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PPSA PRACTICES FOR INSOLVENCY PRACTITIONERS AND THE STATUS OF ITS LEGISLATION REFORM IN ONTARIO

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I. JANUARY 1, 2007: THE STA AND PPSA CHANGES FOR THE STA:

1. What is it and What Does it Do?

Securities Transfer legislation is commercial law dealing with buying, selling and creating security interests in tangible and intangible "investment property" (as defined in the STA). It is not regulatory law akin to statutes regulating the promotion and sale of publicly traded securities, such as prospectus requirements and continuous disclosure information posted on SEDAR.

The *Securities Transfer Act* is based on Article 8 of the American Uniform Commercial Code. It was "Canadianized" by a joint working group from the Uniform Law Conference of Canada and the Canadian Securities Administrators, as the *Uniform Securities Transfer Act* ("USTA") with drafts released for comments in 2002, 2003 and 2004. Jurisdictions have taken up the USTA and passed their own STA legislation, virtually uniformly, as follows:

Provincial Securities Transfer Legislation as at January 2, 2008:

Jurisdiction	Legislation	Status	Proclamation
Alberta	Securities Transfer Act, S.A. 2006, c. S-4.5	RA – May 24, 2006	**Act in force Jan. 1, 2007**
British Columbia	Securities Transfer Act, S.B.C. 2007, c. 10	RA – Mar 29, 2007	Act in force on Proclamation. Proclamations to date: **Entire Act, except section 135, in force July 1, 2007** (B.C. Reg. 128/2007).
Manitoba	Bill 12, The Securities Transfer Act	First Reading – December 4, 2007	
Newfoundland & Labrador	Securities Transfer Act, S.N.L. 2007, c. S-13.01	RA - June 14, 2007	**Act in force Aug. 1, 2007** (N.L. Gazette, July 27, 2007).
Ontario	Securities Transfer Act, S.O. 2006, c.8	RA – May 18, 2006	**Sections 1 to 144 in force January 1, 2007** (Ont. Gazette, November 11, 2006).
Quebec	Bill 47, *Securities and Other Financial Assets Transfer Act*	First Reading November 13, 2007	
Saskatchewan	Securities Transfer Act, S.S.	RA - May 17,	**Act in force**

	2007, c.S-42.3	2007	**September 1, 2007.** (*Saskatchewan Gazette,* August 31, 2007)

Passage of STA statutes in each PPSA jurisdiction went hand in hand with amendments to PPSA, corporation's statutes and enforcement of judgment statutes.

The STA statutes recognize there are two systems for trading in Canada, and brings Canadian Law forward to reflect the market place. There is both:

(i) **The direct holding system** : A certificated security is delivered to the owner of it by the issuer, and the ownership is registered in the books of the issuer. The owner may sell the shares by delivery and endorsement to the buyer or may pledge this security by physical delivery to the lender to hold until the debt is repaid; and

(ii) **The indirect holding system** : This is a "booked based" system and no paper certificates exist. There is no direct relationship between the issuer and the security owner. The "investment property" is dematerialized. The issuer lodges a paper or other evidence for a dematerialized certificate with a central clearer. The investor, by its "securities intermediary" has a "securities account" and a "security entitlement", being the bundle of rights as against the securities intermediary for, *inter alia*, the value of the investment property he or she acquired. The securities intermediary has rights against the central clearing agency for the bulk value of securities held in the securities intermediary's name.

For example: Issuer Inc. ("Issuer") lodges a certificate for 10,000,000 preferred shares with the Canadian Depository for Securities ("CDS"). Big Brokerage Inc. (Broker") buys 2,000,000 of these preferred shares, recorded by CDS in the name of Broker. I buy 10 of these shares via Broker as my securities intermediary, and my next securities account statement shows the value in my account on the statement date of the 10 preferred shares. If I grant a security interest in my "security entitlement" in my security account, then my lender may now under the STA and amended PPSA, take "control" of my investment property as collateral for my obligations.

Under the STA, the investor's "security entitlement" is not sold to the buyer. Rather upon sale, the investor's security entitlement is extinguished in his or her securities account by the securities intermediary, and a new securities entitlement is opened for the transferee in his or her own securities account. These are contractual relationships under the account operation agreement between the investor and the securities intermediary.

Under the STA, the definition of "investment property" includes a "security" and other assets. Of particular note, the definition of "security" in the STA only applies to investments in a partnership or a limited liability company if the interest is either (i) traded on securities exchanges or securities markets or (ii) the issuer elects to have them treated as a "security" under

the STA. This creates due diligence obligation on lender's counsel and buyer's counsel to determine if the STA applies to these partnership or LLC assets.

As an extremely rare event, the Ministry of Government Services of Ontario has published an annotated STA, 2006 providing notes for each section that allow the practitioner to understand its meaning and intent. These annotations were taken from the Article 8 of the Uniform Commercial Code as "Canadianized" for use for the annotations to the Uniform Law Conference of Canada's *Uniform Securities Transfer Act.*

Given the great degree of uniformity among the STA statutes, this very helpful publication, *Annotated Securities Transfer Act, 2006*, is available from Publications Ontario. See Schedule A for how to purchase this Ontario publication.

2. Perfection and Priorities

Perfection for financial assets in an STA jurisdiction can be done by the secured party:

taking possession of certificated securities in the direct system;

making a registration for any financial asset; or

taking "control" for any financial asset.

As most financial assets are negotiable, "control" is the key method to ensure priority for the secured creditor.

For example, for certificated securities the direct system, in the STA provides that a "protected purchaser", (see Ontario PPSA sections 28 (6), 28(7) and section 28.1 and STA section 70) being a person who gives value, has no notice of any adverse claim by a third party to the security, and obtains control of the security, will have priority ahead of a security interest in the same security.

There is no like protected purchaser priority rule in the indirect system, which instead uses "control" to determine priority.

The PPSA relates back to the STA to determine the steps for control. "Control" is defined in the STA (in Ontario see STA sections 23 to 26). It basically means that the secured party has taken all steps necessary for that type of investment property so that the secured may sell it without any action or consent by the debtor.

