4): Registration when multiple security agreements

The Committee believes that *Adelaide Capital Corp. v. Integrated Transport Finance Inc.* (1994), 16 O.R. (3d) 414 (Gen. Div.) was wrongly decided to the extent it requires a

"linkage" between security interests to allow them to be perfected by a single financing statement pursuant to subsection 45(4). Subsection 45(4) of the OPPSA is clearly intended to allow a single financing statement, in the words of the subsection, "to perfect one or more security interests created or provided for in one or more security agreements between the parties". *Adelaide Capital* suggests that, for perfection of multiple security interests between the same parties to be possible under a single financing statement, those interests and the transactions creating them must be "linked" in some way. We note that the *Adelaide Capital* decision is inconsistent with the Saskatchewan Court of Appeal decision in *Royal Bank v. Agricultural Credit Corp. of Saskatchewan* (1994) 7 P.P.S.A.C. (2d) 1. In fact, the *Adelaide Capital* decision relied on the trial decision in *Royal Bank v. Agricultural Credit Corp. of Saskatchewan*, which decision was reversed by the Saskatchewan Court of Appeal.

As a consequence of the *Adelaide Capital* decision, many secured parties in Ontario have completed numerous registrations against the same debtor because of the inability of their legal advisors to provide complete assurance that only one registration is necessary. This has led to unnecessary registrations each containing no more information than the last, with an attendant increase in costs to complete, update, renew and discharge such registrations. It also tends to clog the PPS Registry and to force searchers to spend additional time in reviewing searches and making enquiries in respect to each registration. In turn, these costs are often passed on to debtors. In the Committee's view, it is desirable to clarify that "linkage" is not relevant.

> **We recommend that subsection 45(4) of the OPPSA ("Subsequent security agreements") be deleted and the following be substituted therefor:**
>
> **"Except where the collateral is consumer goods, one financing statement may perfect one or more security interests created or provided for in one or more security agreements between the parties, whether or not such security interests or security agreements are in any way related or linked to each other or were contemplated at the time of registration of the financing statement."**

17. Subsection 46(3): Classification of collateral

In financing statements registered under the OPPSA, the secured party indicates the collateral claimed by putting an "X" in one or more "boxes" indicating that the claim includes collateral within the "consumer goods", "inventory", "equipment", "accounts" or "other" classifications (and, as well, indicating whether or not the claimed collateral includes "motor vehicles"). In addition, and *optionally*, the secured party may include a description of the collateral in the "general collateral description" area (lines 13-15 on

the financing statement): see subsections 3(1)(f), 3(1)(g) and 3(11) of the Regulations to the OPPSA.

However, subsection 46(3) of the OPPSA provides as follows:

> "Except with respect to rights to proceeds, where a financing statement or financing change statement sets out a classification of collateral and also contains words that appear to limit the scope of the classification, then, unless otherwise indicated in the financing statement or financing change statement, the secured party may claim a security interest perfected by registration only in the class as limited."

Thus, where secured parties choose to include a general collateral description, they may intentionally or unintentionally be held to limit the collateral claimed in a financing statement. In this regard, the Committee's view is that users of the PPS Registry can probably be placed in one of four categories:

1. those who will not, under any circumstances, use the general collateral description area for fear of triggering the operation of subsection 46(3);

2. those who use the general collateral description area deliberately, because their collateral claims are limited to particular items or types of collateral and they wish searchers to be aware of this fact;

3. those who use the general collateral description area without realizing the potential effect of subsection 46(3) - that is, those who include descriptions but do not mean them to be exhaustive; and

4. those who use the general collateral description area for internal "reference" information only.

Secured parties in category 3 simply need education to understand the risk of their course of action, because the form itself contains no warning that this result will occur, and only Ontario among the PPSA provinces does not require some form of collateral description beyond the "boxes". Many secured parties in category 4, by contrast, are trying to achieve the legitimate goal of reconciling their registrations to particular internal references (for example, their own file numbers or transaction numbers). Most PPSA jurisdictions in Canada provide a separate line on the financing statement for "additional information" to facilitate the inclusion of this type of information and to keep it distinct from collateral descriptions.

This relatively minor issue should be addressed because it has recently generated litigation. In *Re Linotext Digital Printing* [1997] O.J. No. 3359, Court file no. 31-327624 (Gen. Div.), Epstein J. was called on to determine whether a description such as "re:

Lease 11518" in the general collateral description area constituted "words appearing to limit the scope of" a collateral classification and therefore prevented the financing statement from being effective to perfect security interests created in both the referenced lease and in a general security agreement concluded at the same time with the same debtor. She determined that the reference did not constitute such "limiting words", distinguishing the situation in *Adelaide Capital Corp. v. Integrated Transport Finance Inc.* (1994), 16 O.R. (3d) 414 (Gen. Div.) in which a description of 50 trailers by serial number in the same area did restrict the collateral claim to the described collateral only.

The Committee anticipates further litigation to determine the precise boundaries between "limiting" and "non-limiting" language in the general collateral description area, and does not see this as a fruitful use of judicial resources. One method of dealing with this problem is to implement, as soon as possible, the solution adopted in the other jurisdictions, namely, a separate area for "reference" language - the intention being to prevent those wishing to use such language from being forced to use the general collateral description to do so. A simple mechanism to achieve this would be to redesignate one of the lines in the existing form as an "additional information" line. However, if this does not prove feasible, any alternative designation of another area of the form for this information would suffice.

We recommend that an area of the present financing statement be designated as an area for the entry of "additional information" meaningful to the secured party, which area would not be considered to be a collateral description and accordingly would not be considered for the purpose of the "limiting words" provision of subsection 46(3).

18. Subsections 46(6) and 46(7) and subsections 56(1) and 56(2): Copy of registration to debtor and demand for discharge

These provisions are considered together because they are related. At present, subsection 46(6) requires delivery of a copy of a registration (either a copy of the registered financing statement, financing change statement or verification statement) to the debtor within 30 days after the date of registration, and subsection 46(7) provides for a penalty if the secured party fails to do so without "reasonable excuse". Subsection 56(1) provides a mechanism for a debtor to demand a discharge of a registration following payment or performance of the debtor's obligations under the security agreement. Subsection 56(2) entitles the debtor to require the filing of a discharge where no security interest was created at all.

With respect to providing the debtor with a copy of a registration, the Committee notes that other provincial PPSAs allow the debtor to waive the right to receive the

copy if the waiver is in writing. It is unclear whether such a waiver is permitted under the OPPSA although the answer is probably that it is not. Subsection 46(6) was added to the OPPSA at the recommendation of the Minister's Advisory Committee to make sure that the debtor would be aware that a secured party claimed to have, or contemplated obtaining, a security interest in the debtor's collateral. While we sympathize with this goal, a majority of us also believe that the cost of complying with this requirement far exceeds the benefit to debtors and that it should be made clear that such a waiver is permissible under the OPPSA.

The Committee also believes that a gap exists in the current law respecting the debtor's control over the *content* of a registered financing statement. A debtor who does not contest the existence of a security agreement with the secured party but disagrees with the collateral classification set out in the registered financing statement may have no ability to demand an amendment to the financing statement. The typical example would be a registration by a secured party which indicates a collateral classification not covered by any security agreement with the debtor or a registration which contains an inaccurate general collateral description (for example, claiming "all computer equipment" when only certain types of such equipment are the subject of the secured party's security interest). The Committee notes that subsection 56(2) covers the situation in which "the secured party has not acquired a security interest in the property to which the financing statement .... relates", and entitles the debtor to demand a "financing change statement referred to in section 55", that is, a discharge or partial discharge. However, the wording of this subsection assumes that it will be clear what the property is to which the statement relates. This is not always the case. For example, security agreements creating security interests in one specific computer, all the debtor's computer equipment, or all the debtor's equipment of any kind could all be reflected in a financing statement by putting an "X" in the collateral classification box for "equipment". It is not certain, therefore, that a debtor who wishes it to be clear that the registration relates only to one specific computer would have the right to demand a partial discharge under subsection 56(2).

In the view of the Committee, an amendment to the OPPSA is desirable to provide the debtor with a right to require word limitations of the collateral description in a registration and not merely the right to require a discharge or partial discharge. It is not the Committee's intention to require the secured party to provide a description of the collateral by "item or type" in the financing statement or financing change statement. In our view, the lack of such a requirement in the Ontario system is one of its positive features.

We recommend that subsection 46(6) of the OPPSA ("Copy to debtor") be amended by adding at the end the words "unless the debtor has waived, in writing, the debtor's right to receive such copy".

We recommend that section 56 of the OPPSA ("Demand for discharge") be amended by adding the following new subsections:

"(2.1) Where a financing statement is registered under this Act and the person named in the financing statement as the secured party has not

(a) acquired a security interest in any property within one or within more than one of the collateral classifications indicated on the financing statement, or

(b) included words limiting the scope of a collateral classification within the meaning of subsection 46(3) where the secured party has acquired a security interest only in particular property within the classification,

the person named in the financing statement as the debtor may deliver a written notice to the person named as the secured party demanding a financing change statement referred to in section 49 providing,

(c) in the case of a demand made under clause (a), for the substitution of collateral classifications which do not include any collateral classifications specified in the notice in which the person named in the financing statement as secured party has not acquired a security interest, or

(d) in the case of a demand made under clause (b), for the insertion into the financing statement of words limiting the scope of one or more collateral classifications within the meaning of subsection 46(3) or, at the option of the person named as secured party, a reference to the security agreement or agreements to which the financing statement relates together with words limiting the scope of the collateral claimed to the collateral described in such agreement or agreements,

and the person named as the secured party shall sign and give to the person demanding it, at the place set out in the notice, the financing change statement.

(2.2) For the purpose of subsection (2.1), a secured party is deemed to have 'acquired a security interest' in property when the person named in the financing statement as the debtor is party to a security agreement

with the secured party by which the secured party is granted a security interest in present or after-acquired property of the debtor of like description or is granted a present or future right to acquire a security interest in such property."

19. Clause 63(4)(b): Notice of disposition

There is a question whether the notice requirements in subsection 63(4) apply to guarantors of a secured debt. In practice, secured parties will usually give such notice to guarantors out of an abundance of caution. Prior to 1985, the lower courts were divided in their opinions. However, in *Moskun v. Toronto-Dominion Bank* (1985) 5 P.P.S.A.C. 221 (Ont. H.C.), Trainor J. held at pp. 257-258 that the definition of debtor in the pre-1989 Act was not meant to apply to a guarantor and that a guarantor cannot fairly be described as a person "who owes payment or other performance of the obligation secured". We believe that he was correct and that the same reasoning applies to the definition of debtor in the current OPPSA: see *Lewinsky v. Toronto Dominion Bank* (1995), 9 P.P.S.A.C. (2d) 169 (Ont. Gen. Div.). Indeed, the same reasoning might apply also to the definition of debtor which we have recommended in paragraph 1 of this Submission. Moreover, and despite *Bank of Nova Scotia v. Antoine* (1998), 13 P.P.S.A.C. (2d) 231 (Ont. Gen. Div.), it is not entirely free from doubt that a guarantor is "an obligor who may owe payment or performance of the obligation secured" for the purposes of clause 63(4)(b) in the current OPPSA. We are of the view that guarantors and other persons similarly liable should be entitled to notice of the secured party's intention to dispose of collateral since they may be held liable for any deficiency and therefore have an interest in policing the proper disposition of the collateral. We believe that the OPPSA should be amended to make it clear that they are entitled to such notice. We have not confined the amendment recommended below to a "guarantor" because guarantor has a technical meaning at common law and does not include a person who has agreed to indemnify the secured person against loss resulting from the transaction.

We recommend that clause 63(4)(b) of the OPPSA ("Notice required") be amended by adding at the end of the clause the words "including any person who is secondarily liable as a guarantor or otherwise of the obligation secured", so that the clause would read as follows:

"(b) every person who is known by the secured party, before the date that the notice is served on the debtor, to be an owner of the collateral or an obligor who may owe payment or performance of the obligation secured including any person who is secondarily liable as a guarantor or otherwise of the obligation secured."

20. Subsection 63(6): Date of sending notices

Subsection 63(6) of the OPPSA provides that, in situations where notice to the debtor under clause 63(4)(a) is mailed, the relevant date for the purposes of several clauses in subsection 63(4) is the date of mailing. This subsection is necessary because under Section 68 of the OPPSA, personal service and registered mail are recognized as methods of delivering notices and documents under the OPPSA. If subsections 68(1), (2) and (3) of the OPPSA are amended as recommended below in paragraph 25 of this Submission to recognize other methods of delivery, such as courier and facsimile, then subsection 63(6) of the OPPSA will need to be modified accordingly.

We recommend that subsection 63(6) of the OPPSA be deleted and the following be substituted therefor:

"If the notice to the debtor under clause 4(a) is mailed, sent by courier or by any other transmission provided for in subsections 68(1), (2) and (3), then the relevant date for the purpose of clause (4)(b), subclause (4)(c)(ii) and clause 4(d) shall be the date of mailing, the date that the notice was sent by courier or the date of transmission, as applicable, and not the date of service."

21. Subsection 65(1): Compulsory disposition of consumer goods

Subsection 65(1) of the OPPSA deals with compulsory disposition of consumer goods. It provides that a secured party, whose collateral is consumer goods, must dispose of the collateral within 90 days after taking possession where the debtor has paid at least 60 per cent of the indebtedness secured, unless, after default, the debtor has signed a statement renouncing or modifying such debtor's rights "under this Part". Subsection 65(1) would thus appear to permit a debtor, where consumer goods are involved, to renounce or modify all of the debtor's rights under Part V of the OPPSA. This result could not have been intended because, where the collateral does *not* involve consumer goods, the debtor does not have such broad latitude to renounce or modify all of the debtor's Part V rights. Subsection 65(1) should be revised to make it clearer that a debtor would only be permitted to renounce or modify, after default, the debtor's rights under subsection 65(1).

We recommend that subsection 65(1) of the OPPSA ("Compulsory disposition of consumer goods") be amended by deleting the word "Part" and by substituting therefor the word "subsection".

22. Subsection 65(3): Objection to proposal to accept collateral

Pursuant to subsection 65(2) of the OPPSA, a secured party must serve notice on certain parties if it proposes to accept the collateral in full satisfaction of the obligation secured thereby. Pursuant to subsection 65(3) of the OPPSA, any person entitled to notification under subsection 65(2) has 30 days after service of the notice to deliver to the secured party a written objection to such proposal. In contrast, under the western model, parties entitled to notification of such proposal have only 15 days to deliver to the secured party a written objection to the secured party's proposal. Primarily for the reason of harmonization, we are of the view that this notice period should be the same as the corresponding notice period in the western model.

We recommend that subsection 65(3) of the OPPSA ("Objection") be amended by deleting the word "thirty" and by substituting therefor the word "fifteen".

23. Subsection 65(6): Foreclosure

This provision should be read together with our recommendation in paragraph 22 of this Submission. At present, once a secured party has served notice in accordance with the requirements of the OPPSA that it proposes to accept the collateral in satisfaction of the obligation secured, absent objections the foreclosure will take place at the expiration of a 30-day period following the giving of such notice. There is no mechanism in the OPPSA by which the period can be shortened *even if* all persons entitled to notification consent to a shorter period. The Committee believes that the OPPSA should be amended to provide flexibility in this regard.

