Report on the Study Committee on Reform of Canadian Secured Transactions Law 2002

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Transactions Law 2001-02

Background

[1] As part of the Commercial Law Strategy of the Uniform Law Conference, a study committee on the reform of Canadian secured transactions law was created. Professor Ronald Cuming of the College of Law, University of Saskatchewan, and Professor Catherine Walsh of the Faculty of Law, McGill University, are the co-chairpersons of the Committee.

[2] This is the second year of the Committee's operation. It met once in Toronto (March) and held three telephone conference call meetings (February, May and June).

Membership of the Committee

[3] Tamara Buckwold (College of Law, University of Saskatchewan); John Cameron (Torys LLP, Ontario); Arthur Close (ULCC, British Columbia); Ronald Cuming (College of Law, University of Saskatchewan); Michel Deschamps (McCarthy Tetrault, Quebec); Kenneth Morlock (Fasken Marineau, Ontario & Chair, ULCC Commercial Law Strategy), Catherine Walsh (Faculty of Law, McGill University); Roderick Wood (Faculty of Law, University of Alberta); Hélène Yaremko-Jarvais (ULCC Commercial Law Strategy); Jacob Ziegel (Professor Emeritus, Faculty of Law, University of Toronto).

Mandate of the Committee

[4] The mandate of the Committee is to develop recommendations that might be used by the Uniform Law Conference of Canada to encourage greater harmonization and ongoing modernization of the provincial and territorial laws dealing with secured transactions in personal (movable) property.

Approaches to the Mandate

[5] The approach the Committee employed during the first year of its operation (2000-01) was to attempt to develop a set of recommendations relating to a small number of issues on which broad support for reform could likely be obtained quickly and with little controversy. The selected issues were to have significance for all PPSA jurisdictions and Quebec. However, this approach proved unsuccessful.

[6] As reported in 2001, there was a general consensus among the Committee members that, while some progress had been made, in the longer run the approach initially adopted would not likely result in a significant reduction in the differences between the secured financing law of Ontario and Quebec, respectively, and that of the other provincial and territorial jurisdictions, which enjoy a high degree of uniformity. Further, the approach did not facilitate coordination of the Committee's work with the more comprehensive study of personal property security law being carried out by Professors Cuming and Walsh in connection with the model law prepared by the Canadian Conference on Personal Property Security Law (the basis for the PPSAs in all jurisdictions except Ontario, Quebec and the Yukon Territory). At its 2000 meeting, the ULC had agreed that efforts should be made to coordinate the two projects.

[7] The Committee recommended in its 2001 report that it be authorized to proceed from the basis of the work contained in the Cuming-Walsh study with the ultimate goal of giving systematic

consideration to all aspects of secured transactions law as it relates to personal or movable property.

The Work Plan

[8] At its first meeting following the 2001 meeting of the ULC, the Committee agreed to focus attention on these areas:

- The bank security regime provided by section 427 of the Bank Act and the problems resulting from the conceptual conflict between this specialized system and the general provincial and territorial secured financing regimes (to be carried out in cooperation with the Law Commission of Canada).
- Harmonization of conflict of laws rules, including consideration of which if any of the conflicts features of Revised Article 9 (2001) of the U.S. Uniform Commercial Code might be adapted to Canada.
- Purchase money security interests (including the priority of a security interest in accounts as proceeds, refinancing and cross-collateralization).
- Security interests in licences.
- Anti-assignment clauses affecting accounts and chattel paper.
- Modifications to provincial secured financing law necessitated by the draft Uniform Securities Transfer Act.

[9] Before it reaches conclusions on most of the issues addressed, the Committee will seek input from a wide range of interested parties and organizations. The Committee has considered a number of ways in which to reach the relevant constituencies. The Law Commission has offered to assist in the dissemination of papers and questionnaires relating to reform of Section 427 of the Bank Act. Contact with interested persons may also be made through a special edition of the Commercial Law Strategy newsletter, and otherwise through the ULC website.

[10] The Committee has prepared consultation papers dealing with all (except the last) of the areas identified above. These papers provide a description of the issues involved and solicit responses on suggested alternative approaches to dealing with them. In some cases, the Committee has expressed its view of the preferred approach. Since some of the reports are very lengthy, it was decided that shortened versions will be sent out to potential respondents, and the complete versions will be made available on a web page. The logistical implications of this approach are currently being examined.