The Ontario PPSA section 1(2) provides that a secured party has control:

in certificated securities if it has control as provided in section 23 of the STA;

in any uncertificated security if it has control as provided in section 24 of the STA;

in a security entitlement if it has control as provided in section 25 of the STA; and

in a futures contract as provided in sections 1(2)(d) and (e) of the PPSA.

The Ontario PPSA provides that:

in the direct system, a cerificated security may be perfected by either:

the secured taking delivery of the certificates as outlined in section 68 of the STA (PPSA section 22(2)); or

the secured taking control (PPSA section 22.1(a)).

This is the same in either case as what is done today for certificated securities, being:

the certificate is delivered to the secured party or its agent, endorsed in blank for transfer by the debtor or delivered by the debtor with the necessary power of attorney signed by the debtor; or

the certificate has been reissued in the name of the secured party, even if the certificate bears a legend that it is subject to a security agreement; and

if the issuer is a private corporation, the board of directors of the issuer have passed a resolution approving of the security interest in its shares in favour of the secured party, to deal with any private corporation transfer restrictions.

in the indirect system, an uncertificated investment property may be perfected by control (Ontario PPSA section 22.1(1)).

Control can be achieved either by:

the debtor, secured party and investment intermediary entering into a control agreement, in which the intermediary agrees to take instructions only from the secured party with no additional consent of the debtor; or

the investment property is booked in a securities account in the name of the secured party, and extinguished as a securities entitlement of the debtor.

In any event, to obtain priority by way of control, the secured party must note that:

corporations statutes in STA jurisdictions have allowed private corporations to do away with share certificates and their shares may now be "dematerialized", and the secured party must act accordingly; (in Ontario see OBCA section 54(2));

control need not be absolute control. For example, in the security agreement the debtor may be entitled to receive dividends or vote securities prior to default. However, for control to perfect the interest the secured party needs to ensure that it needs no debtor consent or action before the secured may sell the collateral after default; (see Ontario STA section 25(2));

the security interest in favour of a securities intermediary in a security entitlement created by that intermediary or a security account it maintains,

has priority over other competing security interests in these assets. Here, think of unsettled trades and margin accounts (Ontario PPSA section 30.1(5)). As a due diligence matter, other secured creditors may need to require the security intermediary to subordinate its priority status to their security;

a security interest perfected by control has priority to a completing interest perfected by another method (Ontario PPSA section 30.1(2));

if two secured parties perfected by control, then the first in time has priority (Ontario PPSA section 30.1(4));

there are other specific priority rules (see Ontario PPSA section 30.1) for other types of investment property; and

because the conflict of law rules for investment property are in flux, prudent counsel should ensure the secured party's interests are perfected as required by local law that might in any way be the location of litigation. For example:

- Issuer is a mutual fund located in Montreal;
- Securities intermediary is a federal corporation with a head office in Nova Scotia and dealing via its Toronto branch; and investor is an individual usually resident in Edmonton, but winterizing in Florida at the time of the transaction,

Ontario has delayed enactment of its new PPSA conflict of law sections that provide rules of where a trust, partnership and other entities are deemed to be located, and the rules on the law governing validity of a security interest based on location at the time of attachment which would generality speaking be:

The law of where a certificated security is located;

The law of where the issuers is located for an uncertificated security; and

The law of where the securities intermediary is located for a securities account or securities entitlement.

Ontario will proclaim these sections when enough other Canadian jurisdictions are prepared to do so to allow for uniformity. For a pre STA case on conflicts rules for uncertificated securities, see:

Situs of Uncertificated Securities

This was an application for Letters of Administration with will annexed dealing with the estate of Miss Bloom and the application of the British Columbia *Probate Fee Act* to the uncertificate stocks, bonds and debentures contained in her estate. The *Probate Fee Act* applies to the real and personal property of the

ceased "situated in British Columbia". The issue was whether uncertificated securities are "situated in British Columbia" for purposed of assessing probate fees.

The court held that the uncertificated securities were situated in the Toronto office of The Bank of Nova Scotia Trust Company ("BNS").

The court reviewed the traditional common law test for situs of certificated securities and then by analogy extrapolated through the indirect holding system to the location of the deceased's financial intermediary, being BNS.

The court referred to the writings of J.G. Castell and J. Walker in *Canadian Conflict of Laws* and held as follows at paragraphs 61, 62 and 63:

"... In a multi-tiered holding system, the account will be situated at the financial investment intermediary on whose books the interest of the debtor appears. This is the place with the record that determines title is to be found. The place of the intermediary provides a certain, predictable and practical answer to the conflict of laws question in cross-border collateral transactions."

That is the test advocated by the applicant in the present case. Applying that test, the applicant submits that the situs of the deceased's securities is "the financial investment intermediary on whose books the interest of the deceased is recorded and where her personal representative must go to effect the transmission, and that is the Securities Department of The Bank of Nova Scotia Trust Company in Toronto, Ontario.

I agree with the submission. It has the benefit of clarity and precision, and I find that is arises more naturally from the existing common law tests than the proposal advanced by the Crown.

In argument, the Crown had referred to the work of Uniform Law Conference of Canada and the Alberta Law reform Institute with respect to the pending new legislation providing for the tiered holding system and "securities entitlements" under the *Uniform Securities Transfer Act*, bringing Canada in line with Article 8 of the American UCC. The court held that the Crown's position would constitute a proposal for law reform and would not fall within the requirements of the decision in *The King v. National Trust Company* [1933] S.C.R. 670 at which the court held as follows at page 675:

The circumstance of the particular case may be such that to them, none of the rules as formulated and applied in decided cases or books of authorities is strictly appropriate; and then one must have re course to analogy, and to the principals underlying the decisions or the rules as formulated or deducible therefrom.

