Commercial Law Strategy Federal Security Interests 2000

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Law Commission of Canada

Note - This is a revised version of the Report on Federal Security Interests and supersedes the version distributed earlier.

INTRODUCTION

[1] At the Annual Meeting of the ULCC at Winnipeg in 1999, Roderick Macdonald, President of the Law Commission of Canada, presented a brief report on the status of the federal security interests project.

[2] He reviewed the document prepared by Professor Stephen A. Scott of McGill University concerning the constitutional jurisdiction of the Parliament of Canada to create and to enforce security interests. He also reported on the Round Table held in Toronto to consider how the Law Commission of Canada should pursue this initiative further.

[3] Mr. Macdonald was directed to contact experts with a view to determining how best to launch and manage the needed research studies. It was suggested that two main research projects should be undertaken. One would involve a detailed study of existing federal security interests, grouped according to the framework just identified. Thereafter, a second project would involve a complete review of the constitutional authority of the Parliament of Canada to enact its own legislation or to adopt international conventions relating to security interests. The President indicated that the Law Commission would develop a Request for Proposals to have the first of these studies completed for the next meeting of the ULCC.

STRUCTURE OF THE FEDERAL SECURITY INTERESTS RESEARCH PROJECT

[4] Following the Winnipeg meeting and consultation with attendees at the June 1999 Round Table, the Law Commission prepared a draft Request for Proposals (RFP). This RFP was cast so that it fell within the general agenda of the Law Commission's research on economic relationships. The key elements of this proposal were as follows:

The Law Commission of Canada is interested in examining an area of law that might be described as "federal security interests". This involves determining: (i) What is a federal security interest as a matter of constitutional law? (ii) What is the scope of the jurisdiction of the federal Parliament either to create such interests or to sign on to international conventions creating such interests? (iii) What is a federal security interest as a matter of commercial law? (iv) In addition to statutes like the *Bank Act* and maritime legislation that appear expressly to create security interests, are there other statutes that create legal devices that function (or can be deployed to function) as security? (vi) What, if anything, is the consequence of old doctrines like crown immunity and interjurisdictional immunity when they are applied to agencies, crown corporations and other federal governmental entities that seek to give (or to take) security? (vii) how many federal licenses, permits, etc. exist as an important business asset and how many of them may be made the subject of a security interest under the federal statute in question?

The policy questions the Commission seeks to answer include the following: (i) Is there a case for rationalizing and modernizing these diverse federal security interests among themselves? (ii) Substantively the questions are, for example, can banks, railways, shippers, and airlines actually find a common ground? (iii) If so, should Article 9 and the "substance of the transaction rule" be enacted as the central motif in the federal field? (iv) What can be done to achieve a better integration of provincial and federal interests? Can registries be made compatible? Should there be separate federal registries at all? (v) Is concern about federal security interests a false problem? Would it be better simply to resolve all these problems of harmonization and integration through extensive amendments to the *Bankruptcy and Insolvency Act*?

The Commission sees the overview as comprising a review of the following six topics: (i) security interests

arising in the context of federally regulated enterprises -- maritime law; federal railways; banks; aeronautics; etc.; (ii) security interests in types of property created by federal legislation -- patents; trademarks; copyrights; computer typography; etc.; (iii) security interests in federal property -- federal enclaves such as parks, military bases, etc.; off-shore federal territory; federal personal property; (iv) security interests arising in the context of the federal power over Indians and Lands Reserved to Indians -- land; personal property; intellectual property; (v) non-consensual federal security interests -- federal tax and other claims, whether charges, liens or deemed trusts; federally created non-consensual interests created in favour of persons other than the federal Crown; and (vi) bankruptcy and insolvency issues.

While the work in question will be conceptual and analytical, it is expected that consultation with those who are involved in these fields of legal practice and in the commercial activities in question will be undertaken. The Commission also seeks suggestions about, and an assessment of, alternative approaches to reform of the law governing "federal security interests", including (if appropriate) ideas about a draft statute.

[5] The Commission initially received expressions of interest from four potential contractors. Unfortunately, two of these felt that the time-lines for the project and the budgetary limitations suggested made the project not feasible to pursue. In the early autumn the Law Commission awarded the contract to undertake this research to a group of advocates associated with the firm Fraser Milner Casgrain under the direction of Philip Rimer. The attached document was submitted to the Commission in early June. It is reproduced in full.

OUTLINE OF THE FEDERAL SECURITY INTERESTS REPORT

[6] The Report submitted by Messrs. Fraser Milner Casgrain has three main objectives. First, it identifies and describes the various federal statutory and regulatory provisions dealing with security interests. Second, it reviews whether there is a case for harmonizing the current federal security interest regime. Finally, it identifies some of the options available and notes certain advantages and disadvantages arising from each of the options.