[11] It was also decided that the papers relating to "fast-track" issues reported on by the Committee in 2000-01 would be incorporated in the consultation process. The secured transactions issues covered by these papers include the effects of corporate amalgamation, the taking in payment remedy and exemptions from seizure or security. (See 2001 Report)

[12] Set out below is a brief overview of the matters addressed by the Committee during its meetings. Various members of the Committee prepared discussion papers that have been modified for use as consultation papers.

SECTION 427 OF THE BANK ACT

[13] Professor Wood prepared a consultation paper addressing the joint project of the Committee and the Law Commission of Canada to harmonize the federal Bank Act security and the provincial secured transactions regimes.

[14] As Professor Wood's paper records, three past attempts at reform in this area have failed. Consequently, the purpose of the Committee's consultation efforts will be to determine whether there is sufficient consensus to move forward at this time.

[15] The consultation paper presents three options for reform and

describes the implications of each. These options are: (i) repeal section 427 of the Bank Act; (ii) harmonize the priority rules of section 427 with those of the PPSAs and the Civil Code of Quebec (hereafter the "CCQ") (or, alternatively, retain section 427 only for the purposes of enforcement but otherwise subject Bank Act security to provincial law); (iii) create a comprehensive self-standing federal secured transactions regime for Bank Act security (and possibly other federally regulated secured transactions). The paper records the conclusion that the Committee favours the first option.

HARMONIZATION OF CONFLICT OF LAWS (Private International Law) RULES

[16] Professor Walsh prepared a consultation paper addressing aspects of harmonization of conflict of laws rules at three levels: among the various PPSA regimes; between the PPSA regimes and the Québec Civil Code; and between Canadian rules and the conflicts rules of Revised Article 9 (2001) of the U.S. Uniform Commercial Code. The paper also draws on the recommendations for reform and clarification of the PPSA conflicts rules contained in the Cuming-Walsh Report (2000) to the ULCC.

The consultation paper addresses the following issues:

- Harmonization (among the PPSAs and the CCQ and between Canadian law and Revised Article 9) of the criteria for determining the location of debtor enterprises with a place of business in more than one jurisdiction for the purposes of the choice of law rule (common to all the Canadian regimes) that refers the validity, publicity, and priority of security interests to the law of the debtor's location.
- Harmonization of legal policy concerning the appropriate balance to be struck between protecting secured creditors and protecting the integrity of the local registry in the event of transfer of intangible collateral or mobile tangible assets to a

transferee located in a different jurisdiction who then resells or charges the collateral.

- Clarification that the choice of law rules governing validity and publicity encompass all issues relating to the priority of the secured creditor's rights against competing claimants (this clarification would bring the Canadian conflicts rules more explicitly into harmony with the rules in Revised Article 9).
- Elimination as unnecessary of the choice of law rule, unique to the Ontario PPSA, governing the effects of relocation of goods subject to a seller=s right of revendication (this repeal would bring Ontario conflicts policy into line with the other PPSAs and the CCQ);
- Elimination of the reference to renvoi in the choice of law rules of the non-Ontario PPSAs (this deletion would bring the other PPSAs into line with the Ontario PPSA and the CCQ, as well as with Revised Article 9).
- Clarification in all regimes of the choice of law rule for a priority contest between a possessory security interest (pledge) and a non-possessory security interest in intangibles represented by a negotiable or quasi negotiable document (e.g. cheques, bills of lading).
- Clarification in all regimes of the choice of law rules governing the procedural and substantive aspects of the enforcement of security on the debtor's default.
- Clarification of the meaning of the term "attaches" in the PPSA conflicts rules, and clarification of the PPSA choice of law rules governing the validity, publicity and priority of security interests in the proceeds of original collateral.
- Clarification that the conflicts rules of each province or territory apply: (a) in the case of the PPSAs, to all transactions that would qualify as "security interests" under the domestic law of that province or territory, including deemed security interests such as leases or consignments; (b) in the case of the CCQ, to all transactions, including title transfer, title retention, lease, and

leasing transactions, that are subject to the equivalent publicity requirements that apply to hypothecs.