We recommend that subsection 65(6) of the OPPSA ("Foreclosure") be deleted and the following be substituted therefor:

"(6) If no effective objection is made, the secured party is, at the earlier of

(i) the expiration of the fifteen-day period mentioned in subsection (3), and

(ii) the time when the secured party receives from each person entitled to notification under subsection (2) written consent to the secured party retaining the collateral in satisfaction of the debt,

deemed to have irrevocably elected to accept the collateral in full satisfaction of the obligation secured, and thereafter is entitled to the collateral free from all rights and interests therein of any person entitled to notification under subsection (2) whose interest is subordinate to that of the secured party and who was served with such notice."

24. (New) subsection 65(8) and (new) clause 67(1)(e): Court orders

These recommended new provisions are related. They should also be read together with our general comments in paragraph 33 below with respect to reform concerning the enforcement of security in personal and real property. In our view, it would be desirable to commence a review process with a view to streamlining and integrating sale and foreclosure remedies relating to personal and real property. As an interim measure to help our courts deal with issues pending such review and possible reform, it is desirable to clarify the power of the courts.

We recommend that Section 65 of the OPPSA be amended by adding the following new subsection:

"65(8). Upon application to the Ontario Court (General Division) by the secured party, the court may make an order extending the fifteen-day time period mentioned in subsections (3) and (6), or grant such further or other order as the court may deem necessary for the secured party to be able to foreclose upon both the real property and personal property charged in favour of the secured party in one or more security agreements by the same debtor."

We recommend that subsection 67(1) of the OPPSA ("Court orders and directions") be amended by deleting the word "and" at the end of clause (e), by replacing the period at the end of clause (f) with "; and", and by adding the following new clause:

"(g) to give advice and direction or grant such order as the court may deem necessary for a secured party to enforce its remedies over the real property and personal property charged in favour of the secured party in one security agreement as referred to in subsection 59(6), including, without limitation, an order specifying the parties entitled to notice of such enforcement, rights to redeem collateral, and the accounting for sale surpluses

to be given to third parties with an interest in such real property and personal property."

25. Subsections 68(1), (2) and (3): Service of notices generally

Section 68 of the OPPSA deals with delivery and service of notices and documents under the OPPSA. It recognizes only personal service or registered mail. Personal service can be expensive particularly where service must be made on distant parties such that process servers have to be engaged. Registered mail imposes needless delay. For most persons, the delay can be up to 10 days by virtue of the deemed notice provision in subsection 68(4). Also problematic is that registered mail is not a feasible option for service during postal interruptions. Legislation, both federal and provincial, in other areas allows service by means which are far more convenient. Section 27 of the *Repair and Storage Liens Act* (Ontario) and sections 5 and 113.1 of the Rules under the *Bankruptcy and Insolvency Act* (Canada) ("**BIA**") allow service by courier. Section 5 of the Rules under the BIA and subrule 16.05(1) of the *Rules of Civil Procedure* (Ontario) allow for service by facsimile. Further, many security agreements today provide for delivery of notices by, among other modes, facsimile and courier. In summary, the service provisions of the OPPSA have substantial everyday impact on all users of the OPPSA and should be made to operate in a more cost-effective fashion. These provisions should be brought into line with legislation in other areas and updated in order to accommodate new and changing technologies.

We recommend that subsections 68(1), (2) and (3) of the OPPSA ("Service of notices") be amended by adding the words "or prepaid courier" after the words "by registered mail" and by adding the words "or by any method of transmission which can be read when received using the last reference number of the debtor known to the secured party for such method of transmission", or an appropriate variation thereof, wherever methods of delivery and service are described.

26. Subsection 68(4): PMSI notices and service by registered mail

Subsection 68(4) provides that notices or documents served by registered mail shall be deemed delivered upon the earlier of actual receipt by the addressee and the expiry of 10 days after the day of registration *except* with respect to notices given under subsection 33(1). Subsection 33(1) relates to purchase-money security interests ("**PMSIs**") in inventory. Pursuant to subsection 33(1), priority of a PMSI in inventory over other security interests depends upon, among other things, delivery of a PMSI notice to all other secured parties who have registered interests in the inventory prior to the debtor receiving possession of the inventory. We know no justifiable reason for this

exception. It has been suggested that the exception exists in order to protect prior secured parties who may be relying on deliveries of inventory for their security. However, it seems to us that prior secured parties are generally well aware of the risks of taking security interests in inventory and that the exception prejudices the interests of PMSI suppliers and financers and constitutes an unnecessary impediment to the efficient operation of PMSI financing in Ontario. We note that the exception in subsection 68(4) does not exist in the comparable PPSA legislation of several other provinces.

We recommend that subsection 68(4) of the OPPSA ("Service by registered mail") be amended by deleting the words ", except for the purposes of subsection 33(1),".

27. *Commercial Tenancies Act, R.S.O. 1990, c. L.7*

Jurisprudence in Ontario is to the effect that a landlord's right of distress against the tenant's goods gives rise to a "lien" arising by operation of law that is outside the scope of the OPPSA. As a result, no priority rule in the OPPSA will resolve a dispute between a landlord's right to distrain and a PPSA security interest. Our courts have endeavored to resolve such a priority dispute by giving effect to subsection 31(2) of the *Commercial Tenancies Act* (Ontario) (formerly named the *Landlord and Tenant Act*). Unfortunately, the statutory provision is not clear because it is expressed in pre-PPSA terminology and does not take into account the generic "security interest". The landlord and tenant legislation in some provinces has been amended to afford purchase-money security interests priority over the distraint rights of landlords.

With a view to clarifying the law in Ontario in this regard, we recommend changes both to the *Commercial Tenancies Act* and the OPPSA. The changes to the *Commercial Tenancies Act* in essence would provide that a landlord would not be entitled to distrain upon goods which are subject to a perfected purchase-money security interest at the time the landlord purports to distrain. It is necessary also to make complementary changes to subclause 20(1)(a)(i) of the OPPSA concerning the subordination of an unperfected security interest, in light of the fact that the OPPSA provides statutory "grace" periods in favour of secured parties with respect to the time for perfection by registration of a purchase-money security interest. Hence, even if the secured party has not perfected its purchase-money security interest at the time the landlord exercises its distraint rights, if the purchase-money security interest is perfected within the "grace" period permitted by the OPPSA, the purchase-money security interest should not be subordinated. The recommended changes to the OPPSA, when read together with clause 4(1)(a) of the OPPSA, are not intended to change the law substantively in this area but only to clarify it.

We recommend that the *Commercial Tenancies Act* (Ontario) be amended by adding the following new section:

"31.1 Despite section 31, a landlord shall not distrain for rent on goods and chattels found on the premises which are subject to a perfected purchase-money security interest as defined in the *Personal Property Security Act*."

We recommend that subclause 20(1)(a)(i) of the OPPSA ("Unperfected security interests") be amended by inserting the words "or a person exercising a statutory right of distraint" immediately after the words "or by a rule of law".

We recommend that subsection 20(3) of the OPPSA ("Purchase-money security interest") be amended by deleting the word "and" at the end of clause (c), by replacing the period at the end of clause (d) with "; and", and by adding the following new clause:

> **"(e) a person exercising a statutory right of distraint over the collateral."**

28. (New) subsection 62(2): Household goods and exemptions from seizure

A recent Ontario court decision highlights the apparent lack of consistency between the OPPSA and the *Execution Act* (Ontario) with respect to the personal property of a debtor that is exempt from seizure by a creditor. In *Re Vanhove,* (1995), 20 O.R. (3d) 653 (Gen. Div.), it was held that the exemptions provided by the *Execution Act* do not apply to a secured creditor seeking to enforce its security against the personal and household goods of a debtor. The Committee does not question the result with respect to a *purchase-money* security interest. However, we understand that consumer loan companies frequently take non-purchase money security interests in such goods and that this can cause hardship where it results in a debtor and the debtor's family being deprived of the basic necessities of life. The problem has been addressed in several of the Canadian provinces by extending the exemption available to debtors on execution to goods given as non-purchase money and non-possessory security interests. Provisions leading to a similar result exist in the U.S. Federal Bankruptcy Code and in fair practice rules adopted under the U.S. *Federal Trade Commission Act*. In our view, Ontario policy should be realigned to achieve the same goal.

Clause (a) of the new subsection recommended below establishes the principle of the exemption from seizure. However, the exemption does not apply to a purchase-money security interest because it is generally accepted that that would be unfair to a conditional seller of goods or a lender that provides a purchase-money loan which enables the debtor to acquire the goods. Both these persons are in a very different position than a lender that takes an omnibus security interest from a consumer to secure a non-purchase money loan. Clause (a) also excludes possessory security interests (in effect, pledges) for two reasons: first, because Ontario has a separate act governing pawnbroking transactions and, second, because it is unlikely that a consumer will give a possessory pledge of household goods. Clause (b) of the new subsection which is recommended below is to the effect that a debtor should not be able to claim *more* than the basic exemption permitted under the *Execution Act* by cumulatively claiming additional exemptions where more than one secured party seeks to enforce its security interest against the debtor.

We also wish to draw attention to the need to revise the exemptions under the *Execution Act* to reflect the social and price changes that have occurred since that legislation was last revised and to bring Ontario's exemptions into closer alignment with the much larger exemptions that apply in many of the other provinces.

We recommend that section 62 of the OPPSA ("Possession upon default") be amended by renumbering it as subsection 62(1) and by adding the following as a new subsection:

"(2) (a) Where a debtor has given a security interest in goods that are exempted from execution under the *Execution Act* and which security interest is not a purchase-money security interest and is not a possessory security interest, a debtor who is in default under a security agreement shall have the same right to claim exemption from seizure of the goods by the secured party as the debtor would have had if the secured party were a judgment creditor levying execution against the goods under the *Execution Act*.

(b) Where a debtor has claimed an exemption from seizure under clause (2)(a) and has designated the goods to be exempted, the debtor may not, within a period of twelve months thereafter, claim an exemption from seizure of other goods under any other security agreement."

GENERAL RECOMMENDATIONS

29. Reform concerning security in agricultural property

We reiterate our concern with respect to the possible need for reform of the OPPSA with respect to security interests in seeds and other crop inputs, crops, and other farm assets. Agriculture plays a large part in Ontario's economy. In our view, the OPPSA is imprecise and vague concerning several aspects of agricultural financing. For example, the lack of definition of "crops" requires debtors and creditors to refer to the common law concepts of *fructus naturales* and *fructus industriales* by operation of section 72 of the OPPSA. This leads to priority disputes and other difficulties as between interests in crops solely as personalty (for example, cash crops) and interests in crops as part of the land (for example, orchards). As a further example, section 54 of the OPPSA provides for notice of a security interest to be recorded against title to land for collateral such as crops, fixtures and assignments of rents, but, while sections 34 or 36 of the OPPSA specifically provide priority rules concerning fixtures and assignments of rents vis-à-vis competing real property interests, the OPPSA contains no analogous priority rules with respect to crops. We are also concerned by the inadequacy and vagaries of the "production money security interest" priority provisions in section 32 of the OPPSA. Moreover, as highlighted in our discussion above in paragraph 2, there is a fundamental problem with respect to financing agricultural operations where the chief asset may be a quota, in that case law has held such quotas not to constitute personal property.

Last year, the Committee contacted representatives of a number of participants in agricultural finance in Ontario, including the Agricultural Loan Corporation, the Farm Credit Corporation, counsel for the Ministry of Agriculture, the Farm Business Branch of the Ministry of Agriculture, the Commodity Finance Corporation, several credit unions engaged in farm finance, legal counsel of farm equipment manufacturers and private counsel engaged in representing farmers and their lenders. It became clear from the responses we received that there are widely differing views about whether to revise the OPPSA to deal with these issues. The Committee wrote the Minister in mid-1997 recommending that research be undertaken in this area given the significant role of agriculture in the Ontario economy. The reply we received suggested that nothing would be done at this time to address these concerns. For the reasons we have given, we urge reconsideration of this position.

30. Reform concerning OPPSA subsection 30(6): Reperfected security interests

Subsection 30(6) of the OPPSA deals with the consequences of a security interest originally perfected by registration which has become unperfected and is then reperfected by registration. The subsection gives retroactive effect to the reperfection except with respect to persons who acquired rights in the collateral during the period of

reperfection. The subsection did not appear in the draft bill prepared by the Minister's Advisory Committee and we understand the Minister's Advisory Committee was never consulted about its inclusion in the OPPSA.

This subsection is controversial. On the one hand, it is open to many constructional and principled objections which have been considered in detail elsewhere: see J.S. Ziegel and D. Denomme, *The Ontario Personal Property Security Act - Commentary and Analysis*, at pp. 236-239. While the subsection is ambiguous and contributes to circular priority problems, perhaps the most serious objection to it is that it arguably undermines a fundamental objective of the Act, namely, to establish a reliable and consistent registry system and not to determine competing rights in the same collateral depending on whether or not a third party was actually prejudiced by a secured party's failure to perfect by registration or to reperfect a lapsed registration. As a matter of principle, persons opposed to this subsection assert that the Act should not be pulling in different directions and that there is no persuasive reason why an exception should be made for lapsed registrations reperfected by a later registration and not in other cases where a secured party is deemed to have an unperfected security interest because it has failed to comply with registration requirements in the first place. Such persons argue that, in all such cases, both the Act and the jurisprudence are very clear that the unperfected security interest will be subordinated even though a competing party cannot show that it has acted to its detriment in reliance on the non-registration.

On the other hand, others favour retaining the subsection or, at least, a variation of it amended to remove some of the ambiguities. They contend that, absent such provision, the rigid application of the priority rules in the OPPSA would unfairly prejudice some secured parties and provide unexpected windfalls to others. Specifically, they observe that, absent such provision, a subordinate-ranking secured party who perfected its security interest at a time when an earlier-registered secured party already had a perfected security interest (including a secured party who recognized that it would be in a subordinate position to such earlier-registered security party) would suddenly enjoy a windfall benefit of gaining priority immediately upon the lapse in the registration of the security interest of the earlier-registered secured party. They argue that this is an unnecessarily draconian result. They point out that the western model expressly contemplates - albeit in somewhat different terms than subsection 30(6) of the OPPSA - that a secured party who reperfects its security interest after its registration lapses maintains its priority ranking as against a competing perfected security interest that immediately before the lapse had a subordinate priority ranking.

Views of Committee members are divided on this issue. We recommend that the views of stakeholders be sought and that further consideration be given to this issue.

31. Reform concerning investment securities

We remind the Minister that the Uniform Law Conference of Canada is currently engaged on a Tiered Holding System project. This project proposes to modernize the laws that govern the rights of the investing public in investment property that is held or administered on their behalf by members of the professional investment community, and it continues and extends the rationale of the amendments which were recently made as Part XII of the BIA. The Uniform Law Conference of Canada has been reviewing changes to Article 8 of the UCC and is formulating analogous proposals for Canada. Much of the proposed new law (which is currently called, in draft, the *Uniform Investment Holding and Transfer Act*) deals with a new form of property which is tentatively called an "investment entitlement". The OPPSA is one of several statutes which will need to be amended to conform to the requirements of the new approach if and when adopted.

32. Reform concerning the interaction of the OPPSA and the *Bank Act* (Canada)

There is also need for reform with respect to the interaction of the OPPSA and the *Bank Act* (Canada). This has been (and continues to be) a troublesome area in personal property security. It is one in which the inefficiencies of the current system are impediments not only to the banks but also to many other secured parties. In 1997, our Committee prepared a Submission on the subject which has been submitted by the Canadian Bar Association to the Minister of Finance. That Submission of the Canadian Bar Association was endorsed by the Canadian Conference on Personal Property Security Law. For your information, we attach as Appendix C a copy of that Submission as well as the response from the Minister of Finance dated April 7, 1998. In our view, it is apparent from that response that little, if any, action is planned at the federal level. Therefore, we urge the Minister to liaise with his federal and provincial counterparts with a view to giving serious consideration to the suggestions for reform which have been put forward.

