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A Discussion Paper On Potential Changes to the Model Personal Property Security Act of the Canadian Conference on Personal Property Security Law Part 1 (covering sections 1 to 41)

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Introduction and Overview

Background

This Report suggests possible changes to the Personal Property Security Acts in effect in the Canadian common law provinces and the Yukon Territory, and proposed for adoption in the Northwest Territories and Nunavet. The word "possible"should be stressed. The intention is to generate discussion and comment so as to ensure that any amendments which may ultimately result from these initial proposals enjoy as wide a base of support as possible in the relevant provinces and territories.

The inspiration for the proposed changes is twofold.

The first flows from the approval, in the fall of 1998, of a complete revision of Article 9 (Secured Transactions) of the Uniform Commercial Code in the United States by the National Conference of Commissioners on Uniform State Laws and the American Law Institute.[1] While the Canadian PPSAs differ from Article 9 on many issues of substance, detail and policy, their conceptual structure is rooted in the 1972 Official Version of Article 9, both apply in similar secured financing markets, and the economies of the two countries are closely integrated. In light of these commonalities, the authors of this Report – Professors Cuming and Walsh – co-authored a report to the ULCC last year giving their tentative overview of the possible implications of revised Article 9 for Canadian analysts and legislators. That Report concluded that many features of new Article 9 were unlikely to warrant adoption in Canada, either because they represented a 'catch-up' move by the U.S. drafters, the proposed changes already having been

made in the Canadian PPSAs, or because they were incompatible with Canadian practice, law or policy.

However, the 1999 Report also identified a number of features of the new Article 9 which the authors felt warranted serious consideration for adoption in the Canadian PPSAs. This Report may be considered a follow-up to last year's report to the extent that certain of the changes proposed below are inspired by or adapted from new article 9.

The second reason for the proposed changes is simply the passage of time. A decade has passed since the adoption of the first PPSAs derived from the Model Act of the Canadian Conference on Personal Property Security Law (and it has been more than a decade since Ontario replaced its pioneering PPSA with a '2nd generation' version). Although all the Canadian PPSAs have proved to be exceptionally resilient statutory innovations, even the most carefully-crafted legislation needs to respond to the passage of time, both to repair unintended ambiguities and gaps and to respond to new developments in commercial practice and caselaw.

Structure of Report

In structuring the body of their report, the authors have used the Model PPSA adopted by the Canadian Conference on Personal Property Security Law (CCPPSL) as the prototype for the various discrete PPSAs in effect throughout the country. Changes to the existing text of the relevant section are denoted by underlining for new text, and by strike-out if it is proposed to delete old text. Where substantial changes are proposed, the old text appears in its current form followed by the new text. The comments which follow the proposed text give the author's explanations for why they believe the relevant change is warranted.

The CCPPSL Model was chosen as the prototype for the various Canadian PPSAs because it has been adopted, with minor variations, by all PPSA jurisdictions except Ontario, the Yukon Territory and Nunavut.[2] However, as the comments explain in greater detail, the substance and policy of most of the proposed changes would apply equally to the Ontario PPSA.

Although there is no published version of the Model PPSA, the Saskatchewan PPSA is virtually identical. Readers who wish to consult the Model Act in the course of reading this report can therefore use the Saskatchewan version (or the New Brunswick version if a French language text is preferred[3]).

Subject-Matter Scope of Report

The changes proposed in this Report relate only to Parts I, II and III of the Model PPSA. In very general terms, these Parts deal with the scope of application and interpretation of the PPSAs, conflict of laws, attachment of security interests and the evidentiary requirements for an effective security interest, the *inter partes* rights and obligations of the secured party and debtor, perfection and priorities, and the rights and obligations of third party account debtors obligated on chattel paper or accounts.

The authors intend to prepare a second part to this report, for completion in June 2001, outlining possible changes in the remaining parts of the Model Act, including the function and operation of the PPSA registration regimes, the post-default enforcement regime for security interests, and general and transitional issues.

Limited French Translation

Unhappily, limited resources did not permit translation of the detailed body of this Report into French. It is hoped that the general overview of the proposed changes which follows immediately below goes some distance towards repairing this omission for the French language reader (and may also be of assistance to the more casual English language reader).

Overview of Proposed Changes

A number of the changes proposed in the body of the report are in the nature of clarification or housekeeping exercises. This overview summarizes only those proposals of real substantive significance or interest.

Interpretation

Electronic media considerations: New definitions of "authenticated", "data message" and "writing" are proposed to ensure that the various notices, demands, and agreements contemplated by the PPSA can be authenticated and communicated using electronic media and electronic signatures.

Computer software in goods: It is proposed to add an explicit reference to a computer program in the definition of "goods" in order to remove any doubt that "goods" includes any computer program incorporated in them or integral to their operation (e.g. a brake chip in an automobile). This change would eliminate any perceived necessity to take separate security interests in the goods and the computer program.

Aquatic goods: Changes are suggested to the definition of "crops" and "goods" to confirm and clarify the applicability of the Act to aquatic goods produced in aquacultural operations.

Supporting obligation: It is proposed to revise the definition of "collateral" to include a "supporting obligation" so that a reference anywhere in the Act to "collateral" would include any supporting obligation associated with that collateral. "Supporting obligation" is a proposed new term defined to mean guarantees and other secondary obligations taken to support a primary obligation associated with an intangible, chattel paper, a document of title or an instrument. The express recognition of "supporting obligations" would confirm the principle, implicit in current law, that a supporting obligation is an automatic incident of the collateral it supports. Although the proposed definition is similar to that found in article 9-102, this report does not propose specific rules to govern the attachment, perfection, and priority status of supporting obligations equivalent to those found in articles 9-203, 9-308, 9-310 and 9-322. Rather, by amending the definition of "collateral" to include supporting obligations, attachment and perfection of a security interest in a supporting obligation would occur automatically on the attachment and perfection of a security interest in the collateral to which the supporting obligation relates, and the priority status of the supporting obligation would follow that of the related collateral.

Distinction between true leases and security leases: Neither the Model Act nor any other Canadian PPSA contains guidelines equivalent to UCC §1-201(37) for determining when a lease is in substance a security agreement. Generally this has not been a problem since all PPSA jurisdictions except Ontario subject true leases of a specified duration to the perfection and priority rules of the PPSA. This leaves a small area (enforcement) for disputes to arise over the characterization issue. Nonetheless, statutory guidelines would offer useful clarification especially in the absence of any authoritative judicial test. The proposed new provision generally tracks UCC §1-201(37) with the notable addition of a provision dealing with open-end leases.

Inter-jurisdictional harmonization: A new interpretative canon is proposed, taken from the Atlantic PPSAs, to encourage inter-jurisdictional harmonization in the judicial interpretation of each province's personal property security regime.

Purchase money inventory financing

Extensive additions are proposed to the current definition of "purchase money security interest" in section 2. New clause (iii) would remove any suggestion that purchase money status is lost when a purchase money obligation is refinanced or restructured. New clauses (vi) and (vii) would address the problem of cross-collateralized purchase money security interests in inventory. The proposed additions would extend pmsi priority to any inventory that was formerly subject to a pmsi to secure undercollateralized debt arising under separate pmsi transactions. This reflects the conceptual approach adopted in article 9-103(b) but restricts cross-collateralization to a "related" transaction. This is a legitimate limitation. The law should facilitate crosscollateralization where the parties contemplate a continuing relationship that involves pmsis from the outset so that the secured party need not keep separate accounts for each separate subtransaction. Beyond this, there is a risk of prejudice to prior secured creditors of the same debtor.

Scope

Security interests in licenses: In line with the current Saskatchewan PPSA, it is proposed to expand the definition of "intangible" in the Model Act to expressly include a "license" as separately defined. This would eliminate any doubt that the "personal property" in which a security interest under the PPSA can be taken includes rights under, e.g. an agricultural production quota, notwithstanding that transfer of the right is restricted or subject to the prior consent of the granting authority.

Security interests in wages: S. 4 of the Model Act currently excludes all security interests in wages, salary, commissions, etc., other than fees for professional services. The scope of the exclusion is broader than the prohibition on the assignment of wages, etc. found in provincial employment standards legislation. In the authors view, there is no general justification reason for continuing to exempt valid wage assignments from the general PPSA rules applicable to security interests in accounts. It is therefore proposed to delete the exclusion subject to a local variation in cases where the local policy of the enacting jurisdiction so requires.

Security interests in tort claims: S. 4 currently excludes all security interests in tort damages claims from the scope of the Model Act. It is proposed to narrow the exclusion to damages claims for personal injury or death. This is similar to Article 9-109(d)(12) except that the PPSA expansion is not restricted to tort claims given by persons in the course of business. For excluded tort claims, it is also proposed to extend the exclusion to cover a right to payment which derives from the excluded claim, as where the claim is represented by a settlement agreement. This differs from Article 9 under which excluded tort claims remain subject to sections 9-314 and 9-322 with respect to proceeds and priorities in proceeds. It was felt such a qualified application of the PPSA would lead to unnecessary complexity, and that the same body of non-PPSA law should govern both the excluded claim and any rights to payment derived from the claim.

Trust transactions: New text is added in s. 4 to confirm that the PPSA concept of security does not encompass the interest of a transferor under a "Quistclose trust" or similar arrangement involving the transfer of funds for a specified purpose, failing which the funds (or their proceeds) are to be returned to the transferor as the beneficiary of an express, implied or

resulting trust. The proposed text would also confirm the exclusion of arrangements involving the sale of services by an agent on terms that the agent is to hold the proceeds of such sales on trust for the principal less any agreed commission. A typical example would involve the sale of cargo or passenger transportation services to third parties by a firm acting as sales agent for the carrier.

Bank Act security interests: New text, derived from the current Saskatchewan PPSA, is proposed in section 9 to address the problem of "double dipping" on the part of banks purporting to take both *Bank Act* security and PPSA security to secure the same obligation owing the bank by the same debtor.

Security interests in ships: New text is proposed for s. 4 to expressly exclude security interests taken in registered ships or recorded vessels under the Canada Shipping Act (C.S.A.). The proposed exclusion is not confined to mortgages which are registered under the C.S.A. but would extend to all security interests covering registered ships or recorded vessels even where the security agreement is in a form incapable of registration as a mortgage under the C.S.A., e.g. a conditional sales contract. This approach would ensure that buyers and prospective secured parties of registered ships and recorded vessels can rely with confidence on a search of the C.S.A. registry, without having to undertake a concurrent search of the provincial PPRs. The application of the provincial PPSAs would be confined to security interests in boats which are licensed under the C.S.A. but not recorded or registered in the federal ownership registry.

Conflict of laws

Choice of law for priority: It is proposed to add a specific reference to priority in the choice of law rules of the Model Act, thereby eliminating any doubt that the designated law governs not just the priority consequences of the failure to perfect a security interest and the priority of perfected security interests over unperfected security interests, but also the priority status of the security interest against other competing third party claimants, including perfected security interests, and buyers and lessees of the collateral.

Effect of relocation of collateral to enacting jurisdiction: It is proposed to extend the scope of section 5(3) to require local perfection for all collateral, not just goods, governed by the choice of law rule in section 5, where the collateral is brought into the enacting jursidiction..

Effect of relocation of collateral to other jurisdictions: Current section 5 addresses the conflicts implications of relocation only if the collateral is relocated to the enacting jurisdiction. The proposed changes would clarify that if the collateral is relocated to some other jurisdiction, the law of that other jurisdiction governs the requirements for maintaining the validity and perfected status of the security interest, the effect of perfection or a lapse in perfection, and priority between the security interest and an interest acquired after relocation.

Effect of relocation of debtor: Current section 7 requires application of the law of the location of the debtor for security interests in mobile goods, intangibles, and non-possesory security interests in money and documentary intangibles. It addresses the conflicts implications of a relocation of the debtor to any jurisdiction, not just the enacting jurisdiction. However, it requires re-perfection under the law of the new jurisdiction within the time limits specified in section 7(3) even if the new jurisdiction is not the enacting jurisdiction. This may be challenged as an excessive application of forum standards to extra-provincial events. It is proposed to confine current section 7(3) to cases where the debtor re-locates to the enacting jurisdiction, and to add a new section 7(3.1) to cover cases where the debtor relocates to some other jurisdiction. This would bring section 7 into line with the conceptual changes proposed for section 5.

Conflict in choice of law rules: Sections 5 and 7 currently direct the application of different and potentially conflicting laws to determine the perfected and priority status of a security interest in a security, an instrument, a negotiable document of title, money or chattel paper. Under section 5, the law of the location of the collateral governs if the security interest is perfected by possession. Under section 7, the law of the location of the debtor governs if the security interest is non-possessory. Where a non-possessory interest comes into conflict with a possessory

interest, proposed new section 7(2.1) would resolve the conflict in choice of law rules by requiring application of the law of the jurisdiction where the collateral was situated when the possessory interest attached.

Elimination of renvoi: It is proposed to delete the current reference in s. 7 to the conflicts of laws rules of the jurisdiction in which the debtor is located, thereby eliminating any possibility of renvoi in the application of the choice of law rule in section 7.

Choice of law for enforcement procedure: Under current section 8, procedural issues relating to the enforcement of a security interest are governed by the law of the jurisdiction in which the collateral is located in the case of tangibles, and by the law of the forum in the case of intangibles. In line with general conflict norms, it is proposed to amend section 8 to refer all procedural issues to the law of the forum where enforcement is pursued.

Preservation of mandatory substantive enforcement rules: Section 8 refers substantive issues involved in the enforcement of a security interest to the proper law of the security agreement. It is proposed to add language confirming this is subject to any overriding 'mandatory' provisions of a more closely connected law. This would ensure that a secured party could not evade applicable debtor-protection rules via a choice of law clause in favour of a more remotely connected law which does not offer equivalent protection.

Validity and attachment of security interests: Under sections 5 and 7, the law governing the validity of a security interest is determined by reference to the location of the collateral or the debtor, as the case may be, when the security interest attaches. To address potential conceptual difficulties in applying this rule, it is proposed to add new text in section 8 to confirm that location means location when the security interest would have attached but for any alleged invalidity. The proposal would also confirm that the term "attaches" in sections 5-7 does not refer to the domestic attachment rules of the PPSA, but to the attachment rules of the designated law.

Characterization of "security interests": Proposed new clause 8(2)(c) would confirm that the term "security interest" for the purposes of sections 5-7 means any interest which under the domestic law of the enacting jurisdiction would constitute a security interest. This proposal ensures that the choice of law rules in sections 5-7 are applied even when the relevant lex situs would not characterize the interest in question as a security interest.

Choice of law for security interests in proceeds: Proposed new clause 8(2)(d) would confirm that law governing the validity, perfection, and priority status of a security interest in proceeds of original collateral is the law which, under sections 5 and 7, would govern a security interest in proceeds of that kind if they were original collateral.

Writing requirement for third party effectiveness of security agreements

Collateral description: The current wording of section 10 implies that a generic description of collateral in a security agreement is adequate even if the actual scope of the intended collateral is narrower. The proposed new wording would make it clear that the collateral description must reasonably identify the personal property intended to constitute the collateral. This does not mean that the description must be excessively detailed. Generic descriptions (e.g. "all goods") and super-generic descriptions ("all present and after acquired personal property") would continue to be acceptable so long as they reflect the intended scope of the collateral.

Priority effect of writing requirement: The priority effect of the writing requirement in current section 10 is controversial. Some argue that a secured party acquires a vested priority if section 10 has not been complied with when a competing security security interest is acquired. Others argue that compliance is possible at any time up to when the secured party seeks to actively enforce its security interest against the competing security interest. From a policy viewpoint, neither approach is satisfactory. The proposed new wording would resolve the problem by excepting secured parties from the range of third parties against whom a

security agreement which does not comply with section 10 is unenforceable. Their interests would still be adequately protected by section 18, under which a potential secured creditor can require the debtor to demand from the holder of a competing registered interest an authenticated written statement of the details of the collateral under the security agreement.

Attachment of security interests: "rights in the collateral"

It is proposed to amend section 12 to make it clear that a security interest can be given by a debtor who does not own the collateral but who has the power to create a security interest in it, whether that power is given by the owner or by operation of law. Amended section 12 would also clarify that a debtor acquires rights in collateral subject to a reservation of ownership by the secured party only when the debtor acquires possession of the goods. This ensures protection of a secured party who fails to perfect in time (or at all) from the risk of subordination to competing secured parties in respect of goods subject to the agreement of sale which still remain in its possession. Finally, amended section 12 would confirm that a transferor of accounts or chattel paper under an outright sale retains sufficient rights to support attachment of a competing security interest. This reflects the current understanding of analysts while eliminating the conceptual acrobatics necessary to justify the result under the current Act.

Attachment of security interests in after acquired consumer goods

It is proposed to delete the current section 13 restriction on non-purchase money security in after-acquired consumer goods (a change which already has been made in the Saskatchewan Act). It is felt that the social policy concerns which underpin the restriction would more appropriately be met by extending the exemptions on seizure of consumer goods in provincial judgment enforcement law to all creditors including secured creditors.

Attachment of security interests in future crops

It is proposed to delete the one-year limitation on security in future growing crops from current section 13 on the basis that it is paternalistic and unfair. The current rule means that crop financing under the PPSA is

generally not available because of the increased transaction costs and risks resulting from the restriction. Since security taken under the federal Bank Act is not subject to any equivalent restriction, agricultural producers are effectively limited to bank financing and are denied access to the wider credit market available to other debtors.

Perfection of security interests in chattel paper

The proposed changes to section 24 would recognize the common practice of 'marking' chattel paper to identify the secured party as an alternative to taking physical possession for the purposes of perfection. This change would allow "electronic chattel paper", the subject of a new proposed definition in section 2, to be perfected by possession.

Priority for future advances

Against judgment creditors: Proposed new section 20(1.1) would allow a secured party who has registered a financing statement, but whose security interest does not attach until after registration, to enter into the security agreement and make advances without risk of subordination to an intervening judgment creditor otherwise entitled to priority under subsection (1). Priority for these advances would be conditioned on the secured party acting without actual knowledge of the intervening creditor's interest. This change would reduce transaction costs and risk for secured parties without unduly inconveniencing judgment creditors.

Against buyers: The proposed new section 35(6.1) would make it clear that a buyer or lessee is not affected by the priority status given to future advances made with knowledge of the transfer to the buyer or execution of the lease.

Priority of unperfected security interests

Against the debtor's trustee in bankruptcy: After the model PPSA was drafted, the *Bankruptcy and Insolvency Act* was amended to delete the concept of relation-back from the date of a receiving order to the date of the petition as the effective date of bankruptcy. In order to maintain the effect of the original rule in section 20, it would be necessary to replace the current reference to the date of bankruptcy in section 20 with a

reference to the date of the initial bankruptcy event. This Report does not necessarily propose that change. Amended text is included merely to create an opportunity to reassess whether the date of filing a petition is the appropriate date for determining the effectiveness of an unperfected security interest against a trustee in bankruptcy.

Against buyers of tangible collateral: Proposed alternative A to section 20(3) would delete the requirement that a buyer must take without knowledge of an unperfected security interest to obtain priority. While this approach may seem radical, it would have the great advantage of eliminating difficult problems of proof and of protecting a buyer who, while being aware of a security interest in the relevant goods, honestly believes that the seller will discharge the security interest using the purchase price paid by the buyer. It also would remove an inconsistency in the current priority structure of the Act. It is clear that a secured party can gain priority under section 35 by acquiring and perfecting a security interest with full knowledge of a prior unperfected security interest. The same is true of an execution creditor who can gain priority over an unperfected security interest even though the creditor grants credit and enforces his or her judgment with full knowledge of the security interest. So why not also buyers?

