

WHERE'S WALDO: NEW ONTARIO PPSA DEBTOR LOCATION RULES FINALLY COMING INTO FORCE

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On December 31, 2015 (the "proclamation date") some important and long-awaited amendments to the conflict of laws provisions in the *Personal Property Security Act* (Ontario) (the "PPSA") will finally be proclaimed into force. [1] The much-needed changes will set out clear rules for determining where a debtor is located for the purpose of identifying what law governs the validity, perfection and priority of security interests in certain types of collateral described in section 7(1), which includes intangibles (such as accounts receivable and contract rights) and mobile goods and non-possessory security interests in instruments and chattel paper (referred to in this bulletin as "section 7(1) collateral"). Knowing the location of the debtor for section 7(1) collateral is critical because it determines where to register a PPSA financing statement and where to do a PPSA search. The types of collateral for which debtor location is relevant will remain unchanged, but under the amendments the existing and hard to apply "chief executive office" test will in most circumstances give way to simple "bright line" rules based on where the business debtor is organized. There are also some transitional rules that will allow pre-proclamation date security interests to remain perfected after proclamation, but these may pose some potential traps for the unwary. First, some history. The amendments actually received Royal Assent back in December of 2006, but proclamation was delayed in the expectation that all or at least a critical mass of the other PPSA provinces would proclaim similar amendments to avoid awkward conflicts between the conflict provisions of the various PPSAs. [2] However, with the other provinces also waiting for one to jump in the pool first, the hoped for inter-provincial harmonization never occurred. Possibly spurred on by a recommendation in an expert panel report released last June, [3] the Ministry of Government and Consumer Services finally decided that it was about time that Ontario took the lead and announced the proclamation date earlier this month. We understand that Saskatchewan and British Columbia may soon follow Ontario's example, but uniformity still seems to be a long way off. The amendments will also align the PPSA somewhat more closely with Article 9 of the *Uniform Commercial Code* (the "**UCC**"), although significant differences will remain.

In this bulletin we explain why the amendments were needed, what they provide and what steps secured parties with security interests in the affected types of collateral need to take to ensure continued perfection after the proclamation date.

1. Why the Amendments Were Needed

Section 7(1) of the PPSA now states that the laws of the jurisdiction "where the debtor is located" at the time the security interest attaches govern the validity, perfection, effect of perfection or non-perfection, and priority of (a) a security interest in intangibles, (b) a security interest in goods that are normally used in more than one jurisdiction, if the goods are equipment or inventory leased or held for lease by a debtor to others (often referred to as "mobile goods") and (c) a non-possessory security interest in instruments, negotiable documents of title, money and chattel paper. In addition, the location of the debtor determines the law governing the perfection of a security interest in investment property (such as securities) by registration.

Under section 7(3) in its current form, determining the location of a business debtor with multiple offices has often resembled a game of "Where's Waldo". If the debtor has only one place of business, it is located at that place of business, but if it has more than one, it is located at its "chief executive office". Neither "place of business" nor "chief executive office" is defined in the PPSA, and the sparse case law unhelpfully characterizes these matters as "questions of fact" without much guidance as to how to answer the questions. To reduce the uncertainty, secured parties and their counsel often require an officer's certificate from the debtor setting out such factual indicia as the location of the registered office, where the directors and officers reside, where material agreements are negotiated, where book-keeping functions are performed, and where significant administrative, management and executive functions are carried out. However, while such a certificate may provide some comfort to the lawyer giving the PPSA opinion, considerable uncertainty may still remain where the debtor has multiple centres of operation in several jurisdictions; and if a court finds that the debtor's chief executive office is located in Calgary even though the certificate pointed to Toronto, registration in Ontario but not Alberta will leave the security interest unperfected. To avoid such an outcome, secured parties often end up registering in every jurisdiction that could possibly be the location of the chief executive office, resulting in additional delay and transaction costs.

2. The New Debtor Location Rules

The amendments to Section 7(3) are intended to bring some certainty to this process by focusing on a few objectively verifiable factors that depend on the organizational form of the debtor. Individual debtors will continue to be located in the jurisdiction of their principal residence. However, a debtor that is not a natural person will no longer be deemed to be located at its principal place of business or chief executive office but instead in the jurisdiction in which the debtor was organized, as determined in accordance with the following rules:

- Partnerships, other than limited partnerships, whose partnership agreements state that the agreements are governed by the law of a province or territory of Canada, will be located in that province or territory.