33. Reform concerning the enforcement of security in personal and real property

We have made specific recommendations in paragraphs 22 and 23 above aimed at streamlining the remedy of foreclosure with respect to personal property. It must be noted, though, that it is common for security to be taken in both personal property and real property to secure a loan or other obligation and, in our view, there are a number of other areas where such streamlining and other reforms and clarifications of the law would be desirable. A few of these areas - relating primarily to the remedy of foreclosure - were addressed recently in *Re Dor-O-Matic of Canada Inc.* (1996), 28 O.R. (3d) 125 (Gen. Div.). Blair J. noted that there are uncertainties in the OPPSA. In addition to the areas identified by Blair J., there are a number of other areas which

remain unclear. These pertain, among other things, to the rights of third persons holding a security interest in the personal property and the status of such persons where proceedings take place under the real property legal regime. We anticipate that significant issues may emerge when courts are asked to determine the order of priorities, and the respective rights of secured creditors, where other creditors hold security in the personal property be it prior ranking or subordinate to the interest of the realizing secured creditor. The PPSA legislation in some other provinces has endeavoured to address at least some of these issues but, in the view of the Committee, it would be desirable to examine these issues more broadly and not confine such review to the OPPSA. Such review should also consider the extent to which personal property and real property remedies of sale and foreclosure could be dovetailed so as to avoid unnecessary delay and cost in the realization of security. Obviating the need for a court order would be desirable in some circumstances especially where all interested persons consent to expedited procedures. This may involve concomitant amendments to the OPPSA, the *Mortgages Act* (Ontario) and the *Rules of Civil Procedure* (Ontario). Therefore, we recommend that the Minister commence a review process with a view to the streamlining and integration of sale and foreclosure remedies relating to personal property and real property.

34. UNCITRAL Convention on Receivables Financing

Canada is participating in the current discussions at the United Nations Commission on International Trade Law with respect to "international receivables". We understand that the discussions are well-advanced and that the scope of the proposed Convention is very broad with a potentially profound impact on a wide variety of persons in Ontario. Some individual members of our Committee have been consulted informally by representatives of the Government of Canada and we wish to bring this significant development to your attention. We recommend that this development be closely monitored and the implications assessed.

35. Other improvements

There are other ambiguities, inconsistencies and relatively minor drafting oversights in the OPPSA. A few of these were identified in our 1993 Submission. A few more have been identified in this Submission. These are largely of a non-controversial "housekeeping" nature and might readily be the subject of an omnibus bill. We would be pleased to work with a legislative drafter on an ongoing basis with respect to these and other amendments to the OPPSA.

We will mention just a few for illustrative purposes:

- The definition of "motor vehicle" requires clarification. An Ontario court suggested the need for clarification in *Central Guaranty Trust Co.* v. *Bruncor Leasing Inc.* (1992) 3 P.P.S.A.C. (2d) 298 (Ont. Ct. Gen. Div.).

- The definition of "goods" in subsection 1(1) includes "timber to be cut, minerals and hydrocarbons to be extracted" whereas subsection 11(3) stipulates that the debtor has no rights in minerals or hydrocarbons until they are extracted, or timber until it is cut.

- Subsection 20(3) should be amended to contemplate possession *as a debtor* to be consistent with subsection 33(2); subsection 33(1) should be similarly amended.

- Subsection 35(2) contemplates subordination to the interest of a "subsequent buyer" whereas the analogous provision in subsection 34(2) contemplates subordination to "a subsequent purchaser for value".

- In our view, a number of recent court decisions indicate that the addition to the OPPSA of definitions of what constitutes a "fixture" and "building materials" would provide assistance to practitioners and judges. We believe that the common law in this area is not altogether clear and we note that PPSA legislation in other Canadian jurisdictions has endeavoured to provide a measure of clarification through such definitions.

36. The process of reform

We wish to conclude this Submission with some comments about the process of reform in this vital field.

There are a great many areas where it is necessary to reform and refocus the OPPSA. Just as commercial realities in the United States have necessitated major changes to Article 9 of the UCC in order to update it, the commercial environment in Ontario - which is very similar to that south of the border - also demands regular attention. This important commercial legislation should not be neglected or be dealt with piecemeal on an *ad hoc* basis merely in reaction to complaints from stakeholders. We reiterate that, given the close and substantial economic relationships which exist between persons in Ontario and lenders, borrowers and trading partners in the United States, it is especially important that such updating process take place at this time bearing in mind the recent changes to Article 9 of the UCC.

We recommend that the Minister identify and weigh options for putting in place an orderly process of reform through which stakeholders would be afforded a reasonable opportunity to participate. We can envisage a wide spectrum of options that

the Minister might wish to consider. Among other things, the Minister may wish to consider reconstituting the Minister's Advisory Committee. The Minister might also consider a publicly accessible process for Ontario, akin to that adopted in the United States with respect to reform of the UCC. More broadly, the Minister might wish to consider an interjurisdictional process (possibly under the aegis of the Federal/Provincial Agreement on Internal Trade or involving the Uniform Law Conference of Canada). It is our understanding that the Uniform Law Conference of Canada is currently considering possible mechanisms for preparing a uniform commercial code suitable for adoption by the common law jurisdictions in Canada. These and other options merit serious consideration. Recommendations for such pro-active initiatives have been made on previous occasions and, in our view, the passage of time only accentuates the need for such initiatives.

The Minister may wish to employ any one or more of such options to assist in formulating policy concerning commercial law matters generally or matters generally relating to the OPPSA, or to focus more narrowly on specific areas of reform such as the ones we have highlighted in this Submission. In any event, any structure would need to be properly funded to permit doing the necessary amount of legal and empirical research and to ensure that the job is done right.

Our Committee has knowledgeable and experienced volunteer members but we do not have the financial resources to undertake the research necessary to fully canvass relevant issues and formulate policy recommendations. However, we would be pleased to work wit any structure the Minister may wish to establish.

Appendix A

Appendix A

SUBMISSION TO

THE MINISTER OF CONSUMER AND COMMERCIAL RELATIONS

CONCERNING

THE PERSONAL PROPERTY SECURITY ACT AND THE REPAIR AND STORAGE LIENS ACT

Approved by CBAO Executive May 26, 1993
Approved by CBAO Council June 18, 1993

Canadian Bar Association - Ontario

Canadian Bar Association - Ontario (CBAO), an autonomous provincial branch of the Canadian Bar Association, was founded in 1896. A voluntary membership organization, it represents over 15,000 Ontario lawyers, judges and law students. CBAO has the following objectives:

- to promote and encourage law reform throughout the Province;

- to improve the availability, accessibility and quality of legal services to all residents of Ontario;

- to uphold the standards of the profession of law;

- to encourage high standards of legal education, training and ethics; and

- to preserve the independence and integrity of the judiciary.

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SUBMISSION TO MINISTER OF CONSUMER AND COMMERCIAL RELATIONS
CONCERNING THE PERSONAL PROPERTY SECURITY ACT AND THE REPAIR AND STORAGE LIENS ACT

This Submission constitutes the comments and recommendations of the Canadian Bar Association – Ontario ("CBAO") with respect to the *Personal Property Security Act*, R.S.O. 1990, c. P. 10 (the "PPSA") and the *Repair and Storage Liens Act*, R.S.O. 1990, c. R. 25 (the "Liens Act"), as prepared by the Personal Property Security Law Sub-committee (the "PPSL Committee" or "Committee") of the Business Law Section and approved by the Executive of the CBAO on May 26, 1993.

I. INTRODUCTION

(a) The Legislation

On October 10, 1989, the *Personal Property Security Act, 1989* and the *Repair and Storage Liens Act, 1989* were proclaimed in force. The *Personal Property Security Act, 1989* constituted a very substantial revision to the predecessor statute which had been proclaimed in force on April 1, 1976 and introduced a number of significant changes to the law. The *Repair and Storage Liens Act, 1989* also involved significant changes to the law especially with respect to the concept of a non-possessory lien.

Over three years have passed since the coming into force of this important commercial legislation, so it is timely now to consider some of the practical problems experienced under such legislation and some of the jurisprudence, with a view to possible amendments to the PPSA and the Liens Act.

(b) PPSL Committee

The PPSL Committee of the CBAO's Business Law Section has been in existence for over ten years. It is actively engaged in a variety of matters relating to the PPSA and the Liens Act and other legislation relating to commercial law matters in general and personal property transactions in particular.

One of the key roles of the Committee is to alert the practising bar to case law and other developments concerning such legislation and to provide practice tips. This is done primarily through a newsletter called *Imperfections* – which has been published periodically since 1982 – and through other CBAO newsletters and seminars.

Over the years, the Committee has worked closely with representatives of the Ministry of Consumer and Commercial Relations (the "Ministry") with respect to the legislation, and amendments thereto, and user concerns, and with a view to the development and improvement of the day-to-day functioning of the Personal Property Security Registry. The PPSL Committee has invited comments from the practising bar with respect to "housekeeping" and other amendments to the legislation. The Committee has received many letters and comments from practitioners and others with respect to perceived shortcomings or vagaries in the PPSA and the Liens Act.

A list of the current members of the PPSL Committee, together with a list of the Ministry representatives who are observers, is attached as Appendix "A".

(c) Purpose and Scope of this Submission

The purpose of this Submission is to recommend certain amendments to the PPSA and to the Liens Act. Such recommendations are the result of deliberations of the Committee with respect to the numerous comments which it has received and considered.

This Submission concentrates, for the most part, on "housekeeping" amendments rather than on matters involving substantive policy issues. It is likely that many (but not all) of the recommended amendments will be non-controversial. The Committee's main aim is to suggest amendments which (in the view of the Committee) would clarify some provisions in the legislation and would facilitate the more efficient application of the legislation and use of the computerized registry system. This Submission does not purport to be exhaustive of all relevant concerns – the Committee has views concerning other matters and is prepared to comment further if requested by the Ministry.

The first part of this Submission will deal with the PPSA and, with respect to each provision under consideration, there will be a brief commentary concerning the provision followed by a specific recommendation. The second part of the Submission will similarly deal with the Liens Act. A summary of all the recommendations of the Committee is found at the end of this Submission.

While this Submission includes some brief commentary and some case citations, we have not fully set out in this Submission the details of our research and analysis.

II. PERSONAL PROPERTY SECURITY ACT

1. Subsection 1(1)

The term "purchaser" is defined in such a way that it means a person who takes an interest in *personal* property. It is likely that this was not the intended meaning in clause 34(2)(a) because that section refers to a "purchaser for value of an interest in the real property".

We recommend that subsection 1(1) be amended by changing the definition of "purchaser" to read:

"purchaser" means, except in clause 34(2)(a), a person who takes by purchase.

2. Subsection 1(1)

"Personal property" is defined to include "fixtures" but not "building materials that have been affixed to real property". Neither "fixtures" or "building materials" are defined. The question of what is "fixtures" or "building materials" has arisen on several occasions and primarily relates to the scope of section 34. The jurisprudence appears to be uneven. The topic has been specifically addressed in the legislation of other jurisdictions.

We recommend that subsection 1(1) be amended by adding the following:

"building materials" means materials that are incorporated into a building and includes goods attached to a building so that their removal,

(a) would necessarily involve the dislocation or destruction of some other part of the building and cause substantial damage to the building apart from the loss of value of the building resulting from the removal, or

(b) would result in the weakening of the structure of the building or the exposure of the building to weather damage or deterioration,

but does not include

(c) heating, air conditioning or conveyancing devices, or

(d) machinery installed in a building or on land for use in carrying on an activity inside the building or on the land;

"building" means a structure, erection, mine or works built, constructed or opened on or in land;

"fixture" does not include building materials;

3. (New) Subsection 1(3), Section 2 and Subsection 4(1)

Section 2 of the PPSA provides, among other things, that the PPSA applies to every transaction that in substance creates a security interest including a lease that secures payment or performance of an obligation. Since the introduction of PPSA-type legislation into Ontario over fifteen years ago, no single issue has generated more litigation – and controversy – than the question of whether a particular lease is one to which the PPSA applies. This question has not only been the subject of much litigation but has also been the subject of numerous articles in Canadian legal publications. Indeed, this question has generated even more litigation and controversy in the United States.

Despite the jurisprudence to date in Ontario, the law remains uncertain. Principles for determining whether a lease "in substance creates a security interest" have not been clearly articulated. Clarification in this regard is needed. It would be welcomed not only by the leasing industry – where the question is of considerable importance – but also by the professional and other advisers of secured parties and debtors alike who have to cope with the vagaries of the current situation.

While the possible variations in lease agreements are such that it is not realistic to expect a legislative panacea which will provide a clear answer in every instance, the PPSL Committee is of the view that a statutory paradigm would clarify the application of the PPSA in many instances and would provide a framework for consistent judicial elucidation of the law in this area. The following recommendation is based on the provision in section 1-201(37) of the U.S. Uniform Commercial Code.

We recommend that section 2 be amended by changing the phrase "Subject to subsection 4(1), ..." to "Subject to subsections

1(3) and 4(1), ..." and that a new subsection 1(3) be added, as follows:

For the purposes of this Act,

(a) a lease of goods creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and

(i) the original term of the lease is equal to or greater than the remaining economic life of the goods,

(ii) the lessee is contractually obligated to renew the lease for the remaining economic life of the goods or is contractually obligated to become the owner of the goods,

(iii) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or

(iv) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement;

(b) a lease of goods does not create a security interest merely because

(i) the lessor is a financial institution or other person engaged in whole or in part in the business of lending money,

(ii) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease agreement is entered into,

(iii) the consideration the lessee is obligated to pay the lessor for the right to possession and use of the

goods is based in whole or in part on the measurable use of the goods by the lessee,

(iv) the lessee assumes risk of loss of or damage to the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

(v) the lessee has an option to renew the lease or to become the owner of the goods,

(vi) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or

(vii) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed;

(c) in this subsection,

(i) additional consideration is not nominal if,

(A) when the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or

(B) when the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed;

but additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised,

(ii) "reasonably predictable" and "remaining economic life of the goods" are to be determined with

reference to the facts and circumstances at the time the lease agreement is entered into, and

(iii) "present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain; the discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the lease agreement is entered into, otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the lease agreement was entered into.

4. Subsection 4(1)

There is uncertainty as to the need for registration under the PPSA with respect to a ship mortgage which might otherwise be registered under the *Canada Shipping Act*. See *Re: Doucet* 42 O.R. (2d) 638 (S.C.O. in Bankruptcy). Some clarification in this regard is in order bearing in mind that Ontario has international waterways on the Great Lakes and access into James Bay and Hudson Bay. Alberta and British Columbia have specific exemptions in their respective PPSA's.

We recommend that subsection 4(1) be amended by adding the following new subsection:

[This Act does not apply] to a security agreement governed by an Act of the Parliament of Canada that deals with rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement, including but without limiting the generality of the foregoing, a mortgage under the *Canada Shipping Act*.

