

BUSINESS LAW ADVISORY COUNCIL REPORT: RECOMMENDATIONS FOR AMENDMENTS TO THE PPSA AND RSLA

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On November 16, 2016, the Ontario Ministry of Government and Consumer Services (“**MGCS**”) posted the Fall 2016 report (the “Report”)[[1](#)] of the Business Law Advisory Council (the “**Council**”), which was formed by the MGCS in March 2016 to put forward recommendations for modernizing Ontario’s corporate and commercial statutes. (For background on the Council please see our bulletin [here](#).) As part of its mandate to develop consensus and advise the government on priorities to reform Ontario’s corporate and commercial legislation, the Council has made a number of recommendations in the Report. This bulletin focuses on those relating to the *Personal Property Security Act* (“**PPSA**”)[[2](#)] and the *Repair and Storage Liens Act* (“**RSLA**”)[[3](#)]. (For a review of the corporate law related recommendations of the Report, please see our bulletin [here](#).)

Cash Collateral

Under the current PPSA, secured creditors can perfect their security interests over a debtor’s cash collateral by registering a security interest against “accounts”, which includes deposit accounts. However, because the PPSA does not provide for perfection by “control” over cash collateral (as it now does for investment property such as securities), the secured party cannot be certain of its priority position against other secured parties having security interests in such collateral also perfected by registration .

In contrast, the priority rules governing personal property in a number of other jurisdictions, including Quebec, the US, the UK and the EU, allow a secured party to ensure its first priority position over competing security interests in a debtor’s cash collateral by acquiring control of that collateral through a number of means, including deposit account control agreements. The lack of a control regime for cash collateral in Ontario has been a source of increasing concern among many business and legal professionals. Lenders, derivatives counterparties and other secured parties face some uncertainty as to their priority position when accepting cash collateral from debtors located in Ontario. This uncertainty could cause parties to avoid such contracts in Ontario, require additional and possibly more expensive collateral or demand more restrictive covenants. As a result, Ontario may become a less competitive jurisdiction for transactions involving significant amounts of

cash collateral. In particular, there is an immediate concern regarding transactions involving over-the-counter (OTC) derivatives: in September, 2016, the Office of the Superintendent of Financial Institutions published a guideline that starts to phase in requirements for affected financial institution counterparties to exchange margin to secure obligations under non-centrally cleared derivatives transactions.^[4] Although forms of collateral other than cash are acceptable, cash will become increasingly important as the supply of other acceptable collateral tightens.

To address these concerns, the Council has recommended amending the PPSA to permit security interests in “financial accounts” to be perfected by control, thereby giving them priority over security interests perfected by registration. However, concerns had been raised regarding the effect of the proposed amendments on the statutory priority over all security interests in “accounts” afforded under section 30(7) of the PPSA to the beneficiaries of deemed trusts under the *Pension Benefits Act* and *Employment Standards Act*. To balance these concerns against the need for OTC derivatives counterparties to have assurance of priority in cash collateral, a compromise solution has been recommended that would distinguish deposit accounts that serve as “financial collateral” for “eligible financial contracts” (as such terms are defined in the regulations to the *Bankruptcy and Insolvency Act*) and all other deposit accounts. The former would include deposit accounts serving as collateral for most OTC derivatives. Security interests in those accounts perfected by control would not be subordinate to the interests of pensioners and employees who would otherwise enjoy priority under section 30(7), while security interest in any other deposit accounts, whether or not perfected by control, would continue to be subordinate to those interests.

If implemented, these recommended amendments to the cash collateral regime in the PPSA would help keep Ontario’s OTC derivative market competitive with other jurisdictions that already permit security interests in cash collateral to be perfected by control. In addition, such changes would also facilitate non-derivative cross-border financing transactions, as they would be more harmonious with the approach taken by other jurisdictions, particularly the US.

