Possible Implications of Revised UCC Articles 9 for Canada Personal Security Acts 1999

A Report prepared and presented by:
Professor Ronald C.C. Cuming, College of Law, University of Saskatchewan
Professor Catherine Walsh, Faculty of Law, University of New Brunswick

.....

.....

I. INTRODUCTION

[1] The Permanent Editorial Board for the Uniform Commercial Code, with the support of its sponsors, the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Law (NCCUSL), established in 1990 a study committee to report on the need for revision of Article 9 and related provisions of the Uniform Commercial Code. The study committee issued its report in December 1992, concluding that a variety of specific changes were called for and recommending the creation of a drafting committee to carry out the revision process. A drafting committee, convened in 1993 by the ALI and the NCCUSL, met frequently between 1993 and 1998 and prepared a Final Draft which received the approval of both sponsors in 1998. It is expected that the new Article 9 will be adopted quickly by most states of the United States.

[2] Revised Article 9 preserves the general structure and approach of existing Article 9. But the revisions are extensive. In addition to substantive law changes, there has been extensive rewriting, clarification, and refinement of many provisions. The new Article 9 is a far more complicated creation than its predecessors and its complexity raises an important policy question as to whether the goal of simplifying secured financing law has been ignored.

[3] The conceptual structure of the Personal Property Security Acts enacted in all Canadian

common law jurisdictions except Nunavut is based on the 1972 Official Version of Article 9. While the Canadian legislation is different in substance and detail, both the PPSAs and Article 9 function in the context of similar secured financing markets. In addition, Canadian business activities are now much more integrated than they have ever been with those of the northern states of the United States. These factors justify careful examination of the new Article 9 to determine to what extent it contains approaches that might be considered for integration into Canadian personal property security law.

[4] While there are many features of revised Article 9 that warrant careful examination, in many respects, it represents a "catch up" move on the part of its drafters. It contains many features that have been in Canadian PPSAs for many years. There are features of it that are still not as advanced as their counterparts in Canadian law.

[5] The authors of this Report, Professors Cuming and Walsh, have undertaken a study of the new Article 9 (hereinafter referred to as Article 9[1] part of the Uniform Law Conference Commercial Law Strategy _ which will involve an assessment of its provisions in the light of current Canadian business practices in secured financing markets and public policies affecting those markets. Set out below is a very brief overview of the most significant differences between the Model Personal Property Security Act[2] of the Canadian Conference on Personal Property Security Law and Article 9 that will be the focus of attention in this study. For the most part, the observations in this report apply as well to the Ontario Personal Property Security Act. The conclusions expressed in this report are tentative and may well be modified with respect to particular issues once those issues are examined in greater detail.

II. ARTICLE 9 REVISIONS THAT REFLECT EXISTING POLICY IN PPSA JURISDICTIONS

[6] Many of the features of Article 9, though significant in United States law, will not be novel to a Canadian audience since they are aspects of current Canadian PPSAs. This is especially true with respect to many of the provisions dealing with filing (registration) and enforcement. What follows is a non-exhaustive list of those revisions for which equivalent provision is already made in all or most Canadian Acts.

1. Application to True Consignments

[7] Sections 9-109 and 9-102(20) extend the scope of Article 9 to true consignments. Under Â§ 9-103, a consignor's "security interest" is treated as a purchase money security interest in inventory. This is mirrored in all of the Canadian PPSAs except that of Ontario.

2. Perfection of Security Interests in Instruments by Filing

[8] Section 9-312 expands the type of collateral in which a security interest may be perfected by filing to include instruments. The Canadian PPSAs permit registration as a perfection step for all types of collateral including instruments. Unlike the Canadian PPSAs,

Â§ 9-312 does not permit a security interest in money to be perfected by registration.

3. Production Money Security Interests

[9] An appendix to revised Article 9 contains model definitions and priority rules relating to production money security interests held by secured parties who extend new value used in the production of crops. Because no consensus emerged in the Drafting Committee on this issue, the model provisions were included as an appendix rather than as part of the proposed uniform statutory text of revised Article 9. The Canadian PPSAs, other than that of Ontario provide for production money security priority in respect of not just crops, but also farm animals and fish.

4. Media Neutral Language for Registration Provisions

[10] The Article 9 filing provisions are cast in media neutral terms so as to allow for electronic filing and searching. Since electronic registration and searching has been a feature of Canadian PPSAs for several years, media neutral language is used in both the Acts and the regulations.

