

# SECURED TRANSACTIONS LAW IN CANADA — SIGNIFICANT ACHIEVEMENTS, UNFINISHED BUSINESS AND ONGOING CHALLENGES

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## I. INTRODUCTION

Secured transactions law in all of Canada's provinces and territories is today consolidated in a modern statutory framework: the Personal Property Security Act (PPSA) in the common law provinces and territories, and the Civil Code regime in Québec. The road to reform was a long one, spanning a 25-year period beginning with Ontario's proclamation of the PPSA in 1976 and ending in its adoption by Nunavut and the Northwest Territories in 2001. In Québec, reform came about as part of a much larger initiative: the implementation of a new Civil Code in 1994. With the fundamental reform push now behind us, it seems timely to examine both the past and the future. What has worked, what unfinished business remains and what lies on the horizon?

The drawn out nature of the Canadian reform process might strike external observers as horribly inefficient. Yet incremental reform can sometimes outperform more orthodox planning strategies to the extent it enables continuously improved product performance. This has been very much the result with respect to

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the registry systems that underpin the provincial and territorial secured transactions registry regimes. Part II of this paper chronicles that success story with passing comparisons to the experience under art. 9 of the Uniform Commercial Code (UCC) in the United States.

Although secured transactions law in the strict sense has undergone fundamental legislative reform, it intersects with other areas of private and commercial law and with federal law. Part III investigates these points of intersection, finding that while secured transactions reform has inspired change in related areas, the integration process especially in relation to federal law remains incomplete and imperfect.

Harmonization among the various regimes at the substantive level has been a long standing challenge. Part IV examines developments on that front as well as pending reforms including pressures for further harmonization between the PPSA and the latest iteration of art. 9 of the Uniform Commercial Code.

## II. THE CANADIAN APPROACH TO THE DESIGN OF SECURED TRANSACTIONS REGISTRY SYSTEMS

### 1. Overview

Much of the conceptual structure and approach to priorities of the PPSA was patterned on pre-1990 versions of art. 9 of the UCC.<sup>1</sup> However, this has not been the case with respect to the PPSA registry systems. These systems embody policy choices and approaches either different from or not found in the United States' legislation.<sup>2</sup> Some of the most significant of these are addressed in this section of the paper.

### 2. Electronic Registry Functions

Developments in computer technology that were very important to the design of modern electronic registries occurred after art. 9 was first enacted in most states of the United States. By

1. For comments on the desirability of including in the Canadian Acts new features contained in the 1999 version of art. 9, see R.C.C. Cuming and C. Walsh, "Revised Article 9 of the Uniform Commercial Code: implications for the Canadian Personal Property Security Acts" (2001), 16 B.F.L.R. 339. Pressures to adopt certain features of the 1999 regime are also addressed in Part IV of this paper.
2. For a detailed examination of the Canadian PPSA registry systems, see R.C.C. Cuming, C. Walsh and R.J. Wood, *Personal Property Security Law* (Toronto, Irwin Law, 2005), ch. 6.

comparison, the important groundwork for use of computer technology in registry systems existed when the first PPSAs were brought into effect in Canadian jurisdictions. More importantly, Canadian legislators were not content to pattern their systems on what had been earlier implemented in other jurisdictions. They eschewed attempts to have strict uniformity among jurisdictions and employed a leap-frog approach with the result that innovative features implemented in a jurisdiction were carefully studied in other jurisdictions and, where appropriate, were copied only in an improved form. This incremental development has resulted in the most electronically sophisticated systems in the world. An important factor in this process was the ability of registrars to meet annually under the auspices of the Canadian Conference on Personal Property Security Law (CCPPSL) and to compare developments in all jurisdictions and learn from the reported experiences of jurisdictions that had implemented the most recent innovations.

The Canadian PPS registries, for the most part, are totally electronic. While a few still permit transmission of registration data using hard-copy forms, the incidence of use of this facility is so small as to be insignificant. Registrations, amendments to registrations and discharges are effected remotely using digital transmission of registration data directly to the registry database. The use of computer technology in this way has eliminated some problems and minimized others endemic to older systems that involved the use of hardcopy forms or that do not permit direct entry of registration data. The most important of these problems was delay in effecting or amending registration data, fraud and registry liability. Direct access to the registry database by system-users results in instantaneous registration eliminating the problem of determining whether a registration was effective when the registration form was received at the registry office or when the registration data were entered into the registry database. Direct entry is available only to persons who have been issued unique, computer-recognizable identification numbers. Consequently, problems of unauthorized registrations, amendments or discharges are substantially eliminated. The user to whom an identification number has been issued bears complete responsibility for a change in the registration data associated with a registration effected using that number. Direct entry by registering parties eliminates registry personnel involvement in the registration process and concomitant potential for human error in

data entry. The result is that a registry needs to be concerned only with failure in the system hardware or software. Given the Canadian experience, this is a very minor concern.

What is surprising to a Canadian observer is the extent to which the 1999 version of art. 9 but continues to rely on hard-copy forms to transmit registration data to the registry.<sup>3</sup> Possible explanations for this may be the unwillingness of state legislators to invest in upgrading registry systems. The 1999 version of art. 9 was designed to be a model for substantially uniform secured financing law. Consequently, of necessity, it had to accommodate the types of registry systems that existed in many states.

A factor that might be seen as retarding future modernization of registry systems based on art. 9 is the inclusion in the statute of the many details of the functioning of the registry system.<sup>4</sup> The experience in Canada has been that very little change in the statutory provisions of the PPSA<sup>5</sup> was required to accommodate the transition from systems providing for transmission of registry data in hard-copy form to totally electronic systems. The reason for this was the decision to include rules dealing with detailed features of the registry system in regulations, minister's orders or contracts between the registrars and system-users.

### 3. The Motor Vehicle Influence

On the surface, the roles of PPSA and art. 9 registry systems look similar. However, in some important respects, the Canadian systems have a different focus from that of their U.S. counterparts.

A very important factor that dictated divergence between the Canadian and United States systems is the role that secured

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3. ucc art. 9, Part 5. This is not to suggest that a system based on Part 5 could not be electronic. However, there are features of Part 5 that appears to preclude a direct entry approach to registration. Section 9-520 imposes a statutory obligation on the filing officer to "refuse to accept a record for filing" in prescribed circumstances set out in § 9-516(b). Section 9-518 provides that a person may file a "correction statement" with respect to a record when the person believes that the record is inaccurate or wrongly filed. This has been described as the "desk drawer" approach to dealing with disputes between secured parties and debtors with respect to the validity or accuracy of a filing. The debtor's written objections are put in the desk drawn along with the other document relating to the filing. However, the objection has no legal effect. A person named as debtor in a filing is given the power to force discharge of an invalid registration. Section 9-509(d).

4. *Ibid.*

5. The Acts of the Atlantic Canada provinces, the Northwest Territory and Nunavut provided for a totally electronic system from their inception.

transactions involving motor vehicles played in the design and functioning of the two systems. During the pre-art. 9 and early post-art. 9 periods, the lack of efficient systems for publishing security interests in motor vehicles induced legislators in many states of the United States to employ certificate of title systems,<sup>6</sup> designed principally to deal with vehicle theft, as the method to publish the existence of security interests in motor vehicles. Consequently, registration of security interests in motor vehicles never became a feature of most art. 9 registry systems.<sup>7</sup>

Canadian jurisdictions did not implement certificate of title systems for motor vehicles.<sup>8</sup> Pre-PPSA registry systems provided registration of security interests in this type of collateral. It was a natural transition to continue this approach when computerized PPSA registries were designed and implemented. An aspect of the approach was to require detailed descriptions (serial numbers) in the registrations where the collateral was other than inventory or, in some contexts, equipment, as a method of enhancing the efficacy of registries.

The inclusion of motor vehicle security interests in the Canadian systems has had an unexpected, but very important effect beyond providing efficient protection to third parties by providing

6. A certificate of title system for motor vehicles can be conceptually analogized to a Torrens system for land titles. A person who is disclosed as owner in the records of the relevant authority or the paper title issued by the authority is in law the owner of the vehicle. Section 16 of the 2005 Uniform Certificate of Title Act provides that

... a transfer of ownership without execution of a certificate of title or certificate of origin is not effective as to other persons [*i.e.*, other than the transferor or transferee] claiming an interest in the vehicle.

Furthermore, a security interest in the vehicle not disclosed in the registry records or on the title to the vehicle cannot be asserted against anyone who buys or obtains a security interest in the vehicle. Section 19 of the Act provides that

a transferee of ownership takes subject to ... a security interest in the vehicle indicated on a certificate of title ... [i]f ... the office [responsible for the issue of certificates of title] creates a certificate of title that does not indicate [that] the vehicle is subject to [a] security interest ... a buyer of the vehicle ... takes free [for] the security interest if the buyer ... gives value in good faith, receives possession of the vehicle, and obtains execution of the certificate of title ... and the security interest is subordinate to a conflicting security interest in the vehicle which is perfected after creation of the certificate of title and without the ... secured party's knowledge of the security interest.

