PERSONAL PROPERTY SECURITY LAW REFORM IN CANADA

by

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1. Introduction

All the Canadian common law provinces now have Personal Property Security Acts ("PPSAs"), but this has not signaled the end of personal property security law reform. Far from it. The Ontario Bar Association's Business Law Section Personal Property Security Law Subcommittee ("PPSL Committee")[1] keeps the Ontario PPSA under constant review and it has submitted detailed sets of reform proposals to government in 1993, 1998 and 2006. The Uniform Law Conference of Canada ("ULCC") keeps all the provincial PPSAs under review and it has been responsible for several reform initiatives, as well as having various other proposals under consideration. Finally, the Law Commission of Canada currently has a reference to examine security interests arising under federal laws including the Bank Act,[2] the Canada Shipping Act,[3] and the various federal intellectual property statutes.[4] The project involves the interaction between federal law and the provincial PPSAs and it has generated a number of recommendations which impact on the PPSAs.

Some of these reform proposals have been acted on by government, others are under active government consideration and others still are likely to come under active consideration in the relatively short term. This paper discusses a selection of proposals in these three categories.

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[1] Formerly Canadian Bar Association –Ontario Business Law Section Personal Property Security Law Subcommitee.

[2] SC 1991, c.6.

[3] RSC 1985, c.S-9.

[4] Including the Patent Act RSC 1985, c.P-4, the Copyright Act, RSC 1985, c.C-42, the Trade-marks Act, RSC 1985, c.T-13, the Industrial Design Act RSC 1985, c.I-9, the Integrated Circuit Topography Act SC 1990, c.37 and the Plant Breeders' Rights Act SC 1990, c.20.

Part 2, below discusses a number of proposals made by the PPSL Committee for amendments to the Ontario PPSA. Part 3 discusses some ULCC initiatives, and Part 4 discusses the Law Commission's federal security interests project, focusing on the Commission's proposals for reform of the law relating to intellectual property security interests. Part 5 concludes.

2. The PPSL committee proposals

(a) Introduction

The PPSL Committee, under the auspices of the Canadian Bar Association – Ontario, made detailed submissions to the Ontario government in 1993 and again in 1998 recommending various amendments to the Ontario PPSA.[5] Both the PPSL Committee's reports were pigeon-holed and, with the exception of some technical amendments enacted in 2001, most of its proposals remain unimplemented.

However, there was a change of government in Ontario in 2003, and the new government has recently announced a comprehensive overview of the province's business laws, including the PPSA. The plan is to introduce PPSA amending legislation in the coming fall session of the provincial parliament. With the Minister's encouragement, the PPSL Committee made submissions this past April and May incorporating its earlier reform proposals and making a number of additional recommendations. The PPSL Committee developed its April-May 2006 submissions in close consultation with government representatives and the indications are that its recommendations will receive a more sympathetic hearing this time round than they did on the two previous occasions. [6]

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[5] Canadian Bar Association – Ontario, *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act and the Repair and Storage Liens Act* (1993) (the "1993 PPSL Committee Report"); Canadian Bar Association – Ontario, *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act* (1998) (the "1998 PPSL Committee Report").

[6] The government released a consultation paper on 30 May 2006 incorporating many of the PPSL Committee's proposals and calling for stakeholder responses by 30 June 2006: Ontario Ministry of Government services, *Business Law Modernization Consultation Paper: The Personal Property Security Act* (30 May, 2006).

Some of the PPSL Committee's recommendations relate to what are essentially housekeeping matters or to greater harmonization between the Ontario PPSA and the PPSAs in the other provinces. These recommendations will not be of particular interest in Australia. However, some of the PPSL Committee's other recommendations relate to drafting or policy changes not reflected in the other provinces' PPSAs and which the other provinces themselves would presumably want to consider.

(b) The 1993 PPSL Committee Report

(i)Distinction between true leases and security leases. Section 2 of the Ontario PPSA provides that the Act applies to every transaction that in substance creates a security interest including a lease that secures payment or performance of an obligation. There has been a large amount of litigation on the distinction between leases that do and leases that do not fit this description. To help resolve the issue, the PPSL Committee recommended the enactment of a provision, modeled on s.1-201(37) of the United States Uniform Commercial Code, setting out the governing principles. The issue is a less pressing one outside Ontario because, for the most part, the non-Ontario PPSAs apply to every lease for a period of more than one year whether it secures payment or performance of an obligation or not. However, the enforcement provisions only apply to a lease that secures payment or performance of an obligation and so the distinction is still relevant in that context. For this reason, an amendment along the lines proposed by the PPSL Committee would also be worth consideration in the non-Ontario provinces.[7]

(ii) Security interests in ships. It is unclear whether a ship mortgage which might otherwise be registrable under the Canada Shipping Act requires registration under the Ontario PPSA. To avoid the potential for overlap, the PPSL Committee recommended the enactment of a provision specifying that the Act does not apply to a mortgage under the Canada Shipping Act. There is a provision along these lines in the non-Ontario PPSAs. However, a ULCC

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[7] A ULCC Discussion Paper makes this proposal: RCC Cuming and Catherine Walsh, *A Discussion Paper on Potential Changes to the Model Personal Property Security Act of the Canadian Conference on Personal Property Security Law* (2001), 25-27 ("ULCC Discussion Paper").

Discussion Paper goes further, recommending extension of the exclusion to *any* security interest in a registered ship or recorded vessel under the Canada Shipping Act.[8]
The registration and priority rules in the Canada Shipping Act are limited to security interests in the form of a statutory ship mortgage. They do not apply, for example, to lease or conditional sale agreements. While it is clear that, as a matter of constitutional law, the Canada Shipping Act provisions displace the PPSA rules in the case of a mortgage security interest, there is conflicting case law on the question whether the PPSAs apply in the case of a non-mortgage security interest. Under the PPSL Committee's proposed solution, the registration and priority rules in the Canada Shipping Act would apply to disputes involving a mortgage security interest, but the PPSAs would apply to disputes involving non-mortgage security interests. Under the ULCC Discussion Paper's proposed solution, the PPSAs would not apply at all and, in the case of disputes involving non-mortgage security interests, it would be left to federal maritime law to fill the gaps in the Canada Shipping Act's coverage. The PPSAs would be confined to security interests in vessels licensed under the Canada Shipping Act but not recorded or registered in the federal ownership registry.

The justification for the ULCC Discussion Paper's proposed approach is that "it avoids the confusion which would result from potentially overlapping federal and provincial 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 secured parties of registered ships and recorded vessels can rely with confidence on a search of the CSA registry, without having to make a concurrent search of the provincial PPRs".[9]

A better solution to the overlap problem would be to integrate the statutory regimes by: (1) enacting complementary priority rules in the Canada Shipping Act and the PPSAs ; and (2) making the CSA register compatible with the PPSA registers to allow for the transmission

[8] *Ibid.* 30 and 35-37.
[9] *Ibid* 36.

of data between them.[10] However, particularly given that in Canada there are 13 separate provincial PPSA registers, this would be a very ambitious project. There is currently no political will to integrate the PPSA registers, let alone to achieve integration with other registration regimes. On this basis, the ULCC Discussion Paper's proposed solution may be viewed as a kind of second best, or stop-gap, alternative.