- Corporations, limited partnerships or organizations that are incorporated, continued, amalgamated or otherwise organized under a law of a province or territory of Canada that requires disclosure of the incorporation etc. to be disclosed in a public record (such as filing articles of incorporation under the OBCA) will be located in that province or territory.
- A corporation that is incorporated, continued or amalgamated under the federal law of Canada will be located in the jurisdiction where its registered or head office is located, as set out in (i) its articles or letters patent, or (ii) if (i) does not apply, in its by-laws. (For CBCA corporations, (i) will always apply but federally regulated financial institutions such as banks and insurance companies can elect to designate a head office in their by-laws.)^[4]
- "Registered organizations" (that is, those organized under the law of a U.S. state or U.S. federal law that requires the organization to be disclosed in a public record) will be located in the applicable state or the District of Columbia, as set out in subclauses 7(3)(e) and (f) .
- Trusts will be located (i) in the province or territory governing the trust instrument (such as the declaration of trust or trust deed) or (ii), (if (i) does not apply), where the administration of the trust is principally carried out.
- Only if none of the above applies will the location of the debtor be its chief executive office (presumably, as determined under prior law).

As is not the case with the chief executive office test, once determined under section 7(3), the debtor's location will not change despite such organizational changes as lapse of its status in its jurisdiction, continuance, amalgamation, reorganization, winding up or dissolution. However, it would appear that if a Canadian federal corporation such as a bank or insurance company that specifies the location of its head office in its by-laws changes that location to another province by amending its by-laws, its location will also change for the purposes of the PPSA as well, in which case the security interest could become unperfected under section 7(2) unless re-perfected in the new jurisdiction.^[5]

3. Transitional Provisions: Existing Security Agreements and PPSA Registrations

The amendments contain some complex transitional provisions that will govern whether to apply the old PPSA debtor location rules in force before the December 31, 2015 proclamation date (referred to as "prior law") or the new rules to determine the validity, perfection and priority of security interests. Security agreements entered into before the proclamation date, or entered into before that date and subsequently amended, renewed or extended without including additional collateral, are referred to as "prior security agreements", and a security interest that arises under a prior security agreement is referred to as a "prior security interest".

Validity: The location of debtor rules used to determine the *validity* of "prior security interests" (i.e., whether a

security interest was actually created) will continue to be those under the prior law. For example, if a Nova Scotia company having its chief executive office in Toronto grants a security agreement in section 7(1) collateral on November 2, 2015, the validity of the security interest will be determined under the Ontario PPSA, based on the location of its chief executive office. If the same debtor enters into a security agreement on January 2, 2016, validity will be determined under the Nova Scotia PPSA, based on its jurisdiction of incorporation.

Perfection: In general, after the proclamation date the new debtor location rules will determine what law governs the *perfection* of any security interest in section 7(1) collateral, regardless of whether attachment of the security interest (i.e., when it comes into existence) occurs before, on or after the proclamation date. However, security interests perfected in the jurisdiction determined under the prior law debtor location rules will not automatically become unperfected on January 1, 2016. The transition rule in section 7(7) provides that a prior security interest that was a perfected security interest under the prior law immediately before the proclamation date will continue to be perfected until the earlier of: (1) the day perfection ceases under the prior law (for example, when the registration expires) and (2) the fifth anniversary of proclamation, i.e. December 31, 2020.

Note that, somewhat counter-intuitively, this provision applies regardless of whether the new rules would result in a change of the debtor's location. For example, if an OBCA corporation with its chief executive office in Toronto granted a security interest that was perfected by registration for 10 years under the PPSA on October 1, 2015, that security interest will lapse in respect of section 7(1) collateral on December 31, 2020, not October 1, 2025, despite the fact that under the new rules the debtor continues to be located in Ontario. To prevent this result, the secured party must re-register pursuant to section 7(8) before December 31, 2020. If a prior security interest is re-perfected in this manner, it is deemed to be continuously perfected from the date of perfection under the prior law. So using the previous example, if the secured party re-registers on December 30, 2020, the security interest will be deemed to have been perfected from October 1, 2015. Since its priority will also be determined as of that date, a security interest in the same collateral perfected on January 2, 2016 under the new rules will still rank behind it.

Note also that if under the new rules the debtor's location shifts from Ontario to another jurisdiction, re-perfection must be effected under the laws of that other jurisdiction. For example, if a Manitoba corporation with its chief executive office in Mississauga granted a security interest that was perfected by registration for 10 years under the Ontario PPSA on November 1, 2014, that security interest will lapse in Ontario on December 31, 2020 and no Ontario registration can save it. Instead it will be up to the secured party to register before that date under the PPSA of Manitoba, which is where the new rules will have relocated the debtor. Now if the Manitoba PPSA has not yet been amended to mirror the new Ontario rules and still looks to the debtor's chief executive office, that would seem to bounce the perfection issue right back to Ontario, which would then

bounce it back to Manitoba, *ad infinitum*. However, this ping-pong ball effect (known as *renvoi*) will be prevented by section 8.1 of the Ontario PPSA, which provides that in the conflicts provisions, a reference to the law of a jurisdiction is a reference to its internal law *excluding* its conflict of law rules.^[6] So to ensure priority in Ontario, the secured party must register under the Manitoba PPSA, even though its conflict rules say you must register in Ontario. Until all the PPSA provinces have adopted the new rules, it will still be prudent to register in both jurisdictions (in our example, Ontario and Manitoba), because a court in the unreformed 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.