- Harmonization of legal policy concerning the protection of buyers or lessees who enter into a purchase or lease transaction with the debtor after the relevant assets are brought into their province by the debtor but before the holder of an extraprovincial security interest re-publicises in accordance with the law of the new location.
- Harmonization of legal policy concerning whether there should be an exception to the application of the law of the debtor's location to issues relating to the validity, publicity and priority of a security right in intangible assets and mobile goods where the jurisdiction in which the debtor is located does not maintain a public registry for ensuring public disclosure of security interests;
- Consideration of whether the new unitary rule in Revised Article 9 of the UCC referring all issues of perfection to the jurisdiction where the debtor is located, regardless of the tangible or intangible nature of the collateral, is feasible or desirable in a Canadian context. (On this point, for the reasons set out in the consultation paper, the Committee recommends against incorporation of the new Article 9 rule into the Canadian regimes. However, it is further recommended that the ULCC refer, to the CCPPSL study committee established for this purpose, issues relating to the harmonization of the provincial registry operations including the feasibility of national access gateways.)

PURCHASE MONEY SECURITY INTERESTS

[17] The consultation paper prepared by Professor Buckwold addresses the fact that the various provincial and territorial PPSAs have different priority rules to deal with proceeds collateral in the form of accounts. The position under the CCQ is also addressed. Specifically, the paper addresses the priority competition that may

arise between a secured inventory financer claiming accounts as proceeds, generated by sale of the original inventory collateral, and a prior financer who has taken a general security interest in accounts or an outright assignment of accounts from the business debtor involved.

[18] The policy issue raised in this context is whether or not the inventory financer should take priority over the prior-in-time accounts financer or assignee through assertion of its purchase money security interest (pmsi) in the accounts (assuming that the PPSA requirements for establishing pmsi priority have otherwise been met).

[19] The consultation paper points out that there are, among the PPSAs of the Canadian provinces and territories, three different approaches to resolution of these priority disputes. In Ontario, the inventory financer would have priority on the basis of its pmsi. In the Atlantic Provinces, the inventory financer would have priority, also by reason if its pmsi, provided that it has given the accounts financer the stipulated notice. In the Western provinces and the territories, the accounts financer would have priority if it has given new value for its security interest in the accounts in question.

[20] The Civil Code represents a distinct approach to the problem as it might arise in Quebec. Since a security interest in inventory generally does not extend to or continue in the accounts receivable generated by sale, a priority dispute over accounts is determined on the basis of who is first to register an interest in those accounts. In the scenario contemplated by the consultation paper, the accounts financer would win. The result is therefore substantially the same as that produced by the PPSAs of the Western provinces and the territories.

[21] After setting out the benefits and problems associated with each of the existing PPSA options, the consultation paper presents the following questions: (i) Which of the three options represented by the current PPSAs is preferable; and (ii) Is a uniform approach to these

issues necessary or desirable?

[22] The paper notes that the Committee is aware of no compelling evidence suggesting that the current diversity of approaches is creating significant difficulty, either in terms of legal uncertainty or in terms of the availability of credit to business debtors. While uniformity on this point is no doubt desirable, it may not be essential.

LICENCES

[23] The consultation paper prepared by John Cameron focuses on the need to ensure that licences (whether issued by government or private issuers) are treated as personal (movable) property so as to be available as collateral under secured financing law.

[24] The paper proposes that secured financing law be amended to include both transferable and non-transferable licences in the definition of collateral. The need to include non-transferable licences is dictated by Canadian bankruptcy law. If non-transferable licences can be treated as collateral, proceeds generated by the disposition of the collateral will not become part of the bankruptcy estate.

[25] The consultation paper seeks advice as to whether this measure is commercially necessary.

ANTI-ASSIGNMENT CLAUSES AFFECTING ACCOUNTS AND CHATTEL PAPER

[26] The consultation paper prepared by John Cameron states the Committee's conclusion that all PPSAs should provide that clauses designed to prevent assignments of accounts and chattel paper should be unenforceable except possibly to the extent that they deal with fractional assignments. However, they should be valid to the extent that they provide the basis for account debtors' claims for damages for breach of contract by assignors. This is the law in

provinces that have adopted the Canadian Conference on Personal Property Security Law Model Act.

MODIFICATIONS TO PROVINCIAL SECURED FINANCING LAW NECESSITATED BY THE DRAFT UNIFORM SECURITIES TRANSFER ACT

[27] The Committee did not address this matter since the Draft Uniform Securities Transfer Act was not available.

This report is submitted by Professors Ronald Cuming and Catherine Walsh and has been adopted by the Committee.