MEMORANDUM

To	Minister of Government Services	**Date**	May 19, 2006
From	Personal Property Security Law Subcommittee, Business Law Section, Ontario Bar Association		
Re	PPSA Law Reform -- Conflict of Laws Amendments		

All Canadian PPSAs contain conflict of laws rules which point to the "location of the debtor" to determine the validity, perfection and priority of security interests in some types of collateral. Under these rules, a debtor is deemed to be located at its place of business. Where the debtor has two or more places of business, the rules define the "location of the debtor" by reference to the debtor's chief executive office. In practice, lawyers often cannot easily determine the location of a debtor's chief executive office, which often results in additional expense to ensure that a security interest is perfected and searches are carried out in, and legal opinions obtained from, every jurisdiction which might possibly contain the debtor's chief executive office.

To avoid this additional expense, we recommend that all of the Canadian PPSAs be amended to define "location of the debtor" by reference to, in the case of an individual, his or her residence and, in the case of an organization, the jurisdiction in which the debtor is organized. This new approach as it applies to organizations is consistent with the recommendations of the Study Committee on Reform of Canadian Secured Transactions Law, which recommended to the Uniform Law Conference of Canada ("ULCC") that the location of a Canadian organized debtor be defined by reference to its place of organization. In addition, this new approach is consistent with the recent amendments contained in Revised Article 9 of the Uniform Commercial Code in the United States. However, our proposal goes further by (among other things) creating specific rules to address the location of trusts and general partnerships. Frequently in Canada, income trusts (including REITs, oil and gas trusts and other business trusts) are used as vehicles to raise funds for business, often creating security interests in personal property. It is often difficult to determine the location of a trust -- particularly in the case of income trusts in which the trustees are individuals and the trust has no business office. The proposed new rules would address this problem.

The text of our proposed amendment for the Ontario PPSA is set forth in Schedule "A". Because secured parties will need time to adapt to the definition, we are also proposing transitional rules as set forth in Schedule "B". Finally, there are some related conforming changes necessary in the Ontario PPSA; and these are set forth in Schedule "C". The remainder of this memorandum addresses some details relating to our proposal.

CLAUSE BY CLAUSE COMMENTARY

This portion of the memorandum provides commentary on each section of the proposed amendments.

Subsections 7(5) to (7) -- Location of Debtor (as set forth in Schedule "A")

The new definition of location of debtor applies only to security interests of the type described in section 7(1) -- dealing with security interests in intangible property and certain mobile goods and non-possessory security interests in instruments, negotiable documents of title, money and chattel paper -- and section 7.1 -- dealing with investment securities. Our comments on each subsection are as follows:

- 7(5)(a) deals with individuals, and points to their jurisdiction of residence. For individuals carrying on business as a sole proprietorship, this reflects a change from the current law and tracks Revised UCC § 9-307(b)(1).

- 7(5)(b) deals with corporations and limited partnerships organized under provincial law. Those debtors are located in the jurisdiction under whose provincial laws they are organized.

- 7(5)(c) deals with corporations existing under Canadian federal law, recognizing that the rule must point to a particular province. Those debtors are located in the province in which their registered office or head office is located, as specified in their constating documents. The *Canada Business Corporations Act* (section 19) and the *Canada Not-for-profit Corporations Act* (section 20) each require a corporation's articles to specify the province in which its registered office is located. The *Bank Act* (section 237), the *Insurance Companies Act* (section 260), the *Trust and Loan Companies Act* (section 242) and the *Companies Act* (section 24) each require a company to have a head office in the place within Canada specified in its incorporating instrument or by-laws.

- 7(5)(d) deals with corporations and other entities existing under U.S. state laws. Those debtors are located in the U.S. state under whose laws they exist. The language used tracks Revised UCC § 9-307(e), including the use of the phrase "registered organization". Official Comments 4 and 11 indicate that phrase includes a corporation, a limited liability company and a limited partnership.[1]

- 7(5)(e) deals with corporations and other entities existing under U.S. federal laws. With some minor exceptions, the language used tracks Revised UCC § 9-307(f).[2]

- 7(5)(f) deals with trusts.[3] Where the trust instrument is governed by the laws of a Canadian province, the trust is located in that province.[4] If the trust instrument is

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1 See also the note below about section 7(6).

2 Among other differences, section 7(5) does not track the special rules in Revised UCC § 9-307 which deal with "a branch or agency of a bank that is not organized under the law of the United States or a State" or "foreign air carrier under the Federal Aviation Act of 1958".