The Estate of Bessie Bloom, Deceased [2004] B.C. J. No. 154; B.C.S.C. #70 (SCBC)

II. AUGUST 1, 2007: THE BILL 152 CHANGES:

1. Where Did These PPSA Changes Come From:

There has been a long path to get to these Ontario *Personal Property Security Act* ("PPSA") changes coming into effect on August first. A synopsis of the path follows:

1989: The PPSA, S. O. 1989 is enacted, updating the prior statute.

May 26, 1993: The Personal Property Security Law Committee of the Business Section of the Ontario Bar Association (the "PPSL Committee") provided its submission to the Ontario government recommending changes to the 1989 PPSA (the "1993 Submission").

Oct. 21, 1998: Submission by the PPSL Committee to the Minister recommending again the changes from the 1993 Submission which had not been enacted and providing additional specific reforms, for a total of 36 areas for reform.

2004: The secured transactions working group of the Commercial Law Strategy of the Uniform Law Conference of Canada ("ULCC") studied five areas and recommended changes to increase uniformity among all 12 PPSA statutes and the Quebec Civil Code. These five areas are:

(i) Conflicts of law;

(ii) Proceeds arising from inventory v. receivables security;

(iii) Anti Assignment clauses for financing receivables;

(iv) Priority between *Bank Act* security and provincial security;

(v) Security interest in licences.

see : www.ulcc.ca/2003 proceedings and a further report in the 2004 proceedings.

2004: The joint working group of the ULCC and the Securities Law Administrators produce the *Uniform Securities Transfer Act*, the result of about a decade of work (the "USTA"). see www.ulcc.ca/2004 proceedings.

2006: A working group from across Canada helps to draft the consequent PPSA amendments needed to enable the USTA, providing sample text for both the Alberta PPSA and the Ontario PPSA.

Feb. 13, 2006: PPSL Committee requests that the Minister move forward on the 36 recommendations from 1998.

April 28, 2006:PPSL Committee recommends to the Minister additional PPSA reforms to deal with the check box classification of collateral, rights to proceeds of inventory as

against receivable financiers, conflict of law rules, and a permanent advisory committee to assist the Ministry to modernize the PPSA and keep it modern.

May 8, 2006: The *Securities Transfer Act, 2006* (the "STA") incorporating the consequent PPSA, OBCA and *Executions Act* changes, receives Royal Assent and is proclaimed into force January 1, 2007.

May 19, 2006: PPSL Committee makes further recommendations to the Minister on the conflict of law rules. Many hours of discussions and comments were provided before the release of this submission.

Aug. 1, 2007: With several exceptions, the majority of Schedule E to *An Act to modernize various Acts administered or affecting the Ministry of Government Services, 2006* ("Bill 152") went into effect.

References to the ULCC website is given as these materials provide an excellent analysis of the legal problems and the reasons for reform. Copies of the PPSL Committee's submissions are attached to John Cameron's paper on the STA delivered on February 6, 2007 at the OBA's Mid Winter Institute session on "The Ultimate Review of Key Issues in Business Law". The OBA has been asked to post these PPSL Committee submissions on the Business Section's portion of OBA website, as they too provide excellent analysis of these legal issues.

2. What Changes Does Bill 152 Make to the PPSA:

John Cameron's delivered to the June 5, 2007 OBA program on the STA addresses the PPSA changes that came into effect January 1, 2007 to enable the STA. Comments on these STA changes to the PPSA are not duplicated here.

Ontario's PPSA is the oldest in Canada. The more recent PPSA statutes in Western Canada and Atlantic Canada have a great degree of uniformity in their content. The 2004 ULCC recommendations on five key areas focus on some of these differences.

Bill 152 helps bring Ontario's PPSA more in line with the other 11 PPSA statutes in effect in Canada and the Quebec *Civil Code*. To a large extent Bill 152 is "catch up" legislation moving Ontario ahead to match the Western and Atlantic PPSAs, and gives effect to more, but not all, of the PPSL Committee's recommendations in the 1993, 1998, and subsequent Submissions.

3. Changes to the Registration System:

(a) Elimination of Paper Registration Forms

(i) see new definitions of "financing statement" and "financing change statement".

(ii) see Part IV where there are revisions for the deletion of "branch offices" and "branch registrars", as only the central electronic registry is now needed.

(iii) see Ontario Regulation 56/07 which on August 1, 2007 repealed Ontario Regulation 912, the general PPSA regulation.

(iv) New Ministerial Orders have been prepared pursuant to section 73.1 of the PPSA and should be published in mid June 2007 and went into effect August 1, 2007.

(v) These new Orders largely duplicate Regulation 912, but delete the paper registration forms and processes.

(b) To Come : Elimination of the "Check the Box" Collateral Description

(i) Ontario had the first PPSA registry, created at a time when computer memory was expensive; hence the adoption of the Spartan "check the box" collateral description to save memory and cost.

(ii) All other Canadian jurisdictions use a word description to describe the collateral claimed; Ontario is planning to move to follow the others.

(iii) This change requires the government's PPSA computer system to be altered and we are told that this infrastructure work may take at least two years.

(iv) When it happens the change will come as a Ministerial Order under section 73.1 of the PPSA, amending the required content of a financing statement or financing change statement.

4. <u>More Changed Definitions:</u>

(a) "debtor"

(i) see section 1.

(ii) This revised definition now allows a person who does not owe payment or performance of an obligation to the secured party, but does own or has rights to collateral, to provide a security interest to the secured party in that collateral as a "debtor".

(iii) This definition is found in other jurisdictions of Canada and is also a concept from the United States and will facilitate cross border deals.

(iv) For example a shareholder could pledge his or her shares but not have granted any payment covenant, indemnity or guarantee with the secured party.

(v) Given that indemnities, guarantees and co-borrower obligations give secured parties additional rights than those provided to secured parties under Part V of the PPSA, secured parties will likely continue to want the "debtor" to also enter into a guarantee, indemnity or like covenant with the secured party.

(b) "motor vehicle"

(i) This definition has not changed, but has been carried forward from repealed Regulation 912 into Regulation 56/07.

