

One-on-one with Jennifer Babe

MODERN FINANCE: PANEL RECOMMENDS BUSINESS LAW UPDATES FOR ONTARIO

A group of Ontario lawyers is helping the province update its business laws to make the province a leader in corporate and commercial legislation.

In early 2015, the Ministry of Government and Consumer Services commissioned the Business Law Agenda Stakeholder Panel, a group of corporate and commercial law experts, to review some of the business laws on the statute book for which the Ministry is responsible, and identify opportunities for reform.

"Modern business laws will help ensure Ontario continues to thrive. Our government is working hard to create an environment where businesses can prosper while still ensuring that Ontario consumers are protected," said Minister David Orazietti in a statement.

The group's final report, released by the Minister in July, recommended a "significant reform agenda," targeting "areas where Ontario may be currently at a competitive disadvantage" compared with other jurisdictions in Canada and abroad.

Read on as Jennifer Babe talks us through the key recommendations related to secured lending in Ontario's *Personal Property Security Act*, R.S.O. 1990, c. P.10 (PPSA) and *Repair and Storage Liens Act*, R.S.O. 1990, c. R.25 (RSLA). Babe, a partner in the Toronto office of Miller Thomson LLP, sat as a member of the expert panel.

Can you provide us with some background behind the expert panel convened by the Ministry of Government and Consumer Services?

There is a cluster of 19 statutes that the panel was asked to look at and consider which ones would need reform. The panel was created in February 2015 and reported its conclusions to the Minister in June of this year. The report was released to the public in July for input by October 16th, and there was also a half-day session hosted by the Ontario Bar Association (OBA) for practicing lawyers to talk about what they liked in the report, what was missing, and other kinds of problems that they are encountering from day to day.

What is the history behind previous submissions for PPSA and RSLA reform? The PPSA was heavily amended in 1989, and the RSLA came into force that same year. Since then, there have

been about 14 submissions made by the OBA about one or both of those statutes.

It has been quite frequent because sometimes a case comes up where a judge makes a decision that we think may not have been the most learned, or something else happens that we need to address. For example, there were a number of changes made in 2006 when Canada adopted modernized securities transfer legislation.

Of these proposed amendments, what are the top priorities in terms of importance to the area of practice and why? We have a recommendation about enabling perfection by control of cash collateral that is very important and urgent because Canada has made a commitment to the G20 countries as part of the Third Basel Accord that it must meet by the beginning of 2016. The Basel III rules

require that a secured party taking cash collateral as security needs to be provided with a first-ranking security interest in the cash posted as collateral for a derivatives agreement or a swap agreement.

After that, the next most urgent issue is the huge overheads associated with processing and storing original, "wet ink" portfolios of chattel paper. It would be a huge blessing to get rid of those costs and enable perfection of security interests in electronic chattel paper.

Can you describe the proposed amendments to the PPSA as they relate to cash collateral? In Ontario, a security interest in cash collateral can only be perfected by either possession or registration. In the U.S. they have a 10-year-old rule that we don't have, which allows perfection by control. What that means is that if you are today using cash collateral in Ontario, it will take a number of business days for a law firm to give an opinion about ranking and priority, because you will have to get searches for all the PPSA registrations against the debtor posting the cash collateral, and get priority agreements from its prior creditors. In the swaps and derivatives world, that is simply not possible. There just isn't time the way these markets work.

Our recommendation is that we adopt a provision like the American one and enable perfection by control of an interest in cash collateral, with a priority rule that perfection by control ranks ahead of perfection by registration or possession of an interest in cash collateral.



Jennifer Babe is a partner at Miller Thomson LLP. Her practice emphasizes commercial law, focusing on secured transactions, the securing of sales and leases of significant products, and the purchases of businesses. Jennifer has special expertise in the laws of personal property, as governed by Personal Property Security legislation. Ms. Babe is a highly recognized practitioner in her field with such recognitions as Best Lawyers in Canada and Canadian Legal Lexpert® Directory.

What are the controversial issues surrounding the proposed amendments in connection with cash collateral and is there a compromise?

There is a problem that is unique to Ontario's PPSA, which arises because of a section in our legislation that provides that a statutory deemed trust under the pensions benefit legislation creates a priority interest in the debtor's inventory and accounts. So while we are comfortable with the concept of perfection by control of cash collateral, we are still trying to work out an arrangement that will satisfy everyone relative to this special priority rule for pension trust beneficiaries over accounts holding cash collateral.

There is a division between some practitioners in the pensions bar and the financial services bar, but there is draft proposal to alter the definition of a financial account where cash collateral is involved, and I hope a compromise will be possible.

Can you describe in greater detail the proposed PPSA amendments as they relate to electronic chattel paper? This is another of the more difficult matters

that we addressed. Canada has virtually uniform electronic commerce legislation that allows parties to agree to contract electronically. However, the party selling or leasing cannot use the underlying electronic chattel paper as collateral to raise money in their own business, because there is a PPSA special priority rule that gives priority to the person who holds the original, "wet ink" copy of the contract. This creates a huge overhead cost for processing, printing and storing all these paper forms, because your securitization partners will want to take possession of the hard copies to take advantage of this special priority.

Our American friends have come up with a rule that allows for perfection by control of a security interest in electronic chattel paper that trumps a security interest perfected by other means, and we recommended that Ontario follows suit.

