

COMMENTARIES

ONTARIO'S PERSONAL PROPERTY SECURITY ACT — BILL 152

1. Introduction

Ontario's Personal Property Security Act¹ underwent significant change in 2006. First, the PPSA was amended in conjunction with the enactment of the Securities Transfer Act, 2006.² Second, Schedule E of Bill 152, Ministry of Government Services Consumer Protection and Service Modernization Act, 2006,³ enacted further changes to the PPSA, mainly adopting reform previously recommended by the Ontario Bar Association (OBA). Most of Schedule E has been proclaimed to come into force on August 1, 2007.⁴ This article provides some background for the PPSA changes in Bill 152 and discusses some of the more interesting amendments.

2. Background

The Personal Property Security Legislation Committee (PPSL Committee) of the OBA's Business Law Section has made many submissions for PPSA reform, including the following:⁵

- A lengthy submission in 1998 following the PPSL Committee's multi-year review of the PPSA.

1. R.S.O. 1990, c. P.10 (PPSA).

2. S.O. 2006, c. 8 (STA). The STA establishes new rules relating to the transfer of securities and governs the rights and obligations of issuers, securities intermediaries, investors and secured parties. For details of the provisions of the STA and related PPSA amendments that are most relevant to secured transactions, see John Cameron, "Secured Transactions Under Ontario's *Securities Transfer Act, 2006*" (Toronto, Torys LLP, January 2007), online at Torys <<http://www.torys.com/publications/pdf/AR2007-4T.pdf>> and to be published in a forthcoming issue of the *Banking and Finance Law Review*.

3. S.O. 2006, c. 34 (Bill 152).

4. Ont. Gaz., Vol. 140-10, p. 657.

5. Copies of these submissions are available from the OBA. These submissions and the explanatory notes relating to the PPSA amendments contained in Schedule E to Bill 152 are also available at <<http://www.torys.com/publications/pdf/AR2007-5Tsup.pdf>>.

- A letter dated February 13, 2006 about the portions of the 1998 submission that were not then enacted.
- A letter dated April 28, 2006 about new areas of PPSA reform, including eliminating the “check the box” system of registration, new purchase-money security interest (PMSI) rules for inventory financing and the creation of a permanent advisory committee to address PPSA law reform.
- A letter and memorandum dated May 19, 2006 recommending a new conflict of law rule to determine the location of a debtor, based on the jurisdiction under whose laws the debtor is organized.

Most of the recommended law reform has now been enacted in Bill 152 or in previous legislation amending the PPSA. The remainder of this article focuses on the more noteworthy changes.

3. Bill 152 Amendments

(a) Definition of Debtor

Bill 152 amends the definition of “debtor” to clarify that the term includes a person who creates a security interest in collateral without assuming any of the obligations secured.⁶ Prior to this amendment, some lawyers had suggested that the PPSA requires a person to provide a guarantee of a borrower’s obligations in order to create a valid security interest in collateral. This suggestion was contrary to common law and based exclusively on a very narrow reading of the PPSA, unsupported by any jurisprudence. The OBA’s *Personal Property Security Opinion Report* rejected this suggestion too.⁷ In any event, with this amendment, the matter will now be free from doubt.

(b) Leases

Prior to Bill 152, the PPSA applied to leases of personal property only where the lease secured payment or performance of an obligation. In this respect, the PPSA was out of step with the other PPSAs across Canada, each of which applies not only to those leases but also to any true lease of more than one year. Bill 152 brings the PPSA into conformity with the other PPSAs.

6. “Debtor” is defined in s. 1(1) of the PPSA.

7. Canadian Bar Association — Ontario (now the OBA), *Personal Property Security Opinion Report* (1998), at pp. 44-46.

(c) Conflict of Laws: Location of Debtor

Currently, the PPSA looks to the debtor's location to determine the validity, perfection and priority of

- any security interest in intangible property;
- any security interest in equipment and leased inventory, in either case of a type normally used in more than one jurisdiction (*e.g.*, cars and trucks); and
- a possessory security interest in instruments, negotiable documents of title, money and chattel paper.

Currently, the PPSA also looks to the location of the debtor to determine the perfection of a security interest in

- investment property by registration;
- investment property granted by a broker or securities intermediary, where the secured party relies on attachment of the security interest as perfection; and
- a futures contract or futures account granted by a futures intermediary, where the secured party relies on attachment of the security interest as perfection.⁸

A debtor's location is currently defined by reference to the debtor's place of business if there is one, and the debtor's chief executive office if there is more than one place of business.⁹ The location of the debtor's chief executive office is often difficult to determine in practice, particularly when the debtor is a partnership, a business trust or a wholly owned subsidiary of a foreign corporation. This difficulty often results in additional expense to ensure that a security interest is perfected and searches are carried out in, and legal opinions obtained from, every jurisdiction that might possibly contain the debtor's chief executive office. To resolve these difficulties, the PPSL Committee formed a working group, which consulted with other practising lawyers, to recommend new conflict of laws rules. The new conflict rules in Bill 152 are the product of those efforts.

