PROPOSED PPSA AND RSLA AMENDMENTS CLARIFY DEBTOR LOCATION RULES AND MAKE VINS PARAMOUNT FOR MOTOR VEHICLE REGISTRATIONS

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The Ontario government recently introduced *Bill 154, Cutting Unnecessary Red Tape Act, 2017* ("**Bill 154**"),[1] aimed at decreasing red tape, stimulating business growth and creating jobs by amending various legislation, including the *Personal Property Security Act* (Ontario) (the "**PPSA**")[2] and the *Repair and Storage Liens Act* (Ontario) (the "**RSLA**").[3] Bill 154 passed second reading on October 3 and has been referred to the Standing Committee on Justice Policy, which will hold public hearings in Toronto on October 19. Following certain recommendations of the Business Law Advisory Council, [4] the proposed amendments to the PPSA and RSLA in Schedule 9 of the Bill will bring some much needed clarity to the new debtor location rules proclaimed into force on December 31, 2015,[5] and will codify case law that gives primary importance to including the correct vehicle identification number (VIN) in PPSA and RSLA registrations against motor vehicles.

In this bulletin, we describe the proposed amendments and the reasoning behind them, address any new as well as remaining ambiguities in the debtor location rules, and propose next steps for secured parties wanting to ensure the validity, perfection and priority of their registrations.

1. Proposed Amendments to Conflict of Laws Rules

(a) Change in Jurisdiction of Debtor's Location

Subsection 7(1) of the PPSA provides that the validity, perfection and effect of perfection or non-perfection and priority of security interests in certain types of collateral, including intangibles and "mobile goods" normally used in more than one jurisdiction, are governed by the law of the jurisdiction where the debtor is located at the time the security interest attaches. Before section 7(3) was amended on December 31, 2015, the location of a business debtor with more than one principal place of business was its "chief executive office". The amendments have brought greater certainty to determining a business debtor's location by referencing the organizational form of the debtor rather than its chief executive office, the location of which was often unclear.

But some uncertainties remain in other provisions that still seem to reference physical location. Currently,

subsection 7(2) provides that if a debtor "relocates to another jurisdiction", a security interest perfected under subsection 7(1) continues perfected until the earliest of three possible dates. The problem with this language is that the verb "relocates" seems to refer only to a change in the physical location of the debtor, but under the 2015 amendments, physical location is only one of a number of possible connecting factors that will determine where the debtor is "located" for the purpose of section 7. For example, under the new rules the location of an Ontario Business Corporations Act (OBCA) corporation that is continued into Nova Scotia is deemed to change to Nova Scotia even if all its operations remain in Toronto. Has the debtor "relocated" in this case?

The proposed amendments to subsection 7(2) resolve these uncertainties by updating the language to reflect the new debtor location rules. In subsection 7(2) as amended, the triggering event will be "if the jurisdiction where the debtor is located changes as a result of a change in a factor by which the location of the debtor is determined under subsection (3)". So, for example, the jurisdiction of an OBCA corporation that is continued into Nova Scotia changes to Nova Scotia because the "factor" that determines its location – namely the province under which it is organized as provided in subsection 7(3)(c) – has changed, even thought the debtor has not physically "relocated".

The proposed amendments also harmonize linguistic inconsistencies between various provisions relating to the state of the secured party's knowledge as to the factor that determines when a security interest becomes unperfected. Section 7(2) now specifies that perfection may cease "15 days after the day the secured party receives notice that the debtor has relocated to another jurisdiction" whereas section 7.1(7)(b) says "15 days after the day the secured party knows of the change of the applicable jurisdiction to another jurisdiction". Other provisions of the PPSA refer to when the secured party "learns" of the specified change.[6] Perhaps because "learn" is the broadest term, the proposed amendments uniformly change the verbs to "learns". Section 69 explains when a person "learns" something.[7] That said, the fact that whether a person "learns" of a fact is less objectively verifiable than whether the person has "received notice" may in some instances lead to uncertainty.

(b) Transitional Rules re Change in Jurisdiction of Debtor

Bill 154 also includes some amendments to the transitional rules in subsection 7.2(7) clarifying that these rules apply only in cases where application of the new rules results in a change to the debtor's location but not where no change results.