5. Subsection 4(1)

Similar comments as above can be made with respect to the application of the PPSA to security governed by the *Bank Act* (Canada). There has been litigation (including *Bank of Nova Scotia v. International Harvester* (1991) 1 P.P.S.A.C. (2d) 93 (Ont. C.A.)) and the current law remains uncertain. It would be desirable to add a specific exclusion. Some other jurisdictions have provided for specific exclusions in their PPSAs.

We recommend that subsection 4(1) be amended by adding the following new subsection:

[This Act does not apply] to a security agreement governed by an Act of the Parliament of Canada that deals with rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement, including but without limiting the generality of the foregoing, any agreement governed by Part VIII of the *Bank Act* (Canada).

6. Subsection 5(1)

The opening words of this section – "Except as otherwise provided by this Act, ..." – have generated some confusion as to what other provisions in the PPSA are contemplated by the exception. Provisions in the PPSAs of other jurisdictions are somewhat clearer and it is presumed that the intention is that the reference to other provisions means those provisions found in subsection 5(2) and in sections 6, 7 and 8. See *Royal Bank v. Pattison Bros. Agro Ltd.* 1 P.P.S.A.C. (2d) 136 (Sask. Q.B.)

We recommend that subsection 5(1) be amended to read as follows:

Except as otherwise provided <u>in subsection 5(2) or in sections 6 to 8</u>, ...

7. Subsection 5(5)

In *Ernst & Young Inc. v. Velux Canada Inc.*, (Charron J. Ont. Court of Justice – General Division – July 29, 1991), the court drew a distinction between the right of revendication and the right of dissolution of a sale, both of which arise out of the Quebec Civil Code. The court stated the view that, had it been the intent of the Legislature to include the right of dissolution within the scope of subsection 5(5), it could easily have done so by mentioning it specifically. As a practical matter, it would appear that the right of revendication and the right of dissolution are so similar in their effect that they should be treated similarly in subsection 5(5).

We recommend that subsection 5(5) be amended to read as follows:

"Where goods brought into Ontario are subject to an unpaid seller's right to revendicate, <u>to obtain dissolution of the sales</u>

contract or to resume possession of the goods under the law of the Province of Quebec or any other jurisdiction, the right becomes unenforceable in Ontario twenty days after the goods are brought into Ontario unless the seller registers a financing statement or repossesses the goods within that twenty-day period.

8. Sub-clause 7(1)(a)(ii)

Some questions have arisen as to whether the words "leased or held for lease by a debtor to others" modify only the word "inventory" or also the word "equipment". While it seems only logical that they must modify the word "inventory", the current drafting is not as clear as it might be especially when compared with the PPSAs of other jurisdictions.

We recommend that sub-clause 7(1)(a)(ii) be amended to read as follows:

... if the goods are equipment or are inventory leased or held for lease by the debtor to others;

9. Clause 7(2)(a)

This clause seems unduly narrow in that it only contemplates perfection in Ontario within 60 days *after* the date the debtor changes its location. The secured creditor who knows (or suspects) that the debtor may change location to Ontario but not precisely when, should be able to pre-file to protect itself. The purpose of subsection 7(2) is to facilitate continuity of perfection. Secured parties should be encouraged to register prior to the change of location of the debtor (but not be penalized if they do not) in order to avoid the possibility of the loss of continuity of perfection because of a failure to register within the relevant time.

We recommend that clause 7(2)(a) should be amended to read as follows:

before or within sixty days after the day the debtor changes location;

10. Subsection 7(4)

This subsection prescribes rules for determining the location of the debtor. One rule requires a determination of the debtor's "chief executive office". This sometimes causes difficulties in certain fact situations, such as where senior management have offices in two or more jurisdictions or where directors' meetings are commonly held in different jurisdictions. It would appear that some clarification could be relatively easily achieved at least with respect to debtors that are corporations where the corporation law statute governing such corporation requires a filing in a public office which identifies the "registered office" or "head office" of the corporation. It would facilitate the application of the provision if the office which is identified for corporation law purposes as being the "registered office" or "head office" could be deemed to be the debtor's "chief executive office" for PPSA purposes.

We recommend that subsection 7(4) be amended by adding the following at the end:

; and where the debtor is a corporation and has identified on a public record the "registered office" or "head office" of the corporation pursuant to a requirement of the corporation law of its jurisdiction of incorporation, the office so identified shall be deemed to be the debtor's chief executive office.

11. Section 22

It would seem desirable to clarify that possession of securities and other collateral by any financial institution or other person which in the ordinary course of its business performs custodial or trust services, can be sufficient to achieve perfection by possession notwithstanding that the financial institution or other person may, on a literal interpretation of the PPSA, also be considered to be the "debtor's agent" because it also performs custodial or trust services for the debtor. Concerns in this regard have not been allayed by jurisprudence to date.

We recommend that subsection 1(1) be amended by adding the following definition of "financial intermediary" and that section 22 be amended to provide as follows:

1(1) "financial intermediary" means any person, including without limitation a bank, trust corporation, loan corporation and securities dealer, which in the ordinary course of business holds securities, instruments, chattel paper or negotiable documents of title for its customers, and any nominee of such

person, whether or not such person has a security interest in such securities, instruments, chattel paper or negotiable documents of title.

22(1) Possession or repossession of the collateral by the secured party, or on the secured party's behalf by <u>any financial intermediary other than the debtor or by any other</u> person other than the debtor or the debtor's agent, perfects a security interest in,

(a) chattel paper;
(b) goods;
(c) instruments;
(d) securities;
(e) negotiable documents of title; and
(f) money,

but only while it is actually held as collateral.

22(2) Possession of the collateral on the secured party's behalf by a financial intermediary is not effective to perfect a security interest in the collateral if the financial intermediary also holds the collateral as agent for the debtor.

12. Subsection 28(7)

Subsection 28(7) affords a special priority to a purchaser of a security "... who purchases the security in the ordinary course of business and has taken possession of it ..." without knowledge that the purchase constituted a breach of a security agreement. This special priority prevails over any security interest even though the purchaser knows of the security interest. What is not clear, however, is whether this purchase must be made in the ordinary course of business *of the transferor or the purchaser*.

We think the special priority is justified where the debtor is a dealer in securities or otherwise transfers the security in the ordinary course of the debtor's business. However, we think that, where the purchaser knows of the prior security interest, the purchaser should not be afforded this special priority in other circumstances.

We recommend that section 28(7) be amended to provide as follows:

A purchaser of a security, whether in the form of a security certificate or an uncertificated security, who purchases the security in the ordinary course of the transferor's business and has taken possession of it, has priority over any security interest in it perfected by registration or temporarily perfected under section 23 or 24, even though the purchaser knows of the security interest, if the purchaser did not know the purchase constituted a breach of the security agreement.

13. (New) Subsections 28(9) and 28(10)

Section 28 deals with, among other things, purchasers who are entitled to certain rights where the purchaser has taken possession of the collateral. It would appear desirable for subsections 28(3), (4), (6) and (7) to provide that such possession may be taken by the purchaser or on behalf of the purchaser by a financial intermediary other than the debtor or on behalf of the purchaser by any other person other than the debtor or debtor's agent, in order to facilitate transactions where financial institutions, lawyers and other agents take possession on behalf of the purchaser.

We recommend that new subsections 28(9) and 28(10) be added, as follows:

28(9) For the purposes of this section, the taking of possession by a purchaser is deemed to include the taking of possession on behalf of the purchaser by any financial intermediary other than the debtor or by any other person other than the debtor or the debtor's agent.

28(10) Possession of the collateral on behalf of a purchaser by a financial intermediary is not effective for the purposes of this section if the financial intermediary also holds the collateral as agent for the debtor.

14. Subsection 32(1), Subsection 33(1) and Subsection 33(2)

There is some uncertainty concerning priority matters arising out of the provisions in subsections 32(1), 33(1) and 33(2), on the one hand, and section 28, on the other.

For example, uncertainty may arise where a seller sells inventory to a dealer and reserves a purchase-money security interest, and the dealer then resells the inventory in the ordinary course of the dealer's business. The seller's purchase-money security interest in inventory *or its proceeds* is stated to take priority "over any other security interest in the same collateral" (subsection 33(1)). However, when the dealer resells the inventory, the dealer may obtain proceeds which might be "chattel paper", and if the dealer then sells (or assigns) the "chattel paper" to a purchaser who takes possession of it (a relatively common occurrence), clause 28(3)(b) provides that such purchaser would have priority. Thus, there may be room for doubt as to who is to have priority as to the chattel paper: the original seller of inventory or the purchaser of the chattel paper.

It is our view that the legislative intent is to afford priority to the purchaser of the chattel paper but some clarification in this regard would be desirable.

We recommend that the phrase "Subject to section 28," be inserted at the beginning of each of subsections 32(1), 33(1) and 33(2).

15. Clause 33(1)(b)

It appears that this provision should cover the situation where a third party rather than a debtor is the one actually receiving possession of the inventory. This seems to be what is contemplated in sub-clause 33(1)(a)(ii).

We recommend that clause 33(1)(b) be amended to read as follows:

before the debtor <u>or a third party, at the request of the debtor,</u> receives possession of the inventory, the purchase-money secured party gives notice... .

16. Clause 34(2)(a)

Some circularity and possible inequity results from the decision of *G.M.S. Securities & Appraisals Ltd. v. Rich-Wood Kitchens Ltd. and National Trustco* (1991) 1 P.P.S.A.C. (2d), 233 (Ont. Div. Ct.). While the decision has a lot to recommend it by way of certainty, it has little to recommend it by way of fairness. In the circumstances of the particular case a fixture supplier who had not registered on title was given priority. The issue is whether the simplicity is consistent with the underlying policy of benefiting those who register. The matter is quite complex.

We recommend that consideration be given to adopting a rule that would only benefit those who have registered on title when dealing with real property.

17. Subsection 34(3)

This section refers in the second line to "a" person while the comparable provision in subsection 35(4) refers in the second line to "any" person. There does not appear to be any reason for using different words and it is preferable to adopt consistent language.

We recommend that subsection 34(3) be amended to read as follows:

If a secured party has an interest in a fixture that has priority over the claim of <u>any</u> person having an interest in the real property, ...

18. Subsection 46(4)

In recent months there has been a spate of conflicting decisions interpreting the curative provision in this subsection. One line of cases regards the test as being an objective one following the line of reasoning in *Re Weber* (1990) 1 P.P.S.A.C. (2d) 36. The second line of cases considers the test to be a subjective one having regard to the persons before the court, and follows the line of reasoning in *Canamsucco Road House Food Co. v. Lngas Ltd.* (1991) 2 P.P.S.A.C. (2d) 203 (Ont. Court of Justice - General Division).

The decisions extend not only to cases where the curative provision is invoked vis-à-vis other secured creditors but also to where it is invoked vis-à-vis the debtor's trustee in bankruptcy. See also *Re: Woolf,* Adams J. (Ont. Court of Justice – Bankruptcy Division – October 26, 1992), under appeal; *Re: Tanzer,* McKeown J. (Ont. Court of Justice – Bankruptcy Division – November 6, 1992); *Re: Haasen* (1992), 8 O.R. (3d) 489, *Perrier v. Ford Credit Canada Ltd.* Chadwick J. (Ont. Court of Justice – Bankruptcy Division – November 25, 1992); *B.M.P & Daughters Investment Corp. v. 941242 Ontario Ltd.,* Jarvis J. (Ont. Court of Justice – General Division – October 16, 1992); *Prenor Trust Co. of Canada v. 652729 Ontario Limited* Chadwick J. (Ont. Court of Justice – General Division October 26, 1992); *General Motors Acceptance Corporation of Canada Limited v. Stetsko* (1992) 8 O.R. (3d) 537.

We recommend that subsection 46(4) be clarified taking into account the conflicting Court decisions concerning the interpretation of this subsection.

19. Subsection 46(6)

The mandatory requirement that copies of all registered financing statements or financing change statements or verification statements be provided to debtors within a stipulated time results in a great expenditure of time and money by (some) secured parties. It is arguable that this adversely impacts on consumers and other debtors through the passing on of costs. Moreover, it appears that many debtors do not require or wish to receive such documents and often do not understand what such documents are. It may be that the intent of the section could be fairly accomplished through more effective means.

We recommend that subsection 46(6) be deleted and replaced by the following:

Where a financing statement or financing change statement is registered and the debtor gives notice in writing to the secured party that the debtor requires a copy thereof, the secured party shall deliver to the debtor within 20 days after receiving such notice,

(a) a copy of the registered financing statement or financing change statement, or

(b) a copy of the verification statement with respect thereto.

20. (New) Subsection 46(8)

It is exceedingly difficult to identify the correct legal name and date of birth of an individual. Very few people carry around copies of their birth certificates, passports or Canadian citizenship papers. Therefore, it is quite common for secured parties to misname individuals in their PPSA registrations.

The failure to meet the PPSA's mandatory requirement that the first given name, the initial of the second given name and the surname of an individual debtor must be included in a financing statement results in the security interest being unperfected. There are a great number of reported cases concerning such matters and undoubtedly many other disputes

involving such matters where the issue has not resulted in litigation. To a significant degree, the integrity of the computerized PPSA registry system depends on strict compliance with the mandatory name requirements.

However, it is the view of the PPSL Committee that certain saving provisions are appropriate in limited circumstances, namely, where the registration pertains to collateral which is or includes a motor vehicle and the secured party has in the financing statement set out the correct vehicle identification number ("VIN"). A very high percentage of financing statements registered under the PPSA pertain to motor vehicles. Indeed, where the motor vehicles are "consumer goods", it is mandatory that the financing statements include the VIN. While a searcher making an "individual specific" search would not find the registration in those cases where the secured party has failed to set out the exact name information correctly in the financing statement, the same searcher making a "VIN enquiry" against the correct VIN number of a motor vehicle *would* in fact find such registration.

It should also be borne in mind that it is usually easier to determine the correct VIN number of a motor vehicle than it is to determine (with certainty) the correct name of an individual. Therefore, with respect to motor vehicles, a registry (and search) system that is primarily geared to the VIN number of the motor vehicle, would seem desirable not only for secured parties but also for searchers who are genuinely interested in discovering security registrations against the motor vehicle (and not simply seeking to rely on technical non-compliance with the registration requirements in order to claim later that the security interest is unperfected).

We recommend that a new subsection 46(8) be added, as follows:

> **Where the collateral is or includes a motor vehicle, as defined in the regulations, and the vehicle identification number of the motor vehicle is set out in the designated place on a registered financing statement or financing change statement, as required by the regulations, but the name set out as the name of the debtor is not the name of the debtor as required by the regulations or, if the debtor is a natural person, the date of birth set out as the date of birth of the debtor is not the date of birth of the debtor as required by the regulations, such error in the name or date of birth of the debtor shall be deemed to not be likely to mislead materially a reasonable person with respect to the security interest in such motor vehicle.**

21. Subsection 59(5)

Subsection 59(5) provides that, to the extent that certain sections of the PPSA give rights to the debtor and impose duties upon the secured party, the provisions therein shall not be waived or varied "... except as provided by this Act".

Certain sections of the PPSA - such as subsection 66(1) - expressly contemplate the possibility of a debtor agreeing after default to waive certain rights (for example, the right to redeem). However, there is at present some uncertainty as to which rights a debtor may (or may not) waive after default by signing a written statement and this uncertainty is compounded somewhat by the anomaly in subsection 65(1) which is referred to in paragraph number 23 below.

We recommend that subsection 59(5) be amended to specifically enumerate the sections which provide for the waiver or variance of rights given to the debtor or duties imposed upon the secured party.