(iii) Errors in financing statement. Section 46(4) of the Ontario PPSA provides that an error invalidates a financing statement if "a reasonable person is likely to be misled materially". There is a comparable provision in the non-Ontario PPSAs. The provision is significant because if the financing statement is invalid, the security interest will be unperfected unless the secured party corrects the error or can rely on an alternative method of perfection. Broadly speaking, an error is potentially misleading if the consequence is to make the security interest unsearchable. For example, under Ontario's exact match data retrieval system, any error in the debtor's name is potentially misleading because a search under the debtor's correct name will not disclose the secured party's interest. In the non-Ontario provinces, which have adopted a similar match system, an error will invalidate the financing statement if it prevents a search from disclosing the security interest at all or in a form reasonable searchers are likely to recognize.

If the collateral comprises non-inventory serial-numbered goods – a car, a truck or the like – all jurisdictions provide for registration against both the debtor's name and also the serial number or vehicle identification number (VIN). Assume the secured party correctly discloses the debtor's name on the financing statement, but gets the VIN wrong. Does the VIN error invalidate the financing statement or does the correctly stated debtor's name cure the VIN error? The cases establish that the error invalidates the financing statement. Some courts have held that this is because it is not reasonable to expect a searcher to conduct a search in both the debtor's name index and the serial number index and a searcher who

[10] A measure along these lines was proposed in Queensland Law Reform Commission and Law Reform Commission of Victoria, *Personal Property Securities Law: A Blueprint for Reform* (QLRC DP No. 39 and LRCV DP No. 28, 1992), para. 3.3.8.

searches only in the debtor's name index is unlikely to discover the security interest.[11] Other courts have held that a reasonable searcher would conduct both kinds of search but, even allowing for this, the VIN error is still potentially misleading because it means that the searcher will be unable to discover any security interest a prior owner may have created: the debtor's name search will not retrieve the entry because the entry is indexed against the prior owner's name, not the debtor's and the serial number search will not retrieve the entry, given the VIN error. [12]

Now assume the secured party correctly discloses the VIN on the financing statement, but gets the debtor's name wrong. Does the error invalidate the financing statement? The Canadian provincial courts have split on this question. Some courts take the view that it is not reasonable to expect a searcher to conduct both kinds of search and, since a search against the debtor's name is unlikely to disclose the security interest, the error is an invalidating one.[13] Other courts take the view that a reasonable searcher would conduct both kinds of search and, since a serial number search would disclose the security interest, the debtor's name error does not invalidate the financing statement. [14]

To settle the issue, the PPSL Committee recommended a provision stating specifically that in this second case, the debtor's name error does not invalidate the financing statement. However, some other provinces have taken the opposite tack. For example, the New Brunswick PPSA provides specifically that in *both* cases, the error invalidates the financing statement. There is a similar provision in the other maritime provincial PPSAs and New Zealand has followed suit.[15] There are arguments in favour of either approach, but the statute should resolve the issue one way or the other with a view to saving litigation costs.

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[11] *Re Kelln (Trustee of)v. Strasbourg Credit Union Ltd* [1992] 3 WWR 310 (Sask CA); *Case Power & Equipment v. 366551 Alberta Inc.(Receiver of)* (1994) 23 Alta LR (3d) 361 (Alta CA); *Re Moncton Motor Homes & SalesInc* 2003 NBCA 26 (NBCA).
[12] *Re Lambert* (1994) 7 PPSAC (2d) 240 (OCA); *Gold Key Pontiac Buick (1984) Ltd v. 464750 BC Ltd (Trustee of)* (2000) 2 PPSAC (3d) 206 (BCCA).
[13] See cases cited in n.11.
[14] See cases cited in n.12.
[15] New Zealand PPSA, s.150.

Incidentally, there is a problem with the New Zealand version. The New Zealand regulations treat a motor vehicle's serial number as comprising both the VIN and the vehicle's registration number,[16] while s.172(e) of the Act provides for searches against serial number. The implication seems to be that a searcher has the option of searching against either number. Assume the secured party correctly discloses the VIN in the financing statement, but gets the vehicle registration number wrong, or *vice versa*. Section 150 provides that a serial number error invalidates the financing statement. Does the secured party's error invalidate the financing statement? There are arguments both ways. On the one hand, the courts might say that since the secured party got one of the specified serial numbers right, there is no serial number error. Or they might reach the opposite conclusion on the ground that the secured party failed to get both numbers right.[17] The latter result arguably places too heavy a burden on the registering party. It increases the risks of secured lending and it may affect both the cost and availability of credit. It is open to question whether the benefits to searchers of the additional search option the New Zealand legislation provides are sufficient to offset the costs.

(c) The 1998 PPSL Committee Report

(i)Statutory licences. Can a statutory licence – for example, a tobacco quota, a taxi-cab licence or a nursing home licence – be used as collateral? There is conflicting Ontario case law on this question. In *National Trust Co. v. Bouckhuyt*,[18] the Ontario Court of Appeal had to decide whether a basic production quota to grow tobacco granted under the Farm Products Marketing Act qualified as property within the meaning of the PPSA. The court held that it did not because it was no more than a licence or permission to do what would otherwise be unlawful. Since the licence was not property, it could not be used as collateral.

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[16] Personal Property Securities Regulations, Schedule 1, cl. 9.

[17] Regulation 16 is relevant. It provides that, for the purposes of a search by reference to serial number, the searcher must enter both the vehicle registration number and the VIN. This seems to presuppose that the debtor cannot do one kind of search without the other. On the other hand, as a matter of practice the system will allow the search to proceed even if the debtor only specifies one of the numbers. An issue the courts may have to determine down the track is whether the practice of allowing a search against one number only should be taken into account in determining what amounts to a reasonable search.

[18] (1987) 39 DLR (4th) 543.

In *Re Foster*,[19] it was held that a taxi cab licence issued by the City of Mississauga could be used as collateral. The court distinguished *Bouckhuyt* on the basis that there the licensing authority had an unfettered discretion whether to recognize an assignment of the quota whereas, in the present case, the degree of control exercised by the city was "vastly different". *Re Foster* suggests that the relevant variable is the amount of discretion the licensing statute gives the authority over licence renewals and transfers. The less discretion the authority has, the stronger the licence holder's entitlement and the easier it becomes to characterize the licence as property. On the other hand, the greater the authority's discretion, the more "transitory and ephemeral" the licence holder's entitlement is.

Re Foster is unsatisfactory because it creates uncertainty: parties have no way of knowing at the time of transacting which side of the line a court might subsequently decide the case falls. Moreover, the decision arguably focuses on the wrong question. The real question is not what the licensing statute says *per se* but, rather, whether the secured party is prepared to accept the licence as collateral having regard to whatever restrictions the licensing statute might place on the duration, renewal and transfer of the licence. In other words, the acceptability of a statutory licence as collateral should be a matter for the market to decide, not the courts.

With these sorts of consideration in mind, the PPSL Committee recommended amending the definition of "intangible" in the PPSA to include a specific reference to licences. There is a provision along these lines in the Saskatchewan PPSA. The Saskatchewan PPSA also provides, in ss 57(3) and 59(18) that the secured party's power to realize its security by sale must be exercised in conformity with the terms and conditions governing the transfer of the licence. There are currently no equivalent provisions in the other provincial PPSAs or in New Zealand.

(ii)Sales in the ordinary course of business. Section 28(1) of the Ontario PPSA provides that a buyer of goods from a seller who sells the goods in the ordinary course of business takes them free from any security interest given by the seller even though it is perfected and

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[19] (1992) 89 DLR (4th) 555.

the buyer knows of it, unless the buyer also knew that the sale constituted a breach of the security agreement.