5. Sufficiency of Debtor Name Information

[11] Article 9 clarifies what constitutes a sufficient debtor name (and secured party name) for the purposes of a financing statement (Â§Â§ 9-503, 9-506).[3] The CCPPSL has adopted uniform conventional rules for ascertaining individual debtor name, and the regulations under all of the Canadian PPSAs specify the rules for ascertaining the names of business debtors (or enterprise debtors as they are called in some jurisdictions). However, not all jurisdictions have adopted the CCPPSL model rules as law. Article 9 also tests the sufficiency of filing against a debtor name by reference to the search logic of the particular filing system. A similar uniform provision would be welcome in the PPSAs given some inconsistency in judicial interpretation on this point.

6. Collateral Description Requirements

[12] Article 9-504 confirms the acceptability of a super-generic collateral description in a financing statement, e.g., "all assets" or "all personal property." This is a feature of all Canadian PPSAs. This type of description is also permissible under the PPSAs for security agreements. In contrast, Â§9-108 expressly prohibits the use of "all the debtor's assets" or similar descriptions in security agreements, requiring the parties to instead describe the collateral according to genre or by item or any other method permitting objective determination of the collateral. Even a generic description of collateral is inadequate where the collateral is a commercial tort claim, and for consumer transactions, consumer goods, a security entitlement, a securities account, or a commodity account.

7. Control of Misuse of the Registry - Inaccurate Information in a Registration

[13] Article 9 eliminates the existing Article 9 requirement for debtor signatures on financing statements as incompatible with electronic filing and as an inadequate foil against fraud. The ineffectiveness of requiring the debtor's signature as an anti-abuse measure was recognized in most Canadian jurisdictions when the PPSAs were first enacted. Sections 9-509, 9-625 prohibit an unauthorized financing statement and subject violators to statutory damages of $500 and to civil liability for any resulting losses. The need for an explicit prohibition of this kind has never been demonstrated in PPSA jurisdictions. The ability of debtors under the PPSAs to compel the secured party to discharge an unauthorized or expired financing statement, with damages recoverable for non-compliance, has generally been seen to give the debtor sufficient protection. The drafters of Article 9 have adopted a watered- down version of this aspect of the Canadian system. Section 9-509(c)(2) gives the debtor the right to file a termination statement when there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation or give value and the secured party has failed to respond to a demand.

[14] Section 9-518 permits a debtor who believes a filed record is inaccurate or unauthorized to indicate this fact in the files by filing a correction statement but this "correction" does not affect the effectiveness of the registration. The drafters of most of the Canadian systems took the position that persons searching the registry should have available unambiguous information as to the matters that are disclosed in a registry search.[4] The most dramatic example of the application of this approach is found in the context of discharges. The registrar must register a discharge that is in a form that complies with the registry regulations. This is so even though, unknown to the registrar, the discharge may have been submitted by an unauthorized person. Of course, the system provides backup measures designed to protect a secured party from most of the negative consequences of an unauthorized discharge.

8. Definition of Inventory

[15] The definition of inventory in Â§ 9-102 confirms that the term includes goods leased by the debtor to others as well as goods held for lease. This extension is contained in the definition of inventory in the Canadian PPSAs.

9. Good Faith and Commercial Reasonableness

[16] Section 9-102 contains a new definition of good faith that includes not only honesty in fact but also the observance of reasonable commercial standards of fair dealing. Similar overarching provisions are contained in the Canadian PPSAs derived from the CCPPSL model.

10. Deemed Damages for Non-Compliance

[17] Section 9-625(e) provides that where the secured party has not complied with specific provisions of Article 9, the debtor may recover deemed damages in the amount of $500. This is a feature of Canadian PPSAs.

III. FEATURES OF ARTICLE 9 UNLIKELY TO MERIT CONSIDERATION FOR ADOPTION IN CANADA

[18] While each new feature of Article 9 will be carefully examined in the study, it is safe to conclude at this point that there are many features which, for reasons that are immediately apparent, will not attract much attention or support in Canada. Set out below is a non-exhaustive list of some of these.

1. Health Care Insurance Receivables

[19] Article 9 provides for automatic perfection in the case of a transfer of a health care insurance receivable (a newly defined term in Article 9-102)(46)) to a health care provider. These transfers are normally made by natural persons who receive health care services and the drafters saw little value in requiring perfection. The Canadian context would not justify any equivalent special provision.

2. Restrictive Registration (Filing) Provisions

[20] Article 9 contains a number of provisions which reflect a continued focus on paper-based registrations and an apparent lack of confidence in filing offices. For example, a filing officer has no discretion to reject financing statements (Â§Â§Article 9-520, 9-516(b)); mandatory performance standards are imposed on filing offices (Â§Â§ 9-519, 9-520, 9-523); there is a requirement that filing office rules be published and the office must submit periodic reports (Â§Â§ 9-526, 9-527). A national form of written financing statement is prescribed and filing offices must accept written forms of financing statement and related written records which conform to this national standard (Â§ 9-521).