5. <u>Leases for a Term of More Than One Year</u>

(a) See also the revised definitions of "security interest" and "purchase-money security interest" which are expanded to now include "a lease for a term of more than one year".

(b) See the new section 1 definition of "lease for a term of more than one year" which includes:

(i) A lease for an indefinite term even if one or more of the parties can terminate it inside one year;

(ii) A lease for a term of one year or less if the lessee with the consent of the lessor retains uninterrupted possession for more than one year, but only when the possession does exceed one year; and

(iii) The lease for one year or less if the lease is renewable for a total term in excess of one year; but does include

(iv) A lease of goods by a lessor who does not regularly engage in the business of leasing goods; or

(v) A lease of household furnishings or appliances as part of a lease of land and incidental to the use and enjoyment of the land.

(c) See section 2 which provides that the PPSA applies to leases for a term of more than one year.

(d) See new section 57.1 which provides that Part V of the PPSA on remedies and enforcement, only applies to a security interest if it secures payment or performance of an obligation.

(e) All other PPSA statutes in Canada and the Quebec *Civil Code* apply the lease for a term of more than one year lease provision.

(f) Now all Ontario leases of chattels that fit this definition, should be perfected in time to achieve purchase-money security interest ("PMSI") priority status.

(g) This pushes the determination of the characterization of a lease as a "true lease" as opposed to a "financing lease" or "disguised time purchase" until default by the lessee and enforcement.

(h) see: *DaimlerChrysler Services Canada Inc. v. Cameron* [2007] B.C.J. No. 456, British Columbia Court of Appeal, Prowse, Low and Kirkpatrick JJ.A., March 8, 2007.

The issue before the Court was whether the vehicle lease between the parties was a true lease or a security agreement to which Part 5 of the Personal Property Security Act (B.C.) applied. While many features of the document bore the hallmark of a true lease, the Chambers found that the default clause supported the finding that the transaction was a security lease. The default clause secured the payment of the lease payments and the option price and that the lessor knew it would receive the vehicle's full value and the full benefit of the lease payments in the event of default.

The appeal was allowed. The transaction was held to be a true lease. The default provisions did not create a separate security. They simply represent the calculation of the amounts owing by the lessee upon a breach of the agreement. The chambers judge erred in her characterization of the lease by placing undue emphasis on the default provisions of the lease and, accordingly, by failing to accord proper weight to the option purchase price. The impugned transaction was a true lease that came within the definition of s. 2 and, therefore, was excluded from Part 5 of the BC PPSA

(i) By new section 57.1, Part V of the Ontario PPSA will not apply to true leases, but will govern enforcement of only those leases that secure payment or performance of an obligation.

6. <u>Errors in the Security Agreement</u>

(a) Existing section 11(2)(a) provides that a security interest attaches to the collateral when a debtor signs a security agreement that contains a description of the collateral sufficient to enable it to be identified.

(b) Sections 9(2) on defects or errors in the security agreement and 9(3) on omissions of collateral descriptions are being repealed as they conflict with the section 11(2)(a) requirements.

(c) Secured parties need to ensure the security agreement has a good collateral description to achieve attachment, and which description will also be the key to a word description of the collateral in the financing statement when Ontario drops the "check the box" system.

7. <u>Sales and Leases in the Ordinary Course of Business</u>

(a) Ontario's old *Bills of Sale Act* was repealed in 1989.

(b) It required registration of a bill of sale where title passed to the buyer, but the goods remained in the vendor's possession.

(c) This registration requirement was after forgotten and among other situations, caused losses to consumers when several boat makers failed, causing the unregistered purchasers to lose their goods still in the possession of the insolvent vendor, to the vendor's secured creditors.

(d) After repeal in 1989, there was a gap in how to protect buyers in these situations.

(e) Sections 28(1.1), (1.2) and (1.3) expand section 28(1) to specifically extend protection to buyers in situations where the buyer has not taken possession or title has not passed or the vendor took a security interest in the goods, as long as the goods are identifiable in the contract of sale or the goods have been identified or marked as allocated to the buyer.

(f) Subsections 2.1, 2.2 and 2.3 expand the same protections to protect the rights of the lessee under a lease.

8. PMSI Notices

(a) As outlined in the ULCC papers from 2003 and 2004 there are three different ways priority to the proceeds generated by sale of inventory secured to a PMSI inventory secured party, have priority as against the receivables of the same debtor financed to a second secured party.

(b) Given that the PMSI rights of a financier or lessor of inventory also extends to the proceeds generated by that inventory, Ontario has moved to expand the requirement to send PMSI notices to prior registered PPSA creditors of the debtor who have claimed an interest in either or both the inventory or the receivables of that debtor.

(c) Ontario is now matching the requirements in the Atlantic Canada PPSA statutes.

9. Anti Assignment Clauses and Receivables and Chattel Paper Financing

(a) See new section 40(1) with a new definition "account debtor" and sections 40(1.1), 40(2), 40(3) and 40(4).

(b) These changes validate a security interest granted by an account and chattel paper holder, to enable it to raise funds, despite an anti assignment clause.

(c) Section 40(4) now allows a secured creditor to obtain security over specified accounts of its debtor even though the contract between the debtor and its account debtor prohibits assignment. Anti assignment clauses cannot be upheld as against the assignee secured creditor.

(d) Section 40(1.1) provides that the account debtor retains all of its rights and remedies (including set off) that it had against the assignor, as against the assignee secured creditor of the assignor.

(e) Section 40(2) preserves the same rules that exist in section 53 of the *Conveyancing and Law of Property Act* that the account debtor may pay the assignor until such time as the account debtor has received notice reasonably identifying that the receivable or chattel paper has been assigned. The account debtor is entitled to obtain proof that the assignment has been made before the account debtor is obliged to pay the assignee.

(f) Note that the provisions in new section 40(4) apply to an assignment of "the whole of the account or chattel paper" and not partial assignments.

(g) By contrast the UNCITRAL convention on the assignment of international receivables which Canada is expected to ratify, deals with partial assignments. Any disconnect between Canada's adoption of the convention and this provision will have to be dealt with in future.