22. Clause 63(1)(a)

This section pertains to the secured party's reasonable costs of realization. The section begins with a list of expenses of the secured party and is then worded in such a way as to suggest that any other reasonable expenses incurred by the secured party could only be covered if such other reasonable expenses are specifically identified in the security agreement. This appears to be unduly restrictive. As long as the expenses incurred by the secured party are in fact "reasonable", the secured party should be able to recover such expenses.

We recommend that clause 63(1)(a) be amended to read as follows:

> **the reasonable expenses of seizing, repossessing, holding, repairing, processing or preparing for disposition and disposing of the collateral and any other reasonable expenses of enforcing the security agreement incurred by the secured party; and**

23. Subsection 65(1)

Subsection 65(1) - which deals with compulsory disposition of consumer goods - seems to contemplate the possibility that the debtor may

sign, after default, a statement renouncing or modifying "the debtor's rights *under this Part*" (emphasis added). It would therefore seem that, where consumer goods are involved, the debtor may have latitude after default to renounce or modify *all* the debtor's Part V rights.

This appears anomalous because, where the collateral does *not* involve consumer goods, the debtor does not appear to have such broad latitude to renounce or modify all the debtor's Part V rights.

One would have expected that, if anything, where consumer goods were involved, the legislation would be *less* permissive in allowing the debtor to renounce or modify his rights. It would seem that the reference in subsection 65(1) to a statement renouncing or modifying the debtor's rights should be limited to the debtor's rights *under subsection 65(1)*.

We recommend that subsection 65(1) be clarified with respect to whether a debtor may renounce or modify all the debtor's rights under Part V by signing a written statement after default.

24. Section 69

Subsection 63(4) requires notices to be given in writing. Subsection 65(2) does too. Questions have arisen as to whether notices by fax (that is, telephone transmission) can be given and, in particular, as to whether the provisions in sections 68 and 69 apply to notices given by fax. It appears that they do not.

Effecting notices by registered mail or personal delivery can be very expensive and slow. When there is a postal disruption, registered mail notices are not feasible.

We note that the Rules of Civil Procedure now provide for the service of documents on a solicitor of record by telephone transmission subject to stipulated requirements. Subsection 74(1) contemplates regulations being made to prescribe additional methods of serving notices and other documents for the purposes of section 68; however, it is uncertain whether such regulation could properly include a *deeming* provision similar to that set out in subsection 68(4).

We recommend that subsection 68(1) be amended to permit the serving of notices and documents on any person by telephone transmission, subject to requirements similar to those set forth for the service of documents on a solicitor of record pursuant to Rule 16.05 of the Rules of Civil Procedure, and that subsection

68(4) be amended to provide that a notice or document given or served by telephone transmission shall be deemed to have been given, delivered or served when the addressee actually receives the notice or document, or on the day after the day of transmission, whichever is earlier.

25. Section 72

The extent to which priorities are to be determined under the PPSA having regard to actual knowledge of a secured creditor (or a trustee in bankruptcy) or having regard to whether the secured creditor has acted in good faith, has generated much uncertainty: see, for example, *Perrier v. Ford Credit Canada Ltd.*, Chadwick J. (Ont. Court of Justice – Bankruptcy Division – November 25, 1992); *B.M.P. & Daughters Investment Corp. v. 941242 Ontario Ltd.*, Jarvis J. (Ont. Court of Justice – General Division – October 16, 1992) and *529617 Ontario Ltd. v. Concord Inn Motel Inc.* (1988) 8 P.P.S.A.C. 265 (Ont. D. Ct.). Clarification is required.

We recommend that section 72 be amended to clarify the effect of knowledge on priorities.

26. R.R.O. 1990, Reg. 912, section 1, "motor vehicle"

The applicability of several key provisions in the PPSA depend on whether the collateral is a "motor vehicle". Unfortunately, part of the definition refers to "a machine acquired *for use or used as* a road-building machine" (emphasis added) and, in the context of other provisions in the definition, it is not clear whether the test is an objective or a subjective one. In *Central Guaranty Trustco v. Bruncor Leasing Inc.* (1992) 3 P.P.S.A.C. (2d) 298, Ground J. stated that the definition should, in his view, be amended to clarify that an objective test is intended.

We recommend that item (d) of the definition of "motor vehicle" in R.R.O. 1990, Reg. 912, Section 1 be amended to read as follows:

A road-building machine within the meaning of subsection 1(1) of the *Highway Traffic Act*, R.S.O. 1990, c. H.8.

27. R.R.O. 1990, Reg. 912, clauses 3(1)(i) and (j)

As presently worded, these two clauses require that "if *all* of the collateral is classified as consumer goods" (emphasis added), the principal amount and the maturity date or, if there is no fixed maturity date, an indication that there is no fixed maturity date, be included in the financing statement.

This has led to uncertainty as to whether a claim which includes any other class of collateral in the same registration negates the need for these two pieces of information; for example, in instances where an "x" is inserted in the boxes on line 10 for both "consumer goods" and "other" (for proceeds).

We recommend that consideration be given to amending each of clauses 3(1)(i) and 3(1)(j) in R.R.O. 1990, Reg. 912 to read as follows:

(i) if the classification of the collateral is or includes consumer goods, the principal amount;

(j) if classification of the collateral is or includes consumer goods, the maturity date or, if there is no fixed date of maturity, an indication that there is no fixed maturity date; and

28. R.R.O. 1990, Reg. 912, section 4

This section stipulates certain circumstances in which a financing statement *shall* be designated as a "caution filing". There is uncertainty as to the reason for the requirement. It seems that the purpose for the requirement that an "x" be placed in the caution box in a financing statement is to alert any searcher to a vital piece of information that might otherwise be overlooked, namely, that the secured party who makes the caution filing registration not only has a security interest perfected by registration but one which may date back, for priority purposes, to a much earlier perfection date than simply the date of the Ontario registration. The term "caution" may be ambiguous and perhaps misleading to persons who regard all financing statements as being "cautions" of a sort.

We recommend that R.R.O. 1990, Reg. 912 section 4 be replaced by a new regulation in which the term "caution filing" is changed to "incoming collateral caution" and which makes concomitant changes to Form 1C.

29. R.R.O. 1990, Reg. 912 subsection 16(1)

The current name requirements – in particular those relating to the initial of the second given name – are unduly restrictive. As a practical matter, where the correct date of birth of the individual debtor is set out in the financing statement, such information in combination with the debtor's correct first given name and correct surname should, in the vast majority of cases, provide sufficient information to alert any searcher as to whether there may be security registered against the name of the person in question. Even in the case of a debtor named "John Smith", the correct birth date information should provide adequate particularizing information to enable the searcher to find out if the individual the searcher is concerned about has in fact granted a security interest.

It is therefore not necessary as a practical matter to require that the initial of the second given name be set out in the financing statement. Imposing such requirement only gives grounds to attack the security to those whose primary interest was not to discover the existence of the security interest but rather to find a technical defect.

We recommend that R.R.O. 1990, Reg. 912, subsection 16(1) be replaced by a new regulation in which there is no requirement that the initial of the second given name of the debtor be set out in the financing statement.

30. R.R.O. 1990, Reg. 911, section 1

The registration fee for a perpetual registration is $500. Many users of the registration system would wish to effect a single registration to avoid the pitfalls of failure to renew. It is likely, however, that the $500 fee for a perpetual registration effectively discourages most persons wishing to effect a single registration. The next best alternative is a registration for 25 years (for a fee of $150).

We recommend that consideration be given to reducing the fee for a perpetual registration.

III. REPAIR AND STORAGE LIENS ACT

31. (New) Subsection 9(3)

The name requirements of the Liens Act have given rise to considerable litigation. Several of the reported Liens Act decisions to date have concerned the problem of an incorrect debtor name. Where the repair or storage relates to motor vehicles, comments similar to those above in paragraph number 20 above can be made.

We recommend that a new subsection 9(3) be added, as follows:

> **Where the article is or includes a motor vehicle and the vehicle identification number of the motor vehicle is set out in the designated place on a registered claim for lien or change statement, as required by the regulations, but the name set out as the name of the debtor is not the name of the debtor as required by the regulations made under this Act or, if the debtor is a natural person, the date of birth set out as the date of birth of the debtor is not the date of birth of the debtor as required by the regulations made under this Act, the registered claim for lien shall be deemed to be effective with respect to the lien against such motor vehicle despite such error in the name or date of birth of the debtor.**

32. Subsection 10(1)

Most other Canadian jurisdictions which have enacted legislation similar to the Liens Act have stipulated that a non-possessory lien will only exist if the lien claimant files certain documents within a specified period of surrendering possession. For example, the Manitoba *Garage Keeper's Act, R.S.M. 1987, c. G-10* requires that a financing statement be registered under Manitoba's *Personal Property Security Act*, R.S.M. 1987, c. P35, within 20 days of a garage keeper surrendering possession. Requiring registration of a claim for lien within a specified period after the release of possession would ensure that those searching for liens are provided with reasonably current information.

At present, liens which are many months or even years old will not be disclosed by a search if they are unregistered; however, these liens will become valid and will often enjoy priority from the moment they are registered.

If a time limit were imposed for registration, some comfort could be taken that a search would reveal all liens except only those which may have arisen relatively recently. There are several instances involving vehicles where claims for lien have been registered more than one year after possession was released. In a number of cases, the repair which was the subject of the claim for lien was essentially valueless by the time the claim for lien was registered.

We recommend that subsection 10(1) be amended to read as follows:

... only if the claim for lien has been registered <u>within 90 days after the non-possessory lien arises</u>, ...

33. Subsection 14(3)

Subsection 14(1) indicates that a lien claimant may utilize the services of a sheriff to seize the article. Questions have arisen as to whether any other person – such as a bailiff – may also seize the article or whether *only* the sheriff may seize the article (in the absence of a specific contractual provision concerning such matter). The question is complicated somewhat by the provision in subsection 14(3) which suggests that there may be a lawful power of seizure "otherwise available to the lien claimant by law".

We recommend that section 14(1) be amended to read as follows:

... claim for lien has, unless otherwise agreed, the right to take possession of the article by any method permitted by law and without limiting the generality of the foregoing ... .

34. Sub-clause 15(2)(b)(i)

It appears that the notice requirement of this sub-clause is triggered if the article is a motor vehicle even if it is a motor vehicle for which there is no ownership registration (such as lift trucks), thus leaving uncertainty as to how the requirements of the section can be met. It is also unclear whether the ownership registry contemplated is the registry of the Ministry of Transportation of Ontario.

We recommend that subclause 15(2)(b)(i) be amended to read as follows:

the person named in the permit issued in respect of the article, if the article is a motor vehicle for which a permit has been issued under the *Highway Traffic Act*, R.S.O. 1990, c. H.8.

35. Section 26

This section has been interpreted to mean that, in effect, a separate claim for lien must be registered under the Liens Act each and every time a lien arises: *General Electric Capital Equipment Finance Inc. v. Transland Tire Sales & Service Ltd.*, 2 P.P.S.A.C. (2d) 223. However, the *reason* apparently underlying such requirement – namely, that it would be impossible to determine priorities between different claimants if a series of non-possessory lien claims could be made effective simply by stating the cumulative total of the aggregate claims in a single claim for lien – does not appear to be correct when section 16 is borne in mind. That section contemplates that priorities will be in reverse order to the order in which the lien claimants gave up possession. Thus, extrinsic evidence as to the time possession is given up, will be required in any event in order to establish priorities.

We recommend that a new subsection 26(3) be added, as follows:

One claim for lien may be registered for one or more non-possessory liens which have arisen and taken effect prior to the date of registration of the claim for lien.

36. R.R.O. 1990, Reg. 1003, subsection 10

Comments similar to those in paragraph number 29 above can be made concerning the current name requirements – in particular those relating to the initial of the second given name.

We recommend that R.R.O. 1990, Reg. 1003, subsection 10(1) be replaced by a new regulation in which there is no requirement that the initial of the second given name of the debtor be set out in the claim for lien.

IV. OTHER

37. *Landlord and Tenant Act*, R.S.O. 1990, c. L.7

Jurisprudence in Ontario is to the effect that a landlord's right against goods, after distress is levied, is treated as a "lien" arising by operation of law

that is outside the scope of the PPSA. As a result, no priority rule in the PPSA will resolve a dispute between a landlord's right to distrain and a PPSA security interest.

Our courts have endeavored to resolve such a priority dispute by giving effect to subsection 31(2) of the *Landlord and Tenant Act*. Unfortunately, the application of this statutory provision is not clear because it is expressed in pre-PPSA terminology and does not take into account the generic "security interest" of the PPSA. The landlord and tenant legislation in some western provinces has been amended recently to afford purchase-money security interests priority over the distraint rights of landlords.

We recommend that changes be made to the *Landlord and Tenant Act*, R.S.O. 1990, c. L.7 to clarify the provisions and afford purchase-money security interests priority over the distraint rights of landlords.

38. Verification statements

In *The Bank of Nova Scotia v. Peat Marwick Thorne Inc.*, 2 P.P.S.A.C. (2d) 139 (*Re Clintons Flowers & Gifts Ltd.*), it was held that there is an onus on the secured party to review Verification Statements generated by the Ministry to catch Ministry data entry errors. This is a very important decision which we understand is currently under appeal. We make no comment at this time pending that appeal.

39. Subsection 45(4) of the PPSA

We understand that there is at present before the courts a case concerning the application of subsection 45(4) of the PPSA to financing statements registered under the *Personal Property Security Act*, R.S.O. 1980, c.375. This too is an important issue. Pending the outcome of that case, we make no further comment at this time.

40. Section 79

In *Price Waterhouse v. St. Louis*, (1990) 1 P.P.S.A.C. 43, the court held that, where a mortgage, charge or assignment, the registration of which was provided for in the *Corporation Securities Registration Act*, was the subject of a registration under the PPSA, the PPSA applies only if the registration actually *perfected* the security interest. See also *Re Selox Inc.* (1993) 14 CBR

(3d) 285. We understand that *Re Selox Inc.* is currently under appeal. While we consider this issue to be of importance, we make no further comment at this time pending that appeal.

41. Uniformity with other PPSA legislation

While we have to some extent in this Submission referred to the legislation of other jurisdictions, we have not endeavored in this Submission to suggest amendments to the PPSA with a view to achieving uniformity with the PPSAs of other Canadian provinces. Such effort was beyond the scope of our undertaking. However, the PPSL Committee is strongly of the view that the goal of uniformity, to the maximum extent consistent with Ontario policy objectives, should be set and steps taken with a view to achieving that goal as soon as possible.

We recommend that efforts be undertaken to make the Ontario PPSA more consistent with comparable legislation in other provinces in Canada, to the maximum extent consistent with Ontario policy objectives.

42. Regulations

Section 74 of the PPSA provides that the Lieutenant Governor in Council may make regulations concerning a variety of matters. One of such matters is the definition of the term "motor vehicle". Generally, regulations may be made more expeditiously than amendments to the PPSA itself. If it were possible to add or amend definitions in the PPSA by way of regulation, the ability to provide a timely legislative response to changes in jurisprudence or business circumstances might be enhanced.

We recommend that consideration be given to amending Section 74 of the PPSA to broaden the subject matters concerning which the Lieutenant Governor in Council may make regulations and, specifically, to increase the number of terms which are to be defined by regulation.