[21] Because the Canadian systems are largely automated and have operated efficiently there is none of the distrust of Canadian registry officials that is reflected in Article 9. National uniform registration standards have proved an elusive goal in Canada given staggered implementation and intervening advances in filing technology and thinking. It has not proved to be a practical impediment to value adders acting on behalf of national clientele. Perfect national uniformity is in any event unlikely in Canada given continued differences in registration philosophies on a number of significant issues between Quebec and the common law PPSA jurisdictions, and between the Ontario PPSA and the other PPSAs. It is also not as significant a goal in the Canadian context with only thirteen

provinces and territories and a far smaller population and correspondingly lower incidence of financing activity.

3. Registration Life

[22] Section 9-515 maintains the old Article 9 rule that registrations are effective for a uniform period of five years subject to filing of a continuation statement for a further five-year period. However, it creates a new exception of thirty years for a financing statement filed in conjunction with a public finance transaction or a manufactured home transaction (terms defined in Â§ 9-102(53) and (67)). In contrast, the Canadian PPSAs allow for flexible registration terms from one to twenty-five years or infinity.

4. Registration (Filing) and Searchability

[23] Under Â§ 9-516(a) registration can be effective without being searchable since it is deemed to occur when "a record" is presented to the filing office and accepted by the filing officer. Further, under Â§ 9-516(d), when a filing officer improperly refuses registration, the financing statement is deemed registered in any event except as against "a purchaser of the collateral which gives value in reasonable reliance upon the absence of the record in the files." A purchaser includes a secured party and a buyer. Since the test requires subjective reliance on the part of the purchaser, the deemed registration may be effective against some purchasers and not others. The same approach is used where a filing officer fails to index a record correctly. Again, the registration, although unsearchable, is effective except as against a purchaser.

5. Mandatory Sale of Registry Information

[24] Draft Â§ 9-523(f) provides that "[a]t least weekly, the filing office shall offer to sell or license to the public on a nonexclusive basis, in bulk, copies of all records filed with it under this part, in every medium from time to time available to the filing office." This approach is directly contradictory to the approach employed by several Canadian provinces under which registry information is not sold in bulk.

[25] The reason behind the Canadian approach is that the information in the registry is, in most cases, quite misleading since there is no legal requirement that at any particular time a registration accurately reflect the legal relationship between the persons named as secured party and debtor. Given the fact that it is now common for potential lenders to claim a security interest in all of a debtor's present and after-acquired property, there will be many situations in which the records of the registry will convey a false impression about the creditworthiness of persons named as debtors in registrations. There is a further concern. The information in the registry is designed for a specific use and is supplied under legal compulsion. This being the case, it should not be available to facilitate unsolicited advertising or appropriation of competitor's customer lists.

6. Security Interests in Deposit Accounts

[26] The 1972 Official Text of UCC Â§9-104(l) did not apply to a security interest in a deposit account except to the extent that the "money" in the account was proceeds. Article 9 makes some significant changes in this respect. It permits a secured party to take a security interest in a deposit account. The term "deposit account" means a demand, time, savings, passbook, or like account maintained with a depositary institution but does not include an account evidenced by an instrument (Â§ 9-102(29). It is not clear whether or not it includes what is referred to in Canada as a guaranteed investment certificate which is not represented by an instrument, but is a fixed term "investment," i.e., a loan to the issuer.

[27] Any secured party can take a security interest in a deposit account; however, unlike the Canadian situation, one type of secured party, the deposit-taking institution that owes the account (hereinafter, the bank), is given a very preferred position with respect to perfection and priority of any security interest it takes in the account. The bank's security interest in the account is automatically perfected simply by virtue of the fact that it has "control" of it as a result of being the account debtor (Â§Â§ 9-104 and 9-327). Indeed, the only way to perfect a security interest in a deposit account is by "control"(Â§ 9-314). Another secured party can perfect the security interest by obtaining "control"; however, in order to get this control, the bank's consent must be obtained. The bank need not give this consent, even if the debtor demands that it be given. In effect, the bank is given a veto over whether or not the debtor can give a security interest in his or her bank account. In other words, it can play "dog-in-the manger" if it wishes. Where there are conflicting security interests in a deposit account, a secured party with control is given first priority (Â§ 9-327). This will inevitably be the bank.

[28] Section 9-342 allows what the system is supposed to eliminate: secret security interests. Under the section a bank that has a security interest through control is not obligated to inform any one of its security interests unless requested to do so by its customer. This will make garnishment of bank accounts very difficult. It will mean that the garnisheeing creditor will have to spend the money to get the garnishment summons and serve it on the bank before it can find out whether or not the account is subject to a prior security interest held by the bank.