7. ucc §§ 9-303, 9-311(a)(3) and 9-316(d).

8. In a 2005 report prepared for the Uniform Law Conference of Canada, the author concluded recommended that certificate of title systems for motor vehicles not be recommended for implementation in Canadian jurisdictions. See R.C.C. Cuming, "Should Canadian Jurisdictions Implement Certificate of Title Systems for Motor Vehicles?" (Report, Uniform Law Conference of Canada, 2005) [unpublished].

enhanced searching facilities and significant reduction in risk. Registrations of motor vehicle security interests are much more numerous than registrations relating to other types of collateral. They account for as much as 80% of the total volume of registration in some registries. Large volumes of registrations and the small unit cost of each registration have provided very significant revenue surpluses, some of which have been used to implement system improvements. The exclusion of motor vehicle security interests from art. 9 systems has deprived registries in the United States of this large income. This may account for the reluctance of some state legislators to undertake improvements in art. 9 registries. The income generated by registrations is not sufficient defray the costs of the improvements.

#### 4. Third-Party Protection

As noted above, the Canadian PPSA registry systems focus heavily on secured transactions involving collateral owned or acquired by non-business debtors. At the centre of this focus are registrations relating to purchase money security interests in motor vehicles.

The high-cost and durable nature of motor vehicles results in a large and active market for pre-owned items. A large portion of motor vehicles sold in Canada are financed under secured transactions with the result that, in the absence of effective legal measures, there would exist a significant risk for purchasers of pre-owned vehicles or lenders financing their acquisition. Such measures are provided through the Canadian registry systems.

An important aspect of the Canadian systems is the requirement that a registration relating to a security interest in a motor vehicle held as consumer goods or equipment include a specific identifier (serial number or its equivalent) of collateral.<sup>9</sup> It has long been

9. While the great bulk of registration related to security interests in automobiles and small trucks, systems other than that of Ontario require serial numbers in registrations relating to non-inventory security interests in a wider range of items. For example, s. 2(1)(u) of the Saskatchewan Personal Property Regulation, R.R.S., c. P-6.2, Reg. 1 (which, in this respect is representative of all jurisdictions other than Ontario), defines "serial numbered goods" as meaning "a motor vehicle, a trailer, a mobile home, an aircraft, a boat and an outboard motor for a boat." The term "motor vehicle" is defined in s. 2(1)(o) as "a mobile device that is propelled primarily by any power other than muscle power":

(i) in, on or by which a person or thing may be transported or drawn, and that is designed for use on a road or natural terrain; or  
(ii) that is used in the construction or maintenance of roads;  
and includes a pedal bicycle with a motor attached, a combine and a tractor, but

recognized that a secured transactions registry system based solely on the debtor's name as the registration-search criterion is ineffective in providing protection to remote purchasers or secured credit grantors who are unaware of the debtor's identity and, consequently, are unable to discover a registration relating to a security in property through a registry search.<sup>10</sup> A serial number search facility eliminates this problem for types of collateral subject to security interests with respect to which registrations must include a serial number.<sup>11</sup> Regardless of the number of transactions following the attachment of the original security interest, a remote party is able to use the serial number as a search criterion that will reveal the existence of any prior security interest in an item she intends to purchase or in which it intends to take a security interest.

While almost all of the Canadian systems require serial numbers in registrations relating to security interests in a wide range of tangible personal property,<sup>12</sup> it was not possible to provide third-party protection through this method with respect to all types of property. Many items of collateral do not have serial numbers or reliable serial numbers. In this context, the only search criterion available to a prospective buyer or secured creditor is the debtor's name.<sup>13</sup> A measure implemented in most Canadian jurisdictions<sup>14</sup> to give some protection to buyers of small value goods is to

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does not include a device that runs on rails or machinery designed only for use in farming other than a combine or tractor.

For a judicially formulated approach to application of the Saskatchewan Personal Property Regulation, see *Royal Bank of Canada v. Steinhubl's Masonry Ltd.*, [2004] 1 W.W.R. 267, 2003 SKQB 299. Under Ontario law, serial number (vehicle identification number) registration is required only when the vehicle is held by the debtor as consumer goods. See Minister's Orders under the Personal Property Security Act.

10. This is often referred to as the A-B-C-D problem. B gives a security interest in his motor vehicle to A. A effects a registration using B's name as the registration criterion. B sells the vehicle to C who is either careless or fraudulent. C offers the vehicle to D without disclosing the identity of B or that the vehicle is subject to the security interest of A. D, wanting to protect her interests, obtains a search result using C's name as the search criterion. However, the registration relating to A's security interest was effected using B's name, not C's name as the registration criterion. The registration is valid, but not disclosed in D's search.
11. *Supra*, footnote 9.
12. *Ibid.*
13. While not a solution to the A-B-C-D problem, several jurisdictions have remove uncertainty as to what constitutes the name of the debtor for registration and search purposes. See, e.g., Personal Property Security Regulation, Alta. Reg. 95/2001, s. 20.
14. See, e.g., The Personal Property Security Act, 1993, S.S. 1993, c. P-6.2, ss. 3 and 4 (representative of Acts of all PPSA jurisdictions other than Ontario).

provide a priority rule under which good faith buyers of goods having a value of \$1,000 or less take free from perfected security interests in the goods. While this amount has not been revised upward to reflect inflation over the three decades since it was first set, the concept is sound and the problem of inadequacy is easily addressed through a minor statutory amendment.<sup>15</sup>

A fundamental difference in approach between the PPSAS and art. 9 that affects the position of third parties is a product of the choice of law rules of each system. Under the PPSAS, a person buying or leasing non-mobile goods (or a motor vehicle held by the seller as consumer goods) is, with one exception,<sup>16</sup> entitled to rely on the registry records of the jurisdiction in which the goods are delivered to him or her in order to determine whether the goods are subject to a security interest to which their interest would be subject. This is so, even though the goods are subject to a perfected security interest that attached when the goods were in another jurisdiction. While foreign security interests are deemed perfected for a period of time after the goods have been brought into the jurisdiction, this deeming does not affect a domestic buyer or lessee of the collateral who acquired it without knowledge of the foreign security interest and before it was registered in the buyer or lessee jurisdiction.<sup>17</sup>

Under art. 9, the *situs* of goods is not the determining factor with respect to perfection of a non-possessory security interest. If a security interest in the goods is perfected under the law of the location of the debtor at the time the security interest attached, that perfection will be recognized as giving priority in any other

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15. Article 9 provides a very rough equivalent. As a result of ucc § 9-309(1), a purchase money security interest in consumer goods is automatically perfected without registration. However, under § 9-320, a buyer of goods subject to an unregistered, perfected security interest who acquires the goods from a debtor who held the goods as consumer goods, takes free from the security interest. But this protection is not available if the secured party perfected the security interest by registration prior to the purchase. A buyer who wants to eliminate risk, must always obtain a search in order to determine whether or not a secured party has perfected by registration.

16. The law of the location of the debtor at the time the security interest attaches governs perfection and priority of a security interest in equipment that is of a type normally used in more than one jurisdiction. The Personal Property Security Act, 1993, *supra*, footnote 14, at s. 7(2). This provision does not apply to motor vehicles held by debtors as consumer goods.

17. *Ibid.*, at s. 5(3) (representative of all jurisdictions that have enacted PPSAS other than Ontario). Under the Ontario Personal Property Security Act, R.S.O. 1990, c. P.10, s. 5(2), the goods must have been acquired in Ontario as consumer goods.



state.<sup>18</sup> While priority is a matter addressed under the law of the location of the goods,<sup>19</sup> all states give priority to a security interest perfected under the law of the location of the debtor. As a result, the buyer or lessee cannot rely on a search of the registry of the jurisdiction in which the goods are delivered to him or her. Only if that happens to be the location of the seller (debtor), would a search reveal a registration relating to the goods. The need to protect buyers or lessees of motor vehicles in these circumstances is addressed through the certificate of title systems. The scope of this protection is limited to those types of property for which certificate of titles are issued.<sup>20</sup>

Another feature of the Canadian systems, not included in art. 9, which serves to protect third parties is the application of the registration requirements and related priority structure of the PPSA to leases,<sup>21</sup> and to various types of liens and other interests to which the interest of a subsequent buyer, lessee, or secured party would be subject.<sup>22</sup> This is one aspect of the very pragmatic approach adopted by Canadian legislators. The problems of third-party protection endemic to security agreements are associated as well with leases of and liens on tangible personal property. While the systems do not provide for title registration of property, they require publication of the most common encumbrances affecting property generally acquired by non-business debtors.