43. Deposit Accounts

Concerns have been raised in several common law jurisdictions regarding the ability of financial institutions to take a mortgage, charge or assignment of their customer's deposit accounts. Much of this concern stems from the U.K. decision *In re Charge Card Services Ltd.*, [1987] 1 Ch. 150, [1986] 3 All E.R. 289;

affd [1989] 1 Ch. 497, [1988] 3 All E.R. 702 (C.A.) (without comment on this issue) in which Millett J. expressed the view that it was a legal impossibility for a customer of a bank to grant a charge over a deposit with it.

While we recognize that different theoretical considerations underlie the PPSA and *Charge Card* may not necessarily be followed in Ontario, the decision does introduce an element of uncertainty into the law governing assignments of choses in action generally. We note with interest that both Hong Kong and Bermuda have introduced simple amendments designed to ensure that charges by financial institutions are effective. Section 15A of the Hong Kong Law Amendment and Reform (Consolidated Ordinance) is representative of the confirming amendments and provides as follows:

> "For the avoidance of doubt, it is hereby declared that a person ("the First Person") is able to create and always has been able to create, in favour of another person ("the Second Person") a legal or equitable mortgage or charge over all or any of the First Person's interest in a chose in action enforceable by the First Person against the Second Person, and any mortgage or charge so created shall operate neither to merge the interest thereby created with, nor to extinguish or release that chose in action."

We understand that a similar provision is also under consideration in England.

> **We recommend that consideration be given to making changes to the *Conveyancing and Law of Property Act*, R.S.O. 1990 c. C.34 to clarify that a person (the "first person") may create in favour of another person (the "second person") a legal or equitable mortgage or charge over all or any of the first person's interest in a chose in action enforceable by the first person against the second person.**

V. SUMMARY OF RECOMMENDATIONS

1. **We recommend that subsection 1(1) be amended by changing the definition of "purchaser" to read:**

   "purchaser" means, <u>except in clause 34(2)(a)</u>, a person who takes by purchase.

2. **We recommend that subsection 1(1) be amended by adding the following:**

"building materials" means materials that are incorporated into a building and includes goods attached to a building so that their removal,

(a) would necessarily involve the dislocation or destruction of some other part of the building and cause substantial damage to the building apart from the loss of value of the building resulting from the removal, or

(b) would result in the weakening of the structure of the building or the exposure of the building to weather damage or deterioration,

but does not include

(c) heating, air conditioning or conveyancing devices, or

(d) machinery installed in a building or on land for use in carrying on an activity inside the building or on the land;

"building" means a structure, erection, mine or works built, constructed or opened on or in land;

"fixture" does not include building materials;

3. We recommend that section 2 be amended by changing the phrase "Subject to subsection 4(1), ..." to "Subject to subsections 1(3) and 4(1), ..." and that a new subsection 1(3) be added, as follows:

For the purposes of this Act,

(a) a lease of goods creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and

(i) the original term of the lease is equal to or greater than the remaining economic life of the goods,

(ii) the lessee is contractually obligated to renew the lease for the remaining economic life of the goods

or is contractually obligated to become the owner of the goods,

(iii) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or

(iv) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement;

(b) a lease of goods does not create a security interest merely because

(i) the lessor is a financial institution or other person engaged in whole or in part in the business of lending money,

(ii) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease agreement is entered into,

(iii) the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is based in whole or in part on the measurable use of the goods by the lessee,

(iv) the lessee assumes risk of loss of or damage to the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

(v) the lessee has an option to renew the lease or to become the owner of the goods,

(vi) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or

(vii) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed;

(c) in this subsection,

(i) additional consideration is not nominal if,

(A) when the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or

(B) when the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed;

but additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised,

(ii) "reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the lease agreement is entered into, and

(iii) "present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain; the discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the lease agreement is entered into, otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the lease agreement was entered into.

4. We recommend that subsection 4(1) be amended by adding the following new subsection:

[This Act does not apply] to a security agreement governed by an Act of the Parliament of Canada that deals with rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement, including but without limiting the generality of the foregoing, a mortgage under the *Canada Shipping Act*.

5. We recommend that subsection 4(1) be amended by adding the following new subsection:

[This Act does not apply] to a security agreement governed by an Act of the Parliament of Canada that deals with rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement, including but without limiting the generality of the foregoing, any agreement governed by Part VIII of the *Bank Act* (Canada).

6. We recommend that subsection 5(1) be amended to read as follows:

Except as otherwise provided in subsection 5(2) or in sections 6 to 8, ...

7. We recommend that subsection 5(5) be amended to read as follows:

"Where goods brought into Ontario are subject to an unpaid seller's right to revendicate, to obtain dissolution of the sales contract or to resume possession of the goods under the law of the Province of Quebec or any other jurisdiction, the right becomes unenforceable in Ontario twenty days after the goods are brought into Ontario unless the seller registers a financing statement or repossesses the goods within that twenty-day period.

8. We recommend that sub-clause 7(1)(a)(ii) be amended to read as follows:

... if the goods are equipment or are inventory leased or held for lease by the debtor to others;

9. We recommend that clause 7(2)(a) should be amended to read as follows:

before or within sixty days after the day the debtor changes location;

10. We recommend that subsection 7(4) be amended by adding the following at the end:

; and where the debtor is a corporation and has identified on a public record the "registered office" or "head office" of the corporation pursuant to a requirement of the corporation law of its jurisdiction of incorporation, the office so identified shall be deemed to be the debtor's chief executive office.

11. We recommend that subsection 1(1) be amended by adding the following definition of "financial intermediary" and that section 22 be amended to provide as follows:

1(1) "financial intermediary" means any person, including without limitation a bank, trust corporation, loan corporation and securities dealer, which in the ordinary course of business holds securities, instruments, chattel paper or negotiable documents of title for its customers, and any nominee of such person, whether or not such person has a security interest in such securities, instruments, chattel paper or negotiable documents of title.

22(1) Possession or repossession of the collateral by the secured party, or on the secured party's behalf by any financial intermediary other than the debtor or by any other person other than the debtor or the debtor's agent, perfects a security interest in,

(a) chattel paper;
(b) goods;
(c) instruments;
(d) securities;
(e) negotiable documents of title; and
(f) money,

but only while it is actually held as collateral.

22(2) Possession of the collateral on the secured party's behalf by a financial intermediary is not effective to perfect a security interest in the collateral if the financial intermediary also holds the collateral as agent for the debtor.

12. We recommend that section 28(7) be amended to provide as follows:

A purchaser of a security, whether in the form of a security certificate or an uncertificated security, who purchases the security in the ordinary course of the transferor's business and has taken possession of it, has priority over any security interest in it perfected by registration or temporarily perfected under section 23 or 24, even though the purchaser knows of the security interest, if the purchaser did not know the purchase constituted a breach of the security agreement.

13. We recommend that new subsections 28(9) and 28(10) be added, as follows:

28(9) For the purposes of this section, the taking of possession by a purchaser is deemed to include the taking of possession on behalf of the purchaser by any financial intermediary other than the debtor or by any other person other than the debtor or the debtor's agent.

28(10) Possession of the collateral on behalf of a purchaser by a financial intermediary is not effective for the purposes of this section if the financial intermediary also holds the collateral as agent for the debtor.

14. We recommend that the phrase "Subject to section 28," be inserted at the beginning of each of subsections 32(1), 33(1) and 33(2).

15. We recommend that clause 33(1)(b) be amended to read as follows:

before the debtor or a third party, at the request of the debtor, receives possession of the inventory, the purchase-money secured party gives notice... .

16. We recommend that consideration be given to adopting a rule that would only benefit those who have registered on title when dealing with real property.

17. We recommend that subsection 34(3) be amended to read as follows:

If a secured party has an interest in a fixture that has priority over the claim of any person having an interest in the real property, ...

18. We recommend that subsection 46(4) be clarified taking into account the conflicting Court decisions concerning the interpretation of this subsection.

19. We recommend that subsection 46(6) be deleted and replaced by the following:

Where a financing statement or financing change statement is registered and the debtor gives notice in writing to the secured party that the debtor requires a copy thereof, the secured party shall deliver to the debtor within 20 days after receiving such notice,

(a) a copy of the registered financing statement or financing change statement, or

(b) a copy of the verification statement with respect thereto.

20. We recommend that a new subsection 46(8) be added, as follows:

Where the collateral is or includes a motor vehicle, as defined in the regulations, and the vehicle identification number of the motor vehicle is set out in the designated place on a registered financing statement or financing change statement, as required by the regulations, but the name set out as the name of the debtor is not the name of the debtor as required by the regulations or, if the debtor is a natural person, the date of birth set out as the date of birth of the debtor is not the date of birth of the debtor as required by the regulations, such error in the name or date of birth of the debtor shall be deemed to not be likely to mislead materially a reasonable person with respect to the security interest in such motor vehicle.

21. We recommend that subsection 59(5) be amended to specifically enumerate the sections which provide for the waiver or variance of rights given to the debtor or duties imposed upon the secured party.

22. We recommend that clause 63(1)(a) be amended to read as follows:

the reasonable expenses of seizing, repossessing, holding, repairing, processing or preparing for disposition and disposing of the collateral and any other reasonable expenses of enforcing the security agreement incurred by the secured party; and

23. We recommend that subsection 65(1) be clarified with respect to whether a debtor may renounce or modify all the debtor's rights under Part V by signing a written statement after default.

24. We recommend that subsection 68(1) be amended to permit the serving of notices and documents on any person by telephone transmission, subject to requirements similar to those set forth for the service of documents on a solicitor of record pursuant to Rule 16.05 of the Rules of Civil Procedure, and that subsection 68(4) be amended to provide that a notice or document given or served by telephone transmission shall be deemed to have been given, delivered or served when the addressee actually receives the notice or document, or on the day after the day of transmission, whichever is earlier.

25. We recommend that section 72 be amended to clarify the effect of knowledge on priorities.

26. We recommend that item (d) of the definition of "motor vehicle" in R.R.O. 1990, Reg. 912, Section 1 be amended to read as follows:

A road-building machine within the meaning of subsection 1(1) of the *Highway Traffic Act*, R.S.O. 1990, c. H.8.

27. We recommend that consideration be given to amending each of clauses 3(1)(i) and 3(1)(j) in R.R.O. 1990, Reg. 912 to read as follows:

(i) if the classification of the collateral is or includes consumer goods, the principal amount;

(j) if classification of the collateral is or includes consumer goods, the maturity date or, if there is no fixed date of maturity, an indication that there is no fixed maturity date; and

28. We recommend that R.R.O. 1990, Reg. 912 section 4 be replaced by a new regulation in which the term "caution filing" is

changed to "incoming collateral caution" and which makes concomitant changes to Form 1C.

29. We recommend that R.R.O. 1990, Reg. 912, subsection 16(1) be replaced by a new regulation in which there is no requirement that the initial of the second given name of the debtor be set out in the financing statement.

30. We recommend that consideration be given to reducing the fee for a perpetual registration.

31. We recommend that a new subsection 9(3) be added, as follows:

Where the article is or includes a motor vehicle and the vehicle identification number of the motor vehicle is set out in the designated place on a registered claim for lien or change statement, as required by the regulations, but the name set out as the name of the debtor is not the name of the debtor as required by the regulations made under this Act or, if the debtor is a natural person, the date of birth set out as the date of birth of the debtor is not the date of birth of the debtor as required by the regulations made under this Act, the registered claim for lien shall be deemed to be effective with respect to the lien against such motor vehicle despite such error in the name or date of birth of the debtor.

32. We recommend that subsection 10(1) be amended to read as follows:

... only if the claim for lien has been registered <u>within 90 days after the non-possessory lien arises</u>, ...

33. We recommend that section 14(1) be amended to read as follows:

... claim for lien has, unless otherwise agreed, the right to take possession of the article by any method permitted by law and without limiting the generality of the foregoing ... .

34. We recommend that subclause 15(2)(b)(i) be amended to read as follows:

the person named in the permit issued in respect of the article, if the article is a motor vehicle for which a permit has been issued under the *Highway Traffic Act*, R.S.O. 1990, c. H.8.

35. We recommend that a new subsection 26(3) be added, as follows:

One claim for lien may be registered for one or more non-possessory liens which have arisen and taken effect prior to the date of registration of the claim for lien.

36. We recommend that R.R.O. 1990, Reg. 1003, subsection 10(1) be replaced by a new regulation in which there is no requirement that the initial of the second given name of the debtor be set out in the claim for lien.

37. We recommend that changes be made to the *Landlord and Tenant Act*, R.S.O. 1990, c. L.7 to clarify the provisions and afford purchase-money security interests priority over the distraint rights of landlords.

38. We recommend that efforts be undertaken to make the Ontario PPSA more consistent with comparable legislation in other provinces in Canada, to the maximum extent consistent with Ontario policy objectives.

39. We recommend that consideration be given to amending Section 74 of the PPSA to broaden the subject matters concerning which the Lieutenant Governor in Council may make regulations and, specifically, to increase the number of terms which are to be defined by regulation.

40. We recommend that consideration be given to making changes to the *Conveyancing and Law of Property Act*, R.S.O. 1990 c. C. 34 to clarify that a person (the "first person") may create in favour of another person (the "second person") a legal or equitable mortgage or charge over all or any of the first person's interest in a chose in action enforceable by the first person against the second person.

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Appendix "A"

Members of the PPSL Committee are as follows:

Jennifer Babe
Miller, Thomson
20 Queen Street West
27th Floor
Toronto, Ontario
M5H 3S1
Telephone No. 595-8555
Fax No. 595-8695

R. John Cameron
Tory Tory Deslauriers & Binnington
P.O. Box 270
Suite 3000, Aetna Tower
Toronto-Dominion Centre
Toronto, Ontario
M5K 1N2
Telephone No. 865-8112
Fax No. 865-7380

Gary W. Donais
General Motors Acceptance Corp.
of Canada, Ltd.
3300 Bloor Street West
Suite 2800
Toronto, Ontario
M8X 2X5
Telephone No. 234-6631
Fax No. 234-6614

John J. Lavigne
The Bank of Nova Scotia
General Counsel Department
Scotia Plaza
44 King Street West
Toronto, Ontario
M5H 1H1
Telephone No. 866-3431
Fax No. 866-7767

Geoffrey B. Morawetz
Borden & Elliot
Scotia Plaza
41st Floor
40 King Street W.
Toronto, Ontario
M5H 3E9
Telephone No. 367-6240
Fax No. 367-6749

Kenneth C. Morlock (Chair)
Fasken Campbell Godfrey
P.O. Box 20
Toronto-Dominion Bank Tower
Toronto-Dominion Centre
Toronto, Ontario
M5K 1N6
Telephone No. 868-3429
Fax No. 362-2381

B. Lynn Paul
Inch, Easterbrook & Shaker
1 King St. West
Suite 1500
Hamilton, Ontario
L8P 4X8
Telephone No. 525-4481
Fax No. 525-0031

John M. Vickruck
Paccar of Canada Limited
3rd Floor
6711 Mississauga Road North
Mississauga, Ontario
L5N 4J8
Telephone No. 858-7059
Fax No. 858-2971

Henry J. P. Wiercinski
McCarthy, Tétrault
Box 48, Toronto-Dominion Centre
Toronto-Dominion Bank Tower
Toronto, Ontario
M5K 1E6
Telephone No. 362-1812
Fax No. 868-0673

The Ministry representatives who are Observers on the PPSL Committee are:

Katharine Smith
Director
Personal Property Registration Branch
Ministry of Consumer and Commercial Relations
393 University Avenue, 3rd Floor
Toronto, Ontario
M7A 2H6
Telephone No. 596-3771
Fax No. 596-3838