Subsection 7.2(7) now states that a prior security interest that is a perfected security interest under prior law immediately before the day the amendments came into force (December 31, 2015) continues to be perfected until the beginning of the earlier of the following days: (1) the day perfection ceases under prior law and (2) the fifth anniversary of the day the amendments came into force. As discussed in our prior bulletin, this provision appears to apply regardless of whether the new rules would result in a change of the debtor's location – thus

producing the presumably unintended result that every prior registration must be reperfected before December 31, 2020 to maintain perfection. For example, it was unclear whether a security interest in the property of an OBCA corporation whose chief executive office is in Toronto needed to be reperfected despite the fact that on December 31, 2015 nothing about the debtor changed: its location would still be Ontario whether determined under the old rules (chief executive office) or the new (province of incorporation). Also, it was unclear when subsection 7(2) applied under the new rules.

The amendments are intended to address these uncertainties. As amended, subsection 7.2(7) applies to a prior security interest that is a perfected security interest under prior law immediately before December 31, 2015 (a) if the jurisdiction where the debtor is located on that day, as determined under the new rules is different from the jurisdiction where the debtor was located as determined under the old rules; and (b) if the difference is solely a result of the operation of the new rules and not a result of any actual change in a factor by which the location of the debtor is determined under subsection 7(3). For example, applying (a), if the secured party had a perfected security interest on December 30, 2015 against a Nova Scotia ULC whose chief executive office is in Toronto, then the prior security interest becomes unperfected in Ontario on the specified deadline date and would need to be reperfected in Nova Scotia. However no action is needed for an Ontario corporation whose chief executive office is in Ontario. The deadline is now the earliest of the following: (1) the beginning of the day on December 31, 2020; (2) the beginning of the day perfection ceases under prior law; and (3) the end of the day determined under subsection 7(2) (discussed above), but only if the jurisdiction where the debtor is located on December 31, 2015, as determined under the new rules, later changes as a result of a change in one of the factors that determine location under subsection 7(3). A corresponding clarifying amendment is proposed to subsection 7(8).

What if the change happened to occur on December 31, 2015 (i.e. the day the conflict of laws amendments came into force)? Absent a clarifying provision, two conflicting provisions could apply to the same change – existing subsection 7(2) or the new transitional rule in subsection 7.2(7). The proposed amendment resolves the conflict. If the change occurred solely as a result of the operation of the new rules in subsections 7(3), 7(4) and 7(5) and not as a result of a change in a factor by which the location of the debtor is determined under the new rules – in other words, nothing about the debtor actually changed on December 31, 2015, but the new rules when applied to the same facts yield a different location - then 7.2(7) applies to that change instead of subsection 7(2). Subsection 7.2(7), as discussed above, is a transitional rule that addresses security interests that were perfected under the former conflict of laws rules but that, as a result of the new conflict of laws rules, would immediately cease to be perfected unless the transitional rules existed.

Parallel amendments and clarifications are proposed to subsection 7.1(6), which applies to perfection of a security interest in certain investment property, futures contracts and futures accounts. Similar amendments

are proposed to subsection 7.1(7), which relate to the change in jurisdiction of an issuer, securities intermediary or futures intermediary, in respect of perfection of investment property by control rather than registration. Parallel amendments are also proposed to subsections 7.3(6) and 7.3(7), which relate to perfection of a security interest by registration in investment property.

In addition, now that we know when the original amendments came into force, the proposed amendments to subsections 7.2 and 7.3 also replace the unwieldy phrase "the day subsection 3(2) of Schedule E to the Ministry of Government Services Consumer Protection and Service Modernization Act, 2006 comes into force" with the less cumbersome "December 31, 2015" in various places.

As discussed in our prior bulletin, there continues to be some uncertainty in subsections 7.2(7) and 7.3(6) with respect to a debtor whose location changes from Ontario to another jurisdiction as a result of the coming into force of the new conflict of law rules. Our conclusion on this topic was that a secured party should register in both locations (i.e. Ontario and the other jurisdiction) if the other jurisdiction has not yet adopted the same conflict of laws rules as Ontario, because a court in the other province may not recognize the validity of a registration under its own PPSA which according to its own conflict rules should have been made in Ontario.