### 5. Accommodation of Human Error

Most of the PPSA registry<sup>23</sup> systems have been designed with the recognition that many users of the systems will not be experts and may not understand the necessity to ensure that registration data transmitted to the registry are accurate in every respect. The PPSA provides that a registration is not invalidated by an error or omission in the data unless the deficiency results in the registration

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18. ucc §§ 9-301(1) and (3)(C).

19. ucc § 9-301(2).

20. The 2005 National Conference of Commissioners on Uniform State Laws Uniform Certificate of Title Act, s. 2(34) defines a "vehicle" as "goods that are any type of motorized, wheeled device of a type in, upon, or by which an individual or property is customarily transported on a road or highway, or a commercial, recreational, travel, or other trailer customarily transported on a road or highway."

21. The Personal Property Security Act, 1993, *supra*, footnote 14, at ss. 2(1)(y) and 3(3) (representative of all jurisdictions that have enacted PPSAs).

22. See, e.g., The Commercial Liens Act, S.S. 2001, c. C-15.1, and Repair and Storage Liens Act, R.S.O. 1990, c. R.25.

23. The Ontario system does not provide this facility.

being “seriously misleading.”<sup>24</sup> Registry software has been designed to give meaning to this term.

The paradigm for a PPSA registry is one in which the registering party transmits to the registry the legal name of the debtor (and, where required, the serial number of serial numbered collateral). This is the “perfect registration criterion (criteria).” The searching party uses the legal name of the debtor (or the serial number of serial numbered collateral) in his or her search request. This is the “perfect search criterion.” Since the perfect search criterion matches the perfect registration criterion, the registration will be disclosed. In legal terms, the registration is valid.

The designers of Canadian systems recognized the importance of registry software design that reflects implements the policy of the Acts. They created software that accommodates some deviation from the paradigm. As a result, a search using the legal name of the debtor (or serial number of property) reveals registrations that do not comply in every respect with the requirements of the regulations with respect to the debtor’s name (or serial number of the collateral). As a result, a modified paradigm prevails. The registering party transmits to the registry the perfect registration criterion or a non-perfect registration criterion that is close enough to the perfect registration criterion that the hypothetical searching party who uses the perfect search criterion would not be misled. Whether or not the hypothetical searching party would or would not be misled by the failure of the registering party to use the perfect registration criterion is heavily influenced by the design of the registry software program.

In order for the registration using the non-perfection registration criterion to be valid (because it is not seriously misleading), the program must not only disclose the defective registration, but disclose it in a context that the searching party could reasonably be expected to know or to be suspicious that the debtor or collateral described in the registration is the same person or collateral described in the perfect search criterion. At least two factors go into this determination: the degree of similarity between the perfect search criterion and the non-perfect registration criterion used by the registering party and the number of other registrations revealed when the perfect search criterion is used. If the registration is one of many revealed, a reasonable searching party cannot be expected to take steps to further refine the search

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24. The Personal Property Security Act, 1993, *supra*, footnote 14, at s. 43(6).

through independent investigation of all of the revealed registrations.

### III. INTEGRATING SECURED TRANSACTIONS LAW WITHIN PROVINCIAL AND FEDERAL LAW

#### 1. The Spread of PPSA Terminology and Concepts

The modernization of personal property security law introduced fundamental reform to secured transactions law. It is impossible to point to a single idea, concept or strategy as underpinning the transformation of the law.<sup>25</sup> Rather, the reforms were built upon a series of reforms to key concepts and approaches. The basic building blocks of the reforms are summarized below.

*The unitary concept of security.* In place of a multiplicity of discrete security devices governed by their own set of rules and principles, the PPSA adopts a unitary concept of a security interest that encompasses any interest that in substance secures an obligation without regard to its form or the locus of title.

*The categories of personal property.* The PPSA adopts a new system for categorizing different types of personal property. This replaces the older terminology and divisions, and recognizes new classes of property such as chattel paper.

*The concept of perfection.* The PPSA adopts the concept of perfection to describe the process that affords publicity to the existence of a security interest. This concept plays a crucial role in the determination of priorities.

*The priority regime.* The PPSA provides a series of internal priority rules. These are designed to produce predictable outcomes that accord with reasonable commercial expectations.

*The registry system.* The PPSA adopts a unified registry system that is based on a notice registration rather than a document filing concept.

*The enforcement remedies.* The PPSA provides a single system of enforcement remedies that, for the most part, cannot be varied by agreement. The remedies are designed to maximize the amount recoverable on enforcement.

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25. See Cuming, Walsh and Wood, *supra*, footnote 2, at pp. 36-40.

These reforms to personal property security law have significantly altered the landscape of commercial law. The transformative effect of these new concepts has not been restricted to the field of secured transactions law, but has spilled over into other contiguous areas of commercial law. This can be seen in a number of different contexts. On the simplest level, it involves the spread of the new concepts and terminology of the PPSA into other statutes. For example, many of the statutes that create a statutory charge in favour of the Crown or other body have been amended so as to adopt the new concepts and terminology of the PPSA when specifying the priority ranking of the statutory charge.<sup>26</sup>

The infiltration of PPSA concepts and terminology is most pronounced when there is a major revision of a statute in a related field. The modernization of judgment enforcement law that has occurred in some of the provinces provides a very good example of this phenomenon.<sup>27</sup> The influence of the PPSA can be detected at several different levels. First, the new legislation adopts the same system of categorization of personal property that is used by the PPSA. What this means is that the taxonomy used by the PPSA is spreading and will soon overtake and replace the older taxonomy of the common law as the preferred means of describing different kinds of personal property. Second, the design of the remedies afforded to judgment enforcement creditors has clearly been influenced by the remedial system of enforcement remedies contained in the PPSA.<sup>28</sup> The modernized judgment enforcement statutes adopt the same strategy as the PPSA for maximizing recoveries on enforcement sales — it provides greater latitude in choosing the most appropriate sale process, but imposes on the parties an obligation to exercise these rights in good faith and in a commercially reasonable manner.<sup>29</sup>

26. For example, the statutory charge that secures unpaid wages to employees in Alberta is given priority over any other security interest other than a purchase-money security interest. See *Employment Standards Code*, R.S.A. 2000, c. E-9, s. 109(3) and (4).

27. See *Civil Enforcement Act*, R.S.A. 2000, c. C-15; *Judgment Enforcement Act*, S.N.L. 1996, c. J-1.1; *The Enforcement of Money Judgments Act*, S.S. 2010, c. E-9.22. See also the *Uniform Civil Enforcement of Money Judgments Act* adopted by the Uniform Law Conference of Canada, online: Uniform Law Conference of Canada <[http://www.ulcc.ca/en/us/Uniform\\_Civil\\_Enf\\_Money\\_Judgments\\_Act\\_En.pdf](http://www.ulcc.ca/en/us/Uniform_Civil_Enf_Money_Judgments_Act_En.pdf)>.

28. See R.J. Wood, "Enforcement Remedies of Creditors" (1996), 34 *Alta. L. Rev.* 783.

29. See R.J. Wood, "The Reform of Judgment Enforcement Law in Alberta" (1995), 25 *C.B.L.J.* 110, at pp. 119-120.

One of the most radical modifications to judgment enforcement law is its integration into the PPSA registry system and the replication of the PPSA priority rules in relation to writs or judgments.<sup>30</sup> Under the former law, the issuance of a writ entitled a creditor to pursue judgment enforcement remedies against the debtor's property. Although the writ had a binding effect on personal property, this did not operate as an effective encumbrance because subsequent third parties who acquired an interest in the property typically took free of the writ.<sup>31</sup> Moreover, the judgment enforcement creditor was afforded priority over the holder of a prior unperfected security interest only if the judgment enforcement creditor actually caused the property to be seized under legal process.<sup>32</sup> This has been altered in a majority of jurisdictions. A writ or notice of judgment can be registered in the personal property registry. When registered, it has substantially the same priority status as a security interest.

The introduction of provincial legislation regulating commercial liens<sup>33</sup> similarly reflects the spread of PPSA concepts and terminology into related fields of commercial law. These statutes are heavily influenced by the PPSA.<sup>34</sup> The legislation provides rules for the attachment and perfection of liens and its registration in the personal property registry, contains several priority rules derived from the PPSA, and sets out a system of enforcement remedies that incorporate by reference the enforcement remedies contained in the PPSA.

Despite these successes, there is still much work to be done. Many provinces have shown little interest in taking any further steps towards modernizing their commercial legislation. As well, there are a number of areas, such as sales law, that remain

30. See R.C.C. Cuming, "When an Unsecured Creditor is a Secured Creditor" (2003), 66 Sask. L. Rev. 255; Wood, *ibid.*, at pp. 115-117.