10. Mandatory Full and Partial Discharges

(a) Section 56 of the statute has been updated with respect to the filing of financing change statements when the obligations of the debtor have been performed or with respect to partial discharges when it has been agreed to release at least part of the collateral or where a registration has been made but no security interest granted.

(b) A new provision is section 56(1) provides that where the scope of the collateral claimed in a financing statement is broader than the collateral actually granted under the security agreement, the debtor named in the financing statement may deliver written notice to the secured party demanding that a financing change statement be filed to accurately described the collateral covered by the security agreement.

(c) Revised section 56(4) makes the secured party liable to pay $500 to the debtor or other person entitled to make a demand, plus any damages resulting from the failure, where the secured party without reasonable excuse, fails to provide the required financing change statement or discharge or partial discharge under the prior sections.

11. Changes in Enforcement

(a) *Exemptions from seizure and enforcement*

(i) New section 62(2) provides that any collateral under a security agreement, other than a security agreement perfected by possession or which has PMSI status, that would otherwise be exempt from seizure under the *Executions Act*, are also exempt from the rights of the secured party under subsection 62(1), being rights to repossess.

(ii) It is extremely important that all financiers and lessors, and particularly those engaged in time purchases or financing of motor vehicles with consumers, ensure that they have PMSI priority for all leases and conditional sales.

(iii) It also means the use of chattel mortgages, where a secured party is unable to fall inside the definition of a PMSI, come with an additional risk to the lender where the collateral may be except goods. For example a credit union taking a chattel mortgage on my family used vehicle to secure my loan.

(iv) In adopting this exemption provision Ontario is matching a number of the other PPSA statutes. For example, see:

(A) **PMSI v. exemption from seizure** — Applicant had provided additional funding to debtor, now bankrupt, which allowed him to payout a car loan. This allowed debtor to acquire additional rights in the vehicle, and as such was a PMSI. The exception to exemption from seizure by reason of a PMSI in the PEI PPSA had been met.

TransCanada Credit Corp. v. Wonnacott (Trustee of) (2000) 188 Nfld and PEI R. 198; [2000] PEI J. No. 14 (PEI SC)

(B) **PMSI v. exemption from seizure** — Lessor of a vehicle held a PMSI and was therefore entitled to the exception to the exemption from seizure in the NS PPSA. However, as secured creditor had failed to prove a debt was owing by the bankrupt, lessor had to pay the value of the seized and sold vehicle to the debtor.

Re: Gerrard (2001) C.B.R. (4th) 90 (NSSC)

(C) **Debtor moved provinces; lessor unaware and unperfected upon debtor's bankruptcy** — The vehicle financier had been perfected in New Brunswick but was unaware that Ms. Roberts had moved to Nova Scotia until after she declared bankruptcy. The majority for the Nova Scotia Court of Appeal focussed on NS PPSA section 59(3)(b) which exempts from seizure by a secured creditor, a motor vehicle having a value of up to $6,500, if it is used by the debtor to attend or retain work. Section 59(7) provides that the s. 59(3)(b) exception to seizure does not apply if the goods are subject to a PMSI held by the party intending to seize the goods. As VW Credit had an unperfected PMSI, it was unsecured and subordinate to the trustee and unable to rely on the exception.

VW Credit Canada, Inc. v. Roberts [2001] NSJ No. 84; 2001 NSCA 42, on appeal from (2000) 19 C.B.R. (4th) 139; [2000] NSJ No. 222 (NSCA)

(b) *Objections to a notice to retain the collateral in satisfaction of the debt*

(i) See section 65(3) which provides that the time period within which a person who receives a section 65(2) notice of intention to retain the collateral in satisfaction of the debt, now has 15 days after service of the notice to object, and no longer 30 days.

(ii) This now matches the same 15 day period with respect to objecting to notices of sale.

(iii) New section 65(3.1) allows a person entitled to notice under section 65(1) to apply to a court to extend the 15 day period.

(c) *Enforcement of interests in personalty and realty together*

(i) Section 67(1)(g) has been added to provide the Court power to make orders as to notice, redemption, accounting for surpluses and other matters to enable a secured party to enforce any of its rights and remedies against both real and personal property security. An example, is a trust deed charging a hotel and its contents.

(ii) This allows a process for the secured party to deal with conflicting foreclosure and notice of sale notice provisions found in mortgage enforcement legislation and the PPSA, as well as different statutory duties of accounting relative to surpluses.

(d) *Service of Notices*

(i) Section 68 has been updated to allow for fax and other electronic means of delivery of notices which are required to be served under the PPSA, as well as notices to be served by personal delivery such as a courier service.

(ii) A reminder that section 68(4) was amended earlier in 2006 to drop from the deemed receipt of notices provision the exclusion for PMSI notices. PMSI notices now are deemed to be received in the same manner as any other form of notice delivered under the Act.

(e) *Conflicts of Laws : to Come*

(i) The new provisions in Bill 152 dealing with conflicts of laws rules are not being proclaimed at this time.

(ii) Currently the existing conflicts of law rules in section 7(1) use the location of the debtor at the time the security interest attaches to determine the validity, perfection and priority of security interests in intangibles, mobile goods and a non-possessory security interest in instruments, negotiable documents of title, money and chattel paper.

(iii) For some corporate debtors with multiple offices and for foreign corporations, it has been very difficult to determine the "location of the debtor" by reference to its "chief executive office": where the executives meet may not be an easy or obvious fact.

(iv) The Bill 152 uses the jurisdiction of incorporation and the registered head office of a corporation to provide a definitive and easily determinable rule in making this decision.

(v) The existing PPSA does not provide rules to determining the location of general partnerships, limited partnerships and trusts. Bill 152 does and simplifies that determination.

(vi) A key aspect to uniformity among the PPSA jurisdictions is to have uniformity in the conflict of law rules. Absent uniformity, we go back to conflicts of law from law school and deal with question of renvoi.

(vii) Ontario at this time has not enacted these new conflict of law rules and will wait until other jurisdictions in Canada are prepared to make like amendments.