Allen Doppelt
Senior Solicitor
Companies Branch
Ministry of Consumer and Commercial Relations
393 University Avenue, 2nd Floor
Toronto, Ontario
M7A 2H6
Telephone No. 596-3636
Fax No. 596-0438

Joseph Barrows
Deputy Director
Legal & Client Services
Personal Property Registration Branch
Ministry of Consumer and Commercial Relations
393 University Avenue, 4th Floor
Toronto, Ontario
M7A 2H6
Telephone No. 596-3766
Fax No. 596-3838

Wende Rapson
Solicitor
Personal Property Registration Branch
Ministry of Consumer and Commercial Relations
393 University Avenue
4th Floor
Toronto, Ontario
M7A 2H6
Telephone No. 596-3804
Fax No. 596-3838

Appendix B

Appendix B

Members of the PPSL Committee are as follows:

Jennifer E. Babe
Miller, Thomson
20 Queen Street West
27th Floor
Toronto, Ontario
M5H 3S1
Telephone No.: (416) 595-8555
Fax No.: (416) 595-8695
E-mail: jbabe@millerthomson.ca

Lorna Borenstein
Hewlett-Packard (Canada) Ltd.
5150 Spectrum Way
Mississauga, Ontario
L4W 5G1
Telephone No.: (905) 206-3316
Fax No.: (905) 206-4122
E-mail: lorna_borenstein@hp.com

Michael E. Burke
Blake, Cassels & Graydon
Box 25, Commerce Court West
Toronto, Ontario
M5L 1A9
Telephone No.: (416) 863-3866
Fax No.: (416) 863-2653
E-mail: meb@blakes.ca

R. John Cameron
Tory, Tory, Deslaurier & Binnington
Suite 3000, Aetna Tower
79 Wellington Street West
Toronto-Dominion Centre
Toronto, Ontario
M5K 1N2
Telephone No.: (416) 865-8112
Fax No.: (416) 865-7380
E-mail: jcameron@torytory.ca

Bradley Crawford, Q.C.
McCarthy Tétrault
Suite 4700
Toronto Dominion Bank Tower
Toronto-Dominion Centre
Toronto, Ontario
M5K 1E6
Telephone No.: (416) 601-7899
Fax No.: (416) 868-1862
E-mail: prof@mccarthy.ca

David L. Denomme
Assistant Vice-President, Legal
Newcourt Credit Group Inc.
BCE Place
181 Bay Street
Suite 3500
Toronto, Ontario
M5J 2T3
Telephone No.: (416) 777-5383
Fax No.: (416) 594-5223
E-mail: David_Denomme@
Newcourt.com

Professor Benjamin Geva
Osgoode Hall Law School
York University
North York, Ontario
M3J 1P3
Telephone No.: (416) 736-5045
Fax No.: (416) 736-5736

Donald E. MacKenzie
Lafleur Brown
Suite 920, Box 359
1 First Canadian Place
Toronto, Ontario
M5X 1E1
Telephone No.: (416) 869-0994
Fax No.: (416) 362-5818

Professor Richard H. McLaren
Faculty of Law
The University of Western Ontario
London, Ontario
N6A 3K7
Telephone No.: (519) 661-3354
Fax No.: (519) 661-3790
E-mail: lawrhm@
uwoadmin.uwo.ca

Kenneth C. Morlock (Chair)
Fasken Campbell Godfrey
36th Floor
Toronto Dominion Bank Tower
Toronto-Dominion Centre
Toronto, Ontario
M5K 1N6
Telephone No.: (416) 868-3429
Fax No.: (416) 364-7813
E-mail: ken_morlock@fasken.com

Wende Rapson
General Motors Acceptance
Corporation of Canada, Limited
3300 Bloor Street West
Suite 2800
Toronto, Ontario
M8X 2X5
Telephone No.: (416) 234-6633
Fax No.: (416) 234-6614

Kathryn A. Roka-Ulrich
Osler, Hoskin & Harcourt
P.O. Box 50
1 First Canadian Place
Toronto, Ontario
M5X 1B8
Telephone No.: (416) 862-6786
Fax No.: (416) 862-6666

Neil C. Saxe
Borden & Elliot
Suite 4100
40 King Street W.
Toronto, Ontario
M5H 3Y4
Telephone No.: (416) 367-6032
Fax No.: (416) 361-7068

Edward Weidberg
45 Sheppard Avenue East
Suite 510
Toronto, Ontario
M2N 5W9
Telephone No.: (416) 512-7049
Fax No.: (416) 512-9157

Paul D. Wickens
Heenan Blaikie
P.O. Box 185
Suite 2600
South Tower, Royal Bank Plaza
Toronto, Ontario
M5J 2J4
Telephone No.: (416) 360-3553
Fax No.: (416) 360-8425
E-mail: pwickens@heenan.ca

Henry J.P. Wiercinski
McCarthy, Tétrault
Suite 4700
Toronto Dominion Bank Tower
Toronto-Dominion Centre
Toronto, Ontario
M5K 1E6
Telephone No.: (416) 601-7842
Fax No.: (416) 868-1862

Professor Jacob S. Ziegel
Professor of Law
University of Toronto
78 Queen's Park
Toronto, Ontario
M5S 2C5
Telephone No.: (416) 978-3717
Fax No.: (416) 978-2648
E-mail: jziegel@law.utoronto.ca

The Ministry representatives and other Observers on the PPSL Committee are:

Katharine Smith
Director
Personal Property Security Registration Branch
Ministry of Consumer and Commercial Relations
393 University Avenue
3rd Floor
Toronto, Ontario
M7A 2H6
Telephone No.: (416) 325-8780
Fax No.: (416) 325-0486

Allen Doppelt
Senior Counsel
Companies Branch
Ministry of Consumer and Commercial Relations
250 Yonge Street
Toronto, Ontario
M5B 2N5
Telephone No.: (416) 314-4844
Fax No.: (416) 314-5179

Earle Straus
Legal Services Branch
Ministry of Consumer and Commercial Relations
250 Yonge Street
Toronto, Ontario
M5B 2N5
Telephone No.: (416) 325-8803
Fax No.: (416) 314-5179

Carole Humphries
Canadian Bar Association - Ontario
Suite 200
20 Toronto Street
Toronto, Ontario
M5C 2B8
Telephone No.: (416) 869-1047
Fax No.: (416) 869-1390

Appendix C

Submission on

Harmonization of Section 427 of the *Bank Act* and Provincial *Personal Property Security Acts*

NATIONAL BUSINESS LAW SECTION
THE CANADIAN BAR ASSOCIATION

November 1997

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Submission on Harmonization of Section 427 of the *Bank Act* and Provincial *Personal Property Security Acts*

PREFACE

The Canadian Bar Association is a national association representing over 35,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the Personal Property Security Law Committee of the Business Law Section, Canadian Bar Association — Ontario, with assistance from the Legislation and Law Reform Directorate at National Office. The submission has been endorsed by the Uniform Commercial Code/Personal Property Security Committee and the Financial Institutions Committee of the National Business Law Section of the Canadian Bar Association. It has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the Business Law Section of the Canadian Bar Association.

Harmonization of Section 427 of the *Bank Act* and Provincial *Personal Property Security Acts*

I. Introduction

Since the decision of the Ontario Court of Appeal in *Rogerson Lumber Co. Ltd. v. Four Seasons Chalet Ltd.*,[1] it has been obvious that there is a serious mismatch between s. 427 of the *Bank Act* and the *Personal Property Security Acts* (PPSAs). This conflict has been confirmed by subsequent decisions, notably *Bank of Nova Scotia v. International Harvester Credit Corp. of Canada Ltd.*[2] and by decisions in the other PPS provinces. The provisions of the provincial Acts interacting with s. 427 are not identical, but all who have studied the situation agree that there are problems which need to be addressed and that the current position is fraught with confusion and uncertainty.

With a view to resolving the problems, informal discussions have been held over the past number of months between the Legal Committee of the Canadian Conference on Personal Property Security Law (CCPPSL)[3] and the Canadian Bankers Association to find a mutually acceptable solution. Several members of the Personal Property Security Law Sub-Committee of the Canadian Bar Association — Ontario[4] participated in the discussions.

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1 (1980) 29 O.R. (2d) 193.

2 (1990) 74 O.R. (2d) 738 (O.C.A.).

3 CCPPSL is a voluntary association comprising provincial government officials closely connected with the operation of the provincial PPS Acts and includes lawyers, mainly academics, closely associated with the enactment of the provincial Acts. The CBA is not represented on the CCPPSL, although Kenneth Morlock has attended the last two annual meetings of the Conference.

4 Namely Kenneth Morlock, Bradley Crawford, Richard McLaren and Jacob Ziegel. Bradley Crawford's involvement has been primarily in his capacity as independent counsel for the Canadian Bankers Association.

II. Nature of the Problems

The difficulty of reconciling the two chattel security regimes arise from the different histories, evolution, conceptual structure and functional orientation of each. Section 427 of the *Bank Act* traces its origins to pre-Confederation provisions in the *Mercantile Law Amendment Act* of Upper Canada where it was designed to encourage asset-based inventory financing in the agricultural, forestry and mining sectors of the economy. Since these provisions were incorporated in the first federal *Bank Act* of 1869, they have been frequently amended and expanded. Nevertheless, the provisions still retain their Victorian flavour and, in the view of many observers, constitute neither a coherent nor harmonious legal regime even for the types of transactions to which s. 427 and its companion provisions apply.

Particularly troublesome is the title oriented basis of the s. 427 security interest (see ss. 427(2), 435)[5], which appears to preclude a bank from acquiring an effective security interest unless the debtor is the "owner" of the collateral at the time of the giving of the s. 427 assignment. Even more troubling are the opaque priority provisions in s. 428(1)(a)[6] which, on a literal reading, appear to override a purchase-money security interest in the form of a conditional sale agreement, whether given before or after a s. 427 assignment, unless, in the case of a prior unpaid vendor's "lien", the bank had notice of the lien before acquiring its s.427 interest.

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5 Section 427(2)(a) and (b) in effect make the vesting of the s.427 security in a bank contingent on the person giving security being the "owner" of the collateral at the time of delivery of the security document or becoming the owner at any time thereafter before the release of the security by the bank and, if this condition is satisfied, s. 427(2)(c) vests in the bank for the prescribed types of collateral the same rights and powers as if the bank had acquired a warehouse receipt or bill of lading in which that property was described. Section 435(2)(a) of the Act provides that a bank holding a receipt or bill of lading vests in the bank all the rights and title to the warehouse receipt or bill of lading and to the goods, wares and merchandise covered thereby of the previous holder or owner thereof.

6 Section 428(1) provides that all the rights and powers of a bank in respect of property covered by a warehouse receipt or bill of lading and the rights and powers of the powers of the bank under a s.427 security have, with some enumerated exceptions, priority over all rights subsequently acquired in or in respect of that property, and also "over the claim of any unpaid vendor". Subsection 2 creates an exception to the bank's priority under subs.(1) in the case of an unpaid vendor with a lien on the property at the time of the bank's acquiring the security "unless the same was acquired without knowledge on the part of the bank of that lien".

By way of contrast, the Article 9 based provincial *Personal Property Securities Acts* eschew title as the touchstone for the creation of security interest[7], systematically address each stage in the life of a security interest, and consciously adopt as their goal the rationalization, modernization and simplification of provincial chattel security law. No less important, unlike s. 427, the provincial Acts are available to all secured parties and cover all types of security interest.[8]

Because of these differences in the scope, structure and conceptualization of the two chattel security regimes, the following difficulties have arisen where the provincial and federal security interests interact with each other:

(a) **order of priorities between competing s. 427 and PPSA security interests:** In *Rogerson*, the Ontario Court of Appeal held that s. 428(1) of the *Bank Act* does not override a retention of title under a conditional sale agreement governed by the Ontario PPSA regardless of whether the purchase money security interest has been timely perfected under the Ontario PPSA.[9]

(b) **non-applicability of the first to file rule under the PPSA:** in *Rogerson* the Court also held that the first to file rule in the Ontario PPSA does not apply to competing s. 427 and PPSA interests since the Ontario Act does not apply to a s.427 interest. However, there are contrary Saskatchewan decisions.[10]

(c) **effect of double registration:** with a view to overcoming the effect of *Rogerson*, some banks holding a s.427 interest have resorted to filing a financing statement under the relevant provincial Act without entering into a new security agreement with the debtor governed by the Act. In *Bank of Nova Scotia v. International*

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7 C.f. the Ontario Personal Property Security Act ("OPPSA"), s.2(a). This does not mean that a seller is not free to retain title in a security agreement; it simply means that it is not necessary for the seller to do so to obtain an effective purchase money security interest.

8 See definitions of "Secured Party" and "Security Interest" in OPPSA, s 1(1).

9 To the same effect see Kawai Canada Music Ltd. v. Encore Music Ltd., (1993) 101 D.L.R. (4th) 1 (Alta. C.A.).

10 See Bank of Montreal v. Pulsar Ventures Inc., (1987) 7 PPSAC 258 (Sask C.A.) and Royal Bank v. Agricultural Credit Corp. of Saskatchewan, (1994) 115 D.L.R. (4th)569(Sask. C.A.).

Harvester Credit Corp.,[11] the Ontario Court of Appeal held that the definition of security interest in the Ontario Act was wide enough to permit the bank to register a financing statement even though the bank had only obtained a s. 427 agreement. The Court's reasoning has been much criticized[12] and it is inconsistent both with the structure of the provincial Acts and with the Court's decision in *Rogerson*. Ironically, the first to file rule did not assist the bank after all in *International Harvester* because the Court of Appeal also held that s.427(2)(a) of the *Bank Act* precluded the bank from obtaining an effective security interest before the bank's borrower acquired title to the collateral.

(d) **double documentation**: another technique adopted by banks for maximum protection is to obtain from its customers, in respect of the same collateral, a security interest under the relevant provincial Act as well as a s.427 assignment. The effect of such double documentation has not yet been considered in Ontario but seemingly has been accepted in Saskatchewan.[13] However, commentators are divided about the legal effect of such double documentation. In particular, there is much uncertainty about whether it is possible for a secured party to hold successive security interests in the same collateral governed by two incompatible chattel security regimes and, if it is possible, whether the bank is to put to its election to retain one or the other security interest and if so at what point.[14]

III. Pre-1996 Solutions

Prior to the current round of discussions, the following solutions had been adopted or were recommended to overcome the existing problems:

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11 (1990) 74 O.R. (2nd) 738.

12 See for example R.C.C. Cuming in (1991) 18 CBLJ 135 and J.S. Ziegel in (1991) 6 BFLR 343.

13 Birch Hills Credit Union Ltd. v. CIBC, (1988) 52 D.L.R. (4th) 113 (Sask. C.A.).

14 See further J.S. Ziegel and D.D. Denomme, *The Ontario Personal Property Security Act: Commentary and Analysis* (1994), p 47 and *Compatibility of Federal and Provincial Personal Property Security Law*, R.C.C. Cuming and R.J. Wood (1986) 65 Can. Bar. Rev. 267, 287-92.

(a) **Prohibition of double registrations**: This solution has been adopted in four provincial Acts[15] to resolve the confusion created by cases such as *International Harvester*. However, it does not alleviate the difficulty faced by banks as a result of the decision in *Rogerson* denying them the benefit of the first to file rule;

(b) **Prohibition of double documentation**: Only Saskatchewan appears so far to have resorted to this drastic step[16] and apparently it is grounded in the same reasons that motivated Saskatchewan to prohibit double registrations, namely to avoid confusion and uncertainty. Again, however, this approach does nothing to harmonize s. 427 with the provincial PPS regimes but simply forces banks to elect to take either a s. 427 assignment or a PPSA security interest.