31. Cuming, Walsh and Wood, *supra*, footnote 2, at pp. 396-397.

32. This remains the law in British Columbia and Ontario. See Personal Property Security Act, R.S.B.C. 1996, c. 359, s. 20(a); Personal Property Security Act, *supra*, footnote 17, at s. 20(1)(a).

33. The Commercial Liens Act (Sask.), *supra*, footnote 22; Liens Act, S.N.S. 2001, c. 33 (not yet in force). This legislation is modeled on the Uniform Liens Act adopted by the Uniform Law Conference of Canada available at <<http://www.ulcc.ca/en/us/index.cfm?sec=1&sub=1u7>>. The Ontario Repair and Storage Liens Act, *supra*, footnote 22, is also influenced by PPSA concepts, although to a lesser extent than the statutes based upon the Uniform Liens Act.

34. See R.C.C. Cuming, "The Spreading Influences of PPSA Concepts: the Uniform Liens Act" (1999), 15 B.F.L.R. 1; Alberta Law Reform Institute, *Report on Liens*, Report for Discussion No. 13 (Edmonton, The Institute, 1992), online: Alberta Law Reform Institute <<http://www.law.ualberta.ca/alri/docs/rfd013.pdf>>.

impervious to migration of PPSA concepts. In the United States, sales law and secured transactions law were integrated to reflect the idea that a conditional sales agreement merely gave the seller a security interest in the goods, and that the buyer obtained legal title to the property.<sup>35</sup> Unfortunately, there has been no similar development in Canada, with the result that the interplay between sales law and secured transactions law has sometimes proven to be controversial.<sup>36</sup>

## 2. Interaction with Federal Law

### (a) The Insolvency Statutes

The interaction between provincial secured transactions law and federal insolvency law is problematic on a number of different levels. The first difficulty is that the federal statutes have not been altered so as to take into account the fundamental changes that have taken place in secured transaction law.<sup>37</sup> The Bankruptcy and Insolvency Act<sup>38</sup> (BIA) and the Companies' Creditors Arrangement Act<sup>39</sup> (CCAA) define a secured creditor as a person who holds a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor to secure a debt. The Supreme Court of Canada has held that Parliament in formulating the definition created its own lexicon, and that this definition may well be different from the definition that is used in provincial secured transactions law.<sup>40</sup>

In other contexts, the inclusion of the traditional types of security devices have caused courts to conclude that the definition is restricted to transactions where the debtor conveys an interest in the debtor's property to the creditor.<sup>41</sup> A reference to a pledge,

35. Article 2-401(1) of the Uniform Commercial Code provides that "retention or reservation by the seller of the title [property] in goods shipped or delivered to the buyer is limited in effect to a reservation of a security."

36. See the conflicting view of what constitutes a sale for the purposes of the PPSA in *Royal Bank of Canada v. 216200 Alberta Ltd.* (1986), 33 D.L.R. (4th) 80, 51 Sask. R. 146 (C.A.), and *Spittlehouse v. Northshore Marine Inc.* (1994), 114 D.L.R. (4th) 500, 18 O.R. (3d) 60 (C.A.). See also, J.S. Ziegel, "To What Types of Sale Does Section 28(1) of the OPPSA Apply?" (1995), 24 C.B.L.J. 457.

37. See R.J. Wood, "The Definition of Secured Creditor in Insolvency Law" (2010), 25 B.F.L.R. 341.

38. R.S.C. 1985, c. B-3, s. 2, definition "secured creditor."

39. R.S.C. 1985, c. C-36, s. 2(1), definition "secured creditor."

40. *Caisse populaire Desjardins de l'Est de Drummond v. Canada*, [2009] 2 S.C.R. 94, 309 D.L.R. (4th) 323; *Husky Oil Operations Ltd. v. M.N.R.*, [1995] 3 S.C.R. 453, 128 D.L.R. (4th) 1.

41. *M.N.R. v. Schwab Construction Ltd.* (2002), 31 C.B.R. (4th) 75, 2002 SKCA 6;

mortgage, charge or lien therefore does not include title retention devices such as conditional sales agreements or security leases despite the fact that these transactions secure payment or performance of an obligation.<sup>42</sup> This approach produces startling consequences if extended to the definition in the insolvency statutes.<sup>43</sup> The various statutory charges that secure unpaid wages and unpaid pension contribution as well as court-ordered charges that secure administrative expenses, interim (debtor-in-possession) financing and director and officers' charges would all be rendered ineffective against title retention devices.<sup>44</sup> The 10-day notice of intention to enforce a security would also not need to be given by a person who intends to enforce a conditional sales agreement or security lease.<sup>45</sup>

The solution to this problem is clear. The definition of secured creditor in the federal insolvency statutes should be amended so as to bring it into conformity with the definition found in provincial secured transactions law.<sup>46</sup> It is regrettable that despite the far-reaching changes that were introduced by the 2009 amendment of the insolvency statutes, there was a failure to explore some problems with some of the foundational concepts and definitions.

The federal insolvency statutes have undergone a series of important revisions over the past two decades. One prominent trend is that the statutes have increasingly legislated in respect of the priority ranking of consensual and non-consensual security interests in insolvency proceedings. In the case of Crown claims, the federal provisions have imposed a registration requirement in the provincial property registries in order to validate the Crown's

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*Bank of Nova Scotia v. Turyders Trucking Ltd.* (2001), 32 C.B.R. (4th) 14 (Ont. S.C.J.); *DaimlerChrysler Financial Services (DEBIS) Canada Inc. v. Mega Pets Ltd.* (2002), 33 C.B.R. (4th) 44, 212 D.L.R. (4th) 41, 2002 BCCA 242.

42. The BIA definition of secured creditor was adjusted to harmonize with the civil law system. The definition was amended in 2001 as part of the federal bijuralism project so as to extend its application to security that is generated by title retention, by transfer of title, or by trust. However, the CCAA was not amended in a similar fashion. This creates a difference between common law and civil law. The end result can only be only described as chaotic. In the civil law jurisdiction of Québec, the BIA encompasses quasi-security devices, while the CCAA does not. And in the common law jurisdictions, the quasi-security devices that were reconceptualized as fully fledged security interests under provincial law are arguable wholly outside of the insolvency statutes.
43. See Wood, *supra*, footnote 37.
44. BIA, ss. 50.6, 64.1, 64.2, 81.4 and 81.5; CCAA, ss. 11.2, 11.51 and 11.52.
45. BIA, at s. 244.
46. The federal definitions should not cover deemed security interests as these are not true security devices, but are brought within the scope of the PPSA in order to attract the application of the perfection and priority rules.

claim to a non-consensual security interest in a bankruptcy or restructuring.<sup>47</sup>

Unfortunately, this intervention has led to an even greater lack of harmonization between provincial secured transaction law and federal insolvency law, and has produced a confusing mass of priority rules.<sup>48</sup> The difficulty is that the priority ranking of consensual and non-consensual security interest vary greatly depending upon which insolvency regime is applicable. In some instances, the interest in question is afforded the same priority ranking regardless of which insolvency regime has been invoked. The charge that secures environmental remediation costs falls into this pattern.<sup>49</sup> But this is very much the exception. In many instances, the same rule applies in two of the insolvency regimes but not the third. The 30-day goods priority afforded suppliers operates in a bankruptcy and in a receivership, but not a restructuring.<sup>50</sup> A landlord's right of distress is fully operative in a receivership or restructuring, but is inoperative in a bankruptcy.<sup>51</sup> A statutory deemed charge or Crown claim is fully effective in a receivership, but is severely restricted in a bankruptcy or restructuring.<sup>52</sup> The priority ranking of the deemed statutory trust that secures unremitted GST is likely the most illogical. The deemed trust is operative in a receivership and in a CCAA restructuring, but inoperative in a bankruptcy and in a commercial restructuring under the BIA.<sup>53</sup>

Matters are further complicated by the fact that parties will often choose to invoke one insolvency regime or another simply as a means of obtaining an advantage over another claimant.<sup>54</sup> In many instances, a secured creditor will appoint a receiver, but will

47. BIA, at ss. 86-87; CCAA, at ss. 38-39.

48. See T. Buckwold and R.J. Wood, "Priorities," in S. Ben-Ishai and A. Duggan, eds., *Canadian Bankruptcy and Insolvency Law: Bill C-55, Statute c.47 and Beyond* (Markham, LexisNexis Canada, 2007), p. 101.

49. BIA, at s. 14.06; CCAA, at s. 11.8.

50. BIA, at s. 81.1.

51. *Profoot Enterprises Ltd. (Re)* (1981), 39 C.B.R. (N.S.) 80, 31 A.R. 420 (Q.B.); *Radioland Ltd. (Re)*, 36 C.B.R. 158, 8 D.L.R. (2d) 647 (Sask. C.A.).