3 The opening language (referring to "the debtor is a trustee or trustees acting for a trust") is inconsistent with section 16 of the regulations under the Ontario PPSA which refers the debtor as a trust. Since a trust is not a legal entity, our proposed language is preferable. Our language is consistent with the regulations under the Saskatchewan PPSA. The regulations under the Ontario PPSA should be conformed.

governed by the laws of a jurisdiction outside Canada or does not specify a governing law, then the trust is located in the jurisdiction in which the administration of the trust is principally carried out. A different rule applies for foreign trusts because we believe that the priority rules (particularly the priority rules relating to a judgment creditor) should bear a closer relation to the trust than merely its governing law, where the governing law is foreign and we do not know as much about the policy choices made under that foreign law. This policy concern does not arise in practice within Canada.

- 7(5)(g) deals with general partnerships governed by the laws of a Canadian province, and points to the law of that province. This rule does not apply to general partnerships governed by foreign laws because (like foreign trusts) we believe that the priority rules should bear a closer relation to the partnership than merely its governing law. Foreign general partnerships are governed by the residual rule in section 7(5)(h).

- 7(5)(h) contains the residual rule, for all cases not addressed above, pointing to the debtor's chief executive office.

- 7(6) contains definitions applicable to U.S. debtors, generally tracking the corresponding definitions in Revised UCC § 9-102. Official Comment 11 states that:

> Not every organization that may provide information about itself in the public records is a "registered organization." For example, a general partnership is not a "registered organization," even if it files a statement of partnership authority under Section 303 of the Uniform Partnership Act (1994) or an assumed name ("db") certificate. This is because the State under whose law the partnership is organized is not required to maintain a public record showing that the partnership has been organized. In contrast, corporations, limited liability companies, and limited partnerships are "registered organizations."

- 7(7) deals with the death or incapacity of individuals, and the termination of existence of organized debtors. While Revised UCC § 9-307 does not deal with the death or incapacity of individuals, it does address the termination of existence of organized debtors. We believe a similar rule is desirable in the Canadian PPSAs.

Transitional Rules (as set forth in Schedule "B")

The transitional rules are necessary to allow secured parties time to adjust to the new rules for perfection. Otherwise, when the new rules come into force, security interests of the type described in section 7(1) might immediately cease to be perfected if the new rules pointed to a new debtor location. As well, in the absence of transitional rules, the priority between two or more security interests existing when the new conflicts rule comes into force,

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[4] A "Uniform Income Trusts Act Working Group" is currently preparing a report to the ULCC. We understand that Working Group is not proposing any registration requirement for the creation of an income trust. If a registration requirement were to be established, then the location of that type of debtor might be better defined by reference to the jurisdiction in which the trust is so registered, if there is only one jurisdiction.

may change merely by enactment of that conflicts rule. The proposed transitional rules address the scope of these effects, but (of course) cannot entirely eliminate the prospect of change.

The proposed rules refer to sections 7 and 7.1 of the PPSA as they appear in Bill 41. Our comments on each subsection are as follows:

- (1) to (12) deal with security interests described in section 7 -- i.e. security interests in intangibles and certain mobile goods and non-possessory security interests in instruments, negotiable documents of title, money and chattel paper.

- (1) sets forth some definitions used in the transitional rules.

- (2) is intended to address primarily the renewal or extension (after the new law comes into force) of the maturity date of a chattel mortgage, equipment lease, conditional sale agreement or other similar type of security agreement, including the renewal or extension agreement within the definition of a "prior security agreement".

- (3) is intended to exclude from the definition of a "prior security agreement" amendments which extend the security interest to collateral not addressed by that agreement before the new law comes into force.

- (4) is a minor, self-explanatory provision.

- (5) is included for greater certainty, because nothing in the new rules affects the validity of a security interest.

- (6) to (8) set forth the transitional rules for perfection.

- (6) sets forth the basic rule for perfection -- i.e. the new law applies to determine the perfection of a security interest, except as provided in (7) and (8).

- (7) provides for the continuing perfection of a prior security interest for up to five years after the new law comes into force. Some lawyers advocated a seven year period. We chose a five year period because most PPSA registrations are for five years or less. As well, if a longer period were chosen, then secured parties would be required to determine the historical location of the debtor for a longer period, and to conduct searches in that historical location for a longer period. If a security interest would become unperfected under prior law within the five year period, before being perfected under the new law, then the continuity of perfection rule ceases to apply.

