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IS IT TOO LATE TO REGISTER?

By Jennifer Babe

MARCH 31, 2005

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1. The Effective Date of the Bankruptcy

I have always thought of the effective time of the bankruptcy to be a bright line test: one was either a secured creditor at the time of the bankruptcy, or not. Section 2.1 of the *Bankruptcy and Insolvency Act* (“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 [formerly “receiving order” prior to the December 2004 second set of amendments harmonizing federal statutes to the Quebec civil law] 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The first portion in (a) is an amendment from the prior section 71(1) now repealed, which deemed the effective date of the bankruptcy to relate back to the time of the filing of the application [formerly “petition”]. 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 sections 50.4(8)(a), 57(a), and 61(2)(a).

However, there are some 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.

2. Late Registrations in BIA Situations

As noted above, the effect of BIA section 2.1(a) is to leave a window open to get registered between learning of the issuance of a bankruptcy application, and the issuance of the bankruptcy order. The race of course is always to the swiftest, but the repeal of section 71(1) opened a new space of time to become secured either by an initial filing, or, getting an amendment filed to correct an error.

In addition to this legislative change, there are the following cases:

- (a) *Labrie Equipment Ltd./Équipement Labrie Ltée v. Harvey & Co.* (1993), 21 C.B.R. (3d) 281 (N.L.S.C. (T.D.))

Held: 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 it does not prevent a secured creditor from filing its security documents within the time permitted by provincial legislation.

This decision is intuitively right as the debtor was not bankrupt, but reorganizing its affairs under the BIA. The creditor was still on the right side of the bright line.

- (b) General Electric Capital Canada Inc. v. Interlink Freight Systems Inc. (1998), 42 O.R. (3d) 348; 14 P.P.S.A.C. (2d) 198; 7 C.B.R. (4th) 173; [1998] O.J. No. 4910 (Ont. Ct. Gen. Div.)

Held: the unregistered non-possessory lien under the *Repair and Storage Liens Act* (“RSLA”) was allowed to register after the effective date of the bankruptcy. Justice Gans found the RSLA to be different from the *Personal Property Security Act* (“PPSA”), as he held that nothing in the RSLA makes the RSLA registration time sensitive, except section 10(1) of the RSLA which deals with an intervening bona fide purchaser for value without notice who acquires the subject article before the RSLA registration has occurred.

With respect to the learned Justice Gans, I think this decision was wrongly decided. The RSLA provides:

- (i) in section 3(2) that a possessory repairer’s lien arises upon the start of the repair;
- (ii) in section 4(3) that a possessory storage lien arises upon the storer’s receipt of the article for storage, or repair and storage; and
- (iii) in section 7(2) that a non-possessory repair or storage lien arises upon the claimant giving up possession of the article.

Registration is not needed to create the lien. However, by section 10(1) the RSLA leaves the unregistered non-possessory lien claimant vulnerable to third parties. It reads:

A non-possessory lien is enforceable against third parties only if a claim for lien has been registered, and, where a person acquires a right against an article after a non-possessory lien arises, the right of the person has priority over the non-possessory lien of the lien claimant if a claim for lien was not registered before the person acquired the right. *[emphasis added]*

I think Justice Gans only looked to the second half of section 10 regarding the bona fide purchaser for value without notice, and missed the first part on lack of enforceability against the third party bankruptcy trustee, or here GE as an existing secured creditor. By contrast, the PPSA has section 20(1)(b) which provides very clearly that an unperfected security interest is subordinate to a trustee in bankruptcy. However, I think the less elaborate section 10 of the RSLA has the same effect.

The Ontario Bar Association Business Section has recommended to the Ontario government that that a time limit for registration be included in the RSLA so that secured parties and the public have notice of non-possessory liens in a timely manner and not on the eve of a sale, or here, post bankruptcy.

- (c) Re: Hickman Equipment (1985) Ltd. (2003), 40 C.B.R. (4th) 69; [2003] N.J. No. 48 (N.L.S.C. (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.