[29] The US approach will likely be unacceptable in Canada. Under the current PPSAs, a security interest can be taken in a deposit account just like it can be taken in any other account. Perfection is by registration since an intangible interest is involved. No special privileges are given to account debtors that are deposit-taking institutions other than the common law right of set-off.

[30] The existing law provides sufficient protective measures or privileges to deposit- taking institutions so as to avoid interference with the ordinary business activities of banks. If money, cheques, etc., subject to a perfected security interest are deposited with a deposit-taking institution under circumstances in which the deposit amounts to negotiation of a

negotiable instrument or the repayment of a debt owing by the depositor, the deposit-taking institution is protected, in the former situation if it "buys" the instrument without actual knowledge of the security interest in it, and in the latter case, so long as it is clear that the debtor, by depositing the money or cheque, is intending to repay his or her obligation.

[31] There appears to be no commercial justification in a Canadian context for giving to deposit-taking institutions a veto over the right of a debtor to give a security interest in his or her account to someone other the account debtor. While the concept of perfection by "control" bears further consideration," there is no immediate need to adopt this approach in the current Canadian contexts. If a bank or credit union wants to have a perfected security interest in an account under which it is an account debtor, it can register a financing statement. The Canadian registry systems are efficient, easily accessible and relied upon by third parties. The control approach of Article 9 would simply add an additional step (and transaction costs for both the inquiring party and the account debtor) by requiring someone who proposes to take a security interest in the account to make inquiries from the bank where the account is held.

[32] There is no commercial justification for giving a special priority status to deposit-taking institutions that are also account debtors. They do not occupy a position equivalent to a purchase money financer. The mere fact that a bank or credit union "holds" the account in the capacity of an account debtor should not give to it a special status superior to that of another secured party who has a prior registered security interest in the account. It should certainly not give priority over the interest of a supplier who has a proceeds purchase money security interest in cash proceeds "deposited" in the account.

7. Buyers in The Ordinary Course of Business

[33] Section 9-320(e) addresses an issue that arose in the case law of the United States[5] and which could conceivably arise under the Canadian PPSAs. It prevents an ordinary course buyer of goods from taking free of a security interest if the goods are in the possession of the secured party at the time of the sale. There is no requirement in the Canadian PPSAs that the goods be in the possession of the seller.

[34] It is not clear that the approach taken in Â§ 9-320 is the correct one from a public policy point of view. The policy in the Canadian PPSAs is that when the seller is in the business of selling goods of a type that are collateral under a security agreement, buyers should not have to look beyond appearances when they buy in the ordinary course of business. If they are purchasing goods that are not at the moment of sale in the possession of the seller, they should not be expected to make the almost impossible determination as to whether or not the goods are in the possession of the secured party.[6]
<hrdata-mce-alt="IV. Innovations That Warrant Consideration" class="system-pagebreak" title="IV. Innovations That Warrant Consideration" />

IV. INNOVATIONS THAT WARRANT CONSIDERATION

1. Security Interests in Commercial Tort Claims

[35] Article 9 allows the commercial tort claims of organizations, and the business-related tort claims of individuals (other than claims for personal injury or death), to be taken as original collateral (Â§Â§ 9-102 and 9-109). Like previous versions of Article 9, Canadian PPSAs do not apply to the creation or transfer of a right to damages in tort.

2. Supporting Obligations

[36] Section 9-102(77) introduces the concept of a "supporting obligation", meaning a letter of credit right or a secondary obligation (e.g. a guarantee) that supports payment or performance of an obligation that is collateral. Under Â§ 9-203(f), a security interest in collateral automatically attaches to a related supporting obligation, and under Â§ 9-308(d), perfection of a security interest in collateral automatically perfects a security interest in the supporting obligation. In a similar vein, Â§Â§ 9-203(g) and 9-308(e) confirm that attachment and perfection of a security interest in a right to payment secured by a security interest or other lien on personal or real property constitute automatic attachment and perfection of a security interest in the security interest or other lien. Finally, sections 9-203 (h), (j) and 9- 308(f),(g) clarify that attachment and perfection of a security interest in a securities account or commodities account is also automatic attachment and perfection of a security interest in security entitlements or commodity contracts carried in the accounts. The PPSAs do not contain any equivalent explicit provisions.

3. Sales of Accounts and Payment Intangibles

[37] Article 9 applies to sales of accounts and chattel paper. However, the definition of accounts in Â§ 9-102(2) includes many types of receivables which under previous versions of Article 9 were characterized as general intangibles, the sale of which was, therefore, not governed by the Article. The result is that under Article 9 more types of sales transactions involving accounts will be subject to its filing requirements and priority rules than was the case previously.

[38] Section 9-102(61) creates a new sub-category of general intangibles called "payment intangibles," defined as general intangibles under which the account debtor's principal obligation is monetary. But while payment intangibles fall within the scope of the Article, they are exempt from the usual filing requirement for perfection. Perfection instead is automatic on attachment (Â§Â§ 9-109(a)(3), 9-309(3)).