The new definition of a debtor's location in Bill 152 will make it easier in practice to determine the location of business debtors. The new definition outlines the following:

Individuals: Individuals are located in their jurisdiction of residence.¹⁰ For individuals carrying on business as a sole

8. PPSA, s. 7.1(3)(a) and (5); see also s. 19.2, which describes the circumstances in which perfection by attachment occurs.

9. PPSA, s. 7(4).

10. PPSA, s. 7(3)(a), as enacted by Schedule E.

proprietorship, this reflects a change from the current law and tracks the U.S. Revised Uniform Commercial Code (UCC) § 9-307(b)(1).

Canadian provincial corporations, limited partnerships and unlimited liability companies: A corporation, limited partnership or other organization (e.g., an unlimited liability company) that is incorporated, continued, amalgamated or otherwise organized under the laws of a Canadian province or territory is located in that province or territory.¹¹

Canadian federal corporations: A corporation that is incorporated, continued or amalgamated under a Canadian federal law is located in the province of its registered office or head office, as specified in its special Act, letters patent, articles or other constating document, or (in cases not covered by those rules) as set out in its by-laws.¹²

U.S. state corporations, limited partnerships and LLCs: A “registered organization” that is organized under the laws of a U.S. state is located in that U.S. state.¹³ The phrase “registered organization” is used in Revised UCC § 9-307(e) and the definition of that phrase tracks the corresponding definitions in Revised UCC § 9-102. Official Comments 4 and 11 to Revised UCC § 9-307(e) indicate that the phrase includes a corporation, a limited partnership and a limited liability company.¹⁴

U.S. federal corporations: A specific rule applies to U.S. federal corporations, pointing to a particular U.S. state or the District of Columbia,¹⁵ but this rule is not likely to have much practical application because these entities are not frequently debtors against whom registrations are made.

11. PPSA, s. 7(3)(c), as enacted by Schedule E; that section also requires that the relevant law of that province or territory must require the incorporation, continuance, amalgamation or organization to be disclosed in a public record.

12. PPSA, s. 7(3)(d), as enacted by Schedule E.

13. PPSA, s. 7(3)(e) and (4), each as enacted by Schedule E.

14. Revised UCC § 9-307(c), Official Comment 11 states:

Not every organization that may provide information about itself in the public records is a “registered organization.” For example, a general partnership is not a “registered organization,” even if it files a statement of partnership authority under Section 303 of the *Uniform Partnership Act* (1994) or an assumed name (“db”) certificate. This is because the State under whose law the partnership is organized is not required to maintain a public record showing that the partnership has been organized. In contrast, corporations, limited liability companies, and limited partnerships are “registered organizations.”

15. PPSA, s. 7(3)(f) and (4), each as enacted by Schedule E.

Trusts: Where a trust instrument is governed by the laws of a Canadian province or territory, the trust is located in that province or territory.¹⁶ Where a trust instrument is governed by the laws of a jurisdiction outside Canada or does not specify a governing law, the trust is located in the jurisdiction in which the administration of the trust is principally carried out.¹⁷ According to the submission by the PPSL Committee, a different rule should apply to a foreign trust. The priority rules (particularly the priority rules relating to a judgment creditor) should bear a closer relation to the trust than merely its governing law, because Canadian lawmakers will not know as much about the policies made under a foreign governing law, especially as those policies change from time to time.¹⁸ This policy concern does not arise in practice within Canada.

Canadian general partnerships: If the partnership agreement of a general partnership is expressly governed by the laws of a Canadian province or territory, the partnership is located in that province or territory.¹⁹ According to the submission by the PPSL Committee, this rule should not apply to a general partnership governed by foreign laws because (like foreign trusts) the priority rules should bear a closer relation to the partnership than merely its governing law.²⁰ Foreign general partnerships are governed by the residual rule.²¹

Residual rule: In any case not covered by the rules summarized above, the new law points to the debtor's chief executive office.²²

These new rules regarding location of debtors will not be proclaimed in force until other provinces make conforming changes to their PPSAs, which will not occur before the remainder of Schedule E comes into force on August 1, 2007; so these new rules are unlikely to apply as early as the other changes in Schedule E.

When the new location of debtor rules are proclaimed in force, transitional rules will be necessary to give secured parties time to adjust to the new rules for perfection. Otherwise, when the new location of debtor rules come into force, security interests in

16. PPSA, s. 7(3)(g)(i), as enacted by Schedule E.

17. PPSA, s. 7(3)(g)(ii), as enacted by Schedule E.

18. See memorandum dated May 19, 2006 from the PPSL Committee to the Minister of Government Services ("PPSL May 19 Memo"), *supra*, footnote 5, at p. 3.

