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Bill 41, the Almost Forgotten Corporate Law Amendments that Went into Effect in January 2007

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Bill 41, which went into effect on January 1, 2007, has been widely heralded as the vehicle which finally brought to Ontario the *Securities Transfer Act, 2006* (the "STA") and made consequential amendments to the *Personal Property Security Act* (the "PPSA"). Overshadowed by these significant legislative milestones, however, have been important, albeit less significant changes to the *Business Corporations Act* (the "OBCA") and the *Execution Act* (Ontario). The purpose of this short article is to highlight these often over-looked changes.

1. OBCA Changes

(a) Part VI - Corporate Securities

As a result of the passage of the STA, much of Part VI of the OBCA has been repealed, resurfacing, in modified form, in the STA. Part VI of the OBCA, re-titled "Corporate Securities", is now confined to OBCA corporations, no longer to other types of issuers. Part VI now deals largely with the issuance and content of share certificates and the rights of executors, administrators, trustees in bankruptcy and the like to exercise the rights of registered security holders.

(b) Dematerialization

Before January 1, 2007, an OBCA corporation was required, upon request, to issue a securities certificate in respect of any securities that it issues or, in the alternative, a non-transferable written acknowledgement of the security holder's right to obtain a security certificate. New York and most other U.S. jurisdictions, however, have long recognized that, in the electronic age, paper certificates have become obsolete. As most corporate practitioners have experienced at some time in their careers, paper share certificates are problematic because they must be reproduced, handled and stored. They may be lost, stolen or mutilated. If a security certificate is lost or stolen, it may be exceedingly expensive for the security holder to have it replaced. An indemnity bond must generally be posted.

Under s. 54 of the OBCA, corporations are now given the option to dematerialize their securities. Dematerialization means that a corporation can dispense entirely with issuing security certificates, relying, in the case of offering corporations, completely on book-based entries maintained electronically by the corporation's registrar and transfer agent and, in the case of non-offering corporations, a ledger or register in paper form maintained by a lawyer.

Bill 152: PPSA Amendments

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The Ontario government's recent commitment to modernize its business laws has resulted in significant legislative changes to the *Personal Property Security Act* (Ontario) (the "PPSA").¹ In December 2006, an article by John Cameron was published in *Business Beat* titled "Ontario's Securities Transfer Act, 2006: New Rules for Securities as Collateral", which summarized important rules of the new *Securities Transfer Act, 2006* (Ontario) and related amendments to the PPSA. Further provincial business law reforms were introduced in October 2006 through Bill 152,² which received Royal Assent on December 20, 2006. Bill 152 amends over 30 provincial statutes, including the PPSA. Schedule E to Bill 152 outlines the PPSA amendments and determines the dates upon which the amendments come into force.³

This article provides a brief summary of the principal amendments to the PPSA to be effected by Schedule E of Bill 152.⁴ Each of the amendments summarized in this article will come into force on a day to be proclaimed.⁵

"Check-the-Box" Collateral Classification

Issue: Ontario's current system of describing the collateral by "checking the boxes" in a financing statement is unique to Ontario. By failing to require a narrative description, the Ontario system has led to a lack of certainty and unnecessary costs associated with searches, registrations and third party acknowledgements.

Amendment: The registration system will be changed to remove the "check-the-box" collateral classification system and will now require a mandatory narrative that describes the collateral by item or type.

Note: Notice of this change is contained only in the explanatory notes to Bill 152, not in the legislative text. We understand from the Ministry of Government Services that this change will not actually be enacted for at least two years since implementation will require a massive upgrade of the PPSA computer system.

Definition of "Debtor"

Issue: The definition of "debtor" does not specifically include any third party that pledges its assets as security without assuming liability under the agreement creating the obligation secured. As a result, there has been some doubt as to the validity of a "third party pledge" (where A pledges its assets to secure the obligations of B to C, without granting a guarantee of B's obligations).

Amendment: The definition of "debtor" now includes a person who either owns or has rights in collateral or owes payment or performance of the obligation secured.

Note: It should now be possible to give a clean opinion on a third-party pledge.

Leases of More than One Year

Issue: There has been considerable uncertainty, and continuing litigation, surrounding the issue of whether a particular equipment lease is a "true lease" (which is not governed by the PPSA) or a "financing lease" that is in substance a security agreement (and therefore is governed by the PPSA and should be registered).

Amendment: In line with all other provinces, the PPSA now applies to leases of goods under a lease for a term of more than one year even though the lease may not secure payment or performance of an obligation (s. 2(a)). However, new s. 57.1 provides that Part V of the PPSA (which governs rights and remedies) applies only to security interests that secure payment or performance of an obligation, so "true leases" will not be subject to Part V.

Conflict of Laws - Location of a Debtor

Issue: The location of a business debtor is defined with reference to its chief executive office or place of business, which is not always easy to determine and can lead to increased costs, unnecessary searches and multiple registrations.

Amendment: The location of a business debtor will now be determined by its jurisdiction of incorporation, organization or registered head office (s. 7(3)), which is in line with the U.S. *Uniform Commercial Code* (the “UCC”). The rules are complex, but in simplified form:

- Canadian provincial or territorial corporations: Location is the province or territory that requires public registration of its incorporation, etc.
- Canadian federal corporations: Location is jurisdiction where registered head office is located.
- U.S. Companies that are “registered organizations”: Location is the state designated by the corporation as its state of location, or if a federal corporation, the state designated by U.S. federal law, or Washington D.C. if neither of these tests applies.
- General Partnerships: Location is the province or territory that governs its partnership agreement.
- Limited Partnerships: Location is the province or territory that requires public registration of its formation.
- Trusts: Location is jurisdiction of governing law of the trust instrument, or where administration of the trust is carried out.
- Fallback is still chief executive office if none of the other tests apply.