52. BIA, at ss. 86-87; CCAA, at ss. 38 and 39.

53. *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, 6 C.B.R. (5th) 293 (C.A.); *Gauntlet Energy Corp (Re)* (2003), 49 C.B.R. (4th) 213, 2003 ABQB 894.

54. The use of restructuring proceedings to liquidate businesses has greatly accelerated this problem. See B. Kaplan, "Liquidating CCAAs: Discretion Gone Awry?" in J. Sarra, ed., *Annual Review of Insolvency Law 2008* (Toronto, Carswell, 2009), p. 79; S. Fitzpatrick, "Liquidating CCAAs - Are We Praying to False Gods?" in Sarra, *ibid.*, p. 33.



also seek to invoke a bankruptcy in order to subordinate the holder of a deemed trust, Crown claim, or a landlord who has exercised a right of distress.<sup>55</sup> As well, courts can be persuaded to apply the bankruptcy ranking if it appears that the restructuring proceedings may result in the liquidation of the business.<sup>56</sup>

The shifting priority ranking under the present law makes risk assessment more difficult. It also gives rise to inefficiency as costly insolvency proceedings are invoked for the purpose of trumping a competing claimant. In principle, the same priority rules should operate uniformly across all insolvency regimes. This would go far in eliminating the incentive of a claimant to choose an inappropriate insolvency regime or to invoke more than one insolvency regime in order to gain an advantage over another creditor.

#### (b) Bank Act Security

During the ice age, the continental glaciers occasionally skirted around an area leaving it untouched and very different geologically from the surrounding areas.<sup>57</sup> In the legal topography of Canadian commercial law, the federal Bank Act<sup>58</sup> security occupies this position. Since it is a creature of federal statute, it was unaffected by the fundamental reforms of provincial secured transactions law. It is an area where the older pre-reform concepts continue to reign.

The continued existence of the federal security system would be little more than a curious anomaly were it not for three problems that result from its interaction with provincial law. The first is produced because the two registry systems are independent. Even though the federal Bank Act security system is not widely used, its mere existence makes it necessary for commercial parties to exercise their due diligence by conducting searches under both systems. This undercuts the strategy that favours a single unified registry system.

The second problem is that federal Bank Act security device insulates a bank from the application of provincial farm protection

55. R.J. Wood, *Bankruptcy and Insolvency Law* (Toronto, Irwin Law, 2009), pp. 128-131.

56. *Ivaco Inc. (Re)* (2007), 275 D.L.R. (4th) 132, 83 O.R. (3d) 108 (C.A.), leave to appeal to S.C.C. granted 277 D.L.R. (4th) viii, [2007] 1 S.C.R. xv, per S.C.C. Bull. 5/4/07, Notice of Discontinuance filed 10/31/07, per S.C.C. Bull. 11/16/07, p. 1662.

57. The Cyprus Hills region between Saskatchewan and Alberta is one of the very few examples of unglaciated land in Canada.

58. S.C. 1991, c. 46.

legislation.<sup>59</sup> This gives the bank an advantage over provincially regulated lenders who must obey the provincial limitations on the exercise of enforcement remedies. This is anti-competitive as it creates a non-level playing field among different types of credit grantors.

The third problem concerns the resolution of priority competitions between security interests governed by provincial and federal security systems. The difficulty is that the two systems are based upon an entirely different conception of priority resolution. The provincial system is based upon an internal set of statutory priority rules that are linked to a registry system. The federal system does not contain a complete set of priority rules, but looks to the background principles of property law to fill in the gaps. Attempts to resolve these priority competitions have given rise to an astounding volume of difficult case law<sup>60</sup> and academic writing.<sup>61</sup>

Although greater certainty is slowly emerging as the courts develop the law, the outcomes often frustrate the central goals in the reform of provincial secured transactions law. A case presently before the Supreme Court of Canada<sup>62</sup> offers a good illustration of this. It concerns a competition between an initial unperfected provincial security interest and a subsequent Bank Act security.<sup>63</sup> If the matter were governed by provincial secured transactions law, the unperfected security interest would be subordinate due to its

59. *Bank of Montreal v. Hall*, [1990] 1 S.C.R. 121, 65 D.L.R. (4th) 361.

60. The decision of Jackson, J.A. in *Innovation Credit Union v. Bank of Montreal* (2009), 51 C.B.R. (5th) 163, 306 D.L.R. (4th) 407, 2009 SKCA 35, leave to appeal to S.C.C. granted 306 D.L.R. (4th) vi, [2009] 2 S.C.R. v, S.C.C. judgment reserved 04/19/2010, provides an excellent survey of the case law.

61. See, for example, R.C.C. Cuming and R.J. Wood, "Compatibility of Federal and Provincial Property Security Law" (1986), 65 Can. Bar Rev. 267; W.D. Moull, "Security under Sections 177 and 178 of the Bank Act" (1986), 65 Can. Bar Rev. 242; J.S. Ziegel, "Interaction of Personal Property Security Legislation and Security Interests under the Bank Act" (1986), 12 C.B.L.J. 73; R.J. Wood, "The Nature and Definition of Federal Security Interests," (2001), 34 C.B.L.J. 65; R.C.C. Cuming, "Case Comment: *Innovation Credit Union v. Bank of Montreal* — Interface between the PPSA and Section 427 of the *Bank Act*: Desirable Policy vs. Hard Legal Analysis" (2008), 71 Sask. L. Rev. 143; R.C.C. Cuming, "Fitting a Square (Federal) Peg in a Round (Provincial) Hole: Rationalizing Section 427 *Bank Act* With Provincial Property Security Law" (2010), 73 Sask. L. Rev. 1; J.S. Ziegel, "Renewed Friction between Provincial PPSAs and Bank Act Chattel Security Interests" (2010), 48 C.B.L.J. 312.

62. An appeal of *Innovation Credit Union v. Bank of Montreal*, *supra*, footnote 60, and *Radius Credit Union Ltd. v. Royal Bank of Canada* (2009), 51 C.B.R. (5th) 197, 306 D.L.R. (4th) 444, 2009 SKCA 36, leave to appeal to S.C.C. granted 306 D.L.R. (4th) vi, [2009] 2 S.C.R. ix, was heard by the court on April 19, 2010.

63. Bank Act, ss. 427-429.

lack of perfection. However, priorities are not governed by provincial law, and priority is given to the earlier provincial security interest on the basis that it was the first in time.<sup>64</sup>

Although the Uniform Law Conference of Canada and the Law Commission of Canada recommended the abolition of the Bank Act security regime, Canadian bankers have resisted this response<sup>65</sup> and the Canadian government is reluctant to proceed without a consensus.<sup>66</sup> Unfortunately, there presently appears to be a complete deadlock. Perhaps the only positive sign is that the problem may be diminishing because most banks are choosing to take provincial security rather than Bank Act security.<sup>67</sup> If this process continues, it will eventually become apparent to all that the federal security system no longer serves any useful purpose and that its long overdue retirement will finally come into effect.

#### IV. HARMONIZATION OF SECURED TRANSACTIONS LAW: RECENT DEVELOPMENTS AND ONGOING CHALLENGES

##### 1. PPSA Harmonization

###### (a) Ontario Harmonization Initiatives

PPSA harmonization has long been an elusive goal especially between the Ontario and non-Ontario versions.<sup>68</sup> Amendments to the Ontario Act in 2007 have reduced these differences.<sup>69</sup> Like the other Acts, the Ontario PPSA now:

64. This is only one of several situations where the provincial secured transactions law is undercut. Consider the case where a bank takes a Bank Act security and a subsequent lender takes a purchase-money security interest in goods acquired by the debtor with the enabling loan. If this matter were governed by provincial law, priority would be given to the purchase-money security interest holder so long as the secured party properly followed the procedural steps needed to give it priority. However, the matter is not governed by provincial secured transactions law, and priority is given to the bank on the basis that it was the first in time. See *Royal Bank of Canada v. Moosomin Credit Union*, [2004] 5 W.W.R. 494, 2003 SKCA 115, leave to appeal to S.C.C. refused [2004] 1 S.C.R. xii, 262 Sask. R. 317n.
65. See Canadian Bankers Association, *The 2006 Financial Services Legislation Review: Improving the Legislative Framework for Canadian Consumers* (Toronto, Canadian Bankers Association, June 1, 2005), at pp. 108-113, online: Department of Finance <[http://www.fin.gc.ca/consultresp/06Rev\\_37e.pdf](http://www.fin.gc.ca/consultresp/06Rev_37e.pdf)>.
66. See Department of Finance Canada, *2006 Financial Institutions Legislation Review: Proposals for an Effective and Efficient Financial Services Framework* (Ottawa, Department of Finance, June 2006), online: Department of Finance <[http://www.fin.gc.ca/toc/2006/white06\\_-eng.asp](http://www.fin.gc.ca/toc/2006/white06_-eng.asp)>.
67. M.-A. Poirier, "Analysis of the Interaction between Security under Section 427 of the Bank Act and Provincial Law: A Bijural Perspective" (2003), 63 R. du B. 289.
68. See Cuming, Wood and Walsh, *supra*, footnote 2 for a detailed treatment of the differences.