In *Royal Bank of Canada v. 216200 Alberta Ltd*,[20] customers entered into contracts with a retailer for the purchase of furniture which remained undelivered when the retailer went into receivership. The customers claimed the goods from the receiver relying on the Alberta equivalent of Ontario PPSA, s.28(1). The court held that the provision did not apply because property in the goods had not passed to the customers according to the rules for the passing of property set out in the sale of goods legislation. Therefore, there was no "sale", but only an "agreement to sell" as the sale of goods legislation defines those terms. In *Spittlehouse v. Northshore Marine*,[21] a dealer sold a boat to a customer pursuant to a conditional sale agreement. The boat was subject to a perfected security interest the dealer had given to a finance company. The question was whether PPSA, s.28(1) applied. The finance company argued that it did not, relying on the *Royal Bank of Canada* case. However, the court declined to follow the *Royal Bank of Canada* case and held that s.28(1) should not be read down by reference to the technical meaning of "sale" in the sale of goods legislation.

The court arguably got to the right result in the *Spittlehouse* case, but for the wrong reason. Jettisoning the meaning of "sale" as laid down in the sale of goods legislation would lead to uncertainty in the application of PPSA, s.28(1). It is all very well to say that the provision refers to sales in a non-technical sense, but in the absence of a clear statement as to what that non-technical sense might be, parties have no way of knowing the parameters of the section. The PPSAs take a substance over form approach to secured transactions. As a general rule, they treat all transactions that are in substance security interests the same, regardless of differences in form. If the court in *Spittlehouse* had been more attuned to the PPSA philosophy, it might have reasoned that *in substance*, the transaction between the dealer and the customer was an outright sale coupled with a security interest given by the customer to the dealer to secure payment of the purchase price. On that basis, the dealer had

[20] (1987) 51 Sask. R. 147 (CA).
[21] (1994) 18 OR (3d) 60 (CA).

sold the boat to the customer in the sense the *Royal Bank of Canada* case identified and so the two cases were reconcileable after all.

In any event, the PPSL Committee recommended amending PPSA, s.28 to remove the uncertainty created by these two cases. Specifically, the committee recommended a provision specifying that the section applies provided the goods have been identified to the contract of sale and regardless of whether: (1) property in the goods has actually passed to the buyer; or (2) the seller retained or took a security interest in the goods. The committee also recommended that s.28(1) should not apply in cases where the security interest in competition with the buyer's claim has been perfected by possession and the secured party is in possession of the goods at the time of the buyer's purchase. There is a similar provision in s.9-320 of Revised Article 9. The provision reverses the decision in *Tanbro Fabrics Corp. v. Deering Milliken Inc.*,[22] in relation to the corresponding provision in old Article 9. The rationale is that possession is an accepted way for an inventory financier to protect itself against the risk of inventory sales outside the ordinary course of business and allowing the buyer to prevail in these circumstances would frustrate the inventory financier's legitimate expectations.

(iii) Similar match searches. As noted above, all provinces except Ontario have opted for a similar match system of registry data retrieval. Ontario has opted for an exact match system. An exact match system has no tolerance for errors in the registration and search criteria. For example, all errors, no matter how minor, in the debtor's name as disclosed on the financing statement will prevent a search under the debtor's correct name from retrieving the entry. Likewise, all errors, no matter how minor, in the debtor's name as disclosed on a search application will prevent the search from retrieving entries registered against the debtor's correct name. By contrast, in the case of a similar match system a search will reveal entries under the debtor's name as specified in the search application and also such sufficiently similar names as the technology allows for. The search certificate will disclose a list of similar name entries and it is a matter for the searcher to identify from the list the actual entry the searcher is looking for.

[22] 39 NY 2d 623 (CA, 1976).

The PPSL Committee considered whether Ontario should move to a similar match system. It rejected the idea on two grounds. First, it believed that "the much greater volume of registrations in Ontario, as compared to the other provinces, would lead to search results of unmanageable size being reported in many instances. The effect would be to increase significantly the time which would have to be spent in reviewing the search report and in reacting to its contents. This would necessarily increase the transaction costs for secured parties and, in turn, would likely increase the costs to consumers and other debtors".[23] Secondly, the committee concluded that " since the degree of "closeness" in the search match will always be arbitrary to some extent, the legal effect of including close matches on a search report is not certain. For example, if a searcher discovers a registration in the search process which is "close" but does not match the search criteria exactly, what obligations are imposed on the searcher? A searcher should not have to consider non-complying registrations where the effect of the non-compliance is the failure of the registration to be revealed by a search using criteria which would have been the basis for a valid registration. In short, the disruption and other disadvantages in changing from an 'exact match' system to a 'similar match" system would appear to greatly outweigh the advantages (if any)".[24]

Although the New Zealand PPSA regime is modeled by and large on the Saskatchewan PPSA text and the New Brunswick technology, it nevertheless uses the exact match system. The choice of systems is a matter that will require consideration in Australia. If Australia proceeds with the plan of establishing a single national PPSA register, the PPSL Committee's observations about the volume of registrations and the potentially unmanageable size of search results may need to be taken into account.

(d) The 2006 Committee proposals

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[23] *Op.cit.* 22.
[24] *Ibid.*

(i)PMSI priority: accounts receivable and inventory financiers .Section 33(1) of the Ontario PPSA governs the priority of inventory purchase money security interests. It provides that a purchase money security interest in inventory or its proceeds has priority over any other security interest in the same collateral given by the same debtor provided that: (1) the purchase-money security interest was perfected at the time the debtor obtained possession of the inventory; and (2) before the debtor receives possession of the inventory, the purchase-money secured party gives notice in writing to "every other secured party who has registered a financing statement in which the collateral is classified as inventory before the date of registration by the purchase-money secured party". The notice must state that the person giving it has, or expects to acquire, a purchase-money security interest in inventory of the debtor, describing the inventory by item or type.

Assume Secured Party A grants the debtor a credit facility secured against the debtor's inventory from time to time. A's security interest is perfected by registration. Secured Party B later supplies the debtor with inventory pursuant to a conditional sale agreement. B registers a financing statement before delivering the inventory to the debtor. The effect of PPSA, s.33(1) is that B has priority over A in relation to the inventory and its proceeds, even though A was the first to register, provided B notifies A of its purchase-money security interest before the debtor obtains possession of the inventory. The purpose of the notice requirement is to alert A to the possibility that B's security interest may have priority with respect to the inventory in question. This information may be relevant to A's decision whether it should continue to allow the debtor to draw on the facility. To be sure, A could obtain the information by conducting a register search but to be on the safe side A would have to search before every one of the debtor's drawings. This may be impractical, particularly in cases where the debtor is making frequent drawings. The notice requirement avoids the problem. Incidentally, the corresponding provision in s.74 of the New Zealand PPSA omits the notice requirement, presumably because the legislators did not appreciate its significance.

Assume Secured Party A grants the debtor a credit facility secured against the debtor's accounts receivable from time to time. A's security interest is perfected by registration.

Secured Party B later supplies the debtor with inventory pursuant to a conditional sale agreement. B registers a financing statement before delivering the inventory to the debtor. The effect of s.33(1) is that B has priority over A in relation to accounts receivable generated by the debtor's sale of the inventory, even though A was the first to register. In this case, there is no need for B to notify A because A is not a "secured party who has registered a financing statement in which the collateral is classified as inventory". The upshot is that A has no easy means of discovering from time to time whether it can count on priority in relation to any given batch of the debtor's accounts receivable. The problem also affects securitization arrangements. Assume A is a securitization conduit. It agrees to purchase the debtor's "eligible" accounts receivable on a regular basis during the currency of the arrangement. The PPSA applies to the outright sale of accounts and so A needs to take account of the purchase-money super-priority rule in s.33(1). This means that, for the purposes of the arrangement, A needs to know in advance of each accounts receivable purchase whether the accounts receivable are proceeds of inventory subject to a purchase-money security interest. The absence of a requirement for B to notify A means that A has no ready means of finding out.