- (8) makes clear that, where a security interest is perfected under the new law within the five year period under (7), it is deemed to have been continuously perfected from the date of perfection under the prior law.

- (9) to (12) set forth the transitional rules for priority.

- (9) sets forth the basic rule for priority -- i.e. the new law applies to determine priority except as provided in (10), (11) and (12).

- (10) preserves the rights of execution creditors and buyers who have obtained priority under prior law.

- (11) preserves the expectations of two or more prior secured creditors that prior law will determine their priority, except in the limited case addressed by (12).

- (12) allows an unperfected prior secured creditor to perfect under the new law, and take advantage of the new priority rules by doing so. The purpose of this exception is to encourage secured parties to perfect under the new law, and to simplify the priority rules by reducing the number of situations where the priority rules are determined under prior law. Having said that, our expectation is that the priority rules under the new law are, in most cases, not likely to be materially different than the priority rules under the prior law.

- (13) to (14) deal with investment property.

- (13) is included for greater certainty, because nothing in the new rules affects the validity of a prior security interest in investment property.

- (14) sets forth the basic rule that perfection and priority are governed by the new law, except as provided in (15) and (16). The reference to section 84 contemplates that Bill 41 is enacted.

- (15) and (16) provide a continuity of perfection rule where a security interest in investment property was perfected by registration. To that extent, this rule corresponds to (7) and (8).

- There are no transitional rules for priority, reflecting the expectation that the vast majority of security interests in investment property will be governed by a Securities Transfer Act in Canada, or Revised Article 8 in the U.S., and the desire for a clear and simple rule for this type of collateral.

Continuity of Perfection Rules (as set forth in Schedule "C")

The continuity of perfection rules address the relocation of a debtor (apart from a relocation occurring merely by the new rules coming into force). Section 7(3) is the current rule, reproduced in Schedule "C" merely to provide the reader with the context for 7(4). We believe section 7(4) of the proposed rules is implicit in the current Ontario PPSA and the other Canadian PPSAs; but we have included the rule to provide clarity, and to avoid any doubt arising by including a similar rule in (8) and (16) of the transitional rules. 7.1(6) and 7.1(6.1) are the corresponding rules for investment property.

U.N. CONVENTION

The United Nations Convention on the Assignment of Receivables in International Trade (2001)[5] adopts a different conflict of laws approach for the assignment of international receivables. In determining the location of an assignor, the Convention points to the place where the central administration of the assignor is exercised -- a rule much like our current chief executive office rule. The Convention allows a state to adopt its own different domestic conflict of laws rules where the assignor is located in that state. This means that the Convention could be implemented in Canada in a fashion generally consistent with our proposal, provided the central administration of Canadian organized debtors is exercised in Canada, and the central administration of U.S. organized debtors is exercised in the U.S.

The ULCC at its 2005 annual meeting adopted a pre-Implementation Report recommending provincial and territorial legislation to implement the Convention in Canada and asked a Working Group to prepare a uniform implementing act along with complementary amendments in the areas of choice of law and anti-assignment clauses. The ULCC also asked the Working Group to coordinate with its U.S. counterpart -- the National Conference of Commissioners on Uniform State Laws ("NCCUSL") -- with a view to coordinating implementation efforts in the two countries.

We understand that NCCUSL and the American Law Institute, who are the organizations responsible for Article 9 of the UCC, decided at a meeting with the ULCC Working Group and their Mexican counterparts in April 2006 to prepare amending legislation for Article 9 that would accommodate the Convention choice of law rule. The proposed amendments are to be discussed at a joint meeting scheduled for June 17, 2006. These parties plan that, following industry consultation, a final decision on going forward will be made at a meeting scheduled for November 2006.

While the text of the proposed amendments to Article 9 has not been circulated, we understand the Americans propose to make changes to the conflicts rules for the assignment of international receivables. The changes would (a) limit the application of the location of debtor rules for U.S. organized debtors to those debtors who have their chief executive office in the U.S., and (b) recognize the domestic choice of law rules in a federally organized country (such as Canada) in situations where the chief executive office of the debtor is in that country. We do not know whether, or how quickly, the Americans will be able to change Article 9 in each U.S. state.