Against buyers of intangible collateral: Proposed section 20(4) already appears in the current Saskatchewan and Atlantic PPSAs but not in the other Acts. Its purpose is to approximate the position of a buyer of an instrument or a security or the holder of a negotiable instrument under section 20(3) with the position of a transferee of the same type of property under sections 31(4)-(6). Under the latter sections, an ordinary course transferee takes free of the security interest even though the collateral was acquired with knowledge of it. In the absence of proposed section 20(4), a non-security transferee of property would be in a worse position when in competition with the holder of an unperfected security interest than a transferee of the equivalent property in competition with the holder of a perfected security interest. There can be no policy justification for this anomaly.

Priority of buyers of licences

Proposed new section 30(2.1) would extend the same protection to a transferee of a licence in the ordinary course of business that section 30(2) currently gives to ordinary course buyers and lessees of goods.

Priority repercussions of a failure to include a specific serial number description in a financing statement

The proposed addition of a reference to "consumer goods" in sections 30(7) and 35(4) are intended to change the priority repercussions of a failure to register a serial number description in a financing statement covering serial numbered goods where the goods are held by the debtor as consumer goods. Under the current scheme, failure to register by serial number is fatal to perfection in the case of consumer goods, whereas the priority repercussions of using a generic description are less drastic for equipment. In the latter case, the secured party is subordinated to a buyer for value without notice under section 30(7), and the security interest is treated under 35(4) as unperfected for the purposes of a competition between competing security interests. However, a generic description is sufficient for priority over a judgement creditor or a trustee in bankruptcy. In the view of the authors, this distinction lacks a sufficient policy rationale and introduces unnecessary complexity into the priority structure of the Act. It is therefore proposed to change the Act to authorize the optional use of a generic description for all serial numbered goods, subject to the risk of subordination, in the case of both consumer goods and equipment, to buyers and competing secured parties who have registered by serial number.

Priority in proceeds of money, a negotiable instrument, a security or a negotiable document of title

Proposed new section 31(6.1) would make it clear that the special priority position of a holder of money and a transferee of a negotiable instrument, a security or a negotiable document of title carries over to the proceeds of the property. There is no point in having priority in such forms of collateral if their conversion into proceeds (other than money which the secured party takes into possession thereby bringing itself within section 31(1)) results in the loss of that priority status.

Priority of new purchasers for value of chattel paper

Current section 31(7) distinguishes between the priority of non-inventory financiers and the priority of other secured parties as against a new purchaser for new value who takes possession of the chattel paper in the ordinary course of the purchaser's business. The proposed reformulation would eliminate this distinction thereby enabling inventory financiers to preserve priority in chattel paper which is proceeds of inventory by monitoring the debtor's handling of the paper to ensure that their name is inscribed on it as the purchaser. This change is a logical consequence of the adoption of 'marking' in section 24 as a method of perfection to accommodate the use of electronic chattel paper. It also reflects the authors' recognition that the concerns posed by the commercial financing patterns which existed when the distinction was first introduced are no longer present.

It is also proposed to include chattel paper purchasers within subsection 31(6). As a result of this change, a purchaser of chattel paper has knowledge sufficient to defeat its priority under subsection (7) only if the chattel paper is acquired with knowledge that the transaction violate the terms of the security agreement between the debtor and a prior perfected secured party. This change would not, however, eliminate 'marking' as a means for prior secured parties who are actively monitoring the debtors' chattel paper to preserve their priority claim in specific paper. Under the reformulated subsection (7), the purchaser would take priority only if the specific paper is not already inscribed with the name of a competing claimant.

Much more substantial changes to section 31 will be required on implementation of the proposed Uniform Securities Transfer Act.

Priority between a prior registered accounts financier and an inventory financier claiming priority in accounts as proceeds of inventory.

Different PPSA jurisdictions have adopted different policies on the issue of priority between a prior registered accounts financier and an inventory financier claiming priority in accounts as proceeds of inventory. Section

34(6) of the Model Act would award priority to the accounts financier. Section 34(6) is included in this report to signal to jurisdictions with the opposite rule (Ontario and the Atlantic provinces) the need to reconsider their approach. Giving priority to the purchase money inventory financier is not inappropriate in the context of true secured financing transactions. However, where the debtor has sold its accounts outright to a transferee who has perfected by registration, the policy is far less defensible especially in the light of the growth in securitisation transactions, which depend on the ability of the originator of the accounts to effect a secure sale of the securitised accounts. This concern could be met by adopting subsection 30(6) but confining its operation to a true sales of accounts (this likely would be held to be the intended result under the Ontario and Atlantic PPSAs even without an express rule). However, such a bifurcated approach encourages litigation on the appropriate characterization of the transaction. Consequently, it is suggested that consideration be given to adopting section 34(6) without any such qualification.

Priority effect of lapse or inadvertent or fraudulent discharge of registrations

The proposed new section 35(7.1) would relieve a secured party from any need to re-activate its perfected status, in order to maintain protection against prior subordinate interests, where a registration lapses or is fraudulently or inadvertently discharged after the secured party has begun enforcement measures.

Priority in the event of a corporate amalgamation

Proposed sections 35(10-(11) are designed to address the issue of priority that arises when two or more corporations which have given security interests in their existing and after-acquired property amalgamate and the "new "corporation acquires property that falls within the collateral description of the security agreements executed by the amalgamating corporations.

Protection of account debtors

Derived from article 9-209, proposed new subsection 41(10) would empower a debtor, on termination of a security relationship involving accounts or chattel paper, to require the secured party to send a written notice to any account debtor to whom a notice of the assignment has been sent, releasing the account debtor from any further obligations to the secured party.

Conclusion

If we are to maintain the current broad uniformity which exists among the Canadian PPSAs, it is necessary that there be some vehicle for disseminating ideas about desirable amendments for broad discussion. It is hoped that this Report, delivered as it is through the aegis of the ULCC, offers one such potential vehicle.

While the subject matter of the Report is of obvious direct interest to legislators and analysts in the common law provinces, the authors trust that some of the substantive and policy issues which are addressed will also be of interest to colleagues in the province of Quebec, in view of the commonalities which exist between many of the substantive and policy choices reflected in the Canadian PPSAs and in the Quebec Civil Code provisions on real security in movables.

Comments are welcome on the proposals for change which are made here, as are suggestions for what proposals might usefully be put forward in Part 2, which, as noted earlier, will deal with the provisions of the Model Act relating to registration, enforcement, and more general issues. Professor Cuming may be contacted at Professor Walsh may be contacted at

Section 2(1) – Definitions

( ) "account debtor" means a person who is obligated under an intangible or chattel paper.

COMMENT

This is not a new term or a new definition. It is currently contained in section 41(1). However, under the proposals which follow, the term is used in sections other than 41 (see proposed new s. 9(4) and proposed changes to s. 17(1) below). Consequently, it is suggested that the definition be moved to the general definition section.

( ) "authenticated" includes signed, or, where the writing to be authenticated is in the form of a data message, the use of a method which is as reliable as appropriate in the circumstances, including the purpose of the data message, to identify the authenticating person and to indicate that person's approval of the information contained in the data message to which the authentication relates.

COMMENT

1. The Act currently requires that certain notices, demands, consents etc. be communicated and evidenced in writing: see e.g. sections 18(1)(1), 18(2), 43(12), 59(10)(d), 59(16)(f), 62(1)(a)-(b), 64(4) and 64(5). It is implicit in these sections that the required writing be authenticated. Where appropriate, this report recommends this be made explicit by amending the relevant section to require authentication.

2. Authentication may pose concerns in cases where the required communication is effected electronically (a possibility which the definitions of "writing" and "data message" proposed below is designed to accommodate). The proposed definition of "authenticated" would confirm that authentication may include electronic methods of indicating the identity and approval of the authenticating party.

3. The proposed definition does not specify any particular method of authentication so as to accommodate ongoing technological changes without the need for further legislative amendment. A relative, practice-oriented, standard is adopted to assess the sufficiency of a particular method. It need be only as reliable as appropriate in the circumstances including the purpose of the communication to which the authentication relates.

3. The proposed definition is relevant to the changes proposed below to section 10(1). Under the current wording, a security interest is enforceable against third parties only where the debtor has “signed” a security agreement which describes the collateral. It is proposed to change “signed” to “authenticated”. This change would authorize the use of authenticated electronic data messages for the purposes of compliance with section 10(1).

(*f) "chattel paper" means one or more writings that evidence both a monetary obligation and:*

(i) a security interest in, or lease of, specific goods; or

(ii) a security interest in specific goods and accessions;
or, where the context permits, "electronic chattel paper."

COMMENT

See the proposed definition of “electronic chattel paper” and the comments on the proposed changes to sections 24 and 31 below.

(g) "collateral" means personal property that is subject to a security interest and, where the context permits, includes:

(i) proceeds, and

(ii) a supporting obligation;

COMMENT

1. Proposed clause (i) of the definition of “collateral” would confirm what is now understood; i.e. that collateral includes proceeds as elsewhere defined in section 2(1) to which a security interest extends under section 28(1).

2. Proposed clause (ii) would confirm that a reference anywhere in the Act to “collateral” automatically includes any related supporting obligation if the collateral is one of the types specified in the definition of "supporting obligation" proposed below. See further the comment on that definition.

(l) "crops" means crops, including aquatic crops, whether matured or otherwise, and whether naturally grown or planted, attached to land by roots including underwater land or forming parts of trees or plants attached to land, and includes trees only if they:

(i) are being grown as nursery stock;

(ii) are being grown for uses other than the production of lumber or wood products;

(iii) are intended to be replanted in another location for the purposes of reforestation;

COMMENT

The proposed addition of a reference to "aquatic crops" and "underwater land" in the definition of "crops" would clarify explicitly that the Act applies to crops produced in aquacultural operations. The proposed deletion of the requirement that crops be attached to land "by roots" would recognize that this requirement is inappropriate for aquatic crops which lack roots.

( ) "data message" means information contained in a communication which is generated, sent and received by electronic, optical or similar means including, but not limited to, electronic mail, telegram, telex, telecopy and electronic transfer from computer to computer using an agreed standard to structure the information.

COMMENT

1. The proposed definition of "data message" should be read along with the proposed definitions of "writing" and "authenticated." These new definitions are designed to accommodate the use of electronic communications and electronic authentication in situations where the current wording of the Act might imply that a tangible writing or a conventional signature is required.

1. Although these provisions would not be strictly necessary in a province or territory which enacts the ULC Uniform Electronic Commerce Act, it

would be in keeping with the comprehensive character of PPSA legislation for jurisdictions to accommodate technological change directly in the Act.

(m) "debtor" means:

(i) in a provision dealing with the obligation secured, a person, including a guarantor or other secondary obligor, who owes payment or performance of an obligation secured by a security interest pursuant to a transaction referred to in subsection 3(1), whether or not that person owns or has rights in the collateral;

(ii) in a provision dealing with the collateral, a person who owns or has rights in collateral, and who has given or has agreed to give a security interest in that collateral pursuant to a transaction referred to in subsection 3(1), whether or not that person otherwise owes payment or performance of the obligation secured;

(iii) where the context permits, both of the persons referred to in clauses (i) and (ii);

(iv) where the context permits, a transferor of an account or chattel paper, a consignee, and a lessee [and a buyer] pursuant to a transaction referred to in subsection 3(2); and

(v) in sections 17, 24, 26 and 58, subsections 57(3), 59(14), 61(7) and 64(3) and section 65, the transferee of a debtor's interest in the collateral; or

(ii) a person who receives goods from another person pursuant to a commercial consignment;

(iii)a lessee pursuant to a lease for a term of more than one year;

(iv) a transferor of an account or chattel paper;

(vi) if the person mentioned in subclause (i) and owner of the collateral are not the same person:

(A) where the term "debtor" is used in a provision dealing with the collateral, an owner of the collateral;

(B) where the term "debtor" is used in a provision dealing with the obligation, the obligor; and

(C) where the context permits, both persons;

COMMENT

1. The proposed changes would clarify the intent of the current definition of "debtor". Current clauses (i) and (v) are re-cast as new clauses (i), (ii) and (iii). Current clauses (ii), (iii) and (iv) are recast as new clause (iv) The reference to a guarantor or other secondary obligor in new clause (i) would makes explicit what is implicit in the current wording.

1. The square-bracketed reference to a "buyer" in proposed clause (iv) reflects a local variation: i.e. the inclusion a "sale of goods without a change of possession" as a deemed secured transaction in the Atlantic PPSAs (see further the definition of this term in the Atlantic Acts).

( ) "electronic chattel paper" means chattel paper evidenced by an authenticated writing which contains verifiable data stored in an electronic medium and not otherwise evidenced;

COMMENT

The definition proposed above is meant to expressly accommodate both tangible and electronic forms of chattel paper. See further the comments below on the proposed changes to section 24 and 31.

(u) "goods" means tangible personal property, fixtures, crops, and the unborn young of animals and includes aquatic goods produced in aquacultural operations and a computer program embodied in or accompanying the goods that is ordinarily considered part of the goods or that is an aspect of making the goods functional, but does not include chattel paper, a document of title, an instrument, a security, money or trees, other than trees that are crops, until they are severed or minerals until they are extracted.

COMMENT

1. The proposed addition of an explicit reference to a computer program in the definition of "goods" is designed to eliminate any doubt that goods includes any computer program used in the goods and ordinarily considered to form part of them or to be integral to their operation. Many programs are designed specifically for particular goods. The proposed definition would eliminate any perceived necessity under the existing law to take separate security interests in the goods and the accompanying computer program.

2. The proposed addition of the words "aquatic goods produced in aquacultural operations" is intended to eliminate any existing doubt that aquatic 'livestock' (e.g. farmed salmon) and aquatic crops (e.g. dulse) are included in the current definition of "goods".

( ) "intangible" means personal property that is not goods, chattel paper, a document of title, an instrument, money or a security, and includes a licence;

COMMENT

1. The Saskatchewan PPSA, from which the proposed wording is taken, is the only Canadian PPSA to explicitly include "a licence" within the definition of "intangible." "Licence" is then defined in the Saskatchewan Act to mean: "a right, whether or not exclusive, (i) to manufacture, produce, sell, transport, or otherwise deal with personal property; or (ii) to provide services; that is transferable by the grantee with or without restriction or the consent of the grantor."

1. It is proposed that these definitional clarifications be added to the Model Act for potential incorporation in all the Canadian PPSAs. This would eliminate any doubt that the "personal property" in which a security interest under the PPSA can be taken includes rights under, e.g. an agricultural production quota, notwithstanding that transfer of the right is restricted or subject to the prior consent of the licensing authority.

1. This proposal reflects the consensus among Canadian common law analysts on the appropriate resolution of the issue. It also accords with judicial policy with the exception of a more restrictive line of cases in the Ontario courts. However, the Ontario cases have generated extensive

criticism, and the more recent decisions from that province reflect some regret and an attitude of gradual liberalization. The proposed clarifications would eliminate any further controversy. See further G.T. Johnson, "Discretionary Licenses as Collateral" (1988-89) 3 B.F.L.R. 63; T. Johnson, "Security Interests in Discretionary Licenses under the Ontario Personal Property Security Act" (1993) 8 B.F.L.R. 123; R.M. Mercier, "Saskatoon Auction Mart: Milk Quotas and finally Some Commercial Reality" (1993) 22 Can. Bus. L. J. 466.

1. The purpose of the proposed changes is merely to ensure that a debtor can employ rights under a licence as effective collateral under a PPSA security agreement. In other words, the proposal would not impede the powers of a licensing authority, under the statutory scheme regulating the licence, to restrict transfer of the licence or condition transfer on its consent. Nor would it obligate the grantor to recognize the secured party as the new licensee.

1. This point is clarified by proposed new section 9(5) below under which a statutory provision which restricts or requires the consent of the grantor to the transfer of a licence, or the creation of a security interest in a licence, is declared ineffective but only to the extent that the provision would prevent attachment of a PPSA security interest in the license.

1. In addition, while section 57(3) of the current Saskatchewan Act empowers a secured party to enforce a security interest in a licence by giving notice to the licensee and licensor, section 58(18) then stipulates that the licensee's rights may be disposed of only in accordance with the terms and conditions under which the licence was granted or which otherwise pertain to it. Part 2 of this Report will contain proposals to incorporate equivalent provisions into the Model Act.

1. It should be emphasized that this proposal would not permit a security interest to be taken in a licence where the statute regulating the license prohibits the transfer or the creation of a security interest in the licence. Under the definition of licence proposed below, rights under the license must be "transferable". In this respect, the proposal does not go as far as revised article 9-408 under which it is possible to create an effective

security interest in equivalent rights even where the statute regulating the right imposes an absolute prohibition on transfer. Since the grantor of the licence could not be affected adversely by the security interest (because article 9 protects the grantor in a manner similar to the PPSA as outlined in comment 4 above), the U.S. drafters felt that there was no rational basis for restricting the effectiveness of a security interest in the license.

1. The authors of this report do not share the same view. If a license is entirely non-transferable, it is generally because the legislature has determined, as a matter of public policy, that the rights embodied in the licence are wholly personal to the holder (a physician's licence to practice being the quintessential example). To permit the holder to give a security interest in such a license would give the secured party a measure of *de facto* control over the debtor's exercise of his or her rights which may conflict with the public policy basis for the personal character of the license.

( ) "licence" means a right, whether or not exclusive:

(iv) to manufacture, produce, sell, transport, or otherwise deal with personal property; or

(ii) to provide services;

that is transferrable by the grantee with or without restriction or the consent of the grantor;

COMMENT

See comment on proposed amendment to the definition of "intangible" above.

(hh) "proceeds" means:

(iv) identifiable or traceable personal property, fixtures or crops, in which the debtor acquires an interest:

(A) that are derived directly or indirectly from any dealing, whether by sale, lease, licence, exchange or disposition,with collateral; or the proceeds of collateral;

(B) in which the debtor acquires an interest;

(B) to the extent of the value of the collateral and to the extent payable to the debtor or to the secured party, a right to an insurance payment or any other payment as indemnity or compensation for loss of or damage to the collateral, or proceeds of the collateral for interference with the use of the collateral, for non-conformity of or defects in the collateral or for infringement of rights in the collateral;

(ii a payment made in total or partial discharge or redemption of an intangible, chattel paper, an instrument or a security; and

(iv) value that is collected on or distributed on account of collateral;

but does not include animals merely because they are the offspring of animals that are collateral;

COMMENT

1. The proposed additions to the definition of "proceeds" are designed to make its scope more explicit by clarifying that proceeds include rights to compensation for non-conformity of or defects in the collateral, for interference with the use of the collateral or for infringement of rights in the collateral.

1. The proposed new reference to "value that is collected on or distributed on account of collateral" would confirm that proceeds includes dividends distributed on account of investment property that is collateral.

1. The proposed deletion of the term "proceeds of collateral" in revised sub-clauses (A) and (B) is explained by the proposed addition of "proceeds" to the definition of "collateral" above.

(jj) "purchase-money security interest" means;

(i) a security interest taken in collateral to the extent that it secures all or part of its purchase price;

(ii) a security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights;

(iii) the interest of a lessor of goods pursuant to a lease for a term of more than one year; or

(iv) the interest of a consignor who delivers goods to a consignee pursuant to a commercial consignment;

but does not include a transaction of sale and the lease back to the seller and, for the purposes of this clause, "purchase price" and "value" include credit charges and interest payable for the purchase or loan credit;

(jj) "purchasemoney security interest" means:

(i) a security interest taken in collateral to the extent that it secures all or part of its purchase price;

(ii) a security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights;

(iii) a security interest in collateral referred to in sub- clauses (A) or (B) taken under an agreement providing for the renewal, refinancing, or restructuring of an obligation referred to in sub-clauses (A) or (B);

(iv) the interest of a lessor of goods pursuant to a lease for a term of more than one year; or

(v) the interest of a consignor who delivers goods to a consignee pursuant to a commercial consignment;

but does not include a transaction of sale and the lease back to the seller and, for the purposes of this definition, "purchase price" and "value" include credit charges and interest payable for the purchase or loan credit;

and, when the collateral is inventory, a puchase money security interest

(vi) secures any obligation arising out of a related transaction creating an interest referred to in clause (i) or (ii);

(vii) extends to other inventory in which the secured party holds or held a security interest under a related transaction that secures or secured an obligation referred to in clause (i) or (ii);

and for the purposes of sub-clauses (vi) to (vii), a transaction is related to another transaction when the possibility of both transactions is provided for in the first transaction or a prior agreement between the parties;

COMMENT

1. Extensive additions are proposed to the current definition of "purchase money security interest" necessitating the re-numbering of the paragraphs within the definition. The current definition appears above, followed by the proposed expanded definition.