The maritime PPSAs have addressed the problem by requiring the purchase-money secured party to notify any secured party who has registered a financing statement in which the collateral is classified as inventory *or accounts.* This means that in the last two examples, above, B must notify A as a condition of obtaining priority. The other provinces take a different tack, modeled on the Article 9 approach. They provide that, in the case of a competition between an accounts receivable financier claiming the accounts as original collateral and an inventory financier claiming the accounts as proceeds, the accounts receivable financier takes priority provided it has given new value for its security interest.[25] The main justification is to facilitate securitization transactions.[26] The PPSL Committee has recommended adoption of the maritime PPSA approach in Ontario. It rejected the alternative approach on the grounds that: (1) it involves an unnecessarily radical departure from the purchase-money security interest super-priority rule; and (2) the more modest approach

[25] *E.g.*, Saskatchewan PPSA, s.34 (6).
[26] ULCC Discussion Paper, 69.

represented by the maritime PPSA solution sufficiently protects the accounts receivable financier as well as securitization interests.

(ii) Conflict of laws- location of debtor rule. Under the Canadian and New Zealand PPSAs, the choice of law rules for the validity, perfection and effect of perfection or non-perfection of a security interest are as follows: (1) for ordinary goods and possessory security interests in money and documentary intangibles, the *lex situs* of the collateral applies; and (2) for mobile goods and non-possessory security interests in intangibles, including accounts, the law of the jurisdiction where the debtor is located applies.

A debtor is deemed to be located at the place of the debtor's business, if there is one, at the debtor's chief executive office if there is more than one place of business and otherwise at the debtor's principal place of residence. Old Article 9 incorporated a similar definition. Revised Article 9 changes the law by enacting a special rule for cases where the debtor is a registered organization. A registered organization is an entity organized under United States federal or state law which requires a public record to be maintained disclosing the organization: Revised Article 9, s.9-102(70), (76). A registered organization that is organized under the law of a state is located in that state: s.9-307(e).

The purpose of the reform is to increase certainty and reduce filing errors: a corporation's registered office is easier to verify than the location of its chief executive office or place of business. The PPSL Committee has recommended a similar change for Ontario. The proposed new rules are as follows: (1) if the debtor is a company incorporated in a province, its location is the province; (2) if the debtor is incorporated under federal law, its location is the place specified in its constating instrument or its by-laws; (3) if the debtor is incorporated in a U.S. state, its location is the state; (4) if the debtor is incorporated under U.S. federal law, its location is the state the law designates, the state the debtor designates if authorized to do so or otherwise the District of Columbia; (5) if the debtor is a company incorporated outside Canada or the United States, its location is the place of its chief executive office. Rule (5) is designed to ensure that a debtor which has a substantial presence in Canada does not avoid

the PPSA regime just because it happens to be incorporated in a country that does not have a corresponding regime.

If Ontario adopts this recommendation, it is likely that the other provinces will follow suit because the importance of uniform choice of law rules is generally recognized. On the other hand, the proposed changes are inconsistent with the choice of law rules in the United Nations Convention on the Assignment of Receivables in International Trade and, if enacted, they may preclude Canada from adopting the Convention.[27] The Canadian PPSA conflict of law rules, in common with the Article 9 rules, apply both domestically, to determine which province's laws apply in the case of a dispute with inter-provincial elements and internationally, to determine the applicable law in the case of a dispute with foreign elements. If Australia were to enact a national PPSA choice of law would not be an issue at the domestic level but it would continue to be relevant at the international level. It follows that there would still be a need for conflicts rules. The PPSL Committee's recommendations are relevant to Australia in that connection.

(iii) Security interests in deposit accounts. Old Article 9 did not apply to security interests in deposit accounts as original collateral. Revised Article 9 removes the exclusion and it goes on to create special attachment, perfection and priority rules for these security interests.

Section 9.102(29) defines "deposit account" to mean "a demand, time, savings, passbook or similar account maintained with a bank." Section 9.203(b) provides that, contrary to the general rules governing attachment, a security interest in a deposit account attaches even if the security agreement is not authenticated (signed by the debtor or the electronic equivalent) and does not contain an adequate collateral description. Section 9-312 establishes a new and exclusive form of perfection for security interests in deposit accounts, namely "control". A

[27] The Convention defines location as the State where the debtor has its: (1) place of business; (2) habitual residence if the debtor does not have a place of business; and (3) centre of administration if the debtor has multiple places of business or branches in different States: Article 5(h). "Centre of administration" is equivalent to the chief executive office concept. The Convention choice of law rules are therefore compatible with the current PPSA rules, but they are incompatible with the changes the PPSL Committee has proposed. They could be made compatible if the proposed new place of organization rule were limited to debtors whose place of organization and chief executive office were both within Canada. However, the PPSL Committee rejected a suggestion that it should limit its proposal in this way.

secured party has control over a deposit account if: (1) the secured party is the bank with which the deposit account is maintained; (2) the debtor, the secured party and the bank have agreed in an authenticated record that the bank will comply with the secured party's instructions in relation to the account; or (3) the secured party becomes the bank's customer with respect to the deposit account: s.9-104(a).

Section 9-327 sets out the following priority rules: (1) a security interest held by a party having control over the deposit account has priority over a conflicting security interest held by a secured party that does not have control; (2) subject to (3) and (4), below, security interests perfected by control rank according to priority in time of obtaining control; (3) subject to (4), below, a security interest held by a bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party; and (4) a security interest perfected by control in the third of the senses s.9-104(a) identifies has priority over a security interest held by the bank with which the deposit account is maintained.

The Canadian PPSAs have always applied to security interests in deposit accounts. The PPSAs define "account" broadly to mean all intangibles in the form of a monetary obligation and the definition clearly covers deposit accounts. The normal attachment, perfection and priority rules apply to security interests in deposit accounts. In particular, there is no provision for perfection by control. A secured party, including the depository bank, can obtain a perfected security interest in the deposit account by registering a financing statement and, as a general rule, priority between competing perfected security interests will turn on the order of registration. The New Zealand PPSA is the same in this regard.

The Revised Article 9 rules heavily favour the depository bank over competing secured creditors. The depository bank will nearly always have priority by virtue of having control in the first of the senses s.9-104(a) identifies. The bank can cede control by entering into a tripartite control agreement with the debtor and a competing secured party. However, s.9-342 provides that the bank is not required to enter into a control agreement even if its customer requests or directs and there is little incentive for banks to comply voluntarily. The

competing secured party can also obtain control by having the deposit account established directly in its name as the depository bank's customer. However, this will not be a feasible solution if the debtor requires regular access to the account. Part of the reason for Revised Article 9's special approach to deposit accounts was a concern that if the general rules applied, the debtor might inadvertently give away a perfected security interest in a deposit account *via* a security agreement covering all the debtor's accounts or personal property: Official Comment on Revised s.9-109.