- Applies to a true lease for a term of more than one year;<sup>70</sup>
- Clarifies that the term “debtor” includes the owner of the collateral;<sup>71</sup>
- Confirms the enforceability of an assignment of accounts or chattel paper, notwithstanding an anti-assignment clause.<sup>72</sup>

Pending and recommended reforms to the Ontario Act will produce further harmonization by:

- Requiring inclusion of a narrative collateral description in registrations in place of the “check-box” approach;<sup>73</sup>
- Extending the Purchase Money Security Interest (PMSI) notice periods for inventory collateral to 15 days;<sup>74</sup>
- Entitling a debtor to require a secured creditor to amend the collateral description in a registration;<sup>75</sup>
- Eliminating the five-year cap on “consumer goods” registrations;<sup>76</sup>
- Eliminating the requirement for a transferee to take delivery

69. Ministry of Government Services Consumer Protection and Service Modernization Act, S.O. 2006, c. 34, Sch. E (Bill 152) (in force August 1, 2007). See further Michael E. Burke, “Ontario Personal Property Security Act Reform: Significant Policy Changes” (2010), 48 C.B.L.J. 289.

70. See especially Ontario Personal Property Security Act, *supra*, footnote 17, at ss. 2(c), 1(1) (“lease for a term of more than one year”), and 57(1).

71. *Ibid.*, at s. 1(1) (“debtor”).

72. *Ibid.*, at s. 40(4). As under the other Acts, this provision: (i) applies only if the assignment is of the whole of the account or chattel paper; (ii) preserves the right of the debtor on the assigned obligation to claim damages from the assignor for breach of an anti-assignment clause. Note that new s. 40(1.1) also clarifies and codifies the defences and rights of set off available to the account debtor in a manner broadly similar to the other Acts.

73. Although this change was instituted as part of the 2006 package of reforms, it is not yet in force pending the necessary reprogramming of the electronic registration system for which no date has yet been set. Note that Ontario has also now moved to a completely “paperless” registration system: see Ontario Personal Property Security Act, *supra*, footnote 17, at s. 46. However, telephone searches continue to be available as an alternative to electronic searches.

74. Bill 68, Open for Business Act, 2010, Sched. E, s. 4(2). (The Bill received second reading on June 3, 2010.) The current notice period in the Ontario PPSA is 10 days whereas 15 days is the standard in the other Acts. Note, too, that s. 4(4) of Bill 68 will amend the Ontario PPSA, also in line with the other Acts, to empower a debtor to require a secured creditor to amend the collateral description in a registration to provide a more specific description of the collateral or to remove a class of collateral in which a security interest has not been taken.

75. *Ibid.*, at s. 4(4).

76. Ontario PPSL Committee documents on file with the authors. Whereas the non-Ontario Acts generally entitle registrants to self-select in whole years the registration life of a financing statement, the Ontario Act currently imposes a five-year cap on registrations that include consumer goods: see ss. 51(5)-(6) and 54(2)-(3).

of the collateral to be protected against an unperfected security interest;<sup>77</sup>

- Adopting the individual debtor identification rules developed by the CCPSL.<sup>78</sup>

Ontario law is also now aligned with the non-Ontario Acts in restricting recovery by a secured creditor who enforces against both the collateral and its proceeds to the value of the collateral at the time the proceeds arose.<sup>79</sup> And Ontario has joined Saskatchewan, the Atlantic Provinces and Québec in subjecting secured creditors to the exemptions from seizure applicable to judgment creditors.<sup>80</sup>

#### (b) The Coordination Vacuum

Other amendments to the Ontario Act include new debtor location rules for the purposes of the choice of law provisions that rely on that connecting factor.<sup>81</sup> The current rules locate a debtor with a business presence in more than one jurisdiction at its “chief executive office.” That test requires a factual determination of where the entity’s day-to-day decision-making is centred. To reduce uncertainty, the new rules identify a business debtor’s location by reference to more objectively verifiable criteria such as a company’s “registered office.”<sup>82</sup>

77. *Ibid.* Under s. 20(1)(c) of the Ontario Act as it currently reads, an unperfected security interest in tangible collateral is effective against a transferee for value of collateral unless and until the transferee takes delivery of the collateral. As the PPSL Committee observes, the delivery requirement is anomalous in relation to the other Acts, and results in unnecessary complexity.

78. *Ibid.* The CCPSL rules are currently incorporated in the PPSA regulations in effect in the Atlantic Provinces, Alberta, Manitoba, the Northwest Territories and Nunavut.

79. See, e.g., Alberta Personal Property Security Act, R.S.A. 2000, c. P-7, s. 28(1). In Ontario, this reform has come about as a result of judicial interpretation rather than statutory reform: see *Bank of Nova Scotia v. Ips Invoice Payment System Corporations* (2010), 318 D.L.R. (4th) 751, 2010 ONSC 2101.

80. Ontario Personal Property Security Act, *supra*, footnote 17, at s. 62(2). Note that the Ontario Act has also been amended to require a PMSI inventory financier to give advance notice to the holder of a prior registered interest in accounts: see s. 33(1)(b). This change aligns the Ontario Act with the Acts in effect in the Atlantic Provinces.

81. Under the PPSA, the law of the jurisdiction in which the debtor is located determines the law applicable to the creation and effects of perfection or non-perfection of security interests in intangibles and mobile goods as well as non-possessory security interests in money, negotiable collateral and chattel paper.

82. Ontario Personal Property Security Act, *supra*, footnote 17, at s. 7.2. Specifically, the proposed new rules locate a corporation organized under a law of Canada that requires its organization to be disclosed in a public record in the Province or

The changes are not in force pending implementation by sufficient other jurisdictions to ensure an orderly transition. Thus far, British Columbia and Saskatchewan have come on-board.<sup>83</sup> The slow pace of take-up reflects the absence of an interprovincial institution with the mandate and resources to coordinate reform. The CPPSL exerted a strong harmonizing influence on the non-Ontario PPSAs when they were being implemented but its drafting and coordination functions fell to the wayside once the initial reform was complete. The Commercial Law Strategy of the Uniform Law Conference of Canada produced several reports aimed at harmonizing PPSA reform but the Conference has not on the whole been a successful coordinating venue. Conference participants do not necessarily reflect the views of home constituents or have the ear of their home legislatures, and governments have not been willing to invest in establishing an expert representative sub-body.

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Territory under the laws of which it is incorporated, continued or amalgamated. An organization organized under the law of a U.S. State that requires its organization to be disclosed in a public record is deemed located in the U.S. State designated by U.S. law or by the organization if U.S. law authorizes it to make a designation, and otherwise in the District of Columbia. The location of a partnership that is not a limited partnership depends on whether the partnership agreement states that it is governed by the laws of a province or territory, in which event the partnership is deemed located in that jurisdiction. A similar location rule applies to trustees acting for a trust; if no governing law is stated in the trust instrument, the trustees are deemed located in the jurisdiction where the trust is principally administered. Individuals are deemed located in the jurisdiction of their principal residence. For debtors not falling within the aforementioned categories, the chief executive office location test continues to apply. See further R. John Cameron, "Ontario's Personal Property Security Act — Bill 152" (2007), 45 C.B.L.J. 103.

The proposed reforms do not eliminate all uncertainty. UCC art. 9 applies the chief executive office test to corporations organized under foreign law, including Canadian law. Consequently, if there is any risk of litigation occurring in the United States, perfection should continue to be made in the state, province or territory where the corporation has its chief executive office if this is different from the location of its registered office. Article 9 also applies the chief executive office test to partnerships and trustees. Consequently, perfection should continue to be made in the place where the trustees or partnership have their chief executive office if the collateral includes assets located cross border or if there are other significant U.S. connections.

Note too that the Civil Code of Québec, S.Q. 1991, c. 64, applies a universal "registered office" test to locate legal persons for choice of law purposes (see arts. 3105 and 307) whereas the proposed PPSA registered office test applies only to U.S. and Canadian corporations; otherwise the residual chief executive office test applies.

83. Finance Statutes Amendment Act, 2010, Bill 6, 2010 (B.C.), s. 43; The Personal Property Security Amendment Act, 2009, Bill 102, 2009 (Sask.), ss. 5 and 6.