1. The proposed new clause (iii) is designed to remove any suggestion that purchase money status is lost when a purchase money obligation is refinanced or restructured. The purchase money status would be retained in the original purchase money collateral. However, pmsi status would not extend to any new non-purchase-money collateral brought into the refinancing or restructuring. Nor would purchase money status apply to any new money or value given to the debtor over and above that used to reduce or eliminate the existing purchase money obligation.

1. The proposed new clauses (vi) and (vii) are intended to deal with the problem of cross-collateralized purchase money security interests in inventory. As a matter of strict statutory interpretation, cross-collateralization would not appear to be possible under the current definition of "purchase money security interest". Under the current definition, the only security interest that qualifies is one "taken in collateral... to the extent that it secures all or part of the purchase price of the collateral" or one "taken in collateral (to secure value)... to the extent the value is applied to acquire the collateral." This wording suggests that a purchase money security interest in collateral is strictly proportionate to the extent it secures the price of the collateral or the value used to acquire the collateral.

1. A secured party can, in some situations, accomplish a degree of cross-collateralization through payment allocation. Where there are two or more "pooled" pmsi obligations, the security agreement can provide that

any payment made by the debtor is allocated to each obligation in proportion to the amount of the obligation, with the result that at all times the secured party has a pmsi in all collateral so long as any amount remains owing.

1. There is, however, a basis in decisions of the Saskatchewan Court of Appeal for the conclusion that the courts are prepared to recognize (or, more accurately, to overlook) some degree of cross-collateralization without the need to use payment allocation.

1. In *Battlefords Credit Union Limited v. Ilnicki*, [1991] 5 W.W.R. 673, the Credit Union made a consolidation loan to Ilnicki. The purpose of the loan was to pay several earlier secured purchase money obligations owing to other creditors and an earlier secured purchase money obligation owing to the Credit Union. All of the creditors had purchase money security interests in one or more of 15 items of property that were taken as collateral under the consolidation loan. The Court extended its established position [taken in *Bank of Montreal v. Tomyn* (1989), 84 Sask. R. 253, affirmed (1990), 87 Sask. R. 4 which involved consolidation of several purchase money loans made by the bank providing the consolidation loan] by ruling that the Credit Union acquired, under the security agreement providing for the consolidated loan, a purchase money security interest in the 15 items. The Court concluded that the consolidation loan enabled Ilnicki to "acquire rights in or to" the items within the meaning of the definition of purchase money security interest. It enabled him to rid the items of the purchase money security interests held by the prior creditors. His bundle of rights was thereby added to; his ownership was incomplete before, but complete the moment that these security interests were eliminated.

1. While the issue of cross-collateralization was not raised by counsel or addressed by the Court, one might read into the decision the conclusion that it is not relevant to inquire as to the extent that the value of each item of collateral exceeded or was less than the amount owing to the prior lender who was paid out by the Credit Union. The reason is that there was only one purchase money security interest — the one held by the Credit Union. Nonetheless, the Court concluded that the Credit Union had a

purchase money security interest to the full amount of the consolidation loan. This conclusion implicitly suggests that Canadian courts may not be too demanding when it comes to demonstrating a one-to-one relationship between the collateral and obligation in order to establish a purchase money security interest.

2. The effect of this conclusion is displayed in the following scenario. Assume that only two loans were consolidated. The balance owing on the first loan was $500 and the collateral securing it was worth $1000. The second loan was for $3000 and the value of the collateral securing it was $2000. The total of the consolidated loans would be $3500 and the total value of the collateral would be $3,000. Under the position taken by the Court, the Credit Union would have a security interests in both items of collateral so long as any part of the total of $3500 of refinanced debt remained unpaid. In effect, any security interest in the first item of collateral secures on a purchase money basis debt owing on the second item.

1. In *Farm Credit Corp. v. Gannon*, [1993] 6 W.W.R. 736, 5 P.P.S.A.C. 52, the Saskatchewan Court of Queen's Bench concluded that, when applying the principle established by the Court of Appeal in *Ilnicki*, *supra,* the court will not give any significance to the way in which the money supplied by the consolidation lender is applied by the recipients of the loan. In this case, the recipient of the refinancing loan had applied other money supplied by the debtor to the debt incurred in purchasing the collateral. Only a small part of the consolidation loan was applied to this obligation. The same approach was taken in *Sask. Wheat Pool v. Polowick* (1994), 6 P.P.S.A.C. 391 (Sask.Q.B.).

1. It is clear, therefore, at least in Saskatchewan, that consolidation of existing purchase money obligations, whether owed to the lender providing the consolidation loan or to other creditors who are being paid out, does not preclude the consolidation lender from having a purchase money interest in the collateral to secure the entire debt. This is so even though the effect may be to provide an element of cross-collateralization.

1. However, the approach taken by the Saskatchewan Court of Appeal would not facilitate the use of a security agreement that provides for prospective consolidation of advances, each secured by a purchase money security interest in collateral acquired with the advances. The Credit Union in the *Ilnicki* case was able to find a purchase money security interest in all of the collateral because the Court concluded that a new purchase money security interest was created by the security agreement that provided for the consolidation of the other debts. Where there is no pay out of prior security interests, this same approach cannot be used.

1. The proposed addition to the definition would expand the circumstances in which pmsi cross-collateralization is allowed (although the "related transaction" limitation addressed below would not permit cross-collateralization in the circumstances present in the *Ilnicki* case*)*. The operation of the proposed changes is demonstrated in the following scenarios:

Scenario 1:

June 1: Debtor entered into a security agreement with SP1 giving it a security interest in "all present and after-acquired property." A registration was effected.

July 1: Debtor entered into an inventory financing agreement with SP2 providing for a series of loans over a period of time to allow Debtor to purchase inventory. A registration was effected. The agreement provided that SP2 would have a security interest in the inventory. It also provided that, as each loan was made, the amount of the loan would be consolidated with amounts then owing and that the security interest in the inventory would secure the entire amount owing. Debtor was required to make payments every 30 days amounts that would be set according to the amount outstanding during the previous payment period.

August 1: Loan 1 in the amount of $10 was made and used by Debtor to purchase widgets. (Loan 1 Widgets)

August 25: Debtor sold the Loan 1 Widgets.

August 30: Debtor made the first payment ($5) as required by the agreement. [Note that at this point, SP2 did not have a security interest to protect the remaining $5 that was owing].

September 1: Loan 2 in the amount of $10 was made and used by Debtor to purchase widgets. (Loan 2 Widgets)

September 30: Debtor made a payment of $10 as required by the agreement.

October 1: Debtor became insolvent and terminated business.

At the date of insolvency, Debtor owed $5. Assume that at this point the Loan 2 Widgets are worth $10. The issue is whether or not this debt is secured by a purchase money security interest in Loan 2 Widgets. SP1 claims priority on the basis of having first effected a registration.

Under the terms of the agreement, the $10 was simply applied to the then existing $15 debt reducing it to $5. In effect, the payment was allocated to the amounts proportionally: $3.34 to the Loan 1 obligation and $7.33 to the Loan 2 obligation. The issue is whether the balance of collateral value in the Loan 2 Widgets can be treated as securing (on a purchase money basis) the $1.66 notionally owing for Loan 1. In other words, can the Loan 1 obligation be cross-collaterally secured with the purchase money security interest in the Loan 2 Widgets?

The proposed change has been designed to permit this since the amount owing under Loan 1 is an *obligation arising out of a related transaction creating an interest referred to in clause (i) or (ii).* The point is that, so long as an obligation was once a purchase money obligation, it can be secured by a purchase money security interest securing any other purchase money obligation owing by the same secured party arising under a related transaction.

Scenario 2:

June 1, Debtor entered into a security agreement with SP1 giving it a security interest in “all present and after-acquired property”. A registration was effected.

July 1, Debtor entered into an inventory financing agreement with SP2 providing for a series of loans over a period of time to allow Debtor to purchase inventory. A registration was effected. The agreement provided that SP2 would have a security interest in the inventory. The agreement also provided that as each loan is to be repaid as soon as the collateral purchase with the loan has been sold. It also provides that the security interest in any of the collateral secures any amount owing by Debtor to SP2.

August 1, Loan 1 in the amount of $10 was made and used by Debtor to purchase widgets. (Loan 1 Widgets)

August 10, the Loan 1 Widgets were sold by Debtor. [Note that at this point, SP2 had no security interest in the Loan 1 Widgets.] Debtor failed to repay the August 1 loan.

August 15, Loan 2 in the amount of $10 was made and used by Debtor to purchase widgets. (Loan 2 Widgets).

August 20, the Loan 2 widgets were sold and the consideration was partly cash and partly the value of used widgets traded in by customers of Debtor.

August 21, Debtor paid to SP2 the amount of Loan 2 with the result that this loan was discharged.

September 30, Debtor became insolvent.

At the date of insolvency Debtor owed $10 to SP2 which is the amount of the unpaid Loan 1. The issue here is whether or not SP2 has a purchase money security interest in the traded in proceeds widgets to secure Loan 1. SP1 claims priority on the basis of its first in time registration.

The Saskatchewan Court of Appeal in *Chrysler Credit Canada Ltd. v. Royal Bank*, [1986] 6 W.W.R. 338 (Sask.C.A.) concluded that SP2 would have priority. In effect, the Court concluded that the purchase money security interest in the traded-in widgets survived the discharge of Loan 2, the loan that was secured by the purchase money security interest in the Loan 2 widgets sold by Debtor. This conclusion was thought to be unacceptable

and inconsistent with the concept of purchase money security interest and was specifically reversed by section 34(10) of the SPPSA.

The proposed addition to the definition would allow SP2 to claim a purchase money security interest in the Loan 2 widgets to secure the Loan 1 obligation. *However, this does not extend as well to the proceeds of the sale of the Loan 2 widgets.* A purchase money security interest referred to in clauses (i) and (ii) is a security interest in original collateral and not proceeds collateral. The value must relate to the acquisition of the collateral. This does not include proceeds. This would preclude the result reached by the Saskatchewan Court of Appeal in the *Chrysler Credit* decision and confirm the approach taken in section 34(10) of the SPPSA.

Scenario 3:

June 1, Debtor entered into a security agreement with SP1 giving it a security interest in "all present and after-acquired property". A registration was effected.

July 1, Debtor entered into an inventory financing agreement with SP2 providing for a series of loans over a period of time to allow Debtor to purchase inventory. A registration was effected. The agreement provided that SP2 would have a security interest in the inventory. It also provided that as each loan is made the amount of the loan is consolidated with amounts then owing and that the security interest in the inventory would secure the entire amount owing. Debtor was required to make payments every 30 days of amounts that would be set according to the amount outstanding during the previous payment period.

August 1, Loan 1 in the amount of $10 was made and used by Debtor to purchase widgets. (Loan 1 Widgets)

August 30, Debtor paid $10 as provided in the agreement. [Note that at this point, SP2 had no security interest in the Loan 1 Widgets]

September 2, Loan 2 in the amount of $10 was made and used by Debtor to purchase widgets. (Loan 2 Widgets).

The Loan 2 Widgets depreciate in value so that at the date of Debtor's insolvency they are worth $5.

September 30, Debtor became insolvent and terminated business.

The issue here is whether, as a result of the agreement, SP2 has a purchase money security interest in the Loan 1 Widgets that secures the $5 still owing in connection with the purchase of the Loan 2 Widgets. The proposed change in the definition would recognize that it does. The proposed addition provides that the Loan 2 obligation, being a purchase money obligation, is secured by other inventory *in which the secured party holds or held a security interest under a related transaction that secures or secured an obligation referred to in clause (i) or (ii).* The Loan 1 Widgets are inventory in which the secured party held a security interest under a related transaction that secured an obligation referred to in clause (i) or (ii).

1. The proposed changes to the pmsi definition embodies the conceptual approach contained in UCC 9-103(b) but is more limited in that it restricts cross-collateralization to a "related" transaction. The new concept of cross-collateralization would give a pmsi financier priority with respect to any collateral that was formerly subject to a pmsi to secure undercollateralized debt arising under separate pmsi transactions. This is legitimate where there is some relationship between the two pmsi transactions. However, where the transactions are unrelated, general 'background' lenders might be reluctant to extend secured financing to small businesses without assurance that their debtors' interests in property formerly subject to pmsis will not be subject to new pmsis created under entirely separate transactions entered into after the original pmsi has been paid out. In order for this concern to be addressed, it is necessary to preclude ex post facto consolidation of pmsi obligations. In other words, it would not be possible for the parties to enter into a consolidation agreement providing full crosscollateralization of obligations arising under prior separate agreements (as was done in the *Ilnicki* case *supra*). This is a legitimate restriction. If the parties contemplate a continuing relationship, this should be established from the beginning. The law should facilitate crosscollateralization where there

is a continuing relationship that involves pmsis so that the secured party need not keep separate accounts for each separate subtransaction as the current definition requires. Beyond this, there is a risk of prejudice to prior secured creditors of the same debtor.

(nn) "secured party" means:

(i) a person who has a security interest in whose favour a security interest has been created or provided for pursuant to a transaction referred to in subsection 3(1), whether for that person's benefit or for the benefit of another person;

(ii) a person who holds a security interest or for the benefit of another person; or

(iii) (ii) a trustee, where a security interest is embodied or provided for in a trust indenture; or

(iii) where the context permits, a transferee of accounts or chattel paper, a lessor, and a consignor [and a seller] pursuant to a transaction referred to in subsection 3(2).

COMMENT

1. The proposed terminological changes in clauses (i) and (ii) are designed to eliminate any implication that a person is a secured party for the purposes of applying the provisions of the Act only after a security interest has come into existence.

2. The above proposal also deletes clause (ii) of the existing definition and incorporates its substantive thrust into revised clause (i).

2. The changes proposed above are also intended to directly alert the reader to the fact that the term "secured party" in the PPSA includes both secured parties in the true sense and secured parties under a deemed security transaction. This is the purpose of new clause (iii) and the new reference in clause (i) to a secured party under a section 3(1) transaction. Under the current definition, the same substantive result is effected indirectly by a cross-reference in clause (i) to the term "security interest" which is defined to include both true and deemed security interests.

2. The square-bracketed reference to a "seller" in new clause (iv) reflects a local variation (i.e. a seller under a "sale of goods without a change of possession" is a deemed secured party in the Atlantic Province PPSAs: see further the definition of this term in the Atlantic Acts).

(qq) "security interest" means:

(i) if the interest arises under a transaction referred to in subsection 3(1), an interest that secures payment or performance of an obligation, but does not include . . .

(ii) if the interest arises under a transaction referred to in subsection 3(2), the interest of:

(A) a transferee pursuant to a transfer of an account or a transfer of chattel paper;

(B) a consignor who delivers goods to a consignee pursuant to a commercial consignment;

(C) a lessor pursuant toa lease for a term of more than one year;

[(D) a buyer under a sale of goods without a change of possession];

whether or not the interest secures that does not secure payment or performance of an obligation.

COMMENT

1. The proposed addition of a cross-reference to sections 3(1) and 3(2) in clauses (i) and (ii) of the current definition of "security interest" would clarify that the reference to "security interest" in section 3(1) is confined to a 'true' security interest as defined in clause (i), and that clause (ii) relates solely to the 'deemed' secured transactions in section 3(2).

1. The proposed change to the concluding words of clause (ii) already has been made in the Atlantic PPSAs. This change is intended to eliminate any potential for overlap between a 'true' security interest as defined in clause (i) and the deemed security interests listed in paragraph (ii). The proposed

change would bring clause (ii) into line with the concluding words of section 3(2) of the Act where the relevant change already has been made.

1. The square-bracketed reference to a "sale of goods without a change of possession" in new clause (iv) reflects a local variation: i.e. the inclusion of the non-possessory interest of a buyer of goods as a deemed security interest in the Atlantic PPSAs (see further the definition of "sale of goods without a change of possession" in these Acts).

( ) "supporting obligation" means a secondary obligation that supports the payment or performance of an intangible, chattel paper, a document of title or an instrument.

COMMENT

1. "Supporting obligation" is a proposed new term defined to mean guarantees and other secondary obligations taken to support a primary obligation associated with an intangible, chattel paper, a document of title or an instrument. The express recognition of "supporting obligations" would confirm the principle, implicit in current law, that a supporting obligation is an automatic incident of the collateral it supports.

1. Although the proposed definition is similar to that found in revised article 9-102, this report does not propose specific rules to govern the attachment, perfection, and priority status of supporting obligations equivalent to those found in revised articles 9-203, 9-308, 9-310 and 9-322. As noted above, it is instead proposed to revise the definition of "collateral" to include a "supporting obligation" so that a reference anywhere in the Act to "collateral" would include any supporting obligation associated with that collateral. Under this approach, attachment and perfection of a security interest in a supporting obligation would occur automatically on the attachment and perfection of a security interest in the collateral to which the supporting obligation relates, and the priority status of the supporting obligation would follow that of the related collateral.

(uu) "writing" and "in writing", except in sections 2(o) [document], 2(v) [instrument] and 2(oo)[security] include a data message, if the information contained therein is accessible so as to be usable for subsequent reference.

COMMENT

See the comments above on the proposed new terms "authenticated" and "data message."

Sections 2(5) and 2(6) – Distinction between 'True' Leases and 'Security' Leases

(*5) Unless the relevant circumstances clearly indicate otherwise, a transaction in the form of a lease is a security agreement if:*

(a) the period of the lease is substantially equal to or greater than the period during which the property is suitable for the purposes for which it was designed and the period cannot be terminated at the election of the lessee;

(b) upon the expiry of the one or more initial periods, the lessee is bound to renew the lease for the balance of the period during which the property is suitable for the purposes for which it was designed or is obligated to purchase the property;

(c) at the expiry of one or more initial periods, the lessee has the option to renew the lease for the balance of the period during which the property is suitable for the purposes for which it was designed for no additional value or for a value that is significantly below the market lease rate for the property at the time the option is exercised, unless the market lease rate is greater than the amount payable by the lessee under the option because of changes in the market for the property that could not reasonably have been contemplated by the parties at the time of execution of the lease;

(d) at the expiry of one or more initial periods, the lessee has the option to become the owner of the property for no additional consideration or for a consideration that is significantly below the fair market value for the property at the time the option is exercised, unless the fair market value is greater than the amount payable by the lessee under the option because of changes in the

market for the property that could not reasonably have been contemplated by the parties at the time of execution of the lease;

(e) prior to execution of the lease, the property was owned and used by the lessee and thereafter sold to the lessor;

(f) at the expiry of one or more initial periods the leased property is to be sold and the lessee, whether or not entitled to be paid a surplus, is obligated to pay to the lessor a deficiency, when the deficiency or surplus is calculated by comparing the amount recovered from the sale and an amount specified in the contract.

(6) The following factors, without more, shall not be considered as indicating a security lease:

(g) the present value of the lease payments is equal to or greater than the fair market value of the property at the time of execution of the lease;

(h) subject to subsections (5)(c) and 5(d), the lessee has an option to renew the lease or to become the owner of the property.

COMMENT

1. Neither the Model Act nor any other Canadian PPSA contains guidelines equivalent to UCC §1-201(37) for determining when a lease is in substance a security agreement. Generally this has not been a problem for two reasons. First, all PPSA jurisdictions except Ontario, subject true leases of a specified duration to the perfection and priority rules of the Act. This leaves a very small area (enforcement) for disputes to arise over the characterization issue. Second, the Canadian courts, for the most part, have shown themselves to be adept in applying the PPSA substance test to the characterization issue. However, some have not made the transition in their thinking. In addition, there is no provincial court of appeal that has directly addressed the issue and the potential remains for a fundamental misunderstanding of the conceptual underpinnings of the system as occurred in the British Columbia Court of Appeal decision in *Re Giffen* (1966), 16 B.C.L.R. 29 (reversed on appeal to the Supreme Court of Canada (1998), 155 D.L.R. (4th) 332).