The PPSL Committee considered and rejected a proposal to amend the Ontario PPSA along similar lines. Arguments against the Revised Article 9 approach are that: (1) it gives the depository bank an unjustified competitive advantage over other secured creditors; (2) existing law, including the depository bank's right of set-off**,** adequately protect it against interference with ordinary banking practices; and (3) the concerns which motivated the Article 9 approach have not been pressing ones in Canada. The thinking in the other provinces appears to be the same.[28]

3. ULCC projects

(a)Introduction

The following discussion relates to two matters: (1) the ULCC Discussion Paper;[29] and (2) the proposed uniform securities transfer legislation. The Uniform Securities Transfer Act was drafted by a Task Force set up by the Canadian Securities Administrators and the draft was released in June, 2002. The legislation proposed a number of significant amendments to the PPSAs. The CSA asked the ULCC's working group on the reform of secured transactions

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[28] Ronald CC Cuming and Catherine Walsh, "Revised Article 9 of the Uniform Commercial Code: Implications for the Canadian Personal Property Security Acts" (2002) *Banking and Finance Law Review* 339 at 364-368.

[29] See n. 6, above. The Discussion Paper was presented to the August 2000 meeting of the Uniform Law Conference of Canada and it is available on the ULCC's website.

law to examine these proposed amendments and the ULCC ended up having a significant involvement in the project in that capacity.[30]

(b) The ULCC Discussion Paper

*(i)Introduction.*The ULCC Discussion Paper canvasses a large number of possible amendments to the non-Ontario PPSAs, inspired in part by the Revised Article 9 reforms in the United States. The proposed changes include the following: (1) the introduction of medium neutral language with a view to facilitating electronic transactions; (2) an expanded definition of "purchase-money security interest" aimed at addressing the issues of cross-collateralization and refinancing; (3) inclusion in the definition of "intangible" of a specific reference to licences; (4) statutory confirmation of the point that the PPSAs do not apply to *Quistclose* trusts and the like; (5) the inclusion of a specific exclusion for security interests taken in registered ships or recorded vessels under the Canada Shipping Act; (6) various amendments to the conflict of laws provisions mainly for purposes of clarification; (7) clarification of the rules relating to the collateral description in security agreements; (8) changes aimed at facilitating security interests in electronic chattel paper; (9) various relatively minor changes to the priority rules; and (10) adoption of the Saskatchewan PPSA approach to the competing claims of an accounts receivable financier and an inventory financier claiming a purchase money security interest in the debtor's accounts as proceeds of inventory.[31]

To date none of these recommendations have been endorsed by the ULCC. Some of them have been picked up the PPSL Committee in Ontario and these may find their way into Ontario law. Implementation of the other recommendations does not appear to be imminent. However, it does not follow that they should be discounted. The lack of action to date reflects more on the slow pace of commercial law reform than it does on the value of the recommendations themselves.

[30] The ULCC Working Group's recommendations in relation to the securities transfer law reform project are contained in *Report of the Working Group on Reform of the Law of Secured Transactions* presented at the ULCC Meeting held in Fredericton, New Brunswick, August 2003 ("ULCC Secured Transactions Working Group Report"). The report is available on the ULCC's website.

[31] See Part 2(d)(i), above.

The most important of the ULCC Discussion Paper's recommendations is the one relating to the definition of purchase money security interest. Given time and space constraints, it is not possible to discuss all the recommendations in detail. The following discussion will focus on the purchase-money security interest issue with particular reference to refinancing and cross-collateralization.

(ii) PMSIs and refinancings. The ULCC Discussion Paper recommends adding a paragraph to the definition of "purchase-money security interest" to address the effect of renewals, refinancings and restructurings on pmsi status. The recommendation derives from Revised Article 9, s.9-103(f)(3). Assume a secured party holds a purchase-money security interest. It later agrees to restructure the loan, canceling the original contract and entering into a fresh contract with the debtor that reflects the new payment terms. The same security interest secures the debtor's obligations under the new contract. Does the secured party still have a purchase-money security interest? On a literal reading of the definition as it is presently drafted, the answer is "no", either because the security interest no longer secures the purchase price or because the new loan is not "value for the purpose of enabling the debtor to acquire rights in the collateral". If this were right, the consequence might be to discourage purchase-money loan restructurings. The purpose of the amendment is to make it clear that the pmsi financier does not lose pmsi status in these circumstances.

Assume a secured party holds a purchase-money security interest. A second lender agrees to refinance the loan and to take over the first lender's purchase-money security interest. The safest way of proceeding is to take an assignment of the purchase-money security interest, but for whatever reason, the parties do not proceed in this way. Instead, the second lender advances funds which the debtor uses to pay out the first lender and takes a new security interest in the same collateral. Does the second lender have a purchase-money security interest? Again, on a literal reading of the definition, the answer is "no". Canadian courts

have struggled to avoid this outcome, but the reasoning in the cases is unsatisfactory.[32] The proposed amendment makes it clear that the second lender does have pmsi status.[33]

Assume Secured Party A hold a purchase-money security interest in the debtor's tractor. Secured Party B holds a non- purchase-money security interest in the debtor's forklift truck. Secured Part C agrees to take over the two loans in return for a security interest in the tractor and the forklift. Does Secured Party C have a purchase-money security interest? The effect of the proposed amendment, read in conjunction with other parts of the definition, is that Secured Party C has a purchase-money security interest in the tractor but not the forklift. In other words, the refinancing arrangement gives Secured Party C no larger rights against third parties than Secured Party A and Secured Party B themselves had.

(iii) Cross-collateralization.[34] Assume a secured party makes a loan to enable the debtor to purchase a truck. The security agreement provides that, to secure the loan, the debtor grants the secured party a security interest in all present and after-acquired personal property. Does the secured party have a purchase-money security interest? If the collateral had been limited to the truck itself, the answer would clearly have been "yes". The question is whether the presence of the additional collateral destroys the secured party's pmsi status in relation to the truck. United States courts have divided on this question and Revised Article 9, s.9-103(f) now expressly provides that pmsi status is not lost just because collateral that is not purchase-money collateral also secures the purchase-money obligation. This reflects the position taken by the courts in Canada.[35] The upshot is that the secured party has a purchase-money

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[32] *Battlefords Credit Union Ltd v. Ilnicki* (1991) 82 DLR (4th) 69 (Sask. CA); *Unisource Canada Inc. v. Laurentian Bank of Canada* (2000) 47 OR (3d) 616 (CA).
[33] That is not the end of the story. To obtain super-priority, pmsi status alone is not enough. The pmsi financier must also comply with the procedural requirements set out in the pmsi priority provisions. For example, if the collateral is equipment, the pmsi financier must perfect its security interest before or within 10 days after the debtor obtained possession of the collateral. How does this requirement apply in relation to the second financier? The answer is to read the words as if they said "obtained possession of the collateral as a debtor *of the second financier*". On this reading, the second financier has 10 days after the making of the loan agreement to perfect its security interest: *Unisource Canada Inc. v. Laurentian Bank of Canada* (2000) 47 OR (3d) 616.
[34] The examples in the following discussion are taken from Ronald CC Cuming, Catherine Walsh and Roderick J. Wood, *Personal Property Security Law* (Irwin Law, Toronto, 2005), 341-345.
[35] *Clark Equipment of Canada Ltd v. Bank of Montreal*[1984] 4 WWR 519 (Man. CA).

security interest in the truck and a non-purchase-money security interest in the other collateral.

Assume a secured party makes a loan to enable the debtor to purchase a truck. The security agreement gives the secured party a security interest in the truck. It also contains an all obligations clause which provides that the security interest also secures any other obligations that might be owed by the debtor to the secured party. Does the secured party have a purchase-money security interest? If the secured obligations had been limited to the purchase price of the truck, the answer would clearly have been "yes". The question is whether the all obligations clause changes the outcome. Again, courts in the United States have divided on this question and Revised Article 9, s.9-103(f) now specifically provides that pmsi status is not lost just because the purchase-money collateral secures an obligation that is not a purchase-money obligation. This is consistent with the position the courts in Canada have taken.

