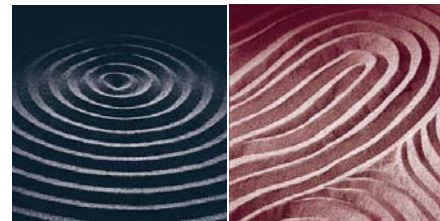


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When is a Lease a “True Lease”?

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WHEN IS A LEASE A “TRUE LEASE”?

Commercial leases of personal property can be categorized as “true leases” or “security leases”. The distinction between these categories is significant in several respects. The British Columbia Court of Appeal recently reformulated the test for distinguishing between true leases and security leases, resulting in greater enforcement options for lessors.

A lease of personal property that is not intended to secure payment or performance of an obligation is commonly termed a true lease. The lease payments under a true lease are consideration for the use of the leased property, not for its acquisition. In contrast, a lease that is intended to secure payment or performance of an obligation is considered to be a security lease.

Most provincial *Personal Property Security Acts* apply differently to these two different types of leases. These acts deem a true lease to create a security interest (provided the term of the lease is for more than one year); however, the remedies and enforcement provisions of the statute do not apply to true leases. Therefore, for example, a long-term true lease must be registered, but the restriction that a lessor cannot both seize the leased property and sue the consumer lessee for damages does not apply to a true lease.

Until recently, the Ontario *Personal Property Security Act* applied only to security leases. Therefore, there was no requirement to register true leases. However, amendments made to the Ontario PPSA in 2007 made it more consistent with the PPSA regimes in the other Canadian provinces. As a result, Ontario now requires registration of both true leases and security leases, but the remedial restrictions on lessors do not apply in the case of true leases.

Cases decided under the Federal *Companies’ Creditors Arrangement Act* also distinguish between these two types of commercial personal property leases. A stay of proceedings that is usually ordered to allow a company to propose its restructuring does not apply to stay ongoing payments due under a true lease. Therefore, lessors often argue that they hold true leases so as to avoid the effect of the stay.

Many cases have addressed the distinction between true leases and security leases. However, in *DaimlerChrysler Services Canada Inc. v Cameron* 2007 BCCA 144, the B.C. Court of Appeal found that one important factor in making that distinction had been wrongfully applied in previous decisions.

In *Cameron*, DaimlerChrysler was the lessor of a vehicle leased to Cameron. It contended that, upon default of the lease, it was entitled to both apply the proceeds of sale of the seized vehicle, as well as to sue Cameron for the deficiency resulting from the damages calculable under its lease. That result would only apply if the remedial provisions of the PPSA did not apply, on the basis that the lease was a true lease.

In the B.C. Supreme Court below, the Court accepted Cameron’s argument that the lease was a security lease, primarily on the basis that the formula for calculating damages under the default provisions of the lease was indicative of a security lease. However, the Court of Appeal, in a unanimous judgment, allowed the appeal and held, “. . . the basis for calculating damages does not distinguish a true lease from a security lease”. Madam Justice Kirkpatrick wrote, for the Court, “It appears to me unhelpful to focus on default provisions and render them determinative of whether a lease is a security lease. The fundamental question is whether a lease secures

payment or performance of an obligation. . . . In my view, it cannot be said that the default provisions in the lease in question create any separate security. They simply represent the calculation of the amounts owing by the lessee upon a breach of the agreement.”

The Court considered a previous line of cases that had emphasized the default provisions of the lease as being an important factor in distinguishing between a true lease and a security lease. However, when the Court analyzed the development of the law of damages for chattel leases, it determined that the default provisions of the lease in question were consistent with the damages available to a chattel lessor at common law, and not necessarily only consistent with a security lease.

The Court emphasized that the test for distinguishing leases under the PPSA is whether a lease secured payment or performance of an obligation. An important factor will be whether any option to purchase at the end of the lease term is for a substantial sum (suggesting a true lease) or a nominal amount (suggesting a security lease). The intention of the parties and the substance of the transaction will always be the focus of the analysis in determining whether a lease was intended to secure payment or performance of an obligation, but default provisions should not be a determinative factor.

Miller Thomson LLP acted for the lessor, DaimlerChrysler, in the *Cameron* case.

The distinction between true leases and security leases will always be made on a case-by-case basis. However, the *Cameron* case has refocused the test for that determination, favourably for lessors.

Gordon Plottel is a lawyer in Miller Thomson’s Vancouver office, specializing in security enforcement matters.