We believe that the rules we are proposing improve the efficiency of secured transactions in Canada, and are good for Canadian business. If the Americans manage to implement the changes to Article 9 described in the paragraph immediately above, and/or if other countries begin to adopt the Convention, then it may be desirable to revisit the Canadian rules. However, until either or both of those events occur, we think Canadians have much to gain by

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[5] The Convention is posted at the UNCITRAL website: www.uncitral.org. (under General Assembly Resolutions, 56th Session, 2001).

acting now to amend the location of debtor rules, without waiting for these foreign developments to occur.[6]

We recognize that the conflict rules in all Canadian PPSAs must be amended at the same time and in the same fashion. We understand that the Ontario government will not be in a position to enact our proposal earlier than in connection with Phase II PPSA amendments contemplated for the fall session of the Legislature this year. That timetable allows for any interested parties to make submissions to the Ontario government about our proposal through the summer.[7]

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[6] Catherine Walsh -- a member of the ULCC Working Group -- believes that Canadian laws governing the priority of execution creditors are more favourable to those creditors than the laws in the United States; and that this difference supports a policy choice for conflicts rules which are consistent with the Convention. In particular, she believes that Revised Article 9 should only apply to the perfection and priority of security interests of U.S. organized debtors where their centre of administration is also in the U.S. We believe that policy choice does not flow from that difference because there are many situations in which Canadian organized debtors may have their centre of administration in the U.S., and in those situations Canadian execution creditors could not take advantage of the proposed conflict of laws rule in the Canadian PPSAs.

[7] Even if the Ontario PPSA is amended this fall in the form proposed by us, it would not be proclaimed until the other Canadian PPSAs are amended, which would allow further time for interested parties to make submissions to the Ontario government about whether the PPSA rules must be conformed to the U.N. Convention.

SCHEDULE "A"

"Location of Debtor" -- Sections 7(5) to (7)

(5) For the purposes of this section, a debtor is located:

(a) if the debtor is an individual, in the jurisdiction where the debtor's principal residence is located;

(b) if the debtor (including without limitation a limited partnership) is incorporated, continued, amalgamated or otherwise organized under a law of a province or territory of Canada that has established a public record necessary for its incorporation, continuance, amalgamation or organization, in that province or territory;

(c) if the debtor is incorporated, continued, amalgamated or otherwise organized under a law of Canada that has established a public record necessary for its incorporation, continuance, amalgamation or organization, in the jurisdiction where its registered office or head office is located, as specified in (i) the special Act, letters patent, articles or other constating instrument by which the debtor was incorporated, continued, amalgamated or otherwise organized, or (ii) its by-laws if subparagraph (i) does not apply;

(d) if the debtor is a registered organization that is organized under the law of a U.S. State, in that U.S. State;

(e) if the debtor is a registered organization that is organized under the law of the United States of America,

(i) in the U.S. State that the law of the United States of America designates, if the law designates a U.S. State of location;

(ii) in the U.S. State that the registered organization designates, if the law of the United States of America authorizes the registered organization to designate its U.S. State of location; or

(iii) in the District of Columbia in the United States of America, if neither subparagraph (i) nor subparagraph (ii) applies;

(f) if the debtor is a trustee or trustees acting for a trust,

(i) and the trust instrument governing that trust states that it is governed by the laws of a province or territory of Canada, in that province or territory; or

(ii) in the jurisdiction in which the administration of the trust by the trustees is principally carried out, if subparagraph (i) does not apply;

(g) except as otherwise provided in paragraph (b), if the debtor is a partnership and the partnership agreement governing that partnership states that is governed by the laws of a province or territory in Canada, in that province or territory; and

(h) except as otherwise provided in this subsection (5), in the jurisdiction where the chief executive office of the debtor is located.

(6) For the purposes of subsection (5), "U.S. State" means a State of the United States of America, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States of America, and "registered organization" means an organization organized solely under the law of a single State or the United States of America and as to which the State or the United States of America must maintain a public record showing the organization to have been organized.

(7) For the purposes of this section, a debtor continues to be located in the jurisdiction specified by subsection (5) despite:

(a) in the case of an individual debtor, the death or incapacity of the individual, and

(b) in the case of any other debtor, the suspension, revocation, forfeiture or lapse of the debtor's status in its jurisdiction of organization, or the dissolution, winding-up or cancellation of the existence of a debtor.

SCHEDULE "B"

Transitional Rules

Drafting Note: References below to sections 7 and 7.1 refer to those sections of the PPSA as amended by Bill 41.

Definitions

(1) In this section:

(a) "prior law" means the law in force immediately before section 7 comes into force, including the applicable law as provided by that law;

(b) "prior security agreement" means a security agreement entered into before section 7 comes into force; and

(c) "prior security interest" means a security interest arising under a prior security agreement.