(c) **Tay Report**: This 1991 report,[17] commissioned by the federal government, recommended the adoption of a federal PPSA which would apply to all security interests taken by a bank. Apparently, after the enactment of such a law, the banks would no longer have been free to obtain a provincial security interest. The Tay report has found little support among commentators.[18] Among the potential for further conflicts between federally and provincially created security interests, it was feared that they would have undetermined the financial integrity of the provincial registry systems. Banks are very large users of provincial registries and there was concern that the registries would not be able to survive commercially without this important source of revenue.

IV. Current Proposals

Although there are still many loose ends, the proposals exchanged to date between the CCPPSL and the Canadian Bankers Association involve concurrent amendments to s.427

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15 See Alberta, B.C. and Saskatchewan, in each case s. 4(b) of the Act. The same provision appears in the New Brunswick Act. Subs. (b) provides that the Act does not apply, among others, to an agreement covered by Part IV, Division B, of the Bank Act.

16 Sask. Act., s.9(2).

17 Derrick C. Tay et al., *Position Paper on Revising Bank Act* Security, (Ottawa, Department of Finance, 1990).

18 For a vigorous critique of the Report see R.C.C. Cuming in (1992) 20 CBLJ 336.

and the provincial Acts, with the majority of the changes appearing in s.427. The parties have agreed in principle on the following points:

(a) Section 427 will adopt a first to file priority rule for all security interests, whether created under provincial or (we assume) federal law, with the exception of purchase-money security interests (PMSIs);

(b) PMSIs will enjoy the same priority over a bank's prior perfected s.427 security interest as they are accorded in the provincial Acts over provincially created security interests. However, the holder of a PMSI in inventory will have to give prior notice to any bank which has registered a "notice of intention" pursuant to s.427;

(c) "security interest" will be defined in accordance with the PPSA terminology and a security interest will encompass deemed security interests (i.e. leases for more that a year, consignment agreements, absolute assignments of accounts, and absolute assignments of chattel paper) in accordance with the provincial provisions;

(d) s. 427 will be amended to give express recognition to the bank's right to claim proceeds;

(e) the "notice of intention" filed under s.427 will disclose which branch of the bank holds the security interest, and the debtor or a third party will be entitled to require the discharge in whole or in part, of a notice of intention where the indebtedness has been discharged;

(f) under s.428, a bank's security interest will be liable to be overridden by the same range of interests that apply to perfected security interests under provincial law (ie. buyers in ordinary course of chattel paper and securities, and holders in due course of negotiable instruments).

V. Weaknesses in Proposals

While adoption of the above proposals will undoubtedly result in a substantial improvement over the current position, they will by no means solve all the problems. They will also create several new ones:

(a) the Canadian Bankers Association has so far been firm in refusing to recognize perfection by possession as a feature of the new s.428 priority provisions. The Association is taking this position despite the fact that perfection by possession, in the case of tangible collateral, has for centuries been the hallmark of a common law pledge and is one of the basic methods of perfection recognized in all the PPSAs;[19]

(b) though there appears to be some flexibility on the Canadian Bankers Association position on this point, s.427 security interests will retain their own federal registry and their own "simpler" registration requirements;[20]

(c) the amendments to s.427 will have to take into account differences in the definitions, priority rules, and a significant number of other provisions among the PPS Acts. For example, the OPPSA contains a different set of deemed security interests from those in the Western Acts and, under the OPPSA, a PMSI in inventory or its proceeds has priority over any competing security interest, including a prior perfected security interest in accounts.[21] In the Western provinces Acts,[22] a PMSI is subordinated to a prior perfected security interest in accounts;

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19 See e.g. *OPPSA*. Act, s.22. Perfection by possession is uncommon in the case of a security interest in inventory although it is intermittently used in field warehousing financing. Perfection by possession can be important, even for inventory, where there has been a defect in the secured party's financing statement which does not come to light until after the secured party has repossessed the inventory on the debtor's default. Section 22 of the OPPSA expressly recognizes that possession "or repossession" is effective to perfect a security interest in tangible collateral. See further Ziegel & Denomme, op.cit., pp. 169-70.

20 There has been some discussion about the feasibility of requiring the s.427 notice of intention to be registered in a PPSA registry. The Canadian Bankers Association has made it clear that, even if this could be arranged, a separate registry would have to be maintained for s.427 security interests and they would have to retain their own registration requirements. Apparently Ottawa is also considering the possibility of establishing a privatized central registry for all security interests governed by federal law. Since no particulars have been disclosed about the features of such a central register it is premature to speculate how they would interact with provincial registries.

21 OPPSA ss.33(1) and (2).

22 E.g., B.C. Act, s.34(5).

(d) apparently, Finance Canada has indicated that it is not prepared to proceed with changes to s.427 unless all the PPSA provinces, at least in principle, express support for the general thrust of the proposals. Assuming support is forthcoming, it is not clear what would be done about Quebec. Politically, it would not seem realistic to exclude the province from the new arrangements. On the other hand, adding Quebec to the picture would add a major layer of complexity since the chattel security provisions in the new *Civil Code*, while influenced by the PPSA concepts, differ from them, and fundamentally, in many respects;[23]

(e) the Canadian Bankers Association has indicated that it expects those provinces which have adopted the prohibition to lift the embargo on double documentation. The CCPPSL has not conceded the point;

(f) it is not clear what will happen to s.427(2)(a) of the *Bank Act* and the other title oriented provisions. If these issues are not addressed, s.427 will be internally inconsistent and a new set of problems may arise;

(g) assuming the retention of a federal register for s.427 interests, (i) non-banking secured parties will continue to have to search two registers, the s. 427 register and the relevant provincial register, and (ii) secured parties holding a PMSI inventory will have to search both registers and give notice under both sets of priority provisions to prior secured parties of record;

(h) it also seems reasonable to predict that the new s. 427 provisions will be much longer that the existing provisions, particularly if the new provisions have to take into account the various differences among the provincial Acts,[24] not to mention the complexities of the new Quebec *Civil Code* rules.[25] The extra length will make ss.427 and 428 of the *Bank Act* still more difficult to understand and will increase the danger of a court not reading the new provisions correctly;

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23 See M. Boodman & R. Macdonald (1996) 27 CBLJ 249.

24 The provincial Acts which follow the Western Model PPSA are substantially uniform. The OPPSA is not based on the Model Act and differs from it on many points of detail and sometimes on important questions of principle.

25 *Supra*, n. 23.

(i) in Ontario, PMSI secured parties will be worse off under the new provisions than they are at present, given the combined effect of *Rogerson* and the actual outcome in *International Harvester*. It is true that these decisions probably give unperfected security interests under the Ontario Act an undeserved windfall *vis-à-vis* a s.427 security, but this result flows directly from the anomaly that two different chattel security regimes can apply to the same collateral, one governed by federal law and the other by provincial law;

(j) although the current proposals only amount to a band aid solution, once adopted it is unlikely they would be repealed soon and replaced with a better and more permanent solution. This is because so much political and intellectual energy will have been invested in reaching agreement on the "interim" provisions that there will be little enthusiasm for starting the negotiations all over again for at least another decade.

VI. Is There a Better Solution?

Given the complexities of the proposals and the weaknesses we have identified in them, it is fair to ask whether there is a better solution. We believe there is and that a better solution would be to suspend or repeal s. 427 with respect to those provinces that have adopted PPS legislation and that do not discriminate against banks. (None do.)[26] This solution would have the following advantages:

(a) there would be only one chattel security regime applicable in the provinces, not two;

(b) it would eliminate problems of double registration and double documentation;

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26 All common law provinces except of Prince Edward Island and Newfoundland have adopted PPS legislation, although the Nova Scotia Act is still awaiting proclamation. PEI is actively considering it and it is reasonable to anticipate that Newfoundland will follow suit before the turn of the century. As common law lawyers, we are not competent to assess the new Quebec legislation. We would anticipate, however, Quebec being included in any discussions involving the consequences of repealing or suspending s.427.

(c) it would avoid the need to register and/or to search for financing statements and notices of intention at the federal and provincial levels;[27]

(d) it would put all secured parties and all financial institutions, banks and non-banks, on the same footing. This would be consistent with federal policy adopted in the 1991 financial institutions legislation that financial institutions should be regulated by function and should no longer be confined to a single type of activity;

(e) it would be consistent with the new powers acquired by banks over the past 15 years and with additional powers currently being sought by them to be allowed to offer consumer automobile leasing and insurance services;

(f) Section 427 is largely confined to inventory financing and some types of equipment financing for farmers, fishermen and aquaculturists. Most other forms of business asset based financing, particularly accounts, equipment and all-asset financing, and all consumer asset based financing have long been governed by provincial law. For the most part, to the best of our knowledge, so far as non-s.427 security interests are concerned, the banks have experienced no difficulties in complying with provincial law or at any rate no more difficulties than are encountered by other secured parties. Such difficulties as previously existed have largely been eliminated by the provincial PPS Acts;

(g) the integration of federal and provincial chattel security law into a single PPSA law is consistent with the US position where all secured parties are governed by the Article 9 law in each of the fifty states (including Louisiana) and the District of Columbia;

(h) to ensure that banks, or other federally incorporated financial institutions, are not discriminated against compared with other secured parties, a statutory mechanism

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27 We recognize the existence of federal registries for intellectual property rights and for security interests in vessels and railway property and rolling stock governed by federal law. These constitute a discrete problem which should be addressed separately on a future occasion.

could be introduced entitling a bank to present a petition before the federal tribunal[28] to lift the suspension of the s. 427 *Bank Act* provisions.

VII. Disadvantage of Suspension of Section 427 from Banks' Point of View

In fairness to the banks, it should be recognized that our preferred solution also contains some disadvantages from their point of view:

(a) it would deprive them of a long established and familiar financing tool often referred to as a "unique" feature of the *Bank Act*. We do not deny the important role s. 427 has served in the past. It seems to us, however, that the provincial PPS Acts are much more rationally organized and easier to understand than s.427, and conceptually more coherent and functionally oriented that the federal provisions;

(b) the registration requirements under the provincial Acts appear more onerous than the those in s. 427. We do not see this as a serious objection. Firstly, the registration requirements under s. 427 are more relaxed because the s. 427 registry is paper based and handles only a modest number of registrations and searches a year. If the registry were computerized (which we understand is a distinct possibility) the system would require the same standards of accuracy in spelling the debtor's name and giving serial numbers for equipment as is required by the provincial registries. Secondly, provincial financing statements are very simple one-page documents. The difficulties that arise stem not from the nature of the document but the needs of a computerized registry for high standards of accuracy. Thirdly, collectively banks are probably the largest users of PSS registries. By all accounts, banks have had little difficulty complying with the provincial registration requirements, or at any rate they have experienced no more difficulty than any other secured party. Moreover, the banks' resources for meeting the registration requirements are better than those of many other secured parties;

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28 The Competition Tribunal would be a possibility.

(c) provincial governments may be tempted to discriminate against banks or to adopt or retain provisions inimical to inventory forms of financing. We believe there are several answers to this concern:

- As already mentioned, the existing PPSAs do not discriminate among secured parties;

- given the current economic climate in all provinces and the anxiety of both levels of government substantially to increase investments and job opportunities in the private sector, it is unlikely to happen in the foreseeable future;

- past provincial discrimination has not been directed against particular institutions but has been in the form of stronger consumer or pro-farmer protection;[29] and

- if a province were to resort to discriminatory legislation the federal government could lift the suspension of s.427 for that province or give a designated tribunal the power to do so. If the habit becomes widespread and provinces misinterpret the federal government's motives in suspending s. 427, the suspension could be lifted for all provinces.

VIII. Conclusion

We do not claim that our preferred solution is perfect but we believe it to be significantly superior in all important respects to the proposals currently under discussion. In particular, we believe our solution to be most appropriate for the 21st century and the vastly different economic and global environment in which all financial institutions will be operating in the future. Even if we are unduly optimistic in our assumption, we believe our recommendations at least deserve to be considered seriously as an alternative to the harmonization approach favoured by the Canadian Conference on Personal Property Security Law and the Canadian Bankers Association.

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29 The Saskatchewan legislation challenged in the Bank of Montreal v. Hall [1990] 1 S.C.R. 190 did not discriminate against banks. It is relevant to note that employee and farmer protective provisions also appear in s.427(9) of the Bank Act and that the provincial protective provisions in Hall were not unique.

The Canadian Bar Association/L'Association du Barreau canadien
902-50 O'Connor
Ottawa, Ontario
K1P 6L2
Tel/Tél: (613) 237-2925 Fax/Télécop: (613) 237-0185
Home Page/Page d'accueil: http://www.cba.org/abc
E-mail/Messagerie Internet: info@cba.org

Minister of Finance

Ministre des Finances

APR 7 1998

Mr. Michael M. Fortier
Chair, National Business Law Section
The Canadian Bar Association
50 O'Connor Street, Suite 902
Ottawa, Ontario
K1P 6L2

Dear Mr. Fortier:

I very much appreciate your taking the time to forward to me a discussion paper on the harmonization of section 427 of the *Bank Act* with provincial legislation on personal property security.

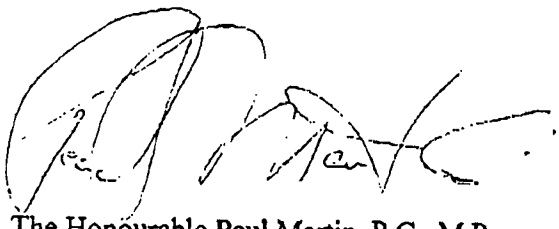
In your submission, prepared by the Personal Property Security Law Sub-Committee of Ontario, it was recommended that section 427 of the Bank Act be suspended or repealed with respect to those jurisdictions that have adopted personal property legislation and do not discriminate against banks.

As you know, inconsistencies between the *Bank Act* and provincial legislation dealing with the taking of personal property security interests have been identified. This issue was raised in the June 1996 consultation paper, "1997 Review of Financial Institutions Legislation: Proposals for Changes". An industry working group was established to examine whether legislative changes were needed and was expected to report back with their recommendations before the end of the legislative review period. The government indicated in the consultation paper that it would be prepared to consider legislative amendments to the *Bank Act* if a consensus was achieved amongst the working group. However, I understand that a consensus was never achieved and, therefore, it was decided that no changes would be made to the *Bank Act* as part of Bill C-82 in this regard.

The recommendation made by the Ontario Sub-Committee will be taken into consideration as we continue our review of this complex issue. However, I do not believe it would be appropriate to contemplate any changes to the legislation until a consensus is achieved amongst stakeholders. Any change to the *Bank Act* in this regard will also have to be discussed with and studied by the provinces before being enacted.

Thank you, once again, for sending me your submission on this issue. I look forward to working towards the common goal of harmonizing the *Bank Act* provisions with provincial personal security legislation.

Sincerely,



The Honourable Paul Martin, P.C., M.P.

CANADIAN BAR ASSOCIATION - ONTARIO
L'ASSOCIATION DU BARREAU CANADIEN - ONTARIO
Suite 200 - 20 rue Toronto Street
Toronto Ontario M5C 2B8 · TDX Box 104
tel/tél: (416) 869-1047 · toll-free/numéro sans frais: 1-800-668-8900 · fax/télécopieur: (416) 869-1390