[39] By itself, the expanded definition of accounts in Article 9 is of little significance from a Canadian perspective. The definition of accounts in the PPSAs is already very broad, encompassing both accounts and payment intangibles as defined in Article 9. However, the PPSAs do not distinguish "payment intangibles" from other accounts, and there is no

equivalent exemption from registration of sales of this type of property. Whether or not an exemption is desirable in order to avoid interference with bank loan participations agreements requires consideration in the Canadian context. However, if no public notice of a sale of this type of property were required, there would be no protection for second or subsequent transferees who, under existing Canadian law, can determine through a search of the registry whether or not an account has been sold to someone else.

4. Security Interests in Investment Property

[40] In 1994 Article 8 of the Uniform Commercial Code was revised and modifications were made to the 1972 Official Text of Article 9 with the aim of accommodating the law to current methods of dealing with interests in securities and to recognize a new form of property called a "security entitlement" in which security interests can be taken. The features of Article 8 that applied to perfection of security interests in investment property have been moved to Article 9 but remain essentially the same. "Investment property" is defined in Â§ 9- 102(49) as a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract or commodity account. Under Â§Â§ 9-312 and 9-314, a security interest in investment property may be perfected by filing or control. Section 9-106 defines control (in part by cross reference to Â§ 8-106). Generally, control of a security entitlement exists when the securities intermediary has agreed with the secured party that the intermediary will follow directions from the secured party without further consent from the debtor. Generally, control of a certificated security occurs by delivery with any necessary endorsement. "Delivery" as defined in Â§ 8-301 without an endorsement will constitute perfection by possession, but not "control" pursuant to Â§ 9-313.

[41] The priority rules for investment property in Â§9-328 are similar but not identical to the priority rules in former Â§ 9-115 which were added in conjunction with the 1994 revisions to Article 8. A security interest in investment property perfected by control generally has priority over a competing security interest otherwise perfected. Security interests perfected by control generally rank according to the time when control was obtained, or in the case of security entitlement and a commodity contact carried in a commodity account, the time when the control arrangement was entered into. (This is a departure from former Â§ 9-115 which accorded them equal ranking). However, as between a security interest held by a securities intermediary in a security entitlement which it maintains for the debtor, and a security interest held by another secured party, the former prevails. In substance if not in name, this is a form of purchase money security interest priority, a feature reflected in the exclusion of investment securities from the Article 9 purchase money security provisions.

[42] A Uniform Law Conference Working Group is presently preparing a Uniform Securities Transfer Act which, if enacted by all provinces, will bring Canadian securities law much more in line with Article 8 of the Uniform Commercial Code. A part of this project is to provide a regulatory scheme for security interests in investment property.

5. Cross-collateralization Involving Purchase Money Security Interests in Inventory

[43] Section 9-103 contains an expanded definition of "purchase money security interest" designed to deal with the problem of cross-collateralized purchase money security interests in inventory. Cross-collateralization occurs where an obligation is secured by a security interest in collateral that secures another obligation. In decisions under previous versions of Article 9, some U.S. courts reasoned that the existence of after acquired property and future advance clauses in purchase money inventory financing transactions meant that each item of inventory was standing as collateral for advances incurred in respect of the acquisition of all items of inventory. Concluding this meant that there were no longer separate PMSIs for each item of collateral, they held that the inventory financiers' PMSIs were thereby transformed into general security interests losing their special purchase money priority status.[7] In a similar vein, U.S. courts have sometimes held that refinancing by a purchase money secured party, whereby the old purchase money loan was paid out with the new financing, transformed the purchase money security interest into an ordinary security interest governed by the first to file priority rule.[8]

[44] Section 9-103(b)(2) reverses the result in these cases. It provides that if the security interest is in inventory that is or was purchase money collateral, the security interest is a purchase-money security interest also to the extent that it secures a purchase money obligation incurred with respect to other inventory in which the secured party holds or held a purchase money security interest.

[45] In a Canadian context, the one-to-one relationship between the obligation and the collateral that is endemic to the concept of purchase money security interest in the PPSAs results in a threat to the purchase money security interest status in cases where the security agreement provides for future advances, contains an after-acquired property clause or where there is refinancing. Where a future advance is involved and the future advance does not relate to the acquisition of new collateral in which the secured party has a purchase money security interest, the future advance cannot be secured by a purchase money security interest, even though there may be value in the collateral sufficient to secure the advance. Where an after-acquired property clause is involved and additional collateral is acquired by the debtor, unless this collateral is acquired with new value obtained from the secured party, it is not possible to have a purchase money security interest in it. Where consolidation and refinancing is involved (i.e., rewriting several loans into a single loan) the secured party cannot expect to have a purchase money security interest in all of the collateral to secure the consolidated debt. If the separate purchase money security interests are to be retained at all after consolidation, they would exist separately only in respect of the amount owing in connection with the separate origin obligations under which they arose. If the consolidation-refinancing involves new money, considerations identical to those associated with future advances arise.