1. The proposed new provision generally tracks UCC §1-201(37) with one notable exception. There is no equivalent in the UCC to proposed subsection (5)(f). The omission is difficult to explain. The bulk of case law in the United States has characterized open-end leases as security agreements. See the discussion of open-end leases in comment 7.

1. It is not possible to prescribe a 'formula' that will in all cases resolve the issue of whether a lease is a security lease or a 'true' operating lease. Any particular lease contract may have characteristics of each type of transaction. What is required is to balance the factors that point to a true lease against those that point to a security lease and to make the determination on the basis of which set of factors predominates. The formulation set out in the proposed provision would create an irrefutable presumption that a transaction in the form of lease is a security agreement if, in the absence of countervailing factors, the agreement is in a form that falls within one of the clauses of the subsections.

4. One of the basic features of a secured contract for the sale of movables is that ownership in the property is transferred to the buyer upon performance of his or her obligations under the contract. While the presence of terms in a transaction under which the lessee is obligated to buy and the lessor is obligated to sell the property inevitably results in the transaction being characterized as a security lease, it does not follow that the absence of such terms dictates the conclusion that the transaction is a true lease and not a security lease. Passage of ownership or title in a technical sense should not be relevant to characterization under section 3. However, ownership in a non-technical sense is. If the practical effect of a transaction labelled a lease is to give the lessee most of the incidents of ownership but not legal title, the transaction is in substance a security lease. The primary incidents of ownership relevant in this context are: (i) use of the property for its full or substantially all of its useful life (*i.e.*, the balance of the period during which the property is suitable for the purposes for which it was designed), generally accompanied by an obligation to pay the equivalent of at least the capital cost of the property plus the cost of the money invested in it by the lessor), (ii) the acquisition

of a substantial "interest" in the property, and (iii) the loss or gain from unusual depreciation or appreciation in the value of the property.

5. If the lessee is required to pay what is the equivalent of the lessor's capital investment plus a credit charge at the rate existing at the date of the agreement, it does not follow that a security lease is involved. The lessee may simply have agreed to pay a premium for use of the leased equipment. However, a clause in a lease giving the lessee the option to purchase the property at less than its expected market value (as determined at the date of execution) indicates that the lessee has acquired an equity in the property not unlike that which it would have acquired under a purchase contract. The economic reality is that it is quite predictable the lessee will pay this amount to the lessor. Consequently, the transaction is a security lease. However, the fact that at the end of a lease term roughly equivalent to the useful life of the property the lessee can purchase the property at its then market value does not prevent characterization of the transaction as a security lease. A consideration of the option price is relevant to the characterization of the transaction only if the option can be exercised at a time when the property has a significant commercial value.

6. Some leases provide that rental payments made up to the point when the option is exercised are to be "credited" to the lessee and deducted from the amount payable under the option. Under a substance test, the amount "credited" to the lessee has little significance; it remains necessary to determine if the amount of new money to be paid by the lessee represents the reasonably expected fair market value of the property at the time of exercise of the option. If the new money is equal to or near the market value of the property, the "credit" is of no significance. If the amount of new money is significantly less than the market value of the property, the term providing for the credit is an overt recognition that the lessee has purchased an "equity" in the property through its lease payments. It is inevitable that, as a rational person, the lessee will exercise the option in order to realize that equity.

7. One of the more popular types of leases currently in use is the "open-end" lease. While a variety of different provisions are used in these leases,

the general pattern is to fix the term for a period less than the useful life of the property. The lease provides that at the end of the term the property will be returned to the lessor who will then sell it. The lessee may purchase the property from the lessor at its appraised value. Whether the lessee or a third person buys the property, the lessee agrees to pay the lessor the difference between the amount recovered by the lessor on the sale of the property and a predetermined amount specified in the lease. If the sale yields more than this amount, the surplus is to be paid to the lessee. Since the term is for less than the useful life of the property and it is not predictable, as a matter of economic realities, that the lessee will purchase the property at the end of the lease term, one might conclude that this type of transaction is a true lease. However, when other aspects of an open-end lease are examined, it becomes clear that the transaction is more properly characterized as a security lease. Under an open-end lease, the lessor has no right to retake the leased property and assert ownership over it at the end of the lease term. The property is returned to the lessor at the end of the term solely for the purpose of sale. Any unusual depreciation or appreciation of the property while it is in the hands of the lessee accrues to the lessee and not the lessor. Accordingly, the lessee is the person who has the "equity" in the property; it is the one who is affected by the price obtained upon sale of the property by the lessor.

7. The fact that the lessee bears some of the obligations of ownership, such as the requirement to repair and insure the property, provides some, but only weak, evidence of a security lease. These factors are not of sufficient weight to be mentioned in the statutory list of factors.

Section 2(7) – Inter-jurisdictional Harmonization

2(7) This Act is to be interpreted and applied, insofar as the context permits, in a manner which promotes the inter-jurisdictional harmony of the law of personal property security in Canada.

COMMENT

1. The proposed new section 2(7) is already found in the PPSAs in effect in Atlantic Canada. Its purpose is to encourage interpretation of each province's PPSA, not as an isolated local statute, but in the context of its roots in similar legislation in force elsewhere, and in light of the increasingly cross-border nature of secured financing transactions.

1. The provision would not, of course, compel a court to endorse even a majority line of jurisprudence from courts in other provinces or territories that it considers to be plainly wrong. Moreover, like any other interpretative canon, the proposed principle would come into play only as an aid to resolving ambiguity and not where the legislation itself were clear on the appropriate resolution. Nor would the principle apply to any issue on which a particular province's legislature has consciously introduced a local variation from personal property security law in force elsewhere.

Section 3 – Scope of Application of the PPSA

3.(1) Subject to section 4, this Act applies:

(a) to every contractual transaction that in substance creates or provides for a security interest without regard to its form and without regard to the person who has title to the collateral; and

(b) without limiting the generality of clause (a), to a chattel mortgage, conditional sale, floating charge, fixed charge, pledge, trust indenture, trust receipt, or to an assignment, consignment, lease, trust, transfer of an account, or transfer of chattel paper that secures payment or performance of an obligation, and to an agreement to sell referred to in section [ ] of the Sale of Goods Act if transfer of property in the goods is subject to payment or performance of an obligation.

COMMENT

1. The proposed addition of the words "contractual" and "provided for" in clause 3(1)(a) is intended to confirm explicitly that the application of the

PPSA is confined to security interests created or provided for in voluntary contractual transactions.

1. Clause 3(1)(b) currently contains an "or" to distinguish transactions which are overtly secured in form (chattel mortgage, conditional sale, floating charge, pledge, trust indenture, trust receipt), from transactions which are absolute in form but which are sometimes used for a security purpose (assignment, consignment, lease, trust or transfer of chattel paper). The insertion of the "or" between the two sets of transactions means that the first set is automatically subject to the Act whereas the second set is subject to the Act only if the transaction satisfies the concluding qualification, i.e. when it "secures payment or performance of an obligation". The proposed change would eliminate the "or" with the result that all of the listed forms of transactions – both those which are secured in form and those which are absolute in form – would be subject to the concluding qualification "where they secure payment or performance of an obligation." Since this qualification tracks the wording of clause (i) of the definition of security interest in section 2, it would be more consistent to have it apply to all of the listed transactions, especially in light of potential ambiguities in the meaning to be attached to some of the transactional forms listed in the first set. This change already has been effected in the Atlantic PPSAs.

1. The proposed reformulation would also replace the current reference to "conditional sale " with a reference to "an agreement to sell referred to in the Sale of Goods Act when transfer of property in the goods is subject to payment or performance of an obligation." "Conditional sale" is not a legal term of art; it is a somewhat ambiguous commercial term. The proposed change would more explicitly confirm that all title retention arrangements in credit sales are to be treated as security agreements for the purposes of the PPSA.

1. The addition in clause (b) of the term "fixed charge" and the replacement of the term "assignment" with "transfer of an account" [transfer of chattel paper is already listed] is proposed in the interests of completeness, and also to make it clear that s. 3(1) refers to all transactions which provide for an interest in accounts or chattel paper as

security for an obligation, whether the transaction is formally structured as an outright transfer or as an agreement to charge the accounts or chattel paper.

Section 4 – Exclusions from the Act

4. Except as otherwise provided in this Act or the regulations this Act does not apply to:

(c) the creation or transfer or an interest in present or future wages, salary, pay, commission or any other compensation for labour or personal services, other than fees for professional services; [delete and replace with local variation if required – see comments 1-4 below]

(f) the creation or transfer of a right to payment that arises in connection with an interest in or a lease of land, other than a right to payment that is evidenced by a security or instrument; [no change but enacting jurisdictions should ensure that their real property legislation is amended to provide for the registration and priority status of assignments of land-related rights to payments: see comment 5 below]

(i) the creation or transfer of a right to damages in tort for personal injury or death of an individual, and of a right to any payment derived from such a right including a right represented by a judgment or a settlement agreement;

(k) an security agreement interest, other than an interest referred to in clause (k.1), in personal property that secures payment or performance of an obligation created by an agreement governed by an Act of the Parliament of Canada that provides a system of priority rules dealing with deals with the rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement the interest, including an interest created by an agreement governed by sections 425 to 436 of the Bank Act (Canada);

(k.1) an interest in a registered ship or recorded vessel under the Canada Shipping Act that secures payment or performance of an obligation;

(l) a trust, whether express, implied or resulting, under which the trustee is obligated to relinquish the trust property, or its value, to the settlor or beneficiary of the trust, provided:

(B) the trustee is not the settlor of the trust;

(B) the trust property is not proceeds derived from a dealing in other property which is collateral under a security ***agreement between the trustee and the settlor or beneficiary to which this Act applies.***

COMMENT

1. Clause 4(c) currently excludes from the PPSA all interests in "present or future wages, salary, pay, commission or any other compensation for labour or personal services, other than fees for professional services." The scope of this exclusion is broader than the prohibition on the assignment of wages, etc. typically found in provincial employment standards legislation. This means that the priority status of otherwise valid assignments of commissions owing for non-professional services (e.g. real estate sales commissions) is determined by the common law rule in *Dearle v. Hall* (first to give notice to the account debtor generally prevails), and that the assignment is effective against a trustee in bankruptcy without perfection by registration: see e.g. *Re Lloyd* (1995), 30 C.B.R. (3d) 113 (Alta. Q.B.); *522446 Alta. Ltd. v. Gladstone Village* (1997), 12 P.P.S.A.C. (2d) 267 (Alta Q.B.); *F.W.C. Land Company v. Turnbull* (1997) (QL) B.C.J. 1985 (S.C.).

1. In view of the commercial importance and prevalence of financing transactions involving interests in commissions and the like, there is no justifiable reason for continuing to exempt them from the general PPSA rules governing the creation or transfer of an interest in an account. It is therefore proposed to delete the exclusion altogether subject to a replacement with a local variation in cases where the local policy of the enacting jurisdiction so requires.

1. In deciding whether a local variation is needed to replace clause (c), it should be understood that the proposed deletion would not prejudice the

continued application of statutory prohibitions on the assignment or creation of an interest in wages, etc. contained in provincial employment standards legislation. The operation of such prohibitions would be preserved by s. 9(1) of the PPSA under which a security agreement is effective according to its terms "except as provided in . . . any other Act." Alternatively, current clause (c) could be replaced by wording which precisely tracks the scope of the prohibition on the assignment of wages, etc. in the employment standards legislation of the enacting jurisdiction so as to narrow the scope of the exclusion to interests which are altogether invalidated under other provincial law in any event. The former approach is found in the Ontario PPSA. The latter approach appears in the Atlantic PPSAs. Both achieve the same substantive result.

1. In some provinces, the employment standards legislation does not invalidate all assignments of wages, etc. within its scope. In Saskatchewan, for instance, assignments to employee credit unions and to tool suppliers are permitted as a matter of local public policy. Where the permissible class of assignees is as narrow as this, the enacting legislature may feel that they should be relieved of the registration burden and priority risks imposed by the PPSA given the absence of any realistic risk of third party prejudice. In that event, the square-bracketed note which accompanies the proposed deletion of clause (c) above would allow for the insertion of an appropriately tailored local exclusion.

1. Under current clause 4(f), assignments of land-related rights to payment, including lease payments, mortgage payments, and payments under agreements for the sale of land, are excluded from the PPSA (unless evidenced by an "instrument" or a "security" as defined in section 2). This policy reflects prevailing commercial expectations and practice and should be maintained. However, while the wording of clause 4(f) should remain the same, it is proposed to include a square-bracketed note to signal the importance of ensuring that the relevant real property legislation in each jurisdiction is amended to provide for the registration and priority status of assignments of land-related rights to payments.

1. The proposed revision to clause (i) is designed to extend the application of the PPSA to security interests taken in commercial tort claims. As

currently drafted, the clause excludes all security interests in tort damages claims from the scope of the Act. This is not commercially reasonable where, for example, a security interest in all of a business debtor's personal property is given and a receiver is appointed to enforce it. The receiver currently cannot treat a security interest in a tort claim held by the debtor (e.g., a claim for inducing breach of contract or a claim for passing off) as an asset falling within the scope of the PPSA security interest being enforced. The receiver's rights and duties are instead governed by law outside the PPSA, as are the conditions governing attachment, perfection and priority of the security interest in the relevant claim. The revision to clause (i) above would expand the scope of the PPSA to include such commercial tort claims by narrowing the exclusion to damages claims for personal injury or death.

1. In narrowing the scope of the existing exclusion, proposed clause (i) would also end any debate on the validity of a security interest taken by a secured party in a cause of action for damages other than damages for personal injury or death. At common law, the assignment of a cause of action is subject to prima facie challenge under the doctrine of champerty and maintenance. This prohibition is subject to several exceptions, including importantly, cases where the assignee has a legitimate commercial interest in the subject matter of the assigned claim: see *Frederickson v. I.C.B.C.*(1986), 4 W.W.R. 504 (B.C.C.A.). This exception arguably covers the case where the assignee is a secured party: see *N.R.S. Block Bros. Realty v. Minerva Technology* (1997), 31 B.C.L.R. (3d) 295 (S.C.). The proposed revision to clause (i) would put the matter beyond doubt in the case of an assignment of a claim for damages other than damages for personal injury or death. Because any security interest taken in such claims would fall within the PPSA, the secured party would have the benefit of section 9(1) under which a security agreement is effective according to its terms, subject only to countervailing statutory provision.

1. The above proposal would further amend clause (i) to expressly exclude from the PPSA a security interest taken in a right to payment which derives from an excluded damages claim for personal injury or death, as where the claim has been reduced to judgment or is represented by a

settlement agreement with the tortfeasor or the tortfeasor's insurer. This would end any debate on whether the exclusion covers interests taken in rights of payment derived from a tort claim and would confirm the conclusions reached in interpreting existing clause (i) in such cases as *Alberta Opportunity v. Dobko & Housgestrol* (1995), 167 A.R. 205 (Q.B.); *Gauthier Estate v. Capital City Savings and Credit Union Ltd.* (1992), 3 P.P.S.A.C. 176, 2 Alta. L.R. (2d) 277 (Q.B.); and *Kanisaj v. O'Brien*,[1998] (QL) A.J. 402 (Q.B.). This would also ensure that the same body of non-PPSA law governs matters relating to the attachment, perfection, priority and enforcement of an interest taken in the claim itself and in rights to payment derived from that claim. In taking this approach, proposed clause (i) differs from revised article 9 under which excluded tort claims remain subject to sections 9-314 and 9-322 with respect to proceeds and priorities in proceeds. It is the view of the authors of this report that such a qualified application of the PPSA would lead to unnecessary complexity, and that the same body of non-PPSA law should therefore govern both the excluded claim and any rights to payment derived from the claim.

1. Proposed clause (i) is broadly similar to revised Article 9 in other respects but it is not identical. Article 9-109(d)(12) excludes tort claims, other than a commercial tort claim. Commercial tort claim is defined in 9-102(13) in a manner which would continue to exclude assignments of tort claims by an individual other than those arising in the course of the claimant's business or profession. In contrast, proposed clause (i) would not exclude a consumer tort claim for damages other than damages for personal injury or death. The latter approach is preferred for the simple reason that consumer contract claims are currently covered by the PPSAs and it is illogical to exclude like claims simply because they happen to be couched in tort as opposed to contract.

1. Admittedly, this begs the question of whether the exclusion of security interests in tort claims should be wholly eliminated. Assuming such assignments are otherwise valid under other law (certainly, one can always assign the fruits of a judgment or a tort claim as an exception to the champerty and maintenance rules), then why not subject them to the same perfection and priority requirements which apply to the assignment

of other rights, including contract rights? The reason for the continued exclusion is pragmatic: a right to damages for personal injury or death is usually made the subject of a security interest or transfer only in the context of a fee agreement between the tort victim and the victim's legal counsel. The limited use of such arrangements suggests they do not raise concerns with publicity and conflicting priority rights to a degree that would justify imposition of the burden of PPSA regulation, especially registration, on the parties. Cases such as *Kanisaj v. O'Brien* (cited above) show that this assumption is not universally true (the debtor in that case had given multiple successive security interests in her damages claim for personal injury). Nonetheless, it seems preferable to first test the experience with narrowing the scope of the exclusion before deciding to delete it altogether.

1. The new paragraph (l) would explicitly confirm that the concept of a 'true' security interest in section 3(1) of the PPSA does not encompass the interest of a transferor under a "Quistclose trust" or similar arrangement involving the transfer of funds on terms that they be applied for a specified purpose, failing which the funds (or their identifiable or traceable proceeds) are to be returned to the transferor as the beneficiary of an express, implied or resulting trust: see *Gignac, Sutts v. National Bank of Canada*(1999), 5 C.B.R. (4th) 44 (Ont. S.C., 1987); *Skybridge Holidays Inc. (Trustee of) v. British Columbia (Registrar of Travel Services)* (1999), 173 D.L.R. (4th) 333,121 B.C.A.C. 16, 48 B.L.R. (2d) 159, 11 C.B.R. (4th) 130, 68 B.C.L.R. (3d) 209.

1. New paragraph (l) is also intended to confirm the exclusion from the PPSA of the kind of trust arrangements encountered in *Ogden v. Award Realty Inc.* [1999] (QL) B.C.J. 422 (Q.B.) and *F.W.C. Land Company v. Turnbull* (1997) (QL) B.C.J. 1985 (S.C.). In both cases, real estate sellers were seeking to recover sales commissions held in trust for them by an insolvent debtor. Their right to do so was challenged on the basis that the claimants' interest in the commissions was a security interest under the PPSA and was therefore ineffective against competing creditors because it had not been perfected by registration prior to the debtor's insolvency. Clearly such arrangements are not security interests. Like 'Quistclose

trusts', they are true trusts in that the beneficiary of the trust who is alleged to be the secured party has and always retains the full beneficial ownership of the trust property while the trustee who is alleged to be the debtor has nothing more than the bare legal title of a trustee. New paragraph (l) is intended to be the issue beyond argument.