Motor Vehicle Registrations under the PPSA and RSLA

Currently under the PPSA, financing statements used to register security interests and repair or storage liens over motor vehicles must set out the individual debtor’s first given name, middle initial, and surname, as well as the vehicle identification number (the “**VIN**”) in certain circumstances where the vehicle is consumer goods or equipment. This information allows potential secured parties to search the online registry system and identify existing security interests registered against the motor vehicle. Under the PPSA, a security interest perfected by registration can become unperfected if a reasonable person is likely to be materially misled by an error or omission in the financing statement. Typically, an error in the individual debtor’s legal name (which should be based on the debtor’s birth certificate or Canadian citizenship papers) has been held to be material enough to

invalidate a PPSA registration. This can be an onerous burden on many businesses that deal with motor vehicles, such as vehicle dealerships or repair facilities, who are not in the practice of requiring birth certificates or Canadian citizenship papers in order to provide goods or services but will easily be able to verify the correct VIN.

Reflecting this business reality, there is an exception under Ontario case law to the above rule where the collateral is a motor vehicle and the VIN must be included in the financing statement. In the 1994 case *Re Lambert*,^[5] the Ontario Court of Appeal considered what kind of error in a financing statement would materially mislead a reasonable person. There, the debtor, whose legal name differed from the name he commonly used, granted a security interest to the secured party over a motor vehicle. The secured party registered against the collateral using the correct VIN, but used the debtor's common name instead of his legal name in the financing statement. When the debtor went bankrupt, the bankrupt's trustee applied for a declaration that the secured party's registration was unperfected because of the error in the debtor's name. In its reasons, the Court concluded that where the collateral is a motor vehicle and used as "consumer goods", a reasonable person would not likely to be materially misled by an error in the debtor's name where the VIN is correctly set out in the PPSA registration because a reasonable person would search under both the name and the VIN.

To achieve greater certainty, the Council has recommended codifying the reasoning in *Re Lambert* in the PPSA and the RSLA. Under these amendments, a registration that purports to perfect a security interest over a motor vehicle constituting consumer goods includes the correct VIN would not be invalidated solely because of an error in the debtor's name.

Implementing these recommendations would be a welcome change for businesses that deal with motor vehicles as consumer goods in Ontario and often lose motor vehicle collateral to bankruptcy trustees, receivers or other secured parties solely because of an unknown error in the debtor name even though the VIN was entered correctly.

Other Recommendations

The Council also recommended some clarifying changes to rectify certain technical issues relating to recent changes to the location of debtor rules in the PPSA^[6], and modernizing and enhancing the integrity and security of the PPSA and RSLA registry system. These recommendations are intended to reduce the administrative and transaction costs associated with searching, filing and maintaining registrations under the PPSA and RSLA registry system, as well as to prevent inadvertent loss of perfection due to clerical errors or fraud.

Conclusion

In general, the Council's recommendations seek to bring the PPSA and RSLA more in line with the business expectations of parties who rely on those statutes to protect their interests in personal property. The MGCS is accepting comments on the Report from the business community and general public until December 12, 2016 via email or mail at the addresses found [here](#). We hope that such stakeholder input will further ensure that the recommendations reflect the commercial realities of lending and doing business in Ontario.

As this bulletin is intended only as a summary we would recommend that you review the Report using our bulletin as a guide.

If you have any questions about the commercial law aspects of the Report or, more broadly, about what actions to take to ensure that your security interests remain perfected, please do not hesitate to contact us. We would be happy to work with you to ensure the validity, perfection and priority of your security interests.

by Julie Han and Tayleigh Armstrong

[1] The Fall 2016 Report of the Business Law Advisory Council to the Minister of Government and Consumer Services can be found [here](#).

[2] R.S.O. 1990, c. P.10.

[3] R.S.O. 1990, c. R.25.

[4] Guideline E-22: Margin Requirements for Non-Centrally Cleared Derivatives, available [here](#).

[5] *Re Lambert* (1994), 20 O.R. (3d) 108 (C.A.).

[6] See McMillan's detailed summary of the PPSA's debtor location rules [here](#).

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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