Held: CIBC was granted 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:

- (i) “the step taken during the stay by a creditor is not a nullity but an irregularity and in appropriate circumstances leave can be granted *nunc pro tunc*” [at paragraph #10; quoting Houlden and Morawetz at 2003 Annotated BIA at page 371];
- (ii) the Court followed the decision in Labrie Equipment (op cit.), which under pre-PPSA law, allowed for registration of conditional sales for 30 days after goods entered the province. The Court held that CIBC’s security could be perfected in the time allowed by provincial legislation, being the 15 day time period for a transfer by debtor;
- (iii) the Court distinguished the decision in Re Giffen [1998] S.C. J. No. 11, where the lessor was totally unperfected at the effective date of the bankruptcy:

“A general provision such as s. 21(1)(a) [unperfected interests subordinate to bankruptcy trustee] should not, despite the absolute nature of its wording, be interpreted so as to overrule the specific intended fifteen-day perfection period established by ss. 36(8) and 52(2) of the PPSA.”; and
- (iv) the Court has the jurisdiction to either recognize the change statement during the stay period *nunc pro tunc* effective on the date of its registration or permit the registration of a new change statement within 15 days of the order to do so. The Court recognized CEFL’s change statement.

This is not one of my favourites for reasoned decisions, given the Labrie Equipment case dealt with a proposal and not a bankruptcy, and the impact of being unperfected as against a bankruptcy trustee by operation of the PPSA, is not lifted by reason of the lack of knowledge of the secured party or other factors relating to harsh circumstances.

3. Companies' Creditors Arrangement Act ("CCAA") Stay Orders

The initial stay order of the court issued for a corporation seeking to reorganize pursuant to the CCAA, typically prohibits, among other actions, any party from taking any step, perfecting, or making any registration against the debtor corporation. There have been however cases allowing for the lifting of the court ordered stay to allow for registration.

4. Post Stay Registrations in CCAA Situations

There are many decisions in CCAA proceedings dealing with lifting the stay order to allow for construction lien registrations. For example, there are number of such orders in the Stelco restructuring. I have not dealt with these, but only PPSA and RSLA cases.

- (a) Re: PSINet Ltd. (2002), 32 C.B.R. (4th) 102; [2002] O.J. No. 633 (Ont. C.A.), appeal from [2001] O.J. No. 3829 (Ont. Sup. Ct. J., Commercial List, Farley, J.)

Held: the applicant was permitted to effect a late re-perfection of its lapsed PPSA registration pursuant to section 30(6) of the PPSA. The Court held that the objecting party had not been prejudiced and had not acquired rights in the collateral during the period of lapse of the secured party's registration.

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

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| Prior to | |
| June 1/04 | certain aircraft leases registered under the B.C. PPSA by third parties |
| June 18/04 | CCAA initial stay order granted which prohibits any person from realizing upon or "otherwise dealing" with any security. |
| June 21/04 | both Alaska Flight Services and Pack Wikert register their respective leases of certain aircraft under the PPSA. |
| Held: | 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 <u>PSI Net</u> (op. cit.) and <u>Air Canada</u> Docket No. 03-CL-4932; (Commercial List, Farley J.) where the initial stay orders specifically enjoined registrations. In these 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". |

I could not find a copy of the decision of Justice Farley in the Air Canada decision noted in this case, but the text of this B.C. decision refers to Justice Farley lifting the stay order for Good Year Tire and Rubber Company where it was again characterized as not prejudicing the other creditors and preventing a windfall to them at the expense of the applicant.

These cases are all based on hard circumstances and the court obviously had sympathy for late renewals and late PPSA registrations to preserve the status quo. These orders allow for perfection. Nothing in the orders deal with priority as among the registered parties, which presumably go to the PPSA rules such as PMSI entitlements and the race to the swiftest. At least the applicants come inside the secured creditor pool, whatever their priority may be. However, these are not bankruptcies but restructurings and as we know, the courts are creative in CCAA decisions.

- (c) Re: Veltri Metal Products Company (2004), 72 O.R. (3d) 292; [2004] O.J. No. 2994 (Ont. Sup. Ct. J.; Commercial List, Molloy J.)

Eagle Press sold a press to the debtor, and was paid for the machinery. It had also installed the press for the debtor and had some \$250,000 of unpaid invoices for its installation services. Eagle Press registered its RSLA non possessory lien on January 13, 2004. On that day, the debtor obtained its initial stay order under the CCAA, effective at 12:00 a.m. that day.

Held: the Court ordered the stay to be lifted *nunc pro tunc* and validated the RSLA registration. The Court noted that a CCAA lien 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.

As noted above for the GE case, the RSLA lien exists by operation of the statute but needs registration to be enforceable against third parties, here being the PPSA secured creditor selling the goods. This appears to be another case where hard circumstances influenced the court to give effect to the claim.