1. New paragraph (l) would also confirm the exclusion from the PPSA of arrangements involving the sale of services by an agent on behalf of a principal on terms that the agent is to hold the proceeds of such sales on trust for the principal less any agreed upon commission. A typical example is the sale of cargo or passenger transportation services to third parties by a firm acting as sales agent for the carrier on terms that any receivables collected by the agent for the sale of the services belong to the carrier, and to be remitted, less the agent's sale commission, to the carrier: see e.g. *Canadian Pacific Air Lines Ltd. v. Canadian Imperial Bank of Commerce*(1987), 42 D.L.R. (4th) 375; *Air Canada v. M & L Travel Ltd.* (1993), 108 D.L.R. (4th) 592. So long as such arrangements involve a true sales agency, and so long as the principal's trust claim is limited to the identifiable or traceable proceeds of the agent's sales, they are true trust/agency arrangements factually remote from the world of security and outside the intended regulatory scope of the PPSA. (Compare *Re Sims Battle Brewster & Associates Inc.*, [1999] (QL) A.J. 1285 (Q.B.) where the trust/agency agreement for proceeds was combined with a security agreement covering non-trust assets as collateral in the event that the proceeds were not paid over by the agent.) Similarly, since the arrangement is one of principal and agency, there is no transfer of an interest in the receivables generated by the agent's sales so as to subject the arrangement to the PPSA as a deemed security interest in the nature of a transfer of accounts under s. 3(2). The agent is simply a conduit through whom 'title' to the collected receivables stemming from the sales passes to the principal/trust beneficiary.

1. To say that such true trust arrangements are currently excluded from the PPSA does not justify why they should continue to be excluded. In all of the situations outlined above, the alleged trustee (debtor) was a business enterprise in apparent possession or control of property

belonging to another. Does this not generate the kind of 'false wealth' and 'secret lien' concerns that prompted the expansion of the PPSA perfection and priority rules to reach deemed security interests in the nature of commercial consignments, leases, and sales of accounts and chattel paper? The difficulty is that there is no easy way of extending the PPSAs to commercial trusts of the kind outlined above without having to deem all trusts to be security interests (more precisely, purchase money security interests) subject to the Act. Moreover, to attempt even a qualified expansion risks interfering to an unacceptable degree in the ability of commercial parties to use agency and trust principles to structure their transactions. Finally, the problems of third party prejudice are almost non-existent in the cases outlined above. Trust law already protects third party transferees, including competing secured parties, who acquire an interest in the trust property from the agent without notice of the trust. And since the trust property is not derived from value added by the trustee in the course of the trustee's business, entitling unsecured creditors to assert a claim to that property would be pure windfall. There is no unjust preference at work here since the trust beneficiary's right is an in rem right to the trust property or its identifiable or traceable proceeds; the right is not simply a unsecured preferential claim against the trustee's general assets. See further Bridge, Macdonald, Simmonds, & Walsh, "Formalism, Functionalism and Understanding the Law of Secured Transactions (1999) 44 McGill L.J. 567 at 610-15.

1. The proposed exclusion of trusts from the PPSA is subject to two provisos.

1. The first proviso arises where the trustee is also the settlor of the trust. It is intended to cover the situation where a debtor agrees to hold property owned by the debtor on trust for the creditor on condition that if the debt is not repaid the property will be transferred to the creditor as trust beneficiary. Such an arrangement is clearly a colourable secured transaction akin to a conventional chattel mortgage.

1. The second proviso comes into play where the trust property is "proceeds derived from a dealing in other property which is collateral under a security agreement between the trustee and the settlor or

beneficiary to which this Act applies." This proviso is intended to cover cases where a security agreement empowers the debtor to deal with the original collateral – typically inventory or accounts – in the ordinary course of the debtor's business on terms that the proceeds of such dealings are to be held on trust for the secured party. Here again the alleged trust transaction is merely a colourable secured transaction since the debtor can eliminate the secured party's proceeds claims at any point by paying out the secured obligation. Inclusion of such an express proviso would confirm the result in *Hounsome Estates v. John Deere Ltd.* (1991), 3 O.R. (3d) 89 (Gen. Div.). It would thereby forestall arguments of the kind successfully advanced, albeit in a non-PPSA context, in *Associated Alloys Pty Ltd v. ACN 0011 452 106 Pty Ltd.* [2000] HCA 25 (11 May 2000). At issue there was whether a 'Romalpa clause' (a trust of proceeds clause) in an inventory financing contract should be characterized as a trust or a charge. If it was a charge, it would have been invalid for nonregistration under the registration of charges provisions of the Australian Corporations Law. The majority in the Australian High Court (Kirby J dissenting) held it was a trust. Although concerns were expressed about the policy implications, the majority considered this to be a matter for the legislature.

1. The second proviso would also cover the situation where a consignee under a true commercial consignment is obligated to hand over the proceeds of any sales of the consigned goods to the consignor. If the arrangement is a true commercial consignment, then the consignor's rights are those of a true trust beneficiary since the consignee is merely acting as the agent for sale of the consignor's property. The situation is analogous to the cases described above involving the sale of services by an agent on behalf of a principal on terms that the proceeds of sales are to be held on trust. However, there is an important difference. The drafters of the PPSA elected to treat commercial consignments as deemed security transactions because of the difficulties faced by third parties in objectively distinguishing inventory held by a debtor on consignment terms from inventory owned by the debtor but subject to an inventory financier's security interest. In the case of agency arrangements involving

the sale of services, no similar concerns with third party prejudice arise because it is objectively evident that the services sold are not performed by the agent, but by the principal. Treatment of the consignor's interest in the proceeds of sale as a security interest, despite its trust character, is a necessary incident of that policy decision to bring commercial consignments within the scope of the PPSA. In the case of agency/trust arrangements involving the sale of services, there is no equivalent deemed security interest in the original subject matter of the sale, and therefore no reason to bring the proceeds of the sale within the scope of the PPSA.

1. The proposed change to clause (k) is designed to confirm that the only federally-regulated security interests which are excluded from the PPSA are those which are subject to a federal priority regime. In its current form, the wording suggests that the PPSA does not apply to any secured transaction to which federal law applies even if the relevant federal law regulates only *inter partes* rights. The proposed reformulation would clarify that federal security interests are subject to the PPSA in the absence of a federal law regulating the priority of the interest. However, the provisions of the PPSA on *inter partes* rights will be inoperative as a matter of constitutional law if they are in actual conflict with any applicable federal law provisions: *Bank of Montreal v. Hall* [1990] 1 S.C.R. 121.

1. On the interplay between the PPSA and federal security interests created under the Bank Act, see further the comments on the proposed additions to section 9 below.

1. Proposed new clause (k.1) would establish a separate express exclusionary rule for security interests taken in registered ships or recorded vessels under the Canada Shipping Act (C.S.A.). "Recorded vessels" in the context of the C.S.A. refers to vessels which are about to be built or are being built and which on completion would be registrable under the Act.

1. Where the security interest takes the form of a mortgage which itself is registered under the C.S.A., the scope of the proposed exclusion accords

with well-established judicial and constitutional principle. The C.S.A. regulates both the enforcement and priority aspects of registered mortgages and it is clear that the provinces lack the constitutional capacity to change the scheme of priorities established by Canadian maritime law: see e.g. *Finning Ltd. v. Federal Business Development Bank* (1989), 56 D.L.R. (4th) 379 (B.C.S.C.).

1. It is true that the statutory priority regime established by the C.S.A. for registered mortgages is not comprehensive. The Act establishes a first-to-register ranking rule for registered mortgages and gives priority to the holder of a registered mortgage over a bankrupt mortgagor's creditors and trustee in bankruptcy. Beyond this, the Act is silent on the appropriate resolution of third party claims. However, this does not mean that provincial law applies to fill the gap. "Canadian Maritime Law" is a body of federal law which includes, in addition to any applicable federal statutes, judicially-developed principles referentially incorporated as federal common law: *I.T.O. v. Mida Electronics*,[1986] 1 S.C.R. 752; *Monk Corporation v. Island Fertilizers Limited* (1991), 1 S.C.R. 779; *Ordon Estate v. Grail* (1998) 3 S.C.R. 437. Consequently, any gaps in the C.S.A. statutory priority regime will be covered by federal common law principles: *Federal Business Development Bank v. "Winder 4135"* [1986] 2 F.C. 154 (1984) 11 D.L.R. (4th) 308.

1. Canadian maritime law in this broad sense applies to the priority status of C.S.A-registered mortgages regardless of whether the priority contest involves a competing claim which itself is derived from maritime law or a security interest taken under provincial personal property security law. Thus, in *Charles R. Bell Ltd. v. The Stephanie Colleen* (1990), 36 F.T.R. 210 (F.C.T.D.), (1994) 74 F.T.R. 1 (F.C.T.D.), it was held that, constitutionally, the provinces cannot extend provincial law to conditional sales contracts covering ship's engines and registered under provincial personal property security law once they become accessions to ships covered by a mortgage registered under the Canada Shipping Act. And see *Governor and Company of the Bank of Scotland v. The Nel* [1999] 2 F.C. 578 (F.C.T.D.) where a supplier of bunkers to a vessel who had retained title to the bunkers pending payment of the purchase price prevailed over the holder of a

registered mortgage on the basis simply of common law principles relating to the passage of property in goods.

1. The scope of the proposed exclusion is not confined to mortgages which are registered under the C.S.A. but extends to unregistered security interests covering registered ships or recorded vessels. The proposed exclusion would apply even where the security agreement is in a form incapable of registration as a mortgage under the C.S.A., e.g. a conditional sales contract or similar arrangement under which the vendor of a registered or recorded vessel retains title pending payment of the purchase price: *Brunswick of Canada v. Bounty III*, [1970] Ex. C.R. 934).

1. The compatibility of the proposed exclusion with existing law in this latter connection is unclear. In *Ford. v. Petford* (1996),11 PPSAC 2d 227 (Ont S.C.), the enforcement provisions of the Ontario PPSA were applied in the context of a conditional sales contract covering a C.S.A.- registered vessel which had been taken and registered under the provincial regime. However, the potential applicability of federal maritime law was not pleaded in that case, and the legitimacy of applying provincial law did not receive any analysis. In *General Motors Acceptance Corp. of Canada, Ltd. v. Furjanic*(1994), 79 F.T.R. 172 (F.C.T.D.), the vendor was held to be entitled to rely on Canadian maritime law in an action for re-possession of a C.S.A.-registered ship notwithstanding that the vendor's security interest had been taken and registered under the Ontario PPSA; see also *Brunswick of Canada v. Bounty III* supra. The decision appears to leave open the possibility that provincial law might apply concurrently. Similarly, in *Re Doucet* (1983), 150 D.L.R. (3d) 53 (Ont. S.C.), federal law was applied to preserve the priority status, as against the debtor's trustee in bankruptcy, of a security interest in a C.S.A.-registered vessel which was neither registered nor registrable under the federal act but had been registered under the Ontario PPSA. However, the court declined to pass on the question of whether the security interest would have been open to challenge by the trustee under provincial law had the security interest not in fact been perfected under the PPSA.

1. On balance, it seemed to us to be preferable to relegate the regulation of security interests in C.S.A. registered vessels exclusively to federal law,

whether or not such interests are registered or registrable under the federal Act. This approach avoids the confusion which would result from potentially overlapping provincial and federal law and eliminates constitutional litigation in the event that the federal and provincial laws are in actual conflict. More importantly, this approach would ensure that buyers and prospective secured parties of registered ships and recorded vessels can rely with confidence on a search of the C.S.A. registry, without having to undertake a concurrent search of the provincial PPRs. This accords with the policy of preserving the integrity of the federal registry established in *Luffman v. Luffman* (1897), 25 O.A.R. 48 which established that a purchaser of a registered vessel takes free from unregistered security or other 'equitable' interests given by the owner even where the purchaser has notice of them.

1. Under the suggested approach, the application of the provincial PPSAs would be confined to maritime mortgages covering vessels which are licensed under the C.S.A. but not recorded or registered in the federal ownership registry. This is in line with the assumption underying the regulations passed in the various jurisdictions which have adopted the model Act, under which boats are treated as serial numbered goods with the serial number ascertained by reference to the federal D.O.T. license number.

1. The proposed approach does not and cannot eliminate all potential for overlap and constitutional conflict between the provincial and federal regimes. The first step in the test for the applicability of Canadian maritime law is whether the subject matter of the legal issue at stake falls within federal legislative competence as tested by reference to whether it is one integrally connected to maritime law. In *Whitbread v. Walley*, [1990] 3 S.C.R. 1273, a case of tortious liability involving a pleasure craft, the Court held that, akin to aeronautics, the area of maritime navigation and shipping extends to pleasure craft as well as commercial vessels. This suggests that the subject matter of marine security, even where the vessel is not registered under the federal act, falls within the federal sphere of competence (certainly this was the assumption underlying *Royal Trust v. Brechert* (1994) 51 B.C.A.C. 200 (C.A.). However, this is not enough to

displace otherwise applicable provincial law of personal property security. The provincial regime may still apply, either as a suppletive source of Canadian maritime law, or because Canadian maritime law does not supply, and cannot be reformed to supply, a counterpart rule for the issue at hand: *Paquin v. Cote* [1999] F.C.J. 1994 (F.C.T.D.). In the critical area of priorities, the absence of any counterpart to the registration regime supplied by provincial law in the case of security interests in licensed vessels gives rise to a strong argument that the provincial PPSAs would apply exclusively under one or another of these theories.

Sections 5-8 – Conflict of Laws Provisions

5(1) Subject to this Act, t The validity, the perfection, and the effect of perfection or non-perfection and the priority of:

(a) a security interest in goods other than goods referred to in clause 7(2)(a)(ii); or

(b) a possessory security interest in a security, an instrument, a negotiable document of title, money or chattel paper;

is governed by the law of the jurisdiction where the collateral is situated when the security interest attaches.

5.(2) For the purposes of subsection (1), an uncertificated security is situated where the records of the clearing agency are kept.

5(3) Where a A security interest in goods referred to in section 5(1) that is perfected pursuant to the law of the jurisdiction in which the goods are collateral is situated when the security interest attaches, and before the goods are collateral is later brought into [the enacting jurisdiction],

(a) subject to clause (c), the security interest continues perfected in [the enacting jurisdiction] if it is perfected in [the enacting jurisdiction]:

(a) (i) not later than 60 days after the day on which the goods are collateral is brought into [the enacting jurisdiction];

(b) (ii) not later than 15 days after the day on which the secured party has knowledge that the goods have collateral has been brought into [the enacting jurisdiction]; or

(c) (iii) before perfection ceases pursuant to the law of the jurisdiction in which the goods were collateral was situated when the security interest attached;

whichever is the earliest,;

(b) subject to clause (c), this Act determines the effect of such continued perfection or non-perfection, and priority between the security interest and any competing interest acquired in the collateral when the collateral is located in [the enacting jurisdiction]; and

(c) if the collateral is goods, the security interest is subordinate to the interest of a buyer or lessee of the goods who acquires an interest while the collateral is located in [the enacting jurisdiction] without knowledge of the security interest and before it is perfected in [the enacting jurisdiction] pursuant to section 24 or 25.

5(3.1) Where a security interest referred to in subsection (1) is perfected pursuant to the law of the jurisdiction in which the collateral is situated when the security interest attaches, and the collateral is later brought into another jurisdiction other than [the enacting jurisdiction], the law of that other jurisdiction determines the requirements for maintaining perfection of the security interest, the effect of continued perfection or non-perfection, and priority between the security interest and any competing interest acquired in the collateral when the collateral is located in that other jurisdiction.

6(1) Subject to section 7,wWhere:

(a) the parties to a security agreement that creates a security interest in goods, other than goods referred to in clause 7(2)(a)(ii), in one jurisdiction understand at the time when the security interest attaches that the goods will be kept in another jurisdiction; and

(b) the goods are removed to the other jurisdiction, for purposes other than transportation through the other jurisdiction not later than 30 days after the security interest attaches;

the validity, the perfection, and the effect of perfection or non perfection and the priority of the security interest are determined by the law of the other jurisdiction.

6(3) Where the jurisdiction to which the goods are removed is not [the enacting jurisdiction] and the goods are later relocated to another jurisdiction other than [the enacting jurisdiction], the security interest is deemed to be a security interest to which subsection 5(3.1) applies if it was perfected pursuant to the law of the jurisdiction to which the goods were removed.

7.(2) The validity, the perfection, and the effect of perfection or non-perfection and the priority of:

(a) a security interest in:

(i) an intangible; or

(ii) goods that are of a type that are normally used in more than one jurisdiction, if the goods are equipment, or inventory leased or held for lease by a debtor to others; and

(b) a non-possessory security interest in a security, an instrument, a negotiable document of title, money and chattel paper;

are governed by the law, including the conflict of law rules, of the jurisdiction where the debtor is located when the security interest attaches.

7(2.1) If a non-possessory security interest in a security, an instrument, a negotiable document of title, money or chattel paper comes into conflict with a possessory security interest acquired in the same collateral, priority is determined by the law of the jurisdiction where the collateral was located when the possessory interest attached.

7(3) Where a security interest is perfected in accordance with the law applicable as provided in subsection (2), and the a debtor relocates to another jurisdiction or transfers an interest in the collateral to a person located in another jurisdiction [the enacting jurisdiction],

(a) the a security interest perfected in accordance with the law applicable as provided in subsection (2) continues perfected in [the enacting jurisdiction] if it is perfected in [the enacting jurisdiction] the other jurisdiction:

(a) (i) not later than 60 days after the day on which the debtor relocates;

(b) (ii) not later than 15 days after the day on which the secured party has knowledge that the debtor has relocated or transferred an interest in the collateral to a person located in the other jurisdiction; or

(c) (iii) prior to the day on which perfection ceases pursuant to the law of the first jurisdiction;

whichever is the earliest, and

(b) this Act determines the effect of continued perfection or non-perfection, and priority between the security interest and any competing interest acquired in the collateral when the debtor is located in [the enacting jurisdiction].

7(3.1) Where a security interest is perfected in accordance with the law applicable as provided in subsection (2), and the debtor subsequently relocates to another jurisdiction other than [the enacting jurisdiction], the law of that other jurisdiction determines the requirements for maintaining perfection of the security interest, the effect of continued perfection or non-perfection, and priority between the security interest and any competing interest acquired in the collateral when the debtor is located in that other jurisdiction.

7(4) If the law governing the perfection of a security interest mentioned in under subsection (2) or (3.1) does not provide for public registration or recording of the security interest or a notice relating to it, and the collateral is not in the possession of the secured party, the security interest is subordinate to:

(a) an interest acquired in [the enacting jurisdiction] in an account payable in [the enacting jurisdiction] intangible; or

(b) an interest in goods, a security, an instrument, a negotiable document of title, money or chattel paper acquired when the collateral was situated in [the enacting jurisdiction];

unless it is perfected pursuant to this Act before the interest mentioned in clause (a) or (b) arises.

7(5) A security interest mentioned in subsection (4) may be perfected pursuant to this Act.

7(6) Notwithstanding subsection (2) and section 6, the validity, the perfection, and the effect of perfection or non-perfection and the priority of a security interest in minerals or in an account resulting from the sale of the minerals at the minehead that:

(a) is provided for in a security agreement executed before the minerals are extracted; and

(b) attaches to the minerals on extraction or attaches to an account on the sale of the minerals;

is governed by the law of the jurisdiction in which the minehead is located.

8(1) Notwithstanding sections 5, 6 and 7:

(a) procedural issues involved in the enforcement of the rights of a secured party against collateral are governed by the law of the jurisdiction in which the collateral is located when the rights are exercised;

(b) (subject to clause (c), procedural issues involved in the enforcement of the rights of a secured party against intangibles the collateral are governed by the law of the forum in which enforcement is pursued;

(c) subject to any applicable mandatory rules of the law of a jurisdiction which is more closely connected to the particular issue, substantive issues involved in the enforcement of the rights of a secured party against collateral are governed by the proper law of the contract between the secured party and the debtor.

8(2) For the purposes of sections 5, 6 and 7, a security interest:

(a) attaches pursuant to the law of a jurisdiction when the requirements of that law for creation of a security interest are satisfied, or, if the validity of the security interest is challenged, when the requirements would have been satisfied but for the invalidity;

(b) is perfected pursuant to the law of a jurisdiction if the secured party has complied with the law of the jurisdiction with respect to the creation and continuance of a security interest with the result that the security interest has a status in relation to other secured parties, buyers and judgment creditors and

a trustee in bankruptcy of the debtor similar to that of an equivalent security interest created and perfected pursuant to this Act;

(c) means any interest which under this Act would constitute a security interest;

(d) includes any interest which under this Act would constitute a security interest in proceeds.