(viii) At the ULCC meeting held in Charlottetown in September 2007, Professor Ronald Cumming provided his paper on certain PPSA amendment ideas to that body. He recommended that these Ontario new rules for conflicts of laws be adopted across Canada. His paper will be posted on the ULCC website shortly.

12. What Changes Were Not Made By Bill 152 from the 1998 Submissions?

(a) Application of PPSA to licences - section 2. Some guidance may come from the Supreme Court of Canada where it basis the appeal for the Nova Scotia Court of Appeal on the nature of filing licences.

See: *Royal Bank v. Saulnier* [2006] S.C.C.A. No. 351 (S.C.C.), on appeal from [2006] N.S.J. No. 307, as altered by N.S.J. No. 387 (N.S.C.A.), on appeal from (2006) 17 C.B.R. (5th) 182 (N.S.S.C.)

At trial, the court held that the bank's general security agreement from the fisherman, now bankrupt, attached to his fishing licences, as they were personal property. The court held that the licences were property in his estate as the fair and correct approach was to characterize federal fishing licences as property given:

> fishermen sold licences, especially lobster licences, for large amounts of money;
>
> they were a bundle of rights constituting marketable property; and
>
> to ignore commercial reality would result in inequitably denying the creditors access to something of significant value in the hands of the bankrupt.

The Nova Scotia Court of Appeal altered the trial court decision by finding that the licences were not an asset in the estate, but the income earned from the licences were part of the estate. The Court held that the licences were not property but that Mr. Saulnier had rights in relation to the licences, such as the income and the right to apply for renewals and the right to have them reissued to a designated third party.

The Supreme Court of Canada has granted leave to appeal

(b) Use of PPSA registry for executions - section 41(1);

(c) Classification of collateral - section 46(3);

(d) Dropping the need for sending a copy of registration to debtor - section 46(6);

(e) *Commercial Tenancies Act* – harmonize the Commercial Tenancies Act, based on title concepts [leases, chattel mortgages, conditional sales] with the PPSA and except goods subject to purchase-money security interests from distraint by landlords;

(f) Reform of other parts of the Act to deal with agricultural property, "crops"; the overlap between Bank Act and provincial PPSA security; the UNCITRAL convention on international receivables; and other improvements;

(g) Create a process for ongoing PPSA reform – continual updates and an ongoing process.

13. Glitches found in Bill 152

Since August first, some items have been found in the proclaimed amendments which need correction, and presumably, after the pending Ontario election, the Ministry may be able to effect changes for the following:

(a) the definition of PMSI inadvertently dropped the final words that exclude from a purchase money security interest, a sale and lease back transaction;

(b) section 46(3 was repealed prematurely. This is the section which provides that when words are entered into the optional collateral description area of the financing statement, the collateral claimed is limited to what is described. This section should not have been repealed until Ontario is able to proclaim into effect the provisions dropping the check the box system and adopting only a word description system as used in the rest of Canada.

This does mean that when considering whether to obtain a third party prior registered secured creditor's subordination or disclosure of collateral letter, that the client should understand that the limiting word section is gone and it is vulnerable to all prior registrations claiming the same check box class of collateral as the client is expecting to have; and

(c) there are no transition rules for one year leases, whether true leases or financing leases. Such clients who may not have previously registered, should now register and obtain waiver letters from prior secured creditors to avoid priority disputes in future.

III. WHEN IS IT TOO LATE TO REGISTER?

The question arises as to how long a secured party has to properly perfect its security interest. It is always desirable to register as quickly as possible to ensure priority and, if necessary, obtain purchase-money security interest ("PMSI ") status. However, the PPSA provides that the secured party is subordinate "until perfected". This leaves the issue of how long the secured party has to perfect.

The effective time of the bankruptcy has been used as a bright line test: one was either a secured creditor at the time of the bankruptcy, or not. Section 2.1 of the BIA provides as follows:

> For the purposes of this Act, the bankruptcy or putting into bankruptcy of a person occurs at the time or date of
>
> (a) the granting of a bankruptcy order against the person;
>
> (b) the filing of an assignment by or in respect of the person; or
>
> (c) the event that causes an assignment by the person to be deemed.

The third portion in (c) deals with the failure of proposals and the deeming of the maker of the failed proposal to be a bankrupt upon the happening of the events set out in section 50.4(8)(a), 57(a), and 61(2)(a) of the BIA.

However, there are cases that are now blurring this bright line, by allowing some parties to pass the line and join the ranks of the secured creditors by way of a late registration.

1. BIA Cases:

(A) PPSA Registration Upheld After Creditor Approval of BIA Proposal

Pioneer Grain Company, Limited v. Sullivan & Associates Inc. 2007 S.K.C.A. 73, [2007] S.J. No. 314, 11 P.P.S.A.C. (3d) (Sask. C.A.), on appeal from 2006 SKQB 399, 10 P.P.S.A.C. (3d) 201 (Sask. Q.B.)

- debtor filed its BIA proposal on May 18, 2006
- Pioneer filed its Saskatchewan PPSA registration on May 30, 2006 for its February 3, 2004 security agreement
- Proposal Trustee denied Pioneer's claim as a secured creditor
- on June 8, 2006 the creditors of the debtor approved the proposal
- the Registrar in Bankruptcy rejected Pioneer as a secured creditor and agreed with the Proposal Trustee
- the Registrar relied on s. 62(1.1) of the BIA in his findings, as being the source to settle the time to determine the claims of creditors as being the time of filing of the notice of intention, or the filing of the proposal if no notice was filed

- the Registrar held that "... certainty must be part of the equation. Certainty can only be achieved if there is a definitive date to determine the claims of creditors."