Assume a bank takes a security interest in all the debtor's present and after-acquired property and registers a financing statement. Later a seller sells fifty head of cattle to the debtor for $25,000 under a conditional sale agreement. The same seller later sells a further 100 head of cattle to the debtor for $50,000 under a similar security agreement. Both security agreements contain a clause saying that the security interest secures not only the goods sold pursuant to the agreement, but also any other goods that the seller sells to the buyer. The seller registers both its security interests and complies with the procedural steps the PPSA prescribes for obtaining pmsi priority. The debtor defaults and all the cattle are sold. There is $15,000 owing to the seller in respect of the first lot of cattle and $45,000 owing in respect of the second lot. The first lot are sold for $20,000 and the second lot are sold for $40,000. Does the seller have a pmsi in the entire $60,000 proceeds?

As the law currently stands, the answer is "no". The seller has a purchase-money security interest in the first lot of cattle for the price of those cattle and, as a result of the cross-collateralization clause, it has a non-purchase-money security interest in the first lot of cattle for the price of the second lot. The seller also has a purchase-money security interest in the

second lot of cattle for the price of those cattle and, as a result of the cross-collateralization clause, it has a non-purchase money security interest in the second lot of cattle for the price of the first lot. The upshot is that, in relation to the $20,000 proceeds from the sale of the first lot of cattle, the seller has priority as to $15,000 by virtue of its pmsi status and the bank has priority as to the remaining $5,000 by virtue of its earlier registration. In relation to the $40,000 proceeds from the sale of the second lot of cattle, the seller has priority as the whole amount since it is less than the amount owing in respect of the second lot.[36]

In the last example, the cattle may be either equipment or inventory, depending on whether the debtor acquired them for resale. Assume they are inventory. Revised Article 9, s.9-103(b) provides that a security interest in goods is a purchase-money security interest if the security interest is in inventory that is or was purchase-money collateral, to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest. On this basis, the seller would have a purchase- money security interest in both lots of cattle for the total amount outstanding on both accounts. This means it would have priority over the bank for the entire $60,000 sale proceeds. The ULCC Discussion Paper recommends a similar amendment to the Canadian PPSAs except that it would limit the new rule to the case where the security agreements are related transactions. A related transaction is one where the possibility of both transactions is provided for in the first transaction or a prior agreement between the parties.[37]

The paper explains the proposed change and the related transactions restriction as follows: "the new concept of cross-collateralization would give a pmsi financier priority with respect to any 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

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[36] Cuming, Walsh and Wood, *op.cit.* 344. *Cf Chrysler Credit Canada Ltd v. Royal Bank of Canada* [1986] 6 WWR 338 (Sask. CA).
[37] ULCC Discussion Paper, 17.

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 cross-collateralization of obligations arising under prior separate agreements. .. . This is a legitimate restriction. If the parties contemplate a continuing relationship, this should be established from the beginning. The law should facilitate cross-collateralization where there is a continuing relationship that involves pmsis so that the secured party need not keep separate accounts for each separate sub-transaction as the current definition requires. Beyond this, there is a risk of prejudice to prior secured creditors of the same debtor".[38]

(c) The Uniform Securities Transfer Act

(i)Introduction. The USTA is based on Article 8 of the United States Uniform Commercial Code. The objective of the legislation is not to change securities holding practices but, rather, to provide a clear and certain legal foundation for current practices, in particular the indirect holding system.[39] With this end in mind, the USTA regulates the holding and transfer of securities and interests in securities. As drafted in 1994, Article 8 applied to both security and non-security transfers of interests in securities ("investment property"). However, the provisions governing security interests were transferred to Article 9 in the course of the most recent Article 9 revision. The proposed Canadian reforms take the same approach: the STA will be enacted in conjunction with a complementary set of PPSA amendments relating to security interests. The following discussion focuses on the proposed PPSA amendments. An overview of the USTA at large is contained in the Appendix, below.

(ii)The Revised Article 9 provisions. Revised Article 9, s.9-102(49) defines "investment property" to mean a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract or commodity account. Sections 9-203 and 9-308 provide for automatic attachment and perfection in certain circumstances and s. 9-305 enacts special choice of law rules for security interests in investment property. However, the most important features of the regime are the provisions relating to perfection by control and the special priority rules for security interests in investment property.

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[38] *Ibid.* 22.

[39] ULCC Secured Transactions Working Group Report, para. [32].

Section 9-102 defines "investment property" to mean a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract or commodity account. A security interest in investment property may be perfected by filing or control: ss 9-312 and 9-314. A security interest in a certificated security may also be perfected by possession: s.9-313(a). Control is defined in s. 9-106 with reference back to s.8-106. The rules are as follows: (1) a secured party has control of a certificated security in bearer form if the certificated security is delivered to the secured party; (2) a secured party has control of a certificated security in registered form if the certificated security is delivered to the secured party and the certificate is indorsed to the secured party or is registered in the name of the secured party ; (3) a secured party has control of an uncertificated security if the uncertificated security is delivered to the secured party or the issuer has agreed that it will comply with instructions originated by the secured party without further consent by the registered owner; (4) a secured party has control of a security entitlement if it becomes the entitlement holder or the securities intermediary has agreed that it will comply with entitlement orders originated by the secured party without further consent by the entitlement holder; (5) delivery of a certificated security occurs when the secured party acquires possession, or another person acquires possession on the secured party's behalf, and delivery of an uncertificated security occurs when the issuer registers the secured party, or another person on behalf of the secured party, as the registered owner. Special rules govern the attachment and perfection of a security interest in a securities account where the securities intermediary is the secured party: ss9-206 and 9-310.

Section 9-328 sets out the priority rules for security interests in investment property as follows: (1) a security interest of a secured party having control of investment property has priority over a security interest of a secured party that does not have control; (2) a security interest in a certificated security in registered form which is perfected by taking delivery and not by control has priority over a conflicting security interest perfected by a method other than control; (3) generally speaking, conflicting security interests of secured parties each of which has control rank according to priority in time of obtaining control; (4) a security interest held by a securities intermediary in a security entitlement or securities account maintained with the securities intermediary has priority over a conflicting security interest

held by another secured party; (5) a security interest held by a commodity intermediary in a commodity contract or a commodity account maintained with the commodity intermediary has priority over a conflicting security interest held by another secured party; (6) conflicting security interests granted by a broker, securities intermediary or commodity intermediary which are perfected without control rank equally; and (7) in all other cases, the residual priority rules apply. Section 8-303 protects the purchaser of a certificated or uncertificated security from adverse claims, including security interests, and this provision is incorporated by reference into Revised Article 9: s.9-331.

The provisions in the Canadian PPSAs relating to investment securities are much more rudimentary. The legislation provides that a purchaser (including a buyer and a secured party) who acquires possession of a certificated or uncertificated security takes free from any perfected security interest if the purchaser gave value and acquired the investment security without knowledge of the security interest.[40] There is a similar provision in the New Zealand PPSA: s. 97. However, there are currently no special attachment or perfection rules for security interests in investment property and, apart from the purchaser protection rule, no special priority rules for competing security interests in the same investment property. The proposed PPSA amendments will incorporate new provisions relating to security interests in investment property modeled on Revised Article 9.