Thus it has been left to each jurisdiction to monitor the need for reform with Ontario the only one to do so in a sustained fashion. Ontario's PPSL Committee invites input from other jurisdictions and is clearly conscious of the value of harmonization. However, it is ultimately an Ontario committee<sup>84</sup> with the result that local policy may sometimes trump harmonization. For example, the Committee recently recommended codification of the rule in *Re Lambert*<sup>85</sup> that a correct Vehicle Identification Number cures any debtor name error in a registration where the debtor holds the vehicle as consumer goods.<sup>86</sup> This departs from the prevailing legislative and judicial policy elsewhere.<sup>87</sup>

Even when the reform is one that all PPSA jurisdictions would support, the absence of a harmonization venue makes concerted action unlikely. For example, the Ontario Act was amended in 2007 to define what constitutes a sale or lease for the purpose of the rules protecting sellers and lessees who acquire collateral in the ordinary course of the debtor's business.<sup>88</sup> This issue requires clarification in all PPSA jurisdictions<sup>89</sup> but it has not been placed on the legislative agenda elsewhere.

The Committee recently recommended elimination of the "without knowledge" limitation on the ineffectiveness of an unperfected security interest against a transferee of collateral.<sup>90</sup> The absence of a harmonization strategy means that this reform if implemented will create a new source of disharmony with the non-Ontario Acts notwithstanding that the underlying policy justifications — to reduce litigation costs and encourage prompt registration — might well have drawn uniform support.<sup>91</sup>

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84. The PPSL Committee is a sub-committee of the Ontario Bar Association.

85. (1994), 7 P.P.S.A.C. (2d) 240, 119 D.L.R. (4th) 93 (Ont. C.A.), leave to appeal to S.C.C. refused 123 D.L.R. (4th) vii, 33 C.B.R. (3d) 291*n*.

86. Ontario PPSL Committee documents on file with the authors.

87. See, for example, The Personal Property Security Act (Sask.), *supra*, footnote 14, at s. 43(7).

88. Ontario Personal Property Security Act, *supra*, footnote 17, at s. 28.

89. See Part III of this paper.

90. Ontario PPSL Committee documents on file with authors.

91. Note that this reform would also bring the PPSA into line with the Civil Code of Québec, *supra*, footnote 82, at art. 2963 which expressly provides that "[n]otice given or knowledge acquired of a right that has not been published never compensates for absence of publication."

## 2. Harmonization with the Uniform Commercial Code

### (a) The Securities Transfer Act

While harmonization of Canadian secured transactions law remains elusive, all jurisdictions have enacted uniform Securities Transfer Acts<sup>92</sup> and complementary amendments to their secured transactions laws. These new regimes are virtual copies of the investment property provisions of UCC arts. 8 and 9.

The STA regime finally gives Canada a legal framework to accommodate a market reality in which the vast majority of publicly traded securities are held and traded through tiers of intermediaries. Harmonization with the UCC made sense in view of the close integration of the Canada/U.S. securities markets. Whether harmonization necessitated importing a carbon copy merits closer scrutiny than has occurred.

Some have argued that the STA/art. 8 regime unduly favours the interests of securities intermediaries and their secured creditors over entitlement holders.<sup>93</sup> In particular, if a securities intermediary is insolvent and there is a shortfall in the financial assets it was required to maintain,<sup>94</sup> a secured creditor of the intermediary who has perfected by “control” has priority over the claims of the intermediary’s customers<sup>95</sup> even if it knew that the

92. At the time of writing, the only exception was Prince Edward Island. Note that the version of the Uniform Securities Transfer Act implemented in Québec is substantively identical to the other Acts, but stylistically less complex owing to differences in the civil law legislative drafting tradition and Code structure: see An act respecting the transfer of securities and the establishment of security entitlements, R.S.Q., c. T-11.002.

93. Francis J. Facciolo, “Father Knows Best: Revised Article 8 and the Individual Investor” (2000), 27 Fla. St. U.L. Rev. 615; Russell A. Hakes, “UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day” (2002), 35 Loy. L.A. L. Rev. 661. See also Mohamed F. Khimji, “The Securities Transfer Act, Insolvency, and Systemic Risk” in J. Sarra, ed., *Annual Review of Insolvency Law 2009* (Toronto, Carswell, 2010), especially at pp. 190-196.

94. Note, however, that an intermediary’s duties to entitlement holders, including its duty to hold sufficient security entitlements and not to pledge its customers’ entitlements to others, is subject to contractual variation. See, e.g., Securities Transfer Act, S.A. 2006, c. S-4.5, s. 98(4). Moreover, parties are free to agree on the standards by which the obligations of good faith diligence reasonableness and care imposed by the Act are to be performed as long as they are “not manifestly unreasonable.” *Ibid.*, at s. 5(2). This level of deference to party autonomy in a setting where intermediary-drafted standard form account agreements are the norm has also elicited criticism from some: see Facciolo, *supra*, footnote 93; Hakes, *supra*, footnote 93.

95. See, e.g., Alberta Securities Transfer Act, *ibid.*, at s. 105(2). In addition, under s. 105(3) a secured creditor of a clearing agency that sustains a shortfall always has priority over the claims of entitlement holders regardless of control.



intermediary was not authorized to use its customers' security entitlements as collateral. To defeat the secured creditor's claim, the account holder bears the onus to prove that the secured creditor acted "in collusion" with the intermediary.<sup>96</sup> The other protected purchaser rules applicable to intermediated securities — rules which are likely to benefit secured creditors and repo lenders — use a "no notice of an adverse claim" standard.<sup>97</sup>

Adoption of the more protective collusion standard for an intermediary's secured creditors was not an inevitable feature of the STA. The 2009 UNIDROIT Intermediated Securities Convention uses a consistent "knows or ought to know" standard for all adverse claims.<sup>98</sup> Of course all property regimes must mediate between preserving security of title for owners and facilitating the transfer and pledge of assets in the interests of market liquidity and access to credit. However the UNIDROIT Convention example indicates that the balance struck by the STA merited more debate than it received.

#### (b) Bank Accounts

Awareness of the need for informed debate about the policy choices underlying the UCC when it comes to large institutional secured creditors is important in light of lobbying by the International Swaps and Derivatives Association to adopt the art. 9 approach to security in bank accounts.<sup>99</sup> The PPSA (like the Civil Code) currently treats a bank account as simply another species of "account" (or "claim"), requiring perfection by registration with priority generally determined by the order of registration. Under the art. 9 "control" regime,<sup>100</sup> a secured party

96. *Ibid.*, at s. 97(7). Acting "in collusion" is defined to mean "in concert, by conspiratorial arrangement or by agreement for the purpose of violating a person's rights in respect of a financial asset": s. 1(1)(r).

97. *Ibid.*, at ss. 96 and 104(1). See generally Facciolo, *supra*, footnote 93; Hakes, *supra*, footnote 93.

98. UNIDROIT Convention on Substantive Rules for Intermediated Securities (Geneva, 2009), arts. 20(2) and 18, online: UNIDROIT <<http://www.unidroit.org/english/conventions/2009intermediatedsecurities/convention.pdf>>

99. See letters of François Bourassa, Chair, International Swaps and Derivatives Association (ISDA) Canadian Steering Committee, to Ontario Ministry of Government Services and Alberta Land Titles and Personal Properties Registry Service dated June 8, 2009 (on file with authors).

100. See UCC § 9-104 (requirements for control); § 9-312 (perfection by control); § 9-327 (priority); and § 9-607 (collection and enforcement). At the conflict of laws level, the law selected by the parties to govern the deposit account agreement would apply to validity, perfection and priority in place of the current PPSA and Civil Code debtor location rule: see UCC § 9-304.

is perfected by control automatically if it is the depository bank and otherwise by becoming the nominal holder of the account or by obtaining a control agreement from the depository bank and the debtor/customer. Except as against a secured party who becomes the account holder, the depository institution has first priority.

Those advocating the art. 9 approach argue that it enables participants in the securities lending, repo and OTC markets to keep their collateral relationships confidential, and relieves them from the risk of registration error and the burden of conducting registry searches and obtaining subordinations.<sup>101</sup> Critics argue that it is inconsistent with the PPSA policy of promoting publicity of security interests, privileges large financial institutions over other credit suppliers, and is unduly complex compared to the current registration-based perfection and priority regime.

The issue is currently under review by the Ontario PPSL Committee.<sup>102</sup> The policy implications of so fundamental a reform merit national debate.