[46] Section 9-103(b)(2) would not give purchase money status to future advances,

however, it would facilitate consolidation and add-on agreements by permitting the secured party to retain a purchase money security interest in all inventory acquired under one or more purchase money arrangement so long as any obligation with respect to any item of that inventory remains undischarged. In other words, the secured party is entitled to treat all of the obligations as essentially a single purchase money obligation secured by all of the collateral in which it holds or held a purchase money security interest.

[47] To date, purchase money security interest cross-collateralization has not developed as a contentious issue in Canadian case law. Canadian courts have not (yet) embraced the rigid approach to cross-collateralization similar to that of courts in the United States. However, the effects of the limited amount of cross-collateralization allowed by Â§ 9-103(b)(2) warrant consideration in a Canadian context.

6. Electronic Chattel Paper

[48] Responding to industry practice, Article 9 recognizes the concept of "electronic chattel paper," defined in Â§ 9-102(31) as chattel paper evidenced by a record or records consisting of information stored in an electronic medium. The concept of electronic chattel paper is also reflected in the revised wording of the definition of chattel paper in Â§ 9-102(11).

[49] A security interest in electronic chattel paper may be perfected by filing or control. "Control" as defined in Â§ 9-105 requires compliance with special rules for the electronic identification of the secured party "on" the electronic copy. Under Â§ 9-330, obtaining control is treated as the equivalent of taking possession for the purposes of applying the special priority rules governing a contest between a purchaser of chattel paper who gives new value and takes possession and the holder of a competing security interest.

7. The Position of Unsecured Creditors (And Trustee in Bankruptcy)

[50] Section 9-317(a)(2) provides that an unperfected security interest is subordinate to the rights of a person who becomes a "lien creditor" (i.e., a creditor who has caused property of the debtor to be seized under some form of judicial process or a trustee in bankruptcy) before the security interest is perfected and before a financing statement covering the collateral is filed. The effect of the provision in most cases may well be very different from what it would be under prior Article 9 law and under current law in Canada.

[51] Under Â§ 9-317(a)(2) a secured party could "shelter" a debtor's property from execution by simply filing a financing statement containing a collateral description "all present and after-acquired property." While this would not shelter the property in which the secured party does not ultimately take a security interest, it would stand in the way of the property being seized since there would always be the chance that the secured party would take such a security interest in the property after a seizure and "squeeze out" the execution creditor's interest. In practice it will mean that a judgment creditor will have to get a

subordination agreement from the secured party or at least an undertaking not to lend money to the debtor on the security of property that the creditor intends to have seized.

[52] It is most unlikely that the approach contained in this section would be adopted in Canada without significant modification. It contravenes the policy of existing law which does not allow a secured creditor to "squeeze out" knowingly an execution creditor through the use of future advances. Further, in the context of Canadian bankruptcy law, it is very doubtful that a security interest can be taken in property of the bankrupt that has vested in the trustee other than pursuant to security agreement that existed prior to the bankruptcy. However, there is reason to re-examine the current Canadian position with a view to putting a secured party in the position where it need not determine whether or not property offered as collateral has been seized or charged with a registered judgment between the date the secured party registered a financing statement and the date a security agreement is executed.

8. Rights of Prior Secured Parties

[53] Section 9-611(c) places on a secured party who is enforcing its security interest an obligation to give a pre-disposition notice to any secured party who, within a specified period before notice is given to the debtor, has filed a financing statement. This provision reinstates in a somewhat expanded fashion the rule in former Â§ 9-504(3) as it read prior to the 1972 amendments to article 9. The 1972 amendments eliminated the duty to give notice to other secured parties other than those from whom the enforcing secured party had received positive written notice of a claim of an interest in the collateral. According to the drafters' comments, the decision to reinstate and expand the requirement was motivated by the perception that many of the problems arising from dispositions of collateral encumbered by multiple security interests can be ameliorated or resolved by ensuring that all secured parties are informed of an intended disposition so as to give them an opportunity to work with one another ahead of the event.