4. Intellectual Property Security Interests

The following example illustrates the problems arising out of the interaction between the federal intellectual property laws and the provincial PPSAs. A debtor located in Ontario gives Secured Party A a security interest in a patent. Secured Party A registers a financing statement under the Ontario PPSA. The debtor later gives Secured Party B a security interest in the same patent. The security agreement is in the form of a mortgage. B registers the assignment in the Patent Office. The debtor later defaults against A and B and both secured

[40] *E.g.*, Saskatchewan PPSA, s.31(4).

parties claim the patent. The outcome of the dispute turns on whether the Patent Act[41] or PPSA priority rules apply.

Patent Act, s.51 provides as follows: “every assignment affecting a patent for invention, whether it is one referred to in section 49 or 50, is void against any subsequent assignee, unless the assignment is registered as prescribed by those sections, before registration of the instrument under which the subsequent assignee claims”. The section implies a first to register rule and so, if it applies B will have priority over A because B registered in accordance with the section, whereas A did not.[42] However, it is uncertain whether the section applies. In the first place, it has not been conclusively determined whether it applies to security agreements at all, or whether it is limited to non-security assignments. Even if the provision does apply to security agreements, it is unclear whether it is limited to the case where both competing security interests take the form of an assignment or whether it applies to hypothecation-type securities as well. Assume, for example, that A’s security interest is in the form of charge. There is an argument for saying that the section does not apply because a charge is not an assignment. On the other hand, the point has not been settled.

If the section does apply, there is a question as to how far it overrides the provincial PPSAs. There is some authority to suggest that the section has negative priority effect only – registration prevents a prior unregistered assignee from prevailing against an innocent subsequent assignee who registers. However, it does not create a positive first-to-register priority rule so as to prevent a later assignee from claiming priority under some other- than - first-to-register priority rule in provincial law.[43] If the section does not apply, it is uncertain whether the provincial PPSAs apply instead. A patent is an “intangible” within the meaning of PPSA, s.1(1) and so the PPSA ostensibly applies to both A’s and B’s security agreements unless it is excluded by statutory provision or as a matter of constitutional law. There is no relevant exclusion in the Ontario PPSA, but there is a provision in all the other PPSAs except the Yukon excluding from the scope of the statute security agreements governed by an Act of

[41] RSC 1985, c.P-4.
[42] Unless B had actual knowledge of A’s security interest at the time of its security agreement with the debtor: *Colpitts v. Sherwood* [1927] 3 DLR 7 (Alta CA).
[43] *Poolman v. Eiffel Productions. SA.* (1991) 35 CPR (3d) 384 (Fed Ct).

Parliament that deals with the rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement. [44]It is open to argument whether this provision applies to the federal intellectual property statutes.[45] PPSA, s. 20(1)(a) provides that an unperfected security interest is subordinate to a perfected security interest in the same collateral. If the PPSA does apply, A will have priority over B because A's security interest is perfected under the PPSA, whereas B's is not.

The Law Commission , in its report on federal security interests,[46] observed that "virtually all aspects of priority contain uncertainty. First, it is not clear which secured transactions fall within the scope of the federal registration provisions. Are all secured transactions federally registrable, or only those that are formally cast as assignments? It may be that none are registrable. Even if registration of a security interest does not establish priority of its own effect, annotation of such a registration may serve as notice or constructive notice and so establish priority indirectly."[47] The Law Commission made the following additional criticisms of the current law. (1) The federal intellectual property registers are unreliable for purposes of title investigation because under three of the statutes – the Trade-marks Act, the Industrial Design Act and the Integrated Circuit Topography Act - registration is merely permissive, while in the case of the other three Acts – the Patent Act, the Copyright Act and the Plant Breeder's Rights Act – details of existing law mean that registration is not authoritative.[48] (2) Current registration practices are not sensitive to the information needs of either prospective secured creditors or prospective assignees of federal intellectual property rights. The patent, copyright and trade-marks data bases are accessible on-line, but the on-line resources were designed for other purposes, such as searching prior patents, and they are not suitable for financing or purchase-related due diligence searches because they may be incomplete or out of date.[49] (3) The law's uncertainty increases direct costs because lenders are routinely advised to register under both federal intellectual property law and the PPSAs and to observe the formal requirements of both systems: "yet even this practice does not

[44] *E.g.*, Saskatchewan PPSA, s.4.
[45] Cuming, Walsh and Wood, *op.cit.* 99.
[46] *Leveraging Knowledge Assets: Reducing Uncertainty for Security Interests in Intellectual Property* (Canada, 2004).
[47] *Ibid..* ix.
[48] *Ibid. viii-ix.*
[49] *Ibid.* ix.

eliminate priority uncertainty of federal registration. And the interaction and potential conflict between federal statutes and provincial secured transactions laws undermine the confidence of secured creditors in the quality of IPR collateral relative to other movable assets."[50]

The Law Commission's recommendations for reform include the following:[51]

(1) Parliament should improve the legal framework governing federal intellectual property rights to reduce the legal uncertainty associated with taking such rights as collateral.

(2) All of the federal intellectual property statutes should create true title registries so that registration of a transfer of a registered federal intellectual property right will be conclusive evidence of legal title against an unregistered transfer.

(3) The federal intellectual property registries should be governed by a strict first-to-register rule of priority in which knowledge of a prior unregistered interest is irrelevant, except in the case of fraud or bad faith.

(4) The federal intellectual property registration regimes should permit the registration of all transfers, grants of interest or interests in applications for grants in federal intellectual property, irrespective of whether those grants of interest are by assignment or licence.

(5) The federal intellectual property registration systems should be overhauled to ensure that they support reliable, current online searching of the full chain of title of all federal intellectual property rights.

(6) Parliament should amend the intellectual property statutes to provide for the federal registration of security interests in the intellectual property registries.

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[50] *Ibid.* ix-x.
[51] *Ibid.* 94-96.

(7) To have priority over other interests subsequently registered in a federal intellectual property registry, a security interest would have to be registered in the federal intellectual property registry system. However, registering a security interest in a federal intellectual property right in the provincial registry system would be effective to establish priority over any interest that was not registered federally, including the debtor's insolvency administrator.

(8) The federal registry system for security interests in intellectual property should adopt a notice-registration system.

(9) The federal registry system for security interests in intellectual property should provide a separate federal name-indexed registry for security interests and should permit a secured creditor to register an interest in after-acquired intellectual property rights.

These recommendations have not yet been acted on. As Point (7), above indicates, the proposed new regime does not do away altogether with the need for multiple registrations and searches. This objective could be achieved by comprehensively integrating the statutes and the registers. This would involve: (1) enacting complementary priority rules in all the relevant statutes; and (2) making the intellectual property title and security interest registers compatible with the PPSA registers to allow for one-stop registrations and searches.[52] This is probably not an achievable outcome in Canada given that there are 13 separate provincial PPSA registers. As mentioned earlier, there is currently no political will to integrate the PPSA registers, let alone to achieve integration with other registration regimes. On this basis, the Law Commission's proposed solution may be viewed as a kind of second best, or stop-gap, alternative.

[52] See text at n.10, above.

5. Conclusion

The purpose of this paper has been to inform Australian readers about current PPSA law reform developments in Canada. If Australia goes ahead with plans to enact personal property security legislation at the State or federal levels, the law makers may want to take into account the proposals this paper discusses. It is true that, with the exception of the securities transfer reforms, none of the proposals have yet been translated into legislation and none of them have been incorporated in the New Zealand PPSA. However, this is not so much a reflection on the merits of the proposals as on the slow pace of commercial law reform. It is possible that at least of some of the proposals, particularly those discussed in Part 2, above, will be adopted in Ontario later this year as part of the government's commercial law reform strategy. In any event, the Australian law makers would be starting with a clean slate and this gives them an opportunity to move now, rather than later, on at least some of the matters addressed above.