2. Proposed Amendments to Motor Vehicle Registration Requirements

Section 46(4) of the PPSA provides that 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. Both practice and case law (with some exceptions) have determined that even a minor error in the debtor's name is sufficient to invalidate the registration. The name of an individual ideally should be confirmed through government documentation such as a birth certificate or passport (but not a driver's license or OHIP card). However, this can be an unrealistic expectation for secured parties dealing with motor vehicles as consumer goods (such as vehicle dealerships and repair mechanics): most consumers do not carry around their birth certificates or passports, and the name on their driver's license may in fact not be their correct legal name. Relying on a correct debtor name therefore exposes such businesses to the real risk that their interests will become unperfected and motor vehicle collateral will be lost to bankruptcy trustees, receivers or other secured parties.

On the other hand, it is a relatively simple matter to confirm the correct vehicle identification number ("**VIN**"). The proposed amendments to the PPSA and RSLA codify existing appellate case law[8] that provides that for motor vehicles which are "consumer goods", an error in the debtor's name in a PPSA registration against such motor vehicles would not be materially misleading to a reasonable person if each VIN is correctly set out in the registration. New proposed section 46.1 of the PPSA and new proposed subsection 9(3) of the RSLA will provide that for a security interest in motor vehicles, an error in a debtor's name in a registration is deemed not likely to

materially mislead a reasonable person if the financing statement (a) correctly sets out the correct VIN of the motor vehicle; (b) contains at least the name of one debtor and, if applicable, the debtor's date of birth; and (c) otherwise complies with the applicable requirements of the PPSA or RSLA, respectively. Further clarification is provided by proposed subsection 46.2 of the PPSA and subsection 9(4) of the RSLA, which set out circumstances where an error or omission will in fact be deemed to be materially misleading to a reasonable person for motor vehicles which are consumer goods: (a) a VIN is missing; (b) the VIN is set out in the wrong place; or (c) the VIN is incorrect. For motor vehicles which are equipment or inventory, new section 46.2 of the PPSA provides that if (a) the VIN is set out in the wrong place, or (b) the VIN (if included) is incorrect, then a reasonable person is deemed likely to be materially misled by such errors. In other words, if you are registering a security interest against a motor vehicle that is consumer goods, and you get the debtor's name wrong, the registration will still be valid so long as the VIN is correct.

These amendments will be a welcome change for businesses that deal with motor vehicles as consumer goods in Ontario, which, once the amendments take effect, will be assured that their security interest will not become unperfected solely as a result of an unknown error in a debtor's name.

3. Next Steps

If passed, Bill 154 will provide some much needed certainty regarding conflict of laws in the PPSA and motor vehicle registrations in the PPSA and RSLA. Meanwhile, secured parties should continue to review existing registrations well before December 30, 2020 to ensure that they do not need to re-register in another jurisdiction to maintain perfection. For further information about the diligence and steps secured parties should take with respect to the conflict of laws amendments, please refer to our prior bulletin.

If you have any questions about the proposed amendments or 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 Robert Scavone, Julie Han and Maria Sagan

[1] Please see the Government of Ontario's News Release dated September 14, 2017: Ontario Introduces New Measures to Help Businesses Save Time and Money (the "News Release") available here, and Bill 154, Cutting Unnecessary Red Tape Act, 2017, available here.

[2] Personal Property Security Act, R.S.O. 1990, c. P.10. The proposed amendments are to subsections 7, 7.1, 7.2, 7.3, 46.1 and 46.2 of the PPSA.

[3] Repair and Storage Liens Act, R.S.O. 1990, c. R.25. The proposed amendments are to subsections 9(3) and 9(4) of the RSLA.

[4] For a complete discussion of the Business Law Advisory Council's recommendations as they relate to the PPSA and RSLA, please see Julie Han and Tayleigh Armstrong's bulletin published in December 2016: Business Law Advisory Council Report: Recommendations for Amendments to the PPSA and RSLA, available here.

[5] For a complete discussion of the 2015 amendments to the PPSA conflict of laws provisions, please see Robert M. Scavone and Maria Sagan's bulletin published in November 2015: Where's Waldo: New Ontario PPSA Debtor Location Rules Finally Coming into Force, available here.

[6] See, e.g., sections 48(2)(b), (3), (4), (7) of the PPSA.

[7] See, e.g., section 69(a) of the PPSA, where "in the case of an individual, information comes to his or her attention under circumstances in which a reasonable person would take cognizance".

[8] Lambert (Re) (In Bankruptcy), (1994) 20 OR (3d) 108 (Ont CA).

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.