[54] Section 9-611(c) requires notice to be given to all secured parties of record, including those who have a priority status ahead that of the secured party who is disposing of the collateral. This is a feature not found in the Canadian PPSAs which require notice to be given only to subordinate secured creditors whose interests in the collateral will be terminated by its disposition. It is presumably based on the consideration that if prior-ranking secured creditors are informed of an impending disposition, they may be prepared to take over the enforcement proceedings or work with the junior party so as to allow for a disposition of the collateral free of all security interests, thereby enhancing the marketability of the collateral for the benefit of all. The requirement to notify even prior ranking creditors should be read along with Â§ 9-615(g) which provides that, when a secured party receives cash proceeds of a disposition of collateral without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest under which the disposition is made, the recipient takes the cash proceeds free of the security interest of other lien and need not account for any surplus. Presumably, the fact

that advance notice must be given if the prior security interest is registered affects the practical operation of this provision by giving the prior-ranking creditor an opportunity to strike the enforcing secured party with notice of its rights in advance of the disposition and receipt of the proceeds.

9. Proof of Transferee's Interest

[55] Section 9-619 provides a measure designed to facilitate the position of buyers at security enforcement proceedings who acquire collateral that is covered by a title registry system (e.g. an automobile subject to a state certificate of title act) or is subject to a registration system (e.g. a copyright under federal law in the U.S.). If the debtor refuses to cooperate in executing the documents necessary to record the new ownership, the secured party may have difficulty in finding a market for the collateral. Section 9-619 answers this need by providing a simple mechanism for obtaining documented record or legal title. A "transfer statement" authenticated by the secured party which states that the secured party has exercised its default remedies with respect to specific collateral, and that a named transferee has acquired the rights of the debtor in the collateral, may be submitted to any official recording office as proof that the transferee is entitled to have title transferred to him or her.

V. SERIOUS DIFFICULTIES RESULTING FROM ARTICLE 9 (CONFLICT OF LAWS)

[56] Article 9 contains dramatically changed conflict of laws rules. One of the effects of these changes will be to destroy the important level of harmonization that previously existed between the Article 9 and PPSA conflict of laws rules. In the future, the outcome of many disputes will depend on the forum in which the matter is litigated. In many situations it will no longer be possible for the courts in the different jurisdictions in the two countries to apply essentially the same choice of law rules.

[57] The traditional approach has been retained for security interests in accounts, intangible collateral and mobile goods. The law of the location of the debtor will continue to govern perfection, the effect of perfection and non-perfection, and priorities. However, with respect to tangible collateral Â§9-301 draws a clear distinction between the law governing perfection, on the one hand, and the law governing the effect of perfection and non-perfection and priority, on the other. The law governing perfection is the local law of the location of the debtor.[9] The law governing the effect of perfection and non-perfection, and priority, is the local law of the jurisdiction where the collateral is located. A by-product of the new approach is that it is no longer necessary to draw a distinction, at the level of perfection, between goods of a type normally used in more than one jurisdiction ('mobile goods") and other goods. All goods are subject to the same perfection venue whatever their use.

[58] Another important change in the choice of law rules of Article 9 relates to the rules for determining the "location of the debtor." The basic rules remain substantially the same (Â§

9-307 (b)). A natural person is deemed to be located at her or his residence with respect to both personal and business assets.[10] A legal person is deemed to be located at its place of business if it has only one, or at its chief executive office if it has more than one place of business. However, if the debtor is located in a jurisdiction outside the United States whose law does not provide for public disclosure of security interests, Article 9 deems it to be located in the District of Columbia (9-307(c))! A very significant change has been made with respect to the location of a "registered organization," i.e., an entity organized solely under a United States federal or state law[11] which requires a public record to be maintained disclosing the organization (Â§ 9-102(70), (76)). Under Â§ 9-307 (e), a registered organization is deemed to be located in its state of organization.[12] This should be contrasted with the former Article 9 rule and the rule in the PPSAs which designate the place of business or chief executive office if there is more than one place of business as the location of an organized entity that has more than one place of business regardless of whether it is organized under a foreign or domestic law.

[59] The change in the law applicable to priorities as a result of these changes in the rules for determining the location of the debtor will not be significant in many cases. However, the decision to have perfection determined universally by the law of the location of the debtor will result in the need in many more cases for third parties to be aware of the necessity to search a registry in a jurisdiction other than the one in which the property being offered for sale or as collateral is located.

[60] This problem is exacerbated by another feature of Article 9, which has been carried over from the former Article 9. Section 9-316(a) provides that perfection under the law of the location of the debtor continues for four months after the debtor changes its location to another jurisdiction. The four-month "grace" period is absolute so far as unsecured creditors and the trustee in bankruptcy are concerned, but is a conditional period so far as purchasers for value are concerned. A purchaser who acquires an interest during the four-month period (or for that matter even before the change in the debtor's jurisdiction) will defeat the secured party who fails to re-perfect during the four-month period. On the other hand, if the secured party does perfect before the expiration of the four month period, its security interest is considered to be retroactively perfected as against an intervening purchaser for value. What is troublesome about this latter aspect from a Canadian point of view is that purchasers for value are exposed to potential loss for the full 120 days after the date the debtor changes location. In other words, they search the registry in the new location yet they still can be defeated by a secured party who perfects in the new jurisdiction any time after they acquire their interest so long as perfection is effected before the expiry of the four-month period. The equivalent period under the Canadian PPSAs is sixty days from the date the debtor changes its location or fifteen days from the date the secured party learns of the change. Moreover, the CCPPSL Model Act provides additional special protection where non-mobile goods are concerned . There is no grace period if the purchaser for value is a buyer (as opposed to a competing secured creditor) of goods other than mobile equipment.[13]