(2) Except as provided in subsection (3), where a prior security agreement is amended, renewed or extended by agreement entered into after section 7 comes into force, the security agreement as amended, renewed or extended is a prior security agreement.

(3) Where a prior security agreement is amended, renewed or extended by agreement entered into after section 7 comes into force to include kinds or items of collateral not referred to in the prior security agreement, the security agreement as amended, renewed or extended is not a prior security agreement with respect to the additional collateral.

(4) Collateral that falls within a general collateral description in a prior security agreement is not additional collateral for the purposes of subsection (3).

Transitional rules for Security Interests Described in Section 7(1)

(5) Section 7 does not affect the law governing the validity of a prior security interest.

(6) Except as provided in subsections (7) and (8), section 7 applies to determine the law governing perfection of a security interest described in subsection 7(1), whether attaching before or after section 7 comes into force.

(7) Unless otherwise perfected in accordance with applicable law determined under section 7, a prior security interest described in subsection 7(1) perfected under prior law immediately before section 7 comes into force, continues perfected until the earlier of:

(a) the day that perfection ceases under prior law, and

(b) the fifth anniversary of section 7 coming into force.

(8) If a prior security interest described in subsection (7) is perfected in accordance with applicable law determined under section 7 before the earlier of the days specified in subsection (7), that security interest is deemed to be continuously perfected from the day of its perfection under prior law.

(9) Except as provided in subsections (10), (11) and (12), section 7 applies to determine the law governing the effect of perfection or of non-perfection and the priority of a security interest described in subsection 7(1), whether attaching before or after section 7 comes into force.

(10) The effect of perfection or of non-perfection and the priority of a prior security interest described in subsection 7(1) in relation to an interest, other than a security interest, in the same collateral arising before section 7 comes into force, is determined under prior law, regardless of whether the prior security interest is perfected in accordance with applicable law determined under section 7.

(11) Except as provided in subsection (12), the law governing the priority of a prior security interest described in subsection 7(1) in relation to any other prior security interest in the same collateral is determined under prior law.

(12) If a prior security interest was not perfected under prior law immediately before section 7 comes into force, and is perfected by registration made or another step taken after section 7 comes into force in accordance with applicable law determined under section 7, the law governing the priority of that prior security interest in relation to any other security interest (including any other prior security interest) in the same collateral is determined under section 7.

Transitional rules for Security Interests in Investment Property

(13) Section 7.1 does not affect the validity of a prior security interest.

(14) Except as provided in subsections (13), (15) and (16) and section 84, section 7.1 applies to determine the law governing the validity, perfection, effect of perfection or of non-perfection and priority of all security interests in investment property, whether attaching before or after section 7.1 comes into force.

(15) Unless otherwise perfected in accordance with applicable law determined under section 7.1, a prior security interest in a security perfected by registration immediately before subsections 7(2) and (5) come into force, continues perfected until the earlier of:

(a) the day that perfection ceases under prior law, and

(b) the fifth anniversary of subsections 7(2) and (5) coming into force.

(16) If a prior security interest described in subsection (15) is perfected in accordance with applicable law determined under section 7.1 before the earlier of the days specified in subsection (15), that security interest is deemed to be continuously perfected from the day of its perfection under prior law.

SCHEDULE "C"

Continuity of Perfection Rules

Drafting Note: These rules presume that Bill 41 is enacted, with the subsections below forming part of Bill 41. Section 7(3) below is unchanged from the version of section 7(3) in Bill 41, and is reproduced below merely to provide some context for these rules.

7(3) If a debtor relocates to another jurisdiction, a security interest perfected in accordance with the applicable law as provided in subsection (2) 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.

7(4) Where subsection (3) applies and the security interest is perfected in the jurisdiction to which the debtor relocates on or before the earliest of the days described in subsection (3), that security interest is deemed to be continuously perfected from the day of its perfection under the previously applicable law.

. . .

7.1(6) If a debtor relocates to another jurisdiction, a security interest perfected by registration pursuant to the law of the jurisdiction designated in subsection (5) remains 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 knows the debtor has relocated to another jurisdiction; and

(c) the day that perfection ceases under the previously applicable law.

7.1(6.1) Where subsection (6) applies and the security interest is perfected in the jurisdiction to which the debtor relocates on or before the earliest of the days described in subsection (6), that security interest is deemed to be continuously perfected from the day of its perfection under the previously applicable law.