[7] The bulk of the Report is devoted to identifying and assessing the various federal statutory and regulatory provisions dealing with security interests. These provisions were classified into eleven categories. Thereafter, a search of the caselaw and the academic literature was performed in order to identify the strengths and weaknesses of each of the provisions, as well as the potential options for reform. Lawyers at Fraser Milner Casgrain were also consulted in an attempt to identify certain practical problems associated with the various federal statutes and regulations dealing with security interests and their interplay with provincial *PPSA* legislation.

[8] Federal statutory and regulatory provisions dealing with security interests can be regrouped into three more general categories:

Provisions related to the granting or taking of security interests by federally-regulated enterprises

This area encompasses security interests relating to banks and other financial institutions, railways and rolling stock and agricultural and agri-food enterprises.

Provisions related to the granting or taking of security interests on federally-regulated property

This area is composed of security interests relating to intellectual property, real and personal property owned by the federal Crown, real and personal property owned by Indians and non-consensual federal security interests.

Miscellaneous provisions

A number of federal statutes also address security interests relating to bankruptcy issues, pensions and benefits, and miscellaneous legislative issues.

[9] By agreement with the Law Commission, not all federal statutes dealing with federal security interests were examined. Left aside were security interests in the area of aeronautics, fisheries, mining (i.e. royalties), employment, maritime shipping, and oil and gas -- in particular, the following statutory and regulatory provisions:

Aeronautics Act, R.S.C. 1985, c. A-2, s. 4.

Air Canada Public Participation Act, R.S.1985, c. 35

(4th Supp.), ss. 8(1)(a). *Atlantic Fisheries*

Restructuring Act, R.S.C. 1985, c. A-14, ss. 4(1)(a) and

4(1)(b). *Canada Marine Act*, 1998, c. 10, s. 31, 91 and

117.

Canada-Newfoundland Atlantic Accord Implementation Act, 1987, c. 3, s. 102-118.

Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act, 1988, c. 28, s. 105-121.

Canada Petroleum Resources Act, R.S.C. 1985, c. 36 (2nd Supp.), s. 84-100.

Canada Shipping Act, R.S.C. 1985, c. S-9, s. 45-54 (see also amendments not in force in 1998, c. 16).

Civil Air Navigation Services Commercialization Act, 1996, c. 20, s. 56(1).

Federal Court Act, R.S.C. 1985, c. F-7, s. 22(2)(c).

Historic Canals Regulations, SOR/93-220, s. 49-51.

National Energy Board Act, R.S.C. 1985, c. N-7, s. 111 and 114.

Petroleum and Gas Revenue Tax Act, R.S.C. 1985, c. P-12, s. 31.

OBJECTIVES OF THE CURRENT FEDERAL REGIME OF SECURITY INTERESTS

[10] Diversity is inherent in Canada's personal property security regime - many, but not all, provinces have adopted modernized personal property security legislation, while Quebec is unique among Canadian personal property law in its application of the *Civil Code*. These systems all operate in conjunction with personal property provisions in federal statutes. The current federal systems offer no consistency in approach. For example, the security system under the *Bank Act* establishes a basic framework, but must borrow from provincial law on several matters. As well, an additional federal registration is required in the case of some intellectual property rights in order to protect a security interest against certain third parties. However, the registration system is not as developed or searchable as the provincial system, and the effect of registration on priorities and other key considerations is unclear.

[11] The statutory objectives of federal statutes tend to be very specific to the purposes of each statute. For example, provisions in the *Indian Act* that limit the ability to take security in the property of Indians are intended to maintain the special property status of Indians created by the Act. Likewise, statutory provisions relating to personal property security in pensions and benefits were created to maintain income bases for retired individuals, and to achieve important social objectives. Federal statutes having an impact on security interests in the agricultural sector were designed to protect what has traditionally been seen as a key component of Canada's economic and historical makeup - the family farm.

[12] It follows that the objectives underlying these federal statutes vary considerably in accordance with the specific statute. At present, there is no policy objective to create an overarching federal security interest regime. The statutes do not attempt to create a complete personal property security regime, and their impact on security interests is for the most part haphazard and peripheral to their primary objectives.

[13] In certain areas, particularly where the impact on security interests is minor or incidental, it can be argued that the federal statutes affecting security interests adequately fulfil their objectives. For example, the modest goal of providing farmers facing financial difficulty with some extra time before their creditors can enforce their security is achieved by the *Farm Debt Mediation Act*. This goal may be described as "modest" in the context of security interests, as it does not involve a registration component and does not impact on the key areas of priority and perfection. Section 244 of the *BIA* achieves a similar goal of providing debtors with some extra time before

creditors can enforce their security.