- the Saskatchewan Queen's Bench agreed with the Registrar

- Pioneer appealed

The Saskatchewan Court of Appeal granted the appeal and found Pioneer to be a secured creditor. The Court of Appeal held that:

(a) Under the BIA the filing of a proposal does not create a bankruptcy *per se*. A bankruptcy only arises under s. 57 of the BIA when the creditors refuse a proposal;

(b) The PPSA is the statute which provides whether a person is or is not a secured creditor; and

(c) Nothing in section 20 of the PPSA makes an unperfected security agreement subordinate to a proposal trustee. If the Legislature had intended section 20 to deal with priority as against proposal trustees it could have done so

(B) Registration Allowed During Proposal

Labrie Equipment Ltd. v. Harvey & Co., [1993] N.J. No. 271, 21 C.B.R. (3d) 281 (T.D.)

- The BIA section 69.1 statutory stay prohibits a secured creditor from enforcing its security after the filing of a notice of intention to file a proposal, but is does not prevent a secured creditor form filing its security documents within the time permitted by provincial legislation.

(C) Registration After Bankruptcy Rectified nunc pro tunc

Re Hickman Equipment (1985) Ltd., [2003] N.J. No. 48, 40 C.B.R. (4 th) 69 (T.D.)

- CIBC Equipment Finance had advanced funds and taken security from Hickman leasing to allow it to acquire certain vehicles. Hickman leasing transferred 9 vehicles to its related corporation, Hickman Equipment, without the knowledge or consent of CIBC. The Newfoundland and Labrador PPSA allows for 15 days for a secured creditor to file a change statement to record a transfer of collateral by debtor. CIBC filed a change statement to record the transfer of the units by debtor within 15 days of learning of it, but after the happening of the bankruptcy of Hickman Equipment.

- The Court granted CIBC leave to file the registration *nunc pro tunc*. The Court held that CIBC filed within the 15 days permitted by the PPSA and should not be punished by the actions of Hickman Leasing, over which CIBC had perfected security.

- The Court held that "the step taken during the stay by a creditor is not a nullity but an irregularity and in appropriate circumstances leave can be granted nu*nc pro tunc*".

2. CCAA Cases

(A) CCAA Stay Lifted nunc pro tunc for Very Late PPSA Registration

Re: TRG Services Inc., formerly The RAM Group Inc. et al [2006] file no. 05-CL-5966 (Ont. S.C.J).

- Court found that the creditors were not attempting to gain an advantage after the CCAA proceedings had commenced but were attempting to hold onto an advantage that they had already negotiated with the debtor. The CCAA discretion should not be exercised to defeat the legal rights of a creditor.

(B) CCAA and Late Renewal

Re: PSINet Ltd., [2002] O.J. No. 633, 32 C.B.R. (4th) 102 (C.A.), appeal from [2001] O.J. No. 3829 (S.C.J.).

- Where all parties had acted in debtor's insolvency as if its parent corporation had a perfected general security agreement, and applicant had not acquired any rights in the collateral during the period of lapse, parent corporations was entitled to a lifting of the CCAA stay order to file a late PPSA renewal by s. 30(6) of PPSA.

(C) Registration of Aircraft Leases After CCAA Stay Order Enjoining Registrations

Re Western Express Air Lines Inc. and Western Express Air Lines (Alberta) Inc. (13 October 2004), Vancouver L041526: reasons of Chief Justice Brenner pronounced in Chambers

- The PPSA registrations done on June 21/04 were declared to be valid and effective and did not breach the stay order. The court reviewed stay orders in the CCAA proceedings of PSINet (op. cit.) and Air Canada Docket No. 03-CL-4932; (Commercial List, Farley, J.) where the initial stay orders specifically enjoined registrations. In theses cases the court lifted the stay order to allow registrations to preserve the status quo. In the case at bar the court noted the other creditors were aware of the leases and all the PPSA registrations "did was prevent them [other creditors] from reaping a potential windfall that they never expected".

(D) RSLA Non Possessory Lien Registered Day CCAA Stay Order Granted

Re Veltri Metal Products Co., [2004] O.J. No. 2994, 72 O.R. (3d) 292 (S.C.J.)

- The Court ordered the stay to be lifted nunc pro tunc and validated the RSLA registration. The Court noted that a CCAA stay is often lifted to allow construction liens to be filed, and by analogy, RSLA lien claimants should likewise be allowed to lift the stay. Issues relating to validity of the subject lien and its priority were not decided at this hearing.

IV. SOME RECENT CASES ON PRIORITY DISPUTES:

1. BIA Interim Receivers and Change Statements:

1231640 Ontario Inc. (Re) [2007] O.J. No. 4561 (Ont C.A.); on appeal from Ground J. at [2006] O. J. No. 2850 (Feldman and LaForme JJ.A., with Weiler J.A. dissenting in part)

- Royal Bank of Canada ("RBC") was a lead lender for a syndicate of lenders to The State Group Limited and held a perfected GSA
- St. Paul Guaranty Insurance Company was also a lender and held the second priority perfected GSA
- State Group defaulted
- On November 14, 2001 PriceWaterhouseCoopers, ("PWC") was appointed as an interim receiver pursuant to section 47 of the BIA by an order obtained by RBC
- On November 14, 2001 PWC sold certain assets of State Group, including its name, and causing the debtor to change its name on November 15, 2001 to 1231640 Ontario Inc.
- Neither RBC nor St. Paul filed financing change statements to record a change of name of the debtor
- On January 30, 2002 PWC assigned the debtor into bankruptcy, a date when both RBC and St. Paul were unperfected
- Subsequently PWC received $5.5 million into the bankrupt's estate, mainly from a $4.5 million income tax refund. RBC was then still owed $29 million and St. Paul was still owed some $88 million
- If the date of determining priority among creditors was the day PWC became interim receiver, RBC was perfected on that date and would receive these funds
- If the date was the date of appointment of the bankruptcy trustee, then both were unperfected and St. Paul would receive the majority of the funds for its larger pro rata shortfall
- The motions judge concluded that pursuant to section 20(2)(b) of the Ontario PPSA the effective day of the appointment of "a person representing the creditors" was the date of the appointment of PWC as trustee in bankruptcy, when both were unsecured creditors
- RBC appealed

Held: Feldman and LaForme, JJ.A. (Weiler J.A. dissenting in part) – appeal dismissed.