COMMENT

1. The proposed addition in sections 5(1) and 6(1) of the words "other than goods referred to in clause 7(2)(a)(ii)" is intended to signal more directly that security interests in mobile goods are governed by the special conflicts rules in section 7, and not the general conflicts rules for goods in section 5 or the special 30-day rule in section 6(1). This change also permits the proposed deletion of the reference to "subject to section 7" at the beginning of section 6(1) and "subject to this Act" at the beginning of s. 5(1).

1. The proposed incorporation of the words "and priority" in sections 5(1), 6(1), 7(2) and 7(6) is intended to eliminate any doubt that the law designated as applicable in these sections governs not just the priority consequences of the failure to perfect a security interest and the priority status of perfected security interests over unperfected security interests, but also determines the priority status of the security interest as against other competing third party claimants, including buyers and lessees of the collateral.

1. Section 5(3) has been similarly amended to confirm that when collateral subject to an extra-provincial security interest is relocated to the enacting jurisdiction, domestic law determines the effect of continued perfection or a lapse in perfection, as well as the priority of the security interest as against other interests acquired in the collateral after its relocation into the enacting jurisdiction. Under the proposed change, the application of domestic priority law under section 5(3) would continue to include the special priority rule in that section protecting buyers and lessees who acquire an interest in goods before the security interest is perfected under domestic law.

1. The proposed changes to section 5(3) would also extend its scope to cover the relocation of any collateral, not just goods, subject to a security interest referred to in section 5(1). This would make it clear that the holder of a possessory security interest in a security, an instrument, a negotiable document of title, money or chattel paper is required, if the collateral is relocated to the enacting jurisdiction (e.g. as a result of a relocation of the secured party's business), to comply with the requirements of section 5(3) for continuing the perfected status of its security interest. Under the proposed change, domestic law would also govern the effect of continued perfection or a lapse in perfection and priority between the security interest and any competing interest acquired in the collateral after its relocation.

1. Current section 5 addresses the conflicts implications of relocation only if the collateral is relocated to the enacting jurisdiction. No guidance is given in the event that litigation takes place in the that jurisdiction involving collateral which was relocated to some other jurisdiction. Does section 5(1) continue to apply? If so, the validity, perfection and priority status of the security interest would be determined, notwithstanding re-location of the collateral, by the law of the jurisdiction where the collateral was originally located. This would be contrary to the common law position and inconsistent with the fact that all Canadian jurisdictions, including Quebec, have legislated a rule equivalent to section 5(3), requiring timely local perfection when collateral is relocated to the enacting jurisdiction, and dealing with the priority of the security interest against interests acquired in the forum following relocation.

1. The proposed new section 5(3.1) is intended to remedy any ambiguity resulting from the silence of the current Act on this point. Under the proposed section, the law of the jurisdiction to which the collateral is relocated would govern the requirements for maintaining the validity and perfected status of the security interest, the effect of perfection or a lapse in perfection, and priority between the security interest and an interest acquired after relocation. The proposed approach reflects both the common law and the results reached in PPSA cases (see *Holy Spirit Credit Union v. McMullan (Trustee of)*, [1994] (QL) M.J. 105 (Q.B.) where a trustee in

bankruptcy in proceedings in Manitoba successfully challenged the perfected status of a security interest in an automobile initially taken and perfected in Manitoba because of the secured party's failure to re-perfect its security interest under the Alberta equivalent of s. 5(3) on the debtor's subsequent relocation of his residence and his assets to Alberta).

1. Proposed new section 6(3) is a consequential change which would flow from proposed new section 5(3.1).

1. Current section 7 requires application of the law of the location of the debtor for security interests in mobile goods, intangibles, and non-possesory security interests in money and documentary intangibles. Current section 7(3) addresses the conflicts implications of a relocation of the debtor to any jurisdiction, not just the enacting jurisdiction. However, it requires re-perfection under the law of the new jurisdiction within the time limits specified in section 7(3) even if the new jurisdiction is not the enacting jurisdiction. This may be challenged as an excessive application of forum standards to extra-provincial events where the security interest does not bear any real or substantial connection to the enacting jurisdiction other than the fact that the litigation occurs there. The proposals set out above would confine current section 7(3) to cases where the debtor re-locates to the enacting jurisdiction, and would add a new section 7(3.1) to cover cases where the debtor relocates to some other jurisdiction. This would bring section 7 into line with the conceptual changes proposed in amended section 5(3) and new section 5(3.1), including application of the law of the debtor's new location to govern the effect of continued perfection or non-perfection and priority between the security interest and an interest acquired after the relocation.

1. Under the special priority rule in current section 7(4) (for which there is no equivalent in the Ontario PPSA), a non-possessory security interest in collateral covered by section 7 must be perfected under the law of the enacting jurisdiction if the law of the jurisdiction where the debtor is located does not provide a public recording system for giving notice of the security interest. In the case of tangible collateral, failure to perfect under domestic law subordinates the security interest to an interest acquired in the collateral when it is situated in the enacting jurisdiction. In the case of

intangible collateral, it is proposed to amend section 7(4) to subordinate the security interest to an interest acquired in the enacting jurisdiction in any form of intangible, not just in an account payable in the enacting jurisdiction as the section currently states. In the case of tangible collateral, the current special priority rule does not violate territorial limits on provincial legislative power because its operation is limited to competing interests in collateral which is situated in the enacting jurisdiction. In the case of intangible collateral, the proposed amendment would likewise require that the competing interest in the intangible have been "acquired in the enacting jurisdiction." It is implicit in this wording that the local transaction under which the interest was acquired would bear a sufficient connection to the enacting jurisdiction to satisfy the territorial limits on provincial legislative power.

1. Proposed new section 7(2.1) is intended to deal with a minor but real problem, already present in the current Act, and brought into sharper focus by the proposed addition in sections 5 and 7 of an explicit reference to the choice of law for priority. The problem arises because sections 5 and 7 direct the application of different and potentially conflicting laws to determine the perfected and priority status of a security interest in a security, an instrument, a negotiable document of title, money or chattel paper. Under section 5, the law of the location of the collateral governs if the security interest is perfected by possession. Under section 7, the law of the location of the debtor governs if the security interest is non-possessory. But what law applies to priority if the debtor creates both a possessory security interest and a non-possessory security interest in the collateral? Proposed new section 7(2.1) would require application of the law of the jurisdiction where the collateral was situated when the possessory security interest attached. This is justified on the theory that legal regimes generally award priority to possessory interests in negotiable collateral in the interests of protecting commercial negotiability.

1. The proposed deletion in section 7(2) of the current reference to the conflicts of laws rules of the jurisdiction in which the debtor is located is intended to eliminate the undesirable complexities created by the

doctrine of *renvoi* in the interests of promoting certainty in secured transactions. The proposed deletion would also resolve the complications which might otherwise arise from the fact that the criteria for determining the location of an enterprise debtor in some non-PPSA legal regimes differs from the chief executive office rule laid down in section 7(1) – e.g. under the Quebec Civil Code, the location of an enterprise debtor is determined by reference to its registered headquarters or statutory seat, not its chief executive office, and under revised Article 9, a similar rule applies for determining the location of U.S. enterprise debtors. In such cases, the proposed deletion would ensure that the reference in section 7 to the law of the jurisdiction where the debtor is located mean the law of the jurisdiction where the debtor's chief executive office is located, and would preclude a further renvoi from that law to the law where the debtor's registered office is located if this is different. Of course, a secured party will still need to perfect and to assess its priority status according to both laws in order to ensure it is adequately protected in all potential fora where the issue might be litigated. However, the proposed deletion would ensure that for the purposes of litigation in the enacting jurisdiction, a security interest will be considered validly perfected if it is perfected in the jurisdiction where the debtor is located as determined by section 7(1), and that the law governing priority will also be that law and only that law.

1. The proposed amalgamation of clauses 8(1)(a) and (b) into a single amended rule is intended to remedy an ambiguity in the current bifurcated approach. Under the current approach, procedural issues relating to the enforcement of the security interest in the collateral are governed by the law of the jurisdiction in which the collateral is located in the case of tangibles, and by the law of the forum in the case of intangibles. This bifurcation is contrary to the widely accepted conflicts doctrine under which enforcement procedure is invariably governed by the law of the forum. in which enforcement is pursued The current formula seems to have been employed to counter the risk that the courts might apply a procedural characterization to such substantive rules as "seize or sue" limitations on a secured party's enforcement rights. However, the cases on the issue have made it clear that the procedural

label is to be used restrictively and that it does not apply to any rule which would affect the substantive outcome or alter the substantive rights of the parties, a philosophy expressly affirmed by the Supreme Court in *Tolofson v. Jensen* (1995), 120 D.L.R. (4th) 289. In light of this, and to avoid confusion with general conflicts norms, it is proposed to amend clause (b) to refer all procedural issues to the law of the jurisdiction where enforcement is pursued.

2. For the same reason, it is also proposed to delete the words "subject to clause (c)" at the beginning of clause (b). These words inadvertently suggest that an issue relating to a secured party's enforcement rights could be characterized as both procedural and substantive. This latter change would bring clause (b) into line with the equivalent provision in the Atlantic and Ontario PPSAs.

1. The proposed addition of the words "subject to any applicable mandatory provisions of the law which is more closely connected to the particular issue," is intended to explicitly confirm that the parties freedom under clause (c) to choose the law to govern substantive issues involved in the enforcement of the rights of a secured party against collateral is subject to any overriding provisions of a more closely connected law, be it that of the forum or of some other jurisdiction. This ensures that a secured party cannot evade the non-waiveable debtor-protection rules of a more closely-connected jurisdiction – e.g. the jurisdiction where the debtor and/or the collateral are located – by incorporating a choice of law clause in the security agreement in favour of a more remotely connected law which does not offer equivalent protection. This proposal is in line with the caselaw on the point – see e.g. *Cardel Leasing Ltd. v. Maxmento* (1991), 2 PPSAC (2d) 302 (Ont Gen Div) – and would eliminate any residual doubt on the overriding application of the mandatory applicable enforcement rules of a closely-connected law notwithstanding the inclusion of a choice of law clause in the security agreement.

1. Proposed new clause 8(2)(a) is intended to address a logical conundrum in the current Act. Under sections 5 and 7, the law governing the validity of a security interest is determined by reference to the location of the collateral or the debtor, as the case may be, when the security interest

attaches. But what if the validity of the security interest is challenged on the basis that the requirements of the lex situs for creation (attachment) of a security interest have not been satisfied (as where, e.g. the lex situs prohibits attachment of a security interest in after-acquired consumer goods)? To address this conceptual difficulty, the proposed new clause confirms that when the validity of a security interest is challenged, the time at which the security interest attaches for the purposes of sections 5-7 is determined by reference to the location of the collateral or the debtor, as the case may be, when the security interest would have attached but for the alleged invalidity. The proposed new clause also confirms that the term "attaches" as used in sections 5-7 does not bring into play the domestic attachment rules of the PPSA of the enacting jurisdiction, but refers instead to the attachment rules of the lex situs at the time the security interest is created (or would have been created in the event validity is challenged).

1. Proposed new clause 8(2)(c) is intended to explicitly confirm that the term "security interest" for the purposes of sections 5-7 means any interest which under the domestic law of the enacting jurisdiction would constitute a security interest. This proposal ensures that the choice of law rules in sections 5-7 are applied even when the relevant lex situs would not characterize the interest in question as a security interest (e.g. as where the lex situs does not characterize a true lease, or commercial consignment, or sale of accounts or chattel paper as a deemed secured transaction). This proposal would eliminate any residual confusion stemming from the contrary analysis in *Re Intex Moulding Ltd.* (1987), 38 D.L.R. (4th) 111 (Ont S.C.), widely considered to be wrong on this point.

1. Proposed new clause 8(2)(d) is intended to deal with an issue not explicitly addressed in the current Act. This is the appropriate law to govern the validity, perfection, and priority status of a security interest in proceeds of original collateral. The proposed new clause, which reflects the implicit result under the current Act, confirms that the applicable law is the law which would govern a security interest in the proceeds if they were original collateral. Of course, the connecting factor for determining the applicable law – the location of the collateral or the location of the

debtor as the case may be – will necessarily be determined as of the time the security interest in the proceeds attaches (or is alleged to have attached) rather than when the security interest in the original collateral attached.

1. The operation of the proposed new clause is illustrated by considering the case of a security interest in inventory located in Saskatchewan created by a corporate debtor headquartered in Quebec. Although, under section 5, Saskatchewan law would govern the perfected status of a security interest in the inventory (other than mobile goods), proposed clause 8(2)(d) would make it clear that the secured party will need to also perfect in Quebec pursuant to section 7 to be assured of a perfected security interest in any intangible proceeds generated by the sale of the inventory. Under section 7 (as brought into play by proposed clause 8(2)(d)), Quebec law would also govern the validity and priority of the inventory financier's security interest in the intangible proceeds. Clarification of this latter point is particularly useful in view of the fact that a security interest may not automatically attach to the proceeds of a dealing in original collateral under the law of Quebec. It follows that where a security interest is created in inventory located in one of the PPSA provinces by a national debtor located in Quebec, the secured party should ensure that any anticipated proceeds are expressly included in the security agreement as original collateral. Otherwise, no security interest will attach under Quebec law, the law which, under section 7, would determine the validity of any claim to an automatic security interest in the intangible proceeds on these facts.

Section 9 – Effectiveness of Security Agreements

9.(1) Except as otherwise provided in this or any other Act, a security agreement is effective according to its terms.

9.(2) A security interest in collateral ceases to be valid with respect to that collateral to the extent that and for so long as the security interest secures payment or performance of an obligation that is also secured by a security in

favour of that secured party on that collateral created pursuant to sections 425 to 436 of the Bank Act (Canada), or replacements thereof.

9.(3) Nothing in subsection (2) affects:

(a) a security interest that secures payment or performance of an obligation owing by a person who is not a party to an agreement between the debtor and the secured party to which any of sections 425 to 436 of the Bank Act (Canada),or replacements thereof, applies; or

(b) a security interest that is created or provided for in a security agreement executed before this section comes into force.

(4) An account debtor as defined in clause 41(1)(a) may take a security interest in the account or chattel paper under which the account debtor is obligated.

(5) A provision in any other statute which restricts or requires the consent of the grantor to the transfer of a licence or the creation of a security interest in a licence is ineffective but only to the extent that the provision would prevent attachment of a security interest in the license under this Act.

COMMENT

1. Proposed sections 9(1)-(3) above address the problem of "double dipping" on the part of banks purporting to take both *Bank Act* security and PPSA security to secure the same obligation owing the bank by the same debtor. These provisions are adopted from section 9 of the Saskatchewan PPSA (including a proposed amendment to the current wording of subsection (2) of that Act) which is the only PPSA to directly addresses the problem at present. It is proposed that equivalent provisions be included in the Model Act for potential incorporation in all the provincial PPSAs. The proposed wording reflects the current Saskatchewan sections (with the addition of the words "or replacement thereof" following the reference to the relevant *Bank Act* sections to accommodate the frequent changes in the section numbering of that Act).

1. The proposed provisions are designed to address the problems described in the following extract from R.C.C. Cuming, "PPSA– Section 178 Bank Act Overlap: No Closer to Solutions" (1991), 18 C.B.L.J. 131 at 139

(footnotes omitted) in which the author comments on the reasoning of Houlden J.A. of the Ontario Court of Appeal in *Bank of Nova Scotia v. International Harvester Credit Corporation of Canada Ltd.* (1990), 74 O.R. (2d) 738; 73 D.L.R. (4th) 385 [note: all references in the following extract to section 178 of the Bank Act should be read as referring to section 427 to reflect the current numbering]:

Dicta in the decision of Houlden J.A. supports the general proposition that a bank holding a section 178 [now 427] security [under the Bank Act] can rely on its rights as a secured party under the PPSA to improve on the legal position that it occupies under the *Bank Act.* He observed:

I see no reason why the bank should not be able to perfect its security interest by taking possession of the collateral, even though the bank has failed to comply with the registration provisions of the *Bank Act*. The security interest of the bank would be invalid under the *Bank Act*, so that the bank would be unable to claim the benefit of the priority provisions of that statute; but would be perfected under the P.P.S.A., and the bank, like any other holder of a security interest, could claim the benefit of the priority provisions of that statute."

... However, it is not clear the answer is as self-evident as Mr. Justice Houlden suggests it might be. He does not appear to have given full consideration to the constitutional implications of it.

The Parliament of Canada has provided in section 178 of the *Bank Act* a financing mechanism for use by the chartered bank. The *Act* specifies the rights of a bank using that system; it also specifies the rights of third parties who acquire interests in the collateral. If a bank fails to comply with the registration requirements of the *Act*, the bank's security is "void as against creditors of the person giving the security and as against subsequent purchasers or mortgagees in goods faith of the property covered by the security." Implicit in Mr. Justice Houlden's statement is the conclusion that a bank can use the PPSA as a mechanism to avoid the consequences of non-compliance with section 178 of the *Bank Act*. However, if section 178 of the *Bank Act* renders "void" a section 178 security as against specified third party interests, is it competent for

provincial personal property security legislation to render it valid and enforceable in priority to those same interests? . . .

It is revealing to apply Mr. Justice Houlden's conclusion in the context of situations other than the one that he apparently had in mind. If, for example, Bank A takes a section 178 security but fails to register as required by the *Bank Act*, can it gain priority over Bank B, which holds a section 178 security, subsequently acquired and properly registered as required by section 178(4), simply by registering a financing statement in the Personal Property Registry and asserting priority under the PPSA on the basis that Bank A has a perfected security interest and Bank B has an unperfected security interest? Can Bank A establish priority over a good faith buyer of the collateral from the debtor by asserting its PPSA priority position? Assume that Bank A does comply with the registration requirements of section 178(4), can it circumvent section 178(7)(a) of the *Bank Act*, which gives priority to unpaid employees of a bankrupt debtor of Bank A, by basing its claim to priority on the PPSA which gives no similar preferential treatment to unpaid employees? To accept that the answer to these questions is yes is to accept that a bank can invoke its position under the PPSA as a method of frustrating the public policies clearly spelled out in the *Bank Act*. Even if one concluded that it is constitutional for a provincial legislature to facilitate circumvention of the *Bank Act* in this way, is there any good reason why it should be seen as having intended this result?

Once again in *dicta,* Mr. Justice Houlden appears to have accepted without question the efficacy of a bank taking a section 178 security agreement and a PPSA security agreement to secure the same debt from the same debtor. He noted: "I have no doubt that the bank intended and tried to get priority over I.H.C.C. to all the collateral but to succeed in that endeavour it would have had to use a document which purported to give it security on the whole and not just one which on its face and under the *Bank Act*, R.S.C. 1985, c. B-1, gave it security only on the borrower's interest in the whole." While the Saskatchewan Court of Appeal appears to have sanctioned this practice, there remains considerable doubt that the banks

will continue to be able to have the best of both the *Bank Act* and the PPSA merely through the maintenance of the practice.

. . . A great deal of additional litigation will be required to sort out the implications of the Court's conclusion that banks have been given rights under two conceptually incompatible legal regimes and can "mix and match" rights and obligations to suit their circumstances at any particular time. One might well conclude the unstated objective of the Court was not to provide definitive judicial guidance but rather to demonstrate the need for cooperative federal-provincial legislative action to restore some order to the prevailing chaos.

1. Proposed subsection (4) would confirm that a creditor can take an effective security interest in an account or chattel paper on which it is also obligated as the account debtor (e.g. a bank which takes a security interest in a guaranteed investment certificate issued by it). Although the proposed provision reflects the long-standing Canadian practice and understanding, some doubt was generated by the contrary English decision in *Re Charge Card Services Ltd.*, [1987] Ch. 150 affirmed [1996] Ch. 245, 258 (C.A.). That decision immediately generated strong objections in banking and commercial circles. Legislation was passed in a number of common law jurisdictions to reverse its effect (e.g. Hong Kong and Singapore), and it has now been overruled in England itself by the House of Lords: see *Morris and Others v. Rayners Enterprises Inc.* [1997] (QL) H.L.J. 45. Proposed subsection (4) would ensure that the issue is removed from debate in common law Canada.