Note: The amendments contain transition provisions that allow previously perfected registrations to remain valid for the earlier of (i) the day that perfection ceases under the previous regime, or (ii) five years from the date the amendments come into force.

Errors in Security Agreements

Issue: The PPSA has conflicting provisions regarding errors in security agreements – s. 9(2) states that a security agreement is not unenforceable against a third party by reason only of a defect, irregularity, omission or error

unless the third party is misled by the defect, etc. This appears to conflict with the general rule in s. 11(2)(a) that in order for attachment to occur the security agreement must contain a description of the collateral sufficient to enable it to be identified. Related s. 9(3) provides that the failure to describe some of the collateral in a security agreement will not affect the effectiveness of the security agreement with respect to collateral that is properly described.

Amendment: Subsections 9(2) and (3) are repealed.

Priority Rules Governing “Sales/Leases in the Ordinary Course of Business”

Issue: Subsections 28(1) and (2) of the PPSA provide that buyers or lessors of goods in the ordinary course of business take them free from any security interest given by the seller or lessor unless it knew that the sale or lease was in contravention of the security agreement. Some UCC case law⁶ held that this rule applied even if the goods were in the possession of the secured party and the buyer did not take possession of them, but there was some uncertainty as to the law in Ontario.

Amendment: The provisions regarding “ordinary course of business” have been amended to clarify that such a buyer or lessee takes the goods free of the seller or lessor’s security interest whether the buyer took possession of the goods, the seller was in possession of the goods at any point in the transaction, the buyer obtained title to the goods or the seller took a security interest in the goods, so long as the goods were identified to the contract of sale or lease.

Note: This amendment represents a deliberate policy decision in favour of buyers and lessees over secured parties, who can now potentially have their collateral “sold out from under” them even if they are in possession of it.

Accounts Receivable Financiers vs. Inventory Financiers - PMSI Priority Rules

Issue: In order to obtain the super-priority accorded to a purchase-money security interest (“PMSI”), an inventory financier is required to give notice of its PMSI to all prior registered secured parties who have registered a financing statement in which the collateral

is classified as inventory (s. 33(1)(b)). This potentially prejudices accounts receivable financiers because they are not entitled to notice of the inventory financier's PMSI even though the inventory financier's PMSI may extend to the accounts receivable (as the PMSI extends to proceeds of the inventory).

Amendment: An inventory financier will now be required to give notice of its PMSI to any secured party that has registered a financing statement in which the collateral is classified as accounts as well as inventory.

Enforceability of Anti-Assignment Clauses

Issue: Contractual clauses that prohibit or restrict the assignment of accounts receivable or chattel paper limit financing sources for secured parties. Under the current PPSA, it is unclear whether breach of an anti-assignment provision by a debtor granting security over accounts or chattel paper invalidates the security interest. The PPSAs of most other provinces make it clear that it does not.

Amendment: Subsection 40(4) will now provide that contractual anti-assignment clauses respecting such collateral are unenforceable against third parties and are binding on the assignor only to the extent of liability for breach of contract.

Additional Amendments of Interest

Registrations: All registrations must now be completed by electronic transmission to the registration system's database by individuals authorized by the registrar (s. 46).

Account Debtors and Assignees of Debt: A debtor obligated by an account or chattel paper may set up against an assignee of the debt, as a defence but not by a counter-claim: (i) any defence available to the debtor against the assignor arising out of the contract or a related contract, and (ii) the right to set off any debt owed by the assignor to the debtor payable before the debtor received notice of the assignment (s. 40(1)).

Seizure of Personal and Household Goods: Personal and household goods are now exempted from seizure by a secured party on default, except for a PMSI in such goods or a possessory security interest (s. 62).

Notice Provisions regarding Foreclosure: Where a secured party gives notice to other secured parties of its intention to accept collateral in full satisfaction of an obligation on default, those who receive notice have 15 days (not 30 days) to object to the foreclosure (s. 65).

Foreclosure on Real and Personal Property: The PPSA has been clarified so that the court may make any order necessary to enable the secured party to enforce foreclosure remedies against real and personal property simultaneously (s. 67).

Service of Notice: In addition to personal service and registered mail, notices under the PPSA may now be delivered by prepaid courier, fax and electronic transmission (s. 68).

The amendments discussed in this article are part of the Ontario government's ongoing efforts to reform provincial business law. Readers should stay tuned to further amendments that modernize the legislation governing business affairs in the Province, in particular the personal property registration system.

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¹ The *New Securities Transfer Act, 2006* (Ontario) and the related PPSA amendments have been proclaimed into force as of January 1, 2007.

² Bill 152, *Ministry of Government Services Consumer Protection and Service Modernization Act, 2006*, 2nd Sess., 38th Leg., Ontario, 2006 (assented to 20 December 2006), S.O. 2006, c. 34.

³ Section 26 of Schedule E determines the coming into force of the Schedule E amendments as follows: Subsection 3(1) and section 4 of Schedule E came into force January 1, 2007 (*i.e.*, the date the *Securities Transfer Act, 2006* was proclaimed into force), as per section 26(2) of Schedule E; the rest of Schedule E comes into force on a day to be proclaimed as per s. 26(1) of Schedule E.

⁴ See also the December 2006 of *Imperfections* in which Jennifer Babe discusses probable Bill 152 amendments to the PPSA.

⁵ You can monitor the Ontario Table of Proclamations at

[http://www.e-laws.gov.on.ca/dblaws/Tables/
Public%20Statutes/Table of Procs.htm](http://www.e-laws.gov.on.ca/dblaws/Tables/Public%20Statutes/Table_of_Procs.htm).

⁶ See *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 350 N.E.2d 590 (NY 1976). The effect of this case was reversed by UCC s. 9-320(e).