### (c) Electronic Chattel Paper

The PPSL Committee is also considering whether the PPSA should be amended to recognize “electronic chattel paper” in line with art. 9.<sup>103</sup> Chattel paper is defined as an agreement that evidences an account owing in relation to a security interest in or a lease of specific goods such as the financing and lease contracts generated by auto dealers and other big ticket retailers. A secured creditor or assignee who takes physical possession of the paper is perfected and has priority over competing claimants including prior-registered secured creditors. Recognition of electronic chattel

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101. Background papers of the Ontario PPSL Committee documents on file with the authors. ISDA members cite the decision of the Supreme Court in *Caisse populaire Desjardins de l'Est de Drummond v. Canada* (2009), 309 D.L.R. (4th) 323, [2009] 2 S.C.R. 94, 2009 SCC 29, as adding further urgency to the case for reform. That case involved an agreement between a bank lender and its debtor that restricted the debtor's right to deal with deposited funds so as to ensure they would be available to the bank in the event of default. The court ruled — albeit in a non-secured transactions context — that these restrictions took the arrangement beyond simple contractual set-off and instead constituted in substance and function a security interest in the funds. This type of arrangement is commonly relied on as an alternative to or a supplement for a registered security interest by ISDA's members; the court's ruling puts its legal efficacy into doubt.

102. Ontario PPSL Committee documents on file with authors.

103. See arts. 9-102(31) (definition of “Electronic chattel paper”) and 9-105 (Control of Electronic Chattel Paper).

paper would extend this privileged status to financiers who obtain electronic “control” of chattel paper.

The PPSL Committee is currently soliciting input from the chattel paper financing industry on the merits of the electronic chattel paper reform initiative.<sup>104</sup> There is little doubt that its support will be forthcoming. The special priority given to possessory security interests in chattel paper concept has no basis in the common law and no counterpart in the civil law of Québec. It is a pure statutory construct incorporated into art. 9 and imported into the PPSA to palliate the objections of financiers of auto dealers and other big ticket retailers to the priority risk and costs of registration. To the extent that recognition of electronic chattel paper will enlarge the scope of the exemption from registration, it will be popular with the industry especially with securitization of auto dealer receivables on the rise in Canada.

Interestingly, the Committee’s survey is Canada-wide. The industry has made it known that it would like to see the special treatment of chattel paper made available in all provinces and territories and the PPSL Committee is seeking ways to promote a harmonized response, perhaps indicating an emerging role as the *de facto* national PPSA harmonization venue.

### 3. The PPSA and the Civil Code — Unnecessary Disharmony?

The Civil Code regime governing movable hypothecs shares the basic policies of the PPSA. While creditors may use other title-based institutions to secure an obligation, the applicable rules incorporate the principal policies governing hypothecs.<sup>105</sup> Most notably, these other devices, like a non-possessory hypothec, must be published by registration in order for the creditor’s right to be set up against “third persons.”<sup>106</sup> The registration requirement also applies to a lease for a term of more than one year and to an outright assignment of claims.<sup>107</sup>

The Code does not specify the categories of “third persons” against whom an unregistered right is ineffective. Does a trustee in bankruptcy qualify? Québec jurisprudence generally had said yes

104. Ontario PPSL Committee documents on file with authors.

105. For a brief comparative overview of the Civil Code secured transactions regime, see Cuming, Walsh and Wood, *supra*, footnote 2, at pp. 47-56.

106. See Civil Code of Québec, *supra*, footnote 82, at arts. 1263 (security trust), 1745, 1749 (reservation of title under an instalment sale), 1750, 1756 (sale with a right of redemption), 1847 (leasing transactions), 1852 (leases for a term of more than one year), 2663 and 2941 (hypothecs).

107. *Ibid.*, at arts. 1642 (assignment) and 1852 (lease for a term of more than one year).

on the theory that the trustee acts as representative of the bankrupt's creditors who are undeniably third persons in relation to the holder of an unpublished right.<sup>108</sup> However, in *Re Lefebvre*<sup>109</sup> the Supreme Court of Canada concluded that an unregistered lease remained effective against the lessee's trustee in bankruptcy. The lessor had retained title to the leased assets, and a trustee in bankruptcy cannot claim any greater right than the bankrupt has.<sup>110</sup> In his companion ruling in *Re Ouellet*<sup>111</sup> Justice LeBel reached the same conclusion with respect to an instalment sale under which the seller had retained title to secure the purchase price.

This reasoning stands in sharp contrast to the court's prior decision in *Re Giffen*.<sup>112</sup> In that case, Justice Iacobucci concluded that the PPSA, by subordinating the lessor's title under an unregistered lease to the lessee's trustee in bankruptcy, had altered the general principle limiting the trustee's property rights to those held by the lessee. His ruling recognized that the underlying legislative policy was to preserve, through the trustee, the rights that the lessee's judgment creditors could have asserted against the lessor but for the intervening bankruptcy.

Justice LeBel distinguished *Giffen* on the basis that the PPSA expressly empowered the trustee to contest the lessor's title for failure to register, thereby giving the trustee an interest greater than that of the lessee.<sup>113</sup> Since the Civil Code did not stipulate a similar consequence, the insolvency principle limiting the trustee's rights to those held by the bankrupt applied.

Justice LeBel's reasons for distinguishing *Giffen* are puzzling. The Code requirements for publication of hypothecs do not expressly name the trustee as a protected third person. Yet Justice LeBel concluded that an unregistered hypothec, unlike an unregistered ownership right, is ineffective against the trustee. He seems to have thought that the Code drafters intended an unregistered right to prevail against the trustee only if it constituted a mere security right.<sup>114</sup> But the relevant question

108. For a review of the pre-*Ouellet*/*Lefebvre* jurisprudence, see Jacques Auger and Albert Bohémier, *The Status of the Trustee in Bankruptcy* (2002), 37 R.J.T. 57; and see J. M. Deschamps, "Le syndic: Un successeur du débiteur? Un cessionnaire? Un représentant des créanciers?" in *Meredith Memorial Lectures* (Don Mills, De Boo, 1985).

109. [2004] 3 S.C.R. 326, 244 D.L.R. (4th) 513.

110. *Ibid.*, at para. 37.

111. *Ouellet (Trustee of) (Re)*, [2004] 3 S.C.R. 348, 244 D.L.R. (4th) 532, at para. 14.

112. [1998] 1 S.C.R. 91, 155 D.L.R. (4th) 332.

113. *Lefebvre*, *supra*, footnote 109, at para. 40.

was or should have been whether the trustee qualified as a “third person” under the Code and it is difficult to see why the drafters would have intended that term to have a more limited meaning in the provisions requiring registration of ownership rights as opposed to hypothecary rights. Moreover, the distinction disregards the negative policy implications emphasized in *Giffen* that would result from subordinating unpublished rights to unsecured judgment creditors prior to bankruptcy but not to the trustee after bankruptcy intervenes to cut off their rights.<sup>115</sup>

The definition of “secured creditor” in the BIA now explicitly includes a seller who reserves ownership under an instalment sale.<sup>116</sup> In Justice LeBel’s view, this change means that a seller’s failure to register its title can now be relied on by the trustee. While that result partially restores the harmony between the Code and the PPSA that existed prior to the *Ouellet* ruling, the method is perverse. The BIA was amended by the Federal Law-Civil Law Harmonization Act.<sup>117</sup> That Act aims to ensure federal legislation is interpreted, to the extent it interacts with provincial concepts of property and civil rights, to take account of differences between the Civil Code and the law of the common law provinces. Ruling that the BIA in effect can amend the meaning of “third persons” in the Code turns that goal on its head.

## V. CONCLUDING THOUGHTS

The hectic pace of reform in the Canadian secured transactions law that occurred during the last decades of the 20th century has slackened. There are several reasons for this, including the general view that the Personal Property Security Acts of the common law jurisdictions and the provisions of the Québec Civil Code providing for hypothecs are working well. However, there is reason to be pessimistic with respect to the possibility of getting changes to federal law that recognize the conceptual and functional innovations in provincial and territorial secured transactions law. Extensive changes have been made in Canadian bankruptcy and

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114. *Ibid.*, at paras. 24-27.

115. See Anthony Duggan and Jacob Ziegel, “Justice Iacobucci and the Canadian Law of Deemed Trusts and Chattel Security” (2007), 57 U.T.L.J. 227, at p. 234.

116. BIA, at s. 2(1) (“secured creditor”), as amended by s. 25 of the Federal Law-Civil Law Harmonization Act, No. 1, S.C. 2001, c. 4. The expanded definition also explicitly includes a creditor who acquires title under a sale with a right of redemption and a trustee who holds title under a security trust pursuant to the Civil Code of Québec, *supra*, footnote 82.

117. *Ibid.*

insolvency law over the last five years. Unfortunately, none of these changes reflect an appreciation in the Department of Industry of the importance of bringing these areas of the law into greater harmony with contemporary provincial and territorial law. The other ongoing challenge is interprovincial harmonization. While amendments to the Ontario PPSA have advanced that goal, new developments — including industry pressure to adopt the UCC art. 9 regime applicable to bank accounts — threaten to create new sources of disharmony in the absence of any effective venue capable of coordinating a national policy consensus.