1. The purpose of proposed new subsection (5) is explained above in the comments on the proposed expansion of the definition of "intangible" to include a "licence."

Section 10 – Evidentiary Requirements for Security Agreements

10(1). Subject to subsection (2), a security agreement is enforceable against a third party only where:

(b) the debtor has signed a security agreement that contains:

(i) a description of the collateral by item or kind or by reference to one or more of the following:

(A) goods;

(B) chattel paper;

(C) securities;

(D) documents of title;

(E) instruments;

(F) money;

(G) intangibles;

(H) crops;

(ii) a statement that a security interest is taken in all of the debtor's present and after-acquired personal property; or

(iii) a statement that a security interest is taken in all of the debtor's present and after-acquired property except specified items or kinds of personal property or except one or more of the following:

(A) goods;

(B) chattel paper;

(C) securities;

(D) documents of title;

(E) instruments;

(F) money;

(G) intangibles;

(H) crops;

10.(2) For the purposes of clause (1)(a), a secured party is deemed not to have taken possession of collateral that is in the apparent possession or control of the debtor or the debtor's agent.

10.(3) A description is inadequate for the purposes of clause (1)(b) if it describes the collateral as consumer goods or equipment without further reference to the item or kind of collateral.

10.(4) A description of collateral as inventory is adequate for the purposes of clause (2)(b) only while it is held by the debtor as inventory.

10.(5) A security interest in proceeds is enforceable against a third party, whether or not the security agreement contains a description of the proceeds.

10.(1) A security interest is enforceable against a third party, other than a secured party, only where:

(a) subject to subsection (2), the collateral is in the possession of the secured party; or

(b) the debtor has authenticated a security agreement that contains a description, whether or not specific, that reasonably identifies the personal property intended to constitute the collateral.

10.(2) For the purposes of clause (1)(a), a secured party is not in possession of collateral that is in the apparent possession or control of the debtor or the debtor's agent.

10.(3) For the purposes of clause (1)(b), a description of collateral reasonably identifies the collateral if it identifies the collateral:

(a) by item or generic category;

(b) subject to subsection (3) and (4), by reference to a type or category of personal property defined in this Act;

(c) as all present and after acquired personal property;

(d) as all present and after acquired personal property other than property described in the manner set out in (a) or (b); or

(e) by any other method that reasonably enables the personal property intended to be covered by the security agreement to be objectively determined.

10.(4) A description of collateral by generic category is an inadequate description for the purposes of clause (2)(b) if it describes the collateral only as "consumer goods" or "equipment".

10.(5) A description of collateral as inventory is adequate for the purposes of clause (2)(b) only while it is held by the debtor as inventory.

10.6) A security interest in proceeds is enforceable against a third party, whether or not the security agreement contains a description of the proceeds.

COMMENT

1. Substantial changes are proposed for current section 10(1), necessitating the recasting and renumbering of the entire section. The significant substantive changes are underlined in the proposed new version.

1. The wording and structure of current section 10(1)(b) might be read to imply that a generic description of collateral is adequate even if this does not reflect the actual scope of the collateral covered by the security agreement (e.g. “all present or after acquired personal property” would be an adequate description even if the actual intended collateral were only a specific automobile) (compare the approach in the current Ontario Act). This would be inconsistent with the policy reflected in subsections (2) and (3), under which certain generic descriptions are declared inadequate because they would not permit a third party to objectively identify the collateral. More importantly, this interpretation would defeat the third party evidentiary and disclosure functions of the section.

1. Proposed new subsection (2) would make it clear that the collateral description must reasonably identify the personal property intended to constitute the collateral. This does not mean that the description must be specific or excessively detailed. New subsection (3) explicitly confirms that generic descriptions (e.g. “all goods”) and super-generic descriptions (“all present and after acquired personal property”), are perfectly adequate if this is the actual scope of the collateral intended to be covered by the security agreement.

1. The priority effect of current section 10(1)(b) gives rise to a controversial issue in the following sequence of events. Assume that SP1 and D enter into an oral security agreement. SP1 registers a financing statement. SP2 and D enter into a written security agreement which covers the same collateral. SP2 effects a registration. SP1 and D then reduce their agreement to writing. D defaults. Who has priority between SP1 and SP2?

1. There are differing views on the correct answer. Professors Cuming and Wood argue that SP1 acquires a vested priority against SP2 if section 10 has not been complied with when the intervening security interest is acquired. In other words, they read section 10 as qualifying the priority rules which govern competing perfected security interests in Part 3, including the first-to-register rule in section 35(1). Professor Walsh agrees that section 10 qualifies section 35 but only in so far as compliance is a pre-condition to the enforceability (under section 10) and attachment (under section 12) of SP1's interest against SP2. Consequently, she argues that SP1 can comply with section 10 at any point up to when SP1 seeks to actively enforce its security interest against SP2: see Catherine Walsh, "The PPSA Writing Requirement and Priority Among Competing Perfected Security Interests" (1994) 9 B.F.L.R. 217.

1. From a policy viewpoint, both interpretations reflect shortcomings in the current approach. If compliance with section 10 is necessary before SP2's interest is acquired, SP2 would presumably also have to show that it had complied with section 10 before SP1 reduced its own agreement to writing. This would deprive the first-to-register rule in section 35 of much of its intended dispute-avoidance value since priority among competing registered security interests under section 35 would be effectively subject to the order in which the competing parties had reduced their security agreements to writing. On the other hand, if SP1 can comply at any time before it seeks to actively assert its priority rights against SP2 under section 35, there seems little point in requiring compliance with section 10 in the first instance.

1. Proposed new subsection 10(1) would resolve these problems by excepting secured parties from the range of third parties against whom a security agreement which does not comply with section 10 is

unenforceable. This would eliminate the current debate concerning the impact of section 10 on the operation of the section 35 priority rule. At the same time, this approach would not deprive potential secured creditors of the right to objective proof of the existence and scope of any competing security interest covered by a registered financing statement. Their interests would still be adequately protected by section 18, under which a potential secured creditor can require the debtor to demand from the holder of a competing registered interest an authenticated written statement of the details of the collateral under the security agreement (if any). A secured party who responds to a demand under section 18 is estopped from later claiming that the information provided was incorrect.

1. Under the proposed reformulation, compliance with section 10(1) would remain a necessary pre-condition to the enforcement of a security interest against other third parties, including transferees who are not secured parties, a trustee in bankruptcy and unsecured judgment creditors. It is important that these other classes of third parties have objective written proof of the contents of a security agreement in order for them to assess their positions vis-á-vis a secured party or person claiming to be a secured party. They do not have the same practical facility as a potential secured party to take advantage of section 18. The potential for fraud on the part of secured parties in misstating the scope of the collateral covered by a security interest is much greater when a trustee or judgment creditor, or even a transferee, is involved.

1. However, changes are proposed below to section 12 and 20 to clarify the relationship between non-compliance with section 10 and the priority of these other classes of third parties. Under current section 12, compliance with section 10 is a pre-condition to third party attachment of a security interest. The proposed reformulation of section 12 below deletes this requirement. A proposed addition to section 20 below would instead make compliance with section 10 a pre-condition to the perfected status of a security interest for the limited purpose of the section 20 subordination rule. Under this approach, a security interest would be subordinated to transferees (other than secured parties), judgment creditors, and a trustee in bankruptcy if the secured party has not

complied with section 10 when their interests 'vest' under section 20. This is also the substantive result under the current Act but the proposed changes achieve it in a more direct and transparent fashion.

Section 12 – Attachment of Security Interests

12.(1) A security interest attaches when:

(a.i) a security agreement exists between the debtor and the secured party;

(a) value is given; and

(b) the debtor has rights in the collateral or the power to create a security interest in the collateral in favour of the secured party; and

(c) except for the purpose of enforcing rights between the parties to the security agreement, the security interest becomes enforceable within the meaning of section 10;

unless the parties have specifically agreed to postpone the time of attachment, in which case it attaches at the time specified in the agreement.

12.(2) For the purposes of clause (1)(b), and without limiting other rights, if any, that the debtor may have in the collateral,:

(a) a lessee pursuant to a lease for a term of more than one year or a consignee pursuant to a commercial consignment has rights in the goods when the lessee or consignee, or the lessee's or consignee's agent, obtains possession of them pursuant to the lease or consignment.;

(b) a debtor pursuant to a transaction within section 3(1) in which a security interest in goods is created by the secured party's retention or reservation of ownership has rights in the goods when the debtor, or the debtor's agent, obtains possession of them pursuant to the transaction; and

(c) a transferor of an account or chattel paper is deemed to retain rights in the accounts or chattel paper notwithstanding the transfer.

COMMENT

1. The proposed addition to section 12(1)(a) is designed to make it clear that a security interest can be given by a debtor who does not own the collateral but who has the power to create a security interest in it, whether that power is given by the owner or by the law (e.g. by operation of principles of agency or estoppel or by virtue of a statutory rule as found, e.g., in provincial sale of goods or factors and agents legislation).

1. Current section 12(2) clarifies the operation of the "rights in the collateral" requirement in cases where a lessee or consignee gives a security interest in goods which are already subject to a prior deemed security interest in the nature of a true lease or a true consignment within section 3(2) of the Act. Under such transactions, the lessor or consignor has ownership of the collateral; the lessee or consignee has only a possessory interest. Section 12(2) confirms that this possessory interest constitutes sufficient rights to support attachment of a competing security interest in the leased or consigned goods.

1. Current section 12(2) may seem redundant since section 12(1) only requires "rights in the collateral", not ownership, and possession clearly constitutes sufficient rights to permit the lessee or consignee to give a security interest in the leased or consigned goods. However, it is important to know not just whether but also when a lessee or consignee acquires sufficient rights to support the attachment of a competing security interest. This is because the PPSA subjects the lessor's and consignor's interest to the same perfection and priority rules which apply to true purchase money security interests. It follows that if the lessor or consignor fails to effect timely perfection, or fails to perfect at all, its ownership interest will be subordinated – under section 35 – to a security interest given by the lessee or consignee if that competing security interest has attached (and is perfected). Section 12(2) confirms that the competing security interest attaches when the lessee or consignee acquires possession of the goods. Thus, any goods covered by the lease or consignment which still remain in the consignor's or lessor's possession will not be caught by the competing interest.

1. The same timing question arises when a true purchase money security interest is created in goods owned by a secured party who reserves its

ownership to secure payment of the price, e.g. under a conditional sale or security lease or security consignment. The secured party's initial ownership raises the question of when the debtor acquires rights in the goods sufficient to support attachment of a competing interest. Does the debtor's contingent ownership right mean that a prior security interest (covering after acquired goods) given by the debtor would attach to the goods as soon as the retention of title agreement was entered into, even before the goods were delivered to the debtor. If so, a secured party who retains ownership but who fails to perfect in time (or at all) risks subordination to competing secured parties even in respect of goods which remain in its possession whereas a true consignee or true lessee in the same position would be indirectly protected by virtue of the attachment rule in section 12(2). The result is an invitation to litigate the distinction between true consignments and leases and security consignments and leases, particularly in inventory financing arrangements. To avoid this, a new clause 2(b) is proposed under which the debtor would acquire rights in collateral subject to a reservation of ownership by the secured party only when the debtor acquires possession of the goods.

1. Proposed new clause 12(2)(c) is designed to address the conceptual problems which arise in satisfying the "rights in the collateral" requirement when a debtor transfers or creates a security interest in accounts or chattel paper which were the subject of a previous transfer. Having previously sold the accounts or chattel paper outright, the debtor no longer would appear to have any rights in the collateral to support attachment of the second security interest. This creates conceptual problems in the event that the second transferee registers before the first. Under the general priority rule in section 35, the interest of the second transferee is clearly meant to have priority. But that priority depends on the second interest having attached, and attachment in turn depends on the debtor still having rights in the collateral when the second interest was created, notwithstanding the prior sale. Proposed clause 12(2)(c) resolves the problem by deeming a transferor, for the limited purposes of section

12(1), to retains its rights in the accounts or chattel paper notwithstanding the transfer.

1. The proposed rule reflects the current understanding of analysts while eliminating the conceptual acrobatics necessary to justify the result under the current Act. See Buckwold and Cuming, "The Personal Property Security Act and the Bankruptcy and Insolvency Act: Two Solitudes or Complementary Systems?" (1997), 12 B.F.L.R. 467, at 487 (observing that by deeming the interest of a seller of accounts or chattel paper to be a security interest, the PPSA implicitly deems the seller to retain rights in the collateral after the sale since a secured transaction inherently involves a relationship in which the debtor has ownership of the collateral and the secured party has a mere charge). Compare Bridge, Macdonald, Simmonds, Walsh, "Formalism, Functionalism and Understanding the Law of Secured Transactions" (1999) 44 McGill L.J. 567, at 586, n. 59 (observing that the "rights in the collateral" requirement in s. 12 implicitly includes the debtor's "contingent" power – under the registration-driven priority structure of the PPSA – to defeat the interest of a buyer of accounts or chattel paper by transferring or charging the accounts a second time to a transferee or secured party who registers first).

1. It should be emphasized that section 12(2) is not concerned with priorities except in the indirect sense that a competing secured party must establish that a debtor under a deemed security transaction (or under a reservation of title security agreement) has sufficient rights in the collateral to support attachment of the competing interest. Nor is it intended to empower the debtor to create a security interest in any greater rights in the collateral than the debtor possesses. This can occur indirectly, however, if the consignor, lessor or transferor fails to perfect and is subordinated under the priority structure of the Act. It has sometimes been argued that the competing claimant's priority is then limited to the debtor's property rights under the relevant transaction (*nemo dat quod non habet*), e.g. the debtor's possessory rights in the case of a lease or consignment or nothing at all in the case of a sale of chattel paper or accounts. The drafters of revised Article 9 dealt with the issue by deeming the debtor to have acquired or retained (as the case may be) the

property rights of the lessor, consignor, or transferor for the purposes of vesting those rights in the prior-ranking secured party. The authors of this Report consider this to be unnecessary in a Canadian context. The definitions of "security interest", "secured party" and "debtor" in section 2 make it clear that the prior-ranking claimant acquires the full ownership interest of the subordinated owner. Moreover, despite the occasional wrong turn, Canadian courts have generally recognized that such arguments are inconsistent with the conceptual basis and priority structure of the PPSAs: see e.g. *TCE Capital v. Kolenc,* [1992] 2 C.B.R. 99 (Ont. Bktcy); *Re Giffen* (1998), 155 D.L.R. (4th) 332 (SCC); and see Cuming and Buckwold, *supra*.

Section 13 – Security in After-Acquired Collateral

13.(2) A security interest does not attach to after-acquired property that is:

(a) a crop that becomes a growing crop more than one year after the security agreement has been entered into, except that a security interest in crops that is given in conjunction with a lease, agreement for sale or mortgage of land may, if the parties so agree, attach to crops to be grown on the land concerned during the term of the lease, agreement for sale or mortgage;

(b) consumer goods, other than an accession, unless the security interest is a purchase money security interest or a security interest in collateral obtained by the debtor as replacement for collateral described in the security agreement .[delete subject to replacement legislation referred to in comments 2 and 3 below]

COMMENT

1. It is proposed to delete the one-year limitation on security in future growing crops from current section 13(2)(a) on the basis that it is paternalistic and unfair. The experience with the current rule indicates that crop financing under the PPSA is generally not available because of the increased transaction costs and risks resulting from the restriction. Since security taken under the federal Bank Act is not subject to any

equivalent restriction, agricultural producers are effectively limited to bank financing and are denied access to the wider credit market available to other debtors.

1. It is also proposed to delete current subsection 13(2)(b) restricting non-purchase money security in after-acquired consumer goods (a change which already has been made in the Saskatchewan Act). The social policy concerns which underpin the section are more appropriately met by extending the exemptions on seizure of consumer goods in provincial judgment enforcement law to all creditors including secured creditors. The proposed approach would still deter the use of secured financing purely for its *in terrorum* value, and would still protect consumer debtors and their families from the risk of deprivation of consumer goods essential to their subsistence and livelihood. However, it would accomplish this without depriving all consumer debtors of all access to secured financing against future consumer goods.

1. In some provinces, the extension of provincial exemption policy to secured creditors has been effected via amendments to existing exemptions legislation (e.g. Saskatchewan) and in others via amendments to part 5 of the PPSA (e.g. the Atlantic provinces). The square-bracketed note above contemplates either approach.

Section 14 – Future Advances

14.(2) Unless the parties otherwise agree, an obligation owing to a debtor to make future advances is not binding on a secured party if:

(a) [Alternative A] the collateral has been seized, attached, charged or made subject to an equitable execution under circumstances described in clause 20(1)(a) or (b), or

(b) [Alternative B] a notice of judgment [or equivalent] has been registered in the Registry; or

(b) the collateral has been sold to a buyer; and

the secured party has knowledge of this fact before making the advances.

COMMENT

1. The addition of proposed clause (b) is explained in the comment to the proposed new section 35(6.1) below.

1. The insertion of a proposed "alternative B" to current clause (a) reflects the fact that some PPSA jurisdictions have adopted registration of a notice of judgment (or judgment enforcement order) in place of (or in addition to) seizure of the collateral as the relevant priority point for assessing priority between a judgment creditor and an unperfected security interest under section 20.

Section 17 – Rights and Obligations of Secured Party

in Possession of Collateral or Collecting Accounts or Chattel Paper

17.(1) In this section, "secured party":

(a) includes a receiver;

(b) subject to clause (c), does not include a secured party under a transaction referred to in subsection (3)(1);

(c) in subsection (2), includes a transferee of chattel paper or an account if the transferee has the right to charge back uncollected collateral or to any recourse in the event of non-payment or other default of the account debtor.

(2) A secured party shall use reasonable care in the custody and preservation of collateral in the possession of the secured party, or in respect of which the secured party exercises collection rights in the case of chattel paper or an account, and, unless the parties otherwise agree, in the case of an instrument, a security, or chattel paper, or an account, reasonable care includes taking steps to preserve rights against other persons.

COMMENT

1. The clarification of the term "secured party" in proposed clause 17(1)(b) recognizes that it would be inappropriate to impose the obligations and liabilities of a true secured party in possession of collateral on a person

who owns the collateral and who is merely deemed to be a secured party under a transaction brought within the Act by subsection 3(2).

1. An exception is recognized in clause (c) for a transferee of accounts or chattel paper who has a right of recourse against the transferor. The transferor's potential recourse liability is the functional equivalent of a debtor's potential deficiency liability in the case of a true secured transaction. The transferor should therefore have the benefit of the same duty of reasonable care in relation to the collateral which is imposed on true secured parties by subsection (2). Relatedly, the proposed changes to subsection (2) would confirm that the secured party's duty to exercise reasonable care in relation to collateral in the form of accounts and chattel paper applies where the secured party is exercising collection rights.

Section 18– Secured Party's Duty to Provide Information about the Security Agreement

18.(1) The debtor, a creditor, a sheriff, a person with an interest in personal property of the debtor or an authorized representative of any of them may, by an authenticated demand in writing containing an address for reply and delivered to the secured party:

(a) at the secured party's most recent address set out in a registered financing statement containing a description of personal property of the debtor; or

(b) at the current address of the secured party, if known by the person who makes the demand;

require the secured party to send or make available the information specified in subsection (2) to the person making the demand or, if the demand is made by the debtor, to any person at an address specified by the debtor.

18.(2) The information that may be demanded pursuant to subsection (1) may be one or more of the following:

(a) a copy of a security agreement that provides for a security interest held by the secured party in the personal property of the debtor;

(b) an authenticated statement in writing of the amount of the indebtedness and of the terms of payment of the indebtedness, as of the day specified in the demand;

(c) an authenticated written approval or correction of an itemized list of personal property attached to the demand indicating which items are collateral as of the day specified in the demand;

(d) a written approval or correction of the amount of indebtedness and of the terms of payment of the indebtedness as of the day specified in the demand;

(e) sufficient information as to the location of the security agreement or a copy of it to enable a person entitled to receive a copy of the security agreement to inspect it.