What are the challenges surrounding these proposed amendments? There are some academics who think control facilitates secret liens, but I'm not sure that is such a concern. After all, there are

not a lot of people other than financial institutions who are going to want to use control of electronic chattel paper to facilitate derivative transactions or portfolios of chattel paper.

Can you take us through some other key proposed amendments recommended in the report? There are a number of recommendations that relate to what I would call low-hanging fruit. These are all relatively easy fixes, involving small tweaks to definitions or overhead processes:

- Ontario is the only province that mandates that every time you do a PPSA registration, a copy must be sent to the debtor. Other provinces allow you to have the debtor agree to waive that requirement. It really doesn't do anything in terms of consumer protection to tell people that they have just time-purchased or leased a motor vehicle. They already know that. In Ontario, we're averaging about 1.4 million registrations a year, so that's a lot of copies to debtors. It's also a big overhead for business without much

value, so we're hoping we can get rid of it pretty soon.

- In about 2006, the regulations pursuant to the PPSA and the RSLA were repealed, and the information that was in them was issued in Minister's Orders. However, Minister's Orders are not easy to look up online in the way that statutes and regulations are. If you are a small business doing repairs or small ticket leasing, you are going to be very hard pressed to find these Orders that tell you how to name a debtor, how to make a registration, and other basic information. So one of our recommendations was to simply make these Orders easily available to the public.
- Another problem is that the PPSA is not clear on whether licences and quotas are personal property; in fact, various cases have held that they are not. This has caused a lot of issues for holders of things like taxi licences, nursing home licences, and milk or tobacco crop quotas, because, although they are very valuable, they can't be used as collateral for raising money. B.C. and Saskatchewan have already amended the definition of "intangibles" under their PPSA statutes to include licences and quotas, and our recommendation is that Ontario do likewise. A lender would still have to enforce their remedies under the statutory regime that issued the licence or quota, but at least they would know that they have a good security interest and not get a qualified opinion letter from their lawyer.
- Ontario has a couple of cases now where the Courts have held that if you screw up naming the debtor in your PPSA registration, but you've got the correct Vehicle Identification Number in the right place in the form, then you may be unperfected for the rest of the debtor's collateral, but you will be perfected for the vehicle that was properly described by the VIN. The report recommended that these decisions be codified into the PPSA and the RSLA. That will be hugely

important to people who finance or lease motor vehicles, because more than 80 per cent of registrations contain a VIN, and it's really difficult in a multicultural country like Canada to name people correctly. They don't tend to show up at the car showroom or the repair shop with their birth certificate or passport in their pocket. By using VINs, it will make the database more accurate for more people.

Of the proposed amendments in the report, which ones are already in motion? The Ministry has already started to adopt a couple of the recommendations that were made in the report, which is very gratifying.

For example, Ontario is the only province that today caps a PPSA registration to five years where the collateral is or includes consumer goods. If you go back 25 years, that made sense because it seemed like a very long time for a consumer to incur a debt. But that isn't true anymore. It's common to see 72- or 84-month car and truck loans or leases. The cap has become a real impediment because you have to actually remember to renew these darn things after five years. The Budget bill this summer repealed that five-year cap, and the Ministry has recently announced that this change goes into effect on November 16, 2015.

Another was in relation to the PPSA's conflict of laws provision dealing with the "location of debtor." These provisions, which more clearly define which jurisdiction's law will apply to the security agreement and its perfection and enforcement, were actually passed in 2006 but never proclaimed into force. The government has recently announced that they will go into effect December 31, 2015.

One of our recommendations under the RSLA has also been accepted. Under the present legislation, storers are given 60 days to tell the owner that their goods are in storage. As you might guess, some storers waited until the 59th day to send out the notice to be able to claim 60 days' worth of storage charges. The province has now drafted

an amendment to reduce that period to 15 days where the item being stored is a motor vehicle bearing Ontario licence plates. This amendment should save consumers, insurance companies, lenders and lessors who have had their car towed and stored after an accident or mechanical breakdown 45 days of storage charges.

Were there other topics of concern that were not addressed in the panel's report? There were some issues raised at the OBA session that were not in the final report.

I think everyone would like to see the end of Ontario's check-the-box system for PPSA registrations. Ontario was the first province to computerize its PPSA registry in the 1980s, when computer memory was very expensive, and the check-the-box system was designed to take up as little memory as possible to describe collateral. Computer technology and memory costs have come way down, but it would take a systems overhaul to allow for a word description, which is a budgetary issue for the Ministry. That is why we didn't address it in the report.

Another issue that was raised at the OBA was that some lenders and lien holders would like to broaden the definition of what qualifies as a motor vehicle under the PPSA. A trailer, for example, doesn't qualify as a motor vehicle because it's not self-propelled, but it does have a unique 17-character VIN. Boats and aircraft could be added without making any changes to the computer system since the existing forms already have spots to enter year of manufacture, make, model and serial number (e.g., a forklift) or VIN.

What are the next steps? The Ontario government is in the process of putting together an Advisory Council on Business Law to assist it on an ongoing basis about the modernization of Ontario's business laws. They are hoping to have that Council in place by the end of November to help the province decide which projects to tackle and in what order to tackle them. ■