

Substantial Amendments to Ontario's PPSA Legislation

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By Rupert Chartrand Michael De Lellis

Ontario has introduced a series of significant amendments to the *Personal Property Security Act (Ontario)* (the PPSA). The last major amendments to the PPSA occurred in 1989. This Osler Update highlights amendments to the PPSA that are of particular interest to court officers of insolvent enterprises and others taking or enforcing security.

In 1976, Ontario was the first province to implement a modernized personal property security regime, modelled after Article 9 of the United States' *Uniform Commercial Code* (the UCC). Since then similar personal property security legislation has been enacted in each of the common law provinces and territories, subject to provincial variations. The majority of the new amendments will come into force on August 1, 2007, but some will come into force at a later, unspecified date. In addition, certain amendments to the PPSA were introduced on January 1, 2007 as a result of an entirely new piece of legislation, the *Securities Transfer Act, 2006* (Ontario). Unless otherwise stated, the amendments discussed will be proclaimed into force on August 1, 2007.

Securities Transfer Act

The *Securities Transfer Act, 2006* (Ontario) (the STA), which is modeled on similar reforms under Article 8 of the UCC, was proclaimed into force on January 1, 2007. It establishes a new legal regime to deal with the holding, transferring and pledging of financial assets. The STA addresses both (a) financial assets that are directly held by investors and (b) financial assets that are indirectly held by investors and recorded in the books of a securities intermediary, which are in turn reflected in the records of a centralized clearing agency system (i.e., CDS). The STA adopts modernized rules to reflect the reality that the vast amount of trading of financial assets on public exchanges is settled in book-based indirect holding systems. For more information on the STA, see our July 7, 2006 Osler Update.

Under the STA, a secured party can still perfect its security interest in "investment property" (a new PPSA classification applicable to most financial assets) by registering a financing statement pursuant to the PPSA. However, a secured party may also perfect its security interest in investment property by "control", which basically means that the secured creditor has taken steps to enable it to deal with the investment property without further action by the debtor. Such control may be obtained by entering into "control agreements" which are consensual agreements between the secured party and the issuer or securities intermediary.

Perfection through "control", rather than by registration, is now the preferred method. A secured party who perfects a security interest in investment property by "control" will defeat a prior secured party who perfects its security interest in such investment property solely by registration. In an insolvency or receivership proceeding, a court-appointed officer will now have to inquire about and review control agreements which could affect other creditors.

Leases With a Term of More Than One Year

A lease "for a term of more than one year", regardless of whether the lease secures payment or performance of an obligation, will be deemed to fall within the scope of the PPSA. This amendment will simplify some of the issues currently associated with the characterization of lease transactions in Ontario, and bring the PPSA in line with its provincial counterparts.

Leases that do not secure payment or performance of an obligation will still be excluded from the operation of Part V of the PPSA which deals with secured party obligations, debtor rights and the enforcement of security. This exclusion will maintain the present PPSA policy: the rights and remedies available to a secured party upon the occurrence of a default by a debtor should only apply to secured transactions. As a consequence, issues surrounding the characterization of lease transactions will not be avoided entirely, but rather deferred until enforcement.

Restrictions on Assignment of Accounts

The amended PPSA will limit the effect of certain contractual provisions between a person obligated on an account or chattel paper (an account debtor) and the person to whom the obligation is owed (an account creditor). More specifically, a contractual clause prohibiting or restricting an account creditor from assigning, or giving a security interest in, the whole of an account or chattel paper will be unenforceable against third parties, and binding on the assigning account creditor only to the extent that the account creditor will be liable to the account debtor for breach of contract. If an account creditor borrows from a third party lender and pledges its interest in an account as security, the third party lender is entitled to enforce its security regardless of any contractual provision between the account debtor and the account creditor.

Preserving PMSI Priority: Notice to Accounts Receivable and Inventory Financiers

The requirement that a purchase money secured party in inventory give notice in writing to all other prior secured parties with an interest in collateral classified as inventory will be expanded. Given that a purchase money security interest (PMSI) also extends to the proceeds of inventory, the PPSA will require that such notices also be given to prior secured parties with an interest in accounts in addition to an interest in inventory.

Foreclosure of Collateral

After default, a secured party may propose to accept the collateral in satisfaction of the obligation secured (except in certain circumstances where the collateral is "consumer goods"). The PPSA prescribes who is entitled to notice of such a proposal and now provides that notified parties have 15 days to object (rather than 30 days) unless the court extends the period. If no objections are received, the secured creditor will be deemed to have accepted the collateral at the end of the period in full satisfaction of the obligations secured.

Simultaneous Foreclosure on Real and Personal Property

Under the amended PPSA, if a secured party has a security interest in both real and personal property, the court may make "any order necessary to enable the secured party to accept both the real and personal property in satisfaction of the obligation secured or to enable the secured party to enforce any of its other remedies against both the real and personal property".

Exemptions From Seizure

Personal property exempt from seizure under the *Execution Act* (Ontario), such as household and other essential property, will be similarly exempt from the right of a secured party to take possession upon default. However, this exemption will not apply to property subject to a PMSI or a possessory security interest. Accordingly, a bankrupt individual will not be able to claim an exemption in most instances for a leased or financed automobile.

Collateral Description Provisions

The present collateral classification requirements on a financing statement, which consists of ticking the appropriate collateral description box(es), are to be replaced by a new classification system that will instead require the secured party to complete a narrative description identifying the collateral by item or type. Collateral description by narrative is not an entirely new concept in Canada, as the majority of the provinces presently operate under such a classification system. Before such a change is implemented, major changes to the Ontario Registrar's computer systems are required and the Regulations will need to be amended. Once this change is implemented, care will need to be taken in reviewing the narrative descriptions in order to ascertain the scope of a secured party's security interest in the collateral of a debtor.

These amendments are the most significant amendments made to the PPSA and amend several aspects of the legislation including, among others, the PPSA priority regime for pledges of financial assets, the PMSI notice requirements, the registration regime and the enforcement process. It is important for court officers of insolvent enterprises and others to be aware of these amendments to the PPSA as they may have a direct impact on the manner in which they take, review or enforce security.