[61] The special protection afforded buyers by the CCPPSL Model reflects the different public policy choices made by legislators as well as a difference between the contexts in which Article 9 and the Canadian PPSAs function. The Canadian system is concerned with the need to protect buyers of goods that are not goods (equipment) of a type normally used in more than one jurisdiction. These will be principally buyers of consumer goods, particularly automobiles and other large-ticket items. Protection of this class of buyers is less of a concern in the United States because of the universal use of certificates of title for motor vehicles.

Footnotes

Footnote: 1 Unless otherwise indicated, references to sections of Article 9 are to sections of the 1998 Revised Text.

Footnote: 2 Enacted with minor variations in all common law jurisdictions except Ontario, Yukon and Nunavut but not yet proclaimed in the Northwest Territories, Manitoba and Newfoundland. In the following comments, references to the provisions of the Manitoba PPSA are to the unproclaimed Act based on the CCPPSL model.

Footnote: 3 There remains a very significant difference between the structure of Article 9 and Canadian personal property security law with respect to the operational details of the registry systems. The details which are dealt with by the regulations in Canada are set out in Article 9.

Footnote: 4 An exception to this generalization is the ambiguity endemic to a system that permits pre-agreement registration and collateral descriptions in registrations that do not necessarily parallel collateral descriptions in security agreements. However, the person named as debtor is given the legal rights to force amendment to the registration so that it reflects the terms of the security agreement or force its discharge when no agreement exists. In any event, the permissible inaccuracy involves only overstatement; it does not involve disclosure of a dispute as to the veracity of the registration or some information contained in it.

Footnote: 5 In Tanbro Fabrics Corp. v. Deering Milliken, Inc., 350 NE2d 590 (NY 1976), a manufacturer of unfinished textiles sold a block of fabric to a processor, retaining possession of the goods as security for the price. The processor contracted to sell the fabric to an ordinary course buyer. The New York court of appeals held that the buyer took free from the manufacturer's security interest under former Â§ 9-307(1).

Footnote: 6 The approach contained in Â§ 9-320 was recommended for inclusion in the Ontario PPSA by a committee of the Ontario Branch of the Canadian Bar Association. See: Canadian Bar Association, Ontario Branch, Submission to The Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act, Oct. 21, 1998, 14-15.

Footnote: 7 For citations and a discussion of the principal cases, see Barkley Clark, The Law of Secured Transactions under the Uniform Commercial Code, rev'd ed (Boston: Warren, Gorham, Lamont, 1993) Â¶3.09(2)(c).

Footnote: 8 Id.

Footnote: 9 The general debtor location rule for perfection applies only to security interests not perfected by possession. Perfection of a possessory security interest continues to be governed by the local law of the jurisdiction in which the collateral is located (Â§ 9-301(2)). There are several other exceptions: goods covered by a certificate of title (Â§Â§ 9-102, 9-301(2)); deposit accounts (Â§ 9-304); investment property (Â§ 9-305); letter of credit rights (Â§ 9-306); security interests perfected by a fixtures filing (Â§ 9-301(4); and security interests in timber to be cut (Â§ 9-301(5)) and in "as-extracted collateral" (Â§ 9-301(6)).

Footnote: 10 This is so even though this is not the place where the individual carries on business. Under the Canadian PPSAs, the location of an individual is where that person carries on business.

Footnote: 11 A legal entity organized under the law of Canada would not be subject to this rule. The result is that the location of the entity would be determined under Â§ 9-307(b), i.e., place of business or chief executive office, if the debtor has more than one place of business..

Footnote: 12 An entity organized under federal law is deemed to be located in the state within the United States designated by the law under which it was organized if any, or in the state that the organization designates if permitted to do so under the relevant federal law, or in the District of Columbia if neither of the first two rules apply (Â§ 9-307 (f)).

Footnote: 13 The special protection afforded buyers by the Ontario PPSA is more limited than under the PPSAs based on the CCPPSL model. Under s. 5(2) of the Ontario Act, a buyer who acquires goods during the relevant grace period, but before the extraprovincial security interest is perfected in Ontario, takes free only if the goods are acquired as consumer goods.

August 1999