APPENDIX

EXTRACT FROM UNIFORM LAW CONFERENCE OF CANADA, REPORT OF THE WORKING GROUP 2002-2003 ON REFORM OF THE LAW OF SECURED TRANSACTIONS (FREDERICTION, NEW BRUNSWICK, AUGUST, 2003)

[30] In June of 2002 the Uniform Securities Transfer Act Task Force created by the Canadian Securities Administrators (CSA) released the draft USTA and proposed amendments to the Ontario Personal Property Security Act and the Alberta Personal Property Security Act (as representative of the CCPPSL Act in force in all common law jurisdictions other than the Yukon and Ontario). The proposed changes to the PPSAs were designed to accommodate new approaches to interests in securities contained in the USTA. These new approaches would affect the way in which security interests can be taken and perfected in securities, and entail a new set of priority rules addressing competing security interests in securities. They also affect the conflict of laws rules applicable to security interests in securities.

The Role of the Working Group

[31] The CSA Task Force provided an extensive package of material to the Working Group with a letter dated June 26, 2002 requesting that the Working Group examine the proposed changes to the PPSAs relating to security interests in securities. Given the importance of this developing area of the law and its effect on aspects of personal property security law, the Group decided to accede to the request…The outcome is a series of recommendations (i) accepting may of the changes proposed by the CSA Task Force, (ii) proposing additional or alternative changes, (iii) rejecting the changes proposed, or (iv) modifying some of the changes proposed. …

Background to the USTA and Proposed PPSA Changes

[32] The objective of the USTA is not to change securities holding practices, but to provide a clear and certain legal foundation for the practices that already dominate the market, especially in the indirect holding system. The key concept in the USTA is the "security entitlement", which is the term used to describe the special property interest of a person who holds a financial asset in a securities account with a securities intermediary. The USTA defines a security entitlement as "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 6 [of the USTA]".

[33] The rights and property interest of an entitlement holder specified in Part 6 may be summarized as follows:

- The entitlement holder does not take the credit risk of the intermediary's other business activities; that is, property held by the intermediary is not subject to the claims of the intermediary's unsecured creditors;
- The intermediary will maintain a one-to-one match between the assets that it itself holds and all of the claims of its entitlement holders;
- The intermediary will pass through to the entitlement holder payments or distributions made with respect to the financial asset;
- The intermediary will exercise voting rights and other rights and privileges of ownership of the financial asset in the fashion directed by the entitlement holder;
- The intermediary will transfer or otherwise dispose of the financial asset at the direction of the entitlement holder; and
- The intermediary will act at the direction of the entitlement holder to convert the security entitlement into any other available form of holding, e.g. obtain and deliver a share certificate.

[34] *A new distinction: direct vs. indirect instead of certificated vs. uncertificated*

A security entitlement is a unique form of property interest, not merely a personal claim against an intermediary. The security entitlement concept provides a number of advantages over existing law, all of which derive from the basic fact that it constitutes a coherent

description of the unique property interest that is central to the indirect holding system. This facilitates the definition and application of clearer and more certain legal rules than those currently extant. What follows are specific examples of these advantages. The format of the old rules was confusing, largely because there was no clear distinction between the rules governing the direct as distinguished from the indirect holding systems. There was, however, a definite demarcation between the rules governing certificated as distinguished from uncertificated securities. Since the USTA recognizes that the much more important distinction is between the direct and the indirect holding systems, the rules applicable to those systems respectively are clearly differentiated.

[35] The distinction between certificated and uncertificated securities is retained, but is of diminished significance. It is relevant only to the relationship between the issuer and the registered owner. Uncertificated securities may be held in either the direct or indirect holding systems, so both systems include rules dealing with them. This distinction is reflected in a number of organizational changes to the governing legislation which should make it easier to understand.

[36] *The entitlement holder's rights are only against its intermediary*

This is not a change in the law. It merely clarifies a reality of current practice that was obscured by the old rules. Conceptually, the old rules define the property interest of an entitlement holder in terms of physical objects (certificates) that were normally held by an upper-tier intermediary (depository). This provides a legal foundation for the notion that the entitlement holder, or someone claiming through or against the entitlement holder, might be able to trace a property interest in a given security all the way to the depository. That notion is, however, impractical and inconsiostent with the need for certainty in the settlement system.

[37] The revised rules make it clear that the entitlement holder's rights may only be asserted against its immediate intermediary. This locates the entitlement holder's property interest with the entitlement holder's intermediary, greatly simplifying the situation. So, for

example, it becomes clear that a creditor wishing to seize the entitlement holder's property must deal with that intermediary.

[38] *Coherent choice of law rules*

Coherent choice of law rules are extremely important to ensure legal certainty in view of the massive and still growing number of cross-border securities transactions. The traditional use of a *lex situs* rule remains workable for certificated securities but is inappropriate for uncertificated securities, for securities held through a clearing agency, and, most importantly for investment property that is indirectly held through a broker or other intermediary.

[39] Like UCC Article 8 (and Article 9), the USTA (and associated revised PPSA rules) provides much clearer choice of law rules designed to respond to the realities of the diverse securities transfer and holding systems. For example, issues relating to the property and third party effects of a property right or a security right in a security entitlement are governed by the law of the jurisdiction in which the intermediary is located as determined by the agreement of the securities intermediary and its customer (with default connecting factors specified in the absence of such an agreement). This approach enables the parties to a transaction to order their affairs in accordance with a single predictable governing law.

[40] *Finality of settlement*

'Finality of settlement means that the transfer of a security, if performed according to certain rules, cannot be unwound. Finality has been a key objective of settlement rules since long before the advent of the indirect holding system. The early transfer rules applied negotiable instruments principles to stock certificates, so that a bona fide purchaser for value without notice acquired shares free from all adverse claims.

[41] Over the years, revisions to the transfer rules were designed, with general success, to extend the finality principle to other types of certificated securities. However, difficulties in

both concept and practice arose from the old rules' application of negotiable instruments concepts to transactions involving securities held in the indirect holding system.

[42] The USTA abandons the terms "bona fide purchaser" and "good faith purchaser" in favour of rules that more clearly state when a purchaser does (or does not) obtain protection against adverse claims. The new term used is "protected purchaser". The USTA narrows, and thereby clarifies, the method of effectively asserting adverse claims and the rights and duties of intermediaries and issuers in respect of such claims.

[43] *Security interests in securities and security entitlements*

The old rules apply pledge concepts that relied upon deemed delivery and possession to perfect a security interest in indirectly-held securities. Pledge concepts are inherently incompatible with the intangible nature of the rights of entitlement holders in the indirect holding system. This produces uncertainty. Use of the concept of security entitlement to accurately describe the property interest involved permits the revised rules to operate more clearly and predictably.

[44] Under the revised PPSA rules, a security interest in "investment property" may be perfected by "control". "Investment property" includes securities, security entitlements and securities accounts. This is intended to facilitate the common practice of granting a creditor a charge against the entire contents of a securities account.

[45] "Control" basically means that the creditor has taken whatever steps are necessary to be in a position to sell the collateral without any further action by the debtor. This does not change the established method of perfecting a pledge of directly-held certificated securities; possession is control. With respect to security entitlements, the creditor may, with the debtor's consent, obtain control by entering into an agreement with the debtor's intermediary to act on the creditor's instructions, or by having the security entitlements transferred into the creditor's own account.