19. PPSA s. 7(3)(b), as enacted by Schedule E.

20. See PPSL May 19 Memo, *supra*, footnote 5, at p. 3.

21. PPSA, s. 7(3)(h), as enacted by Schedule E.

22. *Ibid.*

collateral affected by these new rules might immediately cease to be perfected if the new rules point to a new debtor location. Further, in the absence of transitional rules, the priority between two or more security interests existing when the new rules come into force may change merely by the enactment of the new rules. The transitional rules are set forth in ss. 7.2 and 7.3 as enacted by Schedule E and will come into force when the new location of debtor rules are proclaimed. The submission by the PPSL Committee explains each of the transitional rules in detail.²³

(d) PMSI Rules for Inventory Financing

The current rule that allows a purchase-money security interest in inventory to obtain priority over other security interests in inventory and its proceeds requires the inventory financier to, among other things, give notice of its security interest to all other secured creditors that have registered a financing statement classifying the collateral as inventory.²⁴ Unlike the PPSAS in the Atlantic provinces, the inventory financier is not required to notify other secured creditors that have registered a financing statement in respect of accounts receivable. Bill 152 brings the PPSA into conformity with the PPSAS in the Atlantic provinces, requiring the inventory financier to notify both types of secured creditors—that is, to notify both those that have registered in respect of inventory and those that have registered in respect of accounts receivable.²⁵

(e) Assignment of Accounts and Chattel Paper

Bill 152 adopts the rule contained in other PPSAS that allows a secured creditor to obtain a valid security interest in an account, even though a contract between the account debtor and the assignor prohibits assignment.²⁶ Bill 152 also adopts this rule for an assignment of chattel paper. However, this new rule applies only to an assignment of the *whole* of an account or chattel paper. In this respect, the new rule differs from the United Nations Convention on the Assignment of Receivables in International Trade²⁷ and Revised

23. See PPSL May 19 Memo, *supra*, footnote 5, at pp. 3-5.

24. Section 33(1).

25. In the PPSAS of the western provinces, an accounts receivable financier has priority over a PMSI inventory financier, provided the accounts receivable financier has given new value for its security interest.

26. See new s. 40(4), enacted by Bill 152.

27. See Chapter III, Article 9. The Convention is posted on the UNCITRAL website (under General Assembly Resolutions, 56th Session, 2001). See also Michel Deschamps and Catherine Walsh, *United Nations Convention on the Assignment*

UCC § 9-406(d), which each apply to partial assignments. The PPSL Committee hopes that the new rule will be extended to partial assignments when the PPSA is next amended.

New s. 40(1) and (1.1) of the PPSA are intended to restate the current law about the defences available to an account debtor as against an assignee, and are not intended to make any substantive changes to the common law or the rule currently in s. 40(1).

(f) Eliminating Check the Box Registrations

The current system of registration requires secured parties to classify their collateral as “consumer goods”, “inventory”, “equipment”, “accounts” or “other” property. In practice, persons conducting PPSA searches cannot determine the scope of a security interest from the public record, and must seek subordinations or other estoppel letters when providing financing to business debtors or buying a business asset. The PPSL Committee recommended that the “check the box” system be replaced by a system requiring the secured party to describe its collateral in the financing statement, as required in other provinces and in the United States. The PPSA reform in Bill 152 signals that the Ontario government has accepted that recommendation. However, the Ministry of Government Services indicates that the computer programming necessary to implement these changes will take a year or two to complete.

4. Future PPSA Reform

Some of the PPSA reforms proposed by the PPSL Committee were not included in Bill 152, including the following:

- Clarification that secured creditors can obtain security interests in governmental and other licences without requiring an analysis as to whether the licences are personal property.
- Amendment of the Commercial Tenancies Act²⁸ to prevent a landlord from exercising a right of distraint against a tenant’s personal property in which a secured creditor holds a purchase money security interest (PMSI) — in effect modernizing this area of law. Currently, the statute prevents a landlord from exercising a right of distraint against a

of Receivables in International Trade Pre-Implementation Report, March 31, 2005, presented at the August 2005 Annual Meeting of the Uniform Law Conference of Canada, and available on its website <www.ulcc.ca> under “Proceedings of Annual Meetings” — 2005 — “Civil Section Documents”.

28. R.S.O. 1990, c. L.7.

tenant's personal property in which a secured creditor holds a PMSI, only if that PMSI is in the form of a title reservation clause (*i.e.*, a landlord cannot exercise a right of distraint against personal property in which a conditional sale vendor has reserved title).

- Use of the PPSA registry to record executions, providing a central place to search for all executions filed in Ontario.
- Creation of a permanent advisory committee to advise about PPSA reform. It remains to be seen whether the new Law Commission of Ontario will be willing and able to fulfil this role.²⁹

The PPSL Committee continues to believe that the PPSA ought to be amended to resolve these concerns and hopes to work with the Ministry of Government Services on these and other topics of PPSA law reform. As mentioned above, those other topics include amending the new s. 40(4) to deal with partial assignments of accounts. I expect that the PPSL Committee will wish to consider whether the PPSA should be amended to allow for the perfection of a security interest in a deposit account by way of control, mirroring the rules governing deposit accounts in Revised Article 9 of the UCC.

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29. See the press releases posted at <www.attorneygeneral.jus.gov.on.ca/english/news/2006/20060104-opct.asp> and <www.yorku.ca/yfile/archive/index.asp?Article=7606>.

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