The court considered two questions:

(a) did the appointment of an interim receiver implicitly give the RBC an exemption from filing a change statement to record the change of name of debtor?

All three Justices agreed that it did not. Nothing by statute exempted RBC from the requirement to record a change of name of the debtor to maintain its priority. RBC could have applied to court for permission to lift the stay order to file the change statement and maintain its perfection.

(b) did the RBC's failure to file the change of name amending registration result in its loss of priority as a secured creditor?

Section 20(1)(b) provides that an unperfected security interest in collateral is ineffective against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a trustee in bankruptcy. Section 20(2)(b) provides that the rights of the person in section (1)(b)with respect to the collateral is to be determined as of the date from which the person's representative status takes effect.

Feldman and LaForme, JJ.A. agreed with the trial judge and held the RBC to be unperfected by operation of sections 20(1)(b) and 20(2)(b) on the date of the bankruptcy. The majority held that an interim receiver appointed by court order was not a "person who represents the creditors of the debtor" because:

(i) the assets of the debtor did not vest in an interim receiver but do vest in the bankruptcy trustee by operation of section 71 of the BIA, and that an interim receiver is merely an administrator accountable to the court and possessing only the powers granted in the order;

(ii) the appointment by the order of an interim receiver did not remove any rights of unsecured creditors or judgment creditors to pursue their remedies. By contrast the appointment of the bankruptcy trustee "stops the music" and the trustee is entitled to assess claims and priorities by operation of section 71(2) of the BIA and the rights of judgment creditors under the PPSA as against unperfected security interests ends; and

(iii) Ontario amended its PPSA language in 1989 to follow the other PPSA jurisdictions and deleted the word "receivers" from section 20. The court noted the Manitoba decision in *Roynat Inc. v. Ja-Sha Trucking and Leasing Ltd. (Receiver of)*, [1991] 6 W.W.R. 764, affirmed (1992), 94 D.L.R. (4th) 611 (Man. C.A.) which held that a court appointed receiver was not a person representing the creditors of the debtor for the purposes of Manitoba's like PPSA section 20 in determining priority of an unperfected security interest.

Weiler, J.A. disagreed and would have held the RBC to be perfected on the date to determine priorities, being the date of the appointment of the court ordered interim receiver. She wrote that the interim receiver is a person who represents the creditors of the debtor, noting the PPSA has no definition for this phrase, the deletion of the word "receiver" from the 1989 PPSA was not indicative of the Legislature's intentions, a

section 47 BIA interim receiver is appointed by the court as an officer of the court and not by a single creditor, and owes fiduciary duties to all creditors, and she cites scholarly articles in which this phrase has been analyzed and determined that it is not limited to bankruptcy trustees alone.

2. I Still Don't Know What a Fixture Is

Kennedy Electric Limited v. Dana Canada Corporation 2007 ONCA 664, [2007] O.J. No. 3657 (Ont.C.A.)

- Rumble Automation Inc. was contracted by Dana to build an extension to Dana's plant for $7 million and install a new assembly line to build Ford truck bodies for $44 million

- Rumble subcontracted the design, build and installation of the line to Kennedy Electric, Cassidy Industrial and other suppliers

- The suppliers built and tested the assembly line in two locations. It was then disassembled and moved to the new addition at Dana's St. Mary's plant, which addition was built to house this line

- The assembly line covered 100,000 square feet, was 20 feet high, weighed 500,000 tons, was attached to the floor by up to 3,000 bolts, had 100 platforms and 165 robots. It was due to build Ford truck bodies for 8 years

- Rumble became bankrupt

- Kennedy and Cassidy filed construction liens against Dana's title for their "improvements" to this land

- The trial judge and the Divisional Court (2 in favour, 1 dissenting) both held that the assembly line was not an "improvement" under the *Construction Lien Act* ("CLA") and the liens were to be discharged

- Kennedy and Cassidy appealed

The Ontario Court of Appeal dismissed the appeals. The Court held that:

(a) The lien created by the CLA is to be applied only in the case of construction and building repairs

(b) The "P221" project in St. Mary's was not one integrated construction project. The extension to the building could be used for other purposes and housed 2 additional, separate assembly lines

(c) The Ford truck body assembly line was not permanently attached to the building. It had been disassembled once and moved there. It could be done again, although at a $10 million cost to do so

(d) The issues involved in considering the difference between finding that machinery is installed permanently in a building to operate a business, as opposed to machinery installed in a building to operate a business, but is portable, is a finding of fact in each case

(e) The Court of Appeal found no error in finding a fact by the trial judge to overturn that decision

3. GSA versus Crown Claims

Harbert Distressed Investment Fund, L.P. et al. v. General Chemical Canada Ltd., [2007] O.J. No. 3296; 35 C.B.R. (5th) 163 (Ont. C.A.)

- The Funds were secured creditors of General Chemical, which was a bankrupt
- The interim receiver collected in $6.5 million from General Chemical's operations from inventory and receivables
- The interim receiver sought Court permission to make a distribution of $3.75 million of these funds to the Funds as a secured creditors
- The Ontario Ministry of the Environment ("MOE") claimed clean up costs of General Chemical's contaminated lands under the *Environmental Protection Act* ("EPA")
- The pension plan administrator claimed a lien by section 57(5) of the *Pension Benefits Act* ("PBA") ranking prior to the Funds' security

The motions judge dismissed the application of the MOE and the pension administrator. They appealed.

The Court of Appeal awarded the money to the Funds as secured creditors as:

(a) Section 57(3) of the PBA did not create a trust as contemplated by section 67(1)(a) of the BIA and excluded nothing from the bankrupt's estate for purposes of distributions under the BIA; and

(b) The general security agreement did not extend security to the bankrupt's real property; only to its personalty. Section 14.06(7) of the EPA gave the MOE a security interest over the bankrupt's contaminated lands. As the $3.75 million came from inventory and receivables over which MOE had no security, it was not entitled to these amounts.

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