18.(14) A secured party who replies to a demand mentioned in subsection (1) is estopped for the purposes of this Act as against:

(a) the person who makes the demand; or

(b) any other person who can reasonably be expected to rely on the reply;

to the extent that the person relies on the reply, from denying:

(c) the accuracy of the information contained in the reply to the demand pursuant to clause (2)(b) or (c) or (d); or

(d) that the copy of the security agreement provided in response to a demand pursuant to clause (1)(a) is a true copy of the security agreement required to be provided by clause (2)(a).

18.(15) A successor in interest mentioned in subsection (9) is estopped for the purposes of this Act as against:

(a) the person who makes the demand mentioned in subsection (1); and

(b) any other person who can reasonably be expected to rely on the reply to the demand;

to the extent that the person relies on the reply, from denying:

(c) the accuracy of the information contained in the reply to the demand pursuant to clauses (2)(b) and (c) and (d); or

(d) that the copy of the security agreement that was provided in response to a demand pursuant to clause (1)(a) is a true copy of the security agreement required to be provided by subsection (2)(a).

COMMENT

1. Minor changes are proposed for section 18. It is suggested that section 18(2)(d) be removed as redundant in the light of section 2(b), and that the cross-references to clause (d) in subsections (14)(c) and (15)(c) be deleted as also redundant.

1. The other proposed changes would confirm that the various written communications contemplated by section 18 must be authenticated by their author in view of their disclosure objectives and third party reliance effects. The new definitions of "authenticated" and "writing" proposed to be added in section 2 would confirm that the relevant communications can be authenticated and transmitted electronically.

Section 19 – Perfection of Security Interests

19. Subject to subsection 20(5), a A security interest is perfected when

(a) it has attached, and

(b) all steps required for perfection under this Act have been completed,

regardless of the order of occurrence.

COMMENT

The explanation for the proposed addition of a cross-reference in section 19 to new subsection 20(5) is given in comments 8 and 9 to section 10 above.

Section 21 - Deemed Damages Recoverable by Lessors, Consignors, and Transferors of Chattel Paper and Accounts

21 (1) Where the interest of a lessor for a term of more than one year or of a consignor pursuant to a commercial consignment referred to in subsection (3)(1) is not effective against a judgment creditor pursuant to subsection 20(1) or a trustee or liquidator pursuant to subsection 20(2), the lessor or consignor is deemed, as against the lessee or consignee, as the case may be, to have suffered, immediately before the seizure of the leased or consigned goods or the date of the bankruptcy or winding-up order, damages in an amount equal to:

(a) the value of the leased or consigned goods at the date of the seizure, bankruptcy or winding-up order; and

(b) the amount of loss, other than that mentioned in clause (a), resulting from the termination of the lease or consignment.

(2) Where the interest of a transferee or an account or chattel paper referred to in section 3(2) is not effective against a judgment creditor pursuant to subsection 20(1) or a trustee or liquidator pursuant to subsection 20(2), the transferee is deemed, as against the transferor, to have suffered, immediately before garnishment or seizure of the account or chattel paper or the date of the bankruptcy or winding-up order, damages in an amount equal to the value of the accounts or chattel paper at the date of the garnishment, bankruptcy or winding-up.

COMMENT

The current Act does not address the position of a buyer of an account or chattel paper where the account or chattel paper is lost to a execution creditor or a trustee in bankruptcy due to lack of perfection. The buyer should retain an unsecured claim against the transferor or transferor's estate to the value of the account or chattel paper lost. The result is the same as if the transferor had a right of recourse against the transferee. The proposed new subsection (2) would remedy the failure of the current Act to confirm this point.

Section 24 – Perfection by Possession

24(3) For the purposes of subsection (1) a secured party has possession of chattel paper, including electronic chattel paper, if the chattel paper is specifically inscribed with the name of the secured party as purchaser.

1. Proposed new subsection 24(3) would recognize and legitimate the practice of 'marking' chattel paper to identify the secured party as the assignee or purchaser of the chattel paper as an alternative to taking physical possession. The proposed change would also allow "electronic chattel paper" to be perfected by possession since inscription is feasible for both tangible and intangible paper whereas physical possession is feasible only for tangible paper.

2. See further the proposed definition of "electronic chattel paper" in section 2 and the proposed amendments to section 31 on priority below.

Section 28 – Effect of Disposition of the Collateral and Security Interests in Proceeds

28(1) Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest:

(a) continues in the collateral unless the secured party expressly or impliedly authorizes the dealing free of the security interest; and

(b) extends to the proceeds; . . .

28.(2) A security interest in proceeds is a continuously perfected security interest if the interest in the original collateral is perfected by registration of a financing statement that:

(a) contains a description of the proceeds that would be sufficient to perfect a security interest in original collateral of the same kind;

(b) covers the original collateral, if the proceeds are of a kind that are within the description of the original collateral; or

(c) covers the original collateral, if the proceeds consist of money, cheques or deposit accounts in banks or similar institutions.

28.(3) Where the security interest in the original collateral is perfected but the requirements of subsection (2) have not been met, in a manner other than a manner described in subsection (2), the security interest in the proceeds is a continuously perfected security interest, but becomes unperfected on the expiration of 15 days after the security interest in the original collateral attaches to the proceeds unless the security interest in the proceeds is otherwise perfected by any of the methods and under the circumstances specified in this Act for original collateral of the same kind.

COMMENT

1. The proposed addition to section 28(1) explicitly confirms what is already understood, i.e. that a security interest continues in collateral disposed of by the debtor unless the secured party authorized the dealing "free of the security interest." The proposed change does not, and cannot, resolve the fact-dependent question of whether this was the parties' intention in a particular case.

1. The proposed minor change to section 28(3) is designed to eliminate the suggestion that the subsection does applies only when the security interest in the original collateral is perfected by a method other than registration.

Section 29 – Security Interests in Returned, Seized or Repossessed Goods

29.(3) Where a sale or lease of goods creates an account or chattel paper, and:

(a) the account or chattel paper is transferred to a secured party; and

(b) the goods are returned to, seized or repossessed by the debtor or by the transferee of the chattel paper;

the transferee of the account or chattel paper has a security interest in the goods that attaches when the goods are returned, seized or repossessed.

29.(4) A security interest in goods that arises pursuant to subsection (3) is perfected if the security interest in the account or chattel paper was perfected at the time of the return, seize or repossession, but becomes unperfected on the expiry of 15 days after the return, seizure or repossession unless the transferee registers a financing statement relating to the security interest or takes possession of the goods by seizure, repossession or otherwise before the expiration of that period.

29.(5) A security interest in goods that a transferee of an account has pursuant to subsection (3) is subordinate to a perfected security interest arising pursuant to subsection (1) and to a security interest of a transferee of chattel paper arising pursuant to subsection (3).

29.(6) Subject to subsection (4), a A security interest in goods that a transferee of chattel paper has pursuant to subsection (3) has priority over:

(a) a security interest in goods that reattaches pursuant to subsection (1); and

(b) a security interest in goods as after-acquired property that attaches on the return, seizure or repossession of the goods;

if the transferee of the chattel paper would have priority pursuant to subsection 31(7) as to the chattel paper over an interest in the chattel paper claimed by the holder of the security interest in the goods.

29.(7) A security interest in goods given by a buyer or lessee of the goods mentioned in subsection (1) that attaches while the goods are in the possession of the buyer, lessee or debtor and that is perfected when before the goods are returned, seized or repossessed has priority over a security interest in the goods arising pursuant to this section subsection (1) and, subject to subsection (4), has priority over a security interest that arises pursuant to subsection (3) only if it has priority over the security interest that is a component of the chattel paper transferred to the transferee referred to in subsection (3).

COMMENT

1. It is proposed that the references to accounts be removed from section 29. Under the section, an accounts financier is given a security interest in returned or repossessed goods where the original sale or lease of the goods resulted in an account. This feature of section 29 does not reflect commercial practice. Accounts financiers do not rely on having a security interest in such goods. The deletion of accounts financing from this provision would therefore reduce its complexity without significant commercial prejudice.

1. The suggested changes to subsection (6) are designed to remove an ambiguity in the current wording as illustrated by the following scenario. Assume that SP1 is a wholesale financer with a security interest in the goods sold under the chattel paper transaction. SP2 is the transferee of the chattel paper. When the goods are returned or repossessed, both SP1 and SP2 have a security interest in the goods. SP2 has priority over SP1 as a result of the current subsection (6). What is not clear is whether this priority extends beyond the 15 day period referred to in subsection (4) if SP2 does not perfect its security interest in the returned goods before the expiry of that period. There is a good argument that it does. If this is so, there is potential for a circular priority problem should the debtor become a bankrupt after the expiry of the 15 day period. If SP1 perfects its interest, SP1 has priority over the trustee. However, since SP2's security interest in the goods is unperfected, the trustee has priority over SP2. Since SP2 has priority over SP1, a circularity of priorities exists. While circular priority problems cannot be eliminated completely, they should be avoided when possible. The purpose of the proposed changed is to do this. It would put SP2 in the same position as any other secured party who is given priority based on temporary perfection which, however, is lost when another method of perfection is not employed before the period of temporary perfection. See, for example, section 28(3). Any problems that this approach creates for chattel paper purchasers can be addressed by registering a security interest in the goods involved when the chattel paper is purchased.

Section 30 – Priority of Buyers and Lessees of Goods and Transferees of Licenses

30(2.1) A transferee of a non-exclusive license transferred in the ordinary course of business of the licensor takes free of a perfected or unperfected security interest in the licence created by the licensor whether or not the buyer or lessee knows of it, unless the licensee also knows that the sale or lease constitutes a breach of the security agreement pursuant to which the security interest was created.

30.(6) Where goods are sold or leased, the buyer or lessee takes free from any security interest in the goods that is perfected pursuant to section 25 if:

(a) the buyer or lessee bought or leased the goods without knowledge of a security interest; and

(b) the goods were not described by serial number in the registration relating to the security interest.

30.(7) Subsection (6) applies only to goods that are equipment or consumer goods and are of a kind prescribed as serial numbered goods.

COMMENT

1. The proposed new section 30(2.1) would provide the same protection to an ordinary course of business transferee of a licence that section 30(2) currently gives to ordinary course buyers and lessees of goods. The proposed section should be read in the light of the definitions of "intangible" and "licence" proposed above.

1. The proposed addition of a reference to "consumer goods" in section 30(7) is part of a proposal to change the priority repercussions of a failure to include a specific serial number description in a financing statement covering serial numbered goods, as defined in the PPSA Regulations adopted in each jurisdiction, where the goods are held by the debtor as consumer goods.

1. As presently drafted, the Model Act assumes that the Regulations which govern PPSA registrations in jurisdictions which adopt the Act require a specific serial number description in the financing statement if the serial

numbered goods are consumer goods, but that if they are held by the debtor as equipment, the secured party has the option to describe the goods either in general terms or specifically by serial number. In other words, under the scheme of the Model Act, failure to include a specific serial numbered description is fatal to the perfected status of the security interest in serial numbered consumer goods, whereas the priority repercussions of using only a generic description are less drastic in the case of serial numbered equipment. In the latter case, the secured party is subordinated to a buyer for value without notice under section 30(7), and the security interest is treated under 35(4) as unperfected for the purposes of a competition between competing security interests. However, a generic description will be sufficient to give the secured party priority over a judgement creditor or a trustee in bankruptcy, whereas, in the case of consumer goods, the security interest would be treated as unperfected and therefore subordinated to these classes of third parties pursuant to section 20 of the Act.

1. In the view of the authors of this Report, the existing distinction between consumer goods and equipment on this point lacks a sufficient policy rationale and introduces an unnecessary level of complexity into the priority structure of the Act. Serial number registration is primarily intended to ensure that prospective transferees of an interest in the specific goods in question are able to rely with confidence on a serial number search of the Registry. Consequently, a specific serial number description should be necessary only where their interests might otherwise be prejudiced. It is therefore proposed to change the scheme of the Model Act to authorize the optional use of a generic description for all serial numbered goods, subject to the risk of subordination, in the case of consumer goods or equipment, to buyers under section 30(7) and to competing secured parties who have registered by serial number under section 35(4). In addition to adding a reference to consumer goods in these sections, implementation of this policy change would require the amendment of the relevant parts of each jurisdiction's PPSA Regulations to authorize optional generic descriptions for all serial numbered goods, regardless of whether they are held by the debtor as consumer goods,

equipment, or inventory.

Section 32 – Priority of Repairers' Liens

32. Where a person in the ordinary course of business furnishes materials or services with respect to goods that are subject to a security interest, a lien that the person has with respect to those materials or services has priority over a perfected security interest unless the lien is given by an Act that provides that the lien does not have the priority.

COMMENT

PPSA jurisdictions may wish to consider deleting this provision and enacting the ULC Uniform Liens Act

Section 35 – Residual Priority Rules

35.(4) A security interest in goods that are equipment or consumer goods and are of a kind prescribed as serial numbered goods is not registered or perfected by registration for the purposes of subsection (1), (7) or (8) or subsection 34(2) unless a financing statement relating to the security interest and containing a description of the goods by serial number is registered.

35.(6.1) A buyer or lessee takes free from a security interest to the extent that it secures advances, other than advances referred to in subsection (6)(c), made by the secured party with knowledge of the transfer to the buyer or the execution of the lease.

35.(7) Where:

(a) registration of a security interest lapses as a result of a failure to renew the registration or is discharged without authorization or in error; and

(b) the secured party re-registers [or revives its registration] the security interest not later than 30 days after the lapse or discharge;

the lapse or discharge does not affect the priority status of the security interest in relation to:

(c) a competing perfected security interest that, immediately prior to the lapse or discharge, had a subordinate priority position, except to the extent that the competing security interest secures advances made or contracted for after the lapse or discharge and prior to the re-registration.

35.(7.1) Where registration of a security interest lapses as a result of a failure to renew the registration, or is discharged without authorization or in error, the lapse or discharge does not affect the priority status of the security interest in relation to a person mentioned in section 35(7) when the lapse or discharge occurs after the secured party has seized the collateral as provided in section 58(2) or, in the case of an intangible or chattel paper, has taken the measures referred to in section 57(2).

35.(8) Where a debtor transfers an interest in collateral that, at the time of the transfer, is subject to a perfected security interest, that security interest has priority over any other security interest granted by the transferee before the transfer except to the extent that the security interest granted by the transferee secures advances made or contracted for:

(a) after the expiry of 15 days from the day on which the secured party who holds the first mentioned security interest in the transferred collateral has knowledge of the information required to register a financing change statement showing the transferee as the new debtor; and

(b) before the secured party mentioned in clause (a) amends the registration to disclose the name of the transferee as the new debtor or takes possession of the collateral.

35.(10) When two or more incorporated debtors who have given security interests to separate secured parties amalgamate as provided in The Business Corporations Act or any other applicable legislation,

(i) subject to section 51, priority of the security interests with respect to property of the each separate corporation existing at the date of the amalgamation is to be determined as if the amalgamation had not occurred;

(ii) the security interests in after-acquired property of the merged corporation provided for in security agreements with the separate debtors have equal priority to the value of the obligation owing to each secured party at the date of the amalgamation.

35.(11) The priority of future advances made by a secured party after the amalgamation shall be subject to subsection (10)(ii).

35.(12) A perfected security interest given by the debtor or successor in interest of the debtor has priority over a prior security interest given by the debtor that was unperfected when the first mentioned security interest was given by the debtor or successor, whether or not the debtor or successor in interest of the debtor took free from the prior security interest.

COMMENT

1. The proposed addition of a reference to "consumer goods" in section 35(4) is explained above in the comment which relates to the same proposed change in section 30(7).

1. The proposed new section 35(6.1) addresses a matter not settled in the current Act. It is designed to make it clear that a buyer or lessee is not affected by the priority status given to future advances made with knowledge of the transfer to the buyer or execution of the lease.

1. The proposed new section 35(7.1) is designed to deal with the situation in which a registration lapses or is fraudulently or inadvertently discharged after a secured party has begun enforcement measures. There is no good policy reason to require the secured party to maintain registration in order to maintain protection against prior, subordinate interests. Of course, the security could be subordinated to a person acquiring an interest in the collateral after enforcement measures have commenced since, in the case of goods, seizure is not perfection by possession and, in the case of intangibles, notice to the account debtor is not a perfection step.

4. The minor amendment to section 35(8) is designed to remove an ambiguity in the provision,

5. The proposed sections 35(10-(11) are designed to address the issue of priority that arises when two or more corporations which have given security interests in their existing and after-acquired property amalgamate and the "new "corporation acquires property that falls within the collateral description of the security agreements executed by the amalgamating corporations. Under provincial business corporations legislation, the amalgamated corporation is not treated as a new entity but merely a continuation of the corporations involved in the amalgamation. Consequently, there is no solution in corporate law to the issue that arises when all of the secured parties claim priority to the collateral acquired by the "new corporation."

5. Under the proposal, security interests that exist at the date of the amalgamation are subject to section 51 to the extent that the "new" corporation has a corporate name different from the corporations involved in the amalgamation. However, since business corporation law does not treat the new corporation as a different entity, there is no transfer of the collateral of the corporations involved in the amalgamation to the "new corporation."

5. Since collateral acquired by the "new" corporation is notionally caught by the prior security interests given by the corporations involved in the amalgamation, the effect of the proposal is to give the holders of these interests a pro-rated share in collateral. No secured party can affect the share of another secured party by making future advances to the "new corporation."

8. The proposed new section 35(12) is designed to remove any doubt as to the application of the priority structure of section 35(1) in the "two debtor" situation. See generally, Cuming, "Double-Debtor A-B-C-D Problems in Personal Property Security Legislation" (1992), 7 B.F.L.R. 359.

Section 41 – Effects on Account Debtors of an Assignment of Accounts or Chattel Paper

41.(10) Within 15 days after receiving an authenticated demand in writing from the assignor, the assignee shall send to an account debtor who has received notice of the assignment, an authenticated notice in writing that releases the account debtor from any further obligation to the assignee if:

(a) all of the obligations under the security agreement to which the assignment relates have been performed;

(b) the assignee is not committed to make advances, incur obligations, or otherwise give value; and

(c) the assignment relates to a transaction referred to in subsection 3(1).

COMMENT

Derived from revised article 9-209, proposed new subsection 41(10) would add a useful measure of protection for account debtors on an account or chattel paper which has been assigned as collateral under a 'true' security agreement within subsection 3(1) of the Act. If all outstanding obligations under the security agreement to which the assignment relates have been performed, and the secured party is not committed to extend further advances or otherwise incur any further obligations to the debtor, the proposed subsection would empower the debtor to require the secured party to send a written notice to any account debtor to whom a notice of the assignment has been sent, releasing the account debtor from any further obligations to the secured party.

[1]In the fall of 1998, new Article 9 was disseminated to each state, to be introduced and adopted with a common effective date of July 1, 2001.

[2]The Act has not yet been proclaimed in the Northwest Territories and Manitoba. However, at the annual meeting of the CCPPSL in May 2000 in Montreal, representatives of these jurisdictions stated that they expected proclamation to take place within the coming year. The Ontario Branch of the Canadian Bar Association has recommended changes which would bring the Ontario PPSA closer in line with the CCPPSL Model Act, particularly in the critical area of scope: see *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property*

Security Act (Canadian Bar Association – Ontario: 21 Oct 1998). However, that recommendation has not been acted upon by government.

[3]Readers should be aware that there are a number of minor differences between the New Brunswick and Saskatchewan versions of the Model Act. For present purposes, the most significant of these are: (1) the addition in the New Brunswick version of "a sale of goods without a change of possession" to the list of deemed security interests to which the Act applies pursuant to section 3; (2) the use of registration of a notice of judgment in the Personal Property Registry as the relevant point for determining priority between an unperfected security interest and a judgment creditor pursuant to section 20.