Priority: In general, the new debtor location rules will also determine the law governing the priority of all security interests in section 7(1) collateral, regardless of whether attachment occurs before, on or after the proclamation date. So the priority of two competing security interests that both arise after or even straddle the proclamation date will be governed by the law determined in accordance with the new debtor location rules. However, the law governing the priority of one prior security interest versus another prior security interest will continue to be determined under the prior law rules. For example, if a Quebec corporation whose chief executive office is in Toronto granted a security interest to SP1 on September 1, 2014, which was registered under the Ontario PPSA on that date, and granted a security interest to SP2 on December 1, 2015, also registered under the Ontario PPSA, priority will be determined in accordance with the Ontario PPSA. However, if the same debtor granted both security interests after December 31, 2015, priority will be determined under the *Civil Code* of Quebec, the debtor location dictated by the new rules. The same result would follow if one security interest was granted before and the other after the proclamation date.

New Collateral. If a security agreement entered into before the proclamation date is amended, renewed or extended after that date without including new section 7(1) collateral, it is still a "prior security agreement", which means the old rules still apply. However, if the amendment, renewal or extension adds new collateral that was not previously described in the agreement, the location of the debtor used to determine the perfection and priority of the security interest in the new collateral will be governed by the new rules. For example, if a security agreement entered into by a PEI corporation with its chief executive office in Ontario on October 1, 2015 that lists only "accounts and contracts" in its collateral description is amended on January 2 to add "chattel paper", perfection of the security interest in the chattel paper will then be governed by PEI law. Note that the addition need not result in a change in the check-the-box collateral classification on the financing statement: in both cases, "accounts" and "other" will suffice.

4. Benefits and Harmonization

The amended law will take much of the guesswork out the process of ascertaining a debtor's location to determine where to register a financing statement against section 7(1) collateral and where to conduct PPSA

searches. Instead of having to weigh the various common-law factual indicia of the chief executive office, in most cases secured parties will be able to determine a debtor's location by reviewing agreements provided by the debtor or searching public records. Hopefully, the other PPSA provinces will soon follow Ontario's example so that the debtor location rules are the same across common-law Canada.

While the amendments create a simplified system with similarities to the UCC with respect to section 7(1) collateral, they do not follow the UCC's approach to other types of collateral – such as equipment and inventory. The UCC regime provides a simple and uniform "registered office" rule for almost all types of collateral (the main exceptions being investment property and deposit accounts, security interests in which cannot be perfected by filing), meaning that registrations and searches are generally only required in the jurisdiction of the debtor's registered office. The new Ontario regime instead chose a "middle ground" that more closely reflects existing commercial financing practice, which is to do searches and registrations in the jurisdictions where the debtor has tangible assets.

5. Next Steps

Although in most cases the amendments will provide a five year grace period to perfect security interests under the new rules, secured parties should avoid being caught by surprise on December 30, 2020 and should begin reviewing existing registrations well in advance of that date to identify which ones will need to be "refreshed" during the grace period. Secured parties will also need to develop new due diligence procedures to ascertain the debtor's location in accordance with the new rules for all PPSA registrations and searches done after December 31, 2015. In addition, care should be taken to ensure that if a pre-proclamation security agreement is later amended to add section 7(1) collateral not included in the original and as a result of the new rules, the debtor location changes to another jurisdiction, proper steps are taken to perfect the security interest in the new collateral under the laws of that jurisdiction.

As this bulletin is intended only as a summary we would recommend that you review the amendments to the PPSA before they come into force using our bulletin as a guide.

If you have any questions about the 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 M. Scavone and Maria Sagan

¹ *Personal Property Security Act*, R.S.O. 1990, c. P.10. The amendments relate to Sections 7(3)-(5), 7.2 and 7.3 of the PPSA.[ps2id id='1' target=""]

² For a more detailed discussion of the amendments enacted in 2006, see Eric Friedman's bulletin [Personal Property Security Act \(Ontario\) Amendments](#).^[ps2id id='2' target='']

³ [Business Law Agenda: Priority Findings & Recommendations Report](#), recommendation 4a(ii).^[ps2id id='3' target='']

⁴ See, e.g., the *Bank Act* (Canada), s. 237(1).^[ps2id id='4' target='']

⁵ This provides that if a debtor relocates to another jurisdiction, a security interest perfected in accordance with applicable law (1) continues perfected until the earliest of, (a) 60 days after the day the debtor relocates to another jurisdiction□ (b) 15 days after the day the secured party receives notice that the debtor has relocated to another jurisdiction□ and (c) the day that perfection ceases under the previously applicable law.^[ps2id id='5' target='']

⁶ The other anti-renvoi provisions in the other PPSAs apply only to investment property.^[ps2id id='6' target='']

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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