[14] Federal statutes are somewhat less effective where they purport to regulate key economic sectors. These statutes often create problems involving duplication and uncertainty as to whether the federal or provincial statute should govern. These problems are particularly evident with the federal intellectual property statutes and the *Bank Act*. In the case of the IP sections dealing with registering "transfers" and "assignments", neither their purpose nor their effect is clear. For example, the term "transfer" is not defined, and it is thus unclear whether creating a security interest would constitute a "transfer". The resulting confusion leads most lenders to register security interests in intellectual property under both the provincial and federal statute. The security provisions in the *Bank Act* produce a similar duplication, with banks taking both a *Bank Act* security interest and a *PPSA* security interest in the same collateral to secure the same obligation. Where this is done, it is unclear whether the bank can obtain the best of both worlds by relying on its *Bank Act* security to defeat a competing third party and then asserting its *PPSA* security interest to defeat another. Other problems with the *Bank Act* security provisions include their limited scope, their lack of a comprehensive priority system and their lack of a comprehensive enforcement procedure.

[15] Issues involving secured lending have become immensely more complex and important since the time the security provisions in the *Bank Act* and the registration sections in the federal IP statutes were developed. The creation of detailed and thorough provincial *PPSA* legislation and the case law surrounding it is a reflection of this. The presence of the *PPSA* suggests that where federal objectives and provisions collide with those of the *PPSA*, the federal provisions might be redundant. In other words, the *Bank Act* objective of ensuring that bank loans are secured may already be accomplished by the *PPSA*. Similarly, registering a security interest in IP with the CIPO adds little in terms of accomplishing the lender's usual objective of achieving certainty with respect to priority and perfection.

AVENUES FOR REFORM

[16] Reform of the current federal security interest regime must be undertaken, but critics are divided on the proper course to take. Some advocate the complete abolition of certain federal security interest regimes, specifically the provisions of the *Bank Act*. Others have proposed key factors to be considered, prior to the wholesale unification of all federal security interest provisions under the guise of one single federal personal property security statute.

[17] Of course, were the second option to be contemplated, several collateral issues would have to be addressed. These include, for example, whether or not the federal security system would provide a comprehensive code. If not, thought must be given as to what law would be used to supplement the federal statute. In addition, it would have to be decided whether or not the federal system would be the exclusive means by which a security interest would be taken, and to what extent provincial law would play a part. Again, if the federal security system is not to be exclusive, it would have to be decided whether a secured party could hold both federal and provincial security in the same property. If this is the case, thought must be given as to whether the parties could elect between federal and provincial law, and whether a single security document could give rise to security under both the federal and provincial systems. Still again, a method of registration must be created – either a centralized federal registry, or a registry on regional bases. It must also be determined to what extent the provincial registries would be utilized. Moreover, if the federal security system is *not* exclusive, the creators must give thought as to the method by which priorities will be determined when a provincial security interest conflicts with a federal security interest. Finally, the creators of a federal security system must determine to what extent civil and common law rules may be harmonized and incorporated into the federal system, and to what extent provincial law may be harmonized with federal legislation.

[18] Apart from these general questions, there are several options that can be pursued in attempting to overcome existing problems with the current federal security interest regime. First of all, the government may choose to modify the security interest provisions of each individual federal statute. Alternatively, the government could suspend a select few problematic security provisions, for example, in relation to the provisions of the *Bank Act*. Thirdly, in an attempt to unify all federal security interest provisions, the government could enact a comprehensive federal personal property security act.

[19] A review of all relevant federal security interest provisions suggests that it may be difficult to find an underlying objective sufficient to unify all the systems under the umbrella of a single federal personal property statute. Changes to individual security systems may be sufficient to compensate for existing deficiencies. For example, only minor changes may be required to produce a more effective and clear registration system for security interests in railways and rolling stock under the *Canada Transportation Act*. The implementation of a unified federal personal property security act would produce a massive change to the existing federal security interest system and, as might be expected, may produce further complications and adjustments. To be worth the effort, any unified federal personal property security act must effectively resolve the majority of the outstanding issues with the current federal security interest regime.

[20] The suspension of currently problematic security interest provisions may provide a temporary solution. For example, some critics have advocated the abolition of the security interest provisions under the *Bank Act*. If this step were to be taken, the federal government must ensure that the unique security needs of the banks are met. A better solution may be to amend the current security provisions to more effectively address the problems associated with taking *Bank Act* security.

FOLLOW-UP AND NEXT STEPS

[21] The Law Commission will be meeting in August to determine what the next steps for this project should be. Among the possibilities are to seek detailed studies of one or two areas -- for example, intellectual property, the *Bank Act*, questions relating to "Indians and Lands Reserved to Indians" -- to complement this general overview. Another would be to get a detailed paper on the constitutional authority of the Parliament of Canada to enact its own legislation or to adopt international conventions relating to security interests. The Commission will also have to decide how it wants to disseminate the work already done. Finally it will have to decide if it should proceed to the issuance of a Discussion Paper and formal Report on this topic. The input of the ULCC on all these questions is respectfully sought.