

# **REPORT OF THE STUDY COMMITTEE ON REFORM OF CANADIAN SECURED TRANSACTIONS LAW**

**2003-04**

## **Background**

[1] The Committee on Reform of Canadian Secured Transactions Law created as part of the Commercial Law Strategy of the Uniform Law Conference continued work during the current report period. Professors Buckwold, Cuming and Wood shared the responsibilities of chairperson.

## **Membership of the Committee**

[2] Ian Binnie (Ontario); Professor Tamara Buckwold (Saskatchewan), Michael Burke (Ontario); John Cameron (Ontario), Arthur Close (British Columbia), Professor Ronald Cuming (Saskatchewan), David Denomme (Ontario), Michel Deschamps (Quebec), Professor Catherine Walsh (Quebec) Professor Roderick Wood (Alberta), Professor Jacob Ziegel (Ontario). [Michael Burke and Professor Ziegel did not play active roles in the work of the Committee].

## **Overview of Committee Activity**

[3] The period 2002-03 was a very active one for the Committee as displayed in its report to the ULCC of June 2003. The Committee addressed several areas of personal property security law with a view to determining the need and support for harmonization of these areas. It also addressed the problems associated with conflict between provincial secured financing law and section 427 of the *Bank Act*. In addition, it worked with Mr. Eric Spink, a member of the Working Group of the Canadian Securities Administrators in developing most of the changes that were necessary to harmonize the PPSAs with the proposed Uniform Securities Transfer Act. This work involved several meetings and the preparation of an extensive report.

## **The Interface between the PPSAs and the USTA**

[4] The meetings held by the Committee in 2004 focused on matters arising out of the

June 2003 report including matters the Committee was not able to finally resolve before presenting the Report. Set out below are the conclusions reached by the Committee with respect to these matters. This portion of the report should be read as supplementary to the 2003 report dealing with the PPSA-USTA.

### **Application of USTA to the Crown**

[5] Section 12 of the USTA provides that the Act is binding on the Crown. While in some provinces (e.g., British Columbia) all legislation applies to the Crown unless a statute expressly provides otherwise, in other provinces, section 12 is necessary if the Crown is to be bound. While no formal vote was taken, there was general support in the Committee for the retention of section 12.

### **Conflict of Laws Rules: OPPSA/ CCPSL Model Act s. 7.1(4)**

[6] After extensive discussion of the conflict of laws rules applicable to interests in investment property, it was agreed that section 7.1 as recommended in the 2003 Report be changed. The Committee was particularly concerned with the potential for conflict between the PPSA-USTA and the *The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary*. Ultimately, it was decided that there is no formulation that would remove all potential for conflict or potential for confusion.

[7] The Committee decided to recommend the following formulation prepared for the Committee by Eric Spink.

#### *Applicable law - investment property*

*7.1(1) The validity of a security interest in investment property is governed by the law*

*(a) of the jurisdiction where the certificate is located if the collateral is a certificated security,*

*(b) of the issuer's jurisdiction if the collateral is an uncertificated security,*

*(c) of the securities intermediary's jurisdiction if the collateral is a security entitlement or a securities account,*

*(d) of the commodity intermediary's jurisdiction if the collateral is a commodity contract or a commodity account,*

*when the security interest attaches.*

*(2) Except as otherwise provided in subsection (4), perfection, the effect of perfection or nonperfection, and the priority of a security interest in investment property is governed by the law*

*(a) of the jurisdiction in which the certificate is located if the collateral is a certificated security,*

*(b) of the issuer's jurisdiction if the collateral is an uncertificated security,*

*(c) of the securities intermediary's jurisdiction if the collateral is a security entitlement or a securities account,*

*(d) of the commodity intermediary's jurisdiction if the collateral is a commodity contract or a commodity account.*

*(3) For the purposes of this section*

*(a) the location of a debtor is determined by subsection 7(1),*

*(b) the issuer's jurisdiction is determined by subsection 51(1) or (2) of the Uniform Securities Transfer Act;*

*(c) the securities intermediary's jurisdiction is determined by subsections 52(1) and (2) of the Uniform Securities Transfer Act,*

*(d) the following rules determine a commodity intermediary's jurisdiction:*

*(i) if an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that a particular jurisdiction is the commodity intermediary's jurisdiction for purposes of this Act, that jurisdiction is the commodity intermediary's jurisdiction;*

*(ii) if subclause (i) does not apply and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the agreement is governed by*

*the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction;*

*(iii) if neither subclause (i) nor (ii) applies and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction;*

*(iv) if none of the preceding subclauses applies, the commodity intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the commodity customer's account is located;*

*(v) if none of the preceding subclauses applies, the commodity intermediary's jurisdiction is the jurisdiction in which the chief executive office of the commodity intermediary is located.*

*(4) The law of the jurisdiction in which the debtor is located governs*

*(a) perfection of a security interest in investment property by registration;*

*(b) perfection of a security interest in investment property granted by a broker or securities intermediary where the secured party relies on attachment of the security interest as perfection; and*

*(c) perfection of a security interest in a commodity contract or commodity account granted by a commodity intermediary where the secured party relies on attachment of the security interest as perfection.*

*(5) If a debtor relocates to the Province, a security interest perfected pursuant to the law of the jurisdiction designated in subsection (4) remains perfected until the earliest of*

*(a) 60 days after the day the debtor relocates;*

*(b) 15 days after the day the secured party knows the debtor has relocated to the Province; or*

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

*(6) A security interest in investment property which is perfected under the law of the issuer's jurisdiction, the securities intermediary's jurisdiction or the commodity intermediary's jurisdiction, as applicable, remains perfected until the earliest of*

*(a) 60 days after a change of the applicable jurisdiction to another jurisdiction;*

*(b) 15 days after the day the secured party knows of the change of the applicable jurisdiction to another jurisdiction; or*

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

*[(7) To the extent applicable, this section is subject to the provisions of the Act Respecting the Convention on the Law Applicable to Certain Rights in Respect of Securities Held With an Intermediary.]*

[8] It was brought to the attention of the Committee that there is an error in the 2003 Report applicable to OPPSA s. 7(1). It was agreed that this aspect of the Report be amended to provide as follows:

OPPSA s. 7(1) should read as follows:

7. (1) The validity, ~~perfection and effect of perfection or non-perfection,~~

***(a) of a security interest in ,***

***(i) an intangible, or***

***(ii)...***

***(b) of a non-possessory security interest in a security, an instrument, a negotiable document of title, money, chattel and chattel paper, ...***

#### **OPPSA/CCPPSL MODEL ACT s. 17.1**

[9] The Committee concluded that the OPPSA/CCPPSL Model Act s. 17.1 as set out in the 2003 Report should be changed to read as follows:

*17.1(1) Unless otherwise agreed by the parties and notwithstanding section 17, a secured party having control under subsection 1(1.1) of investment property as collateral*

*(a) may hold as additional security any proceeds received from the collateral;*

*(b) shall either apply money or funds received from the collateral to reduce the secured obligation or remit such money or funds to the debtor; and*

*(c) may create a security interest in the collateral.*

*(2) Notwithstanding subsection (1) and section 17, a secured party having control*

*under subsection 1(1.1) of investment property as collateral may sell, transfer, use or otherwise deal with the collateral in the manner and to the extent provided in the security agreement.*

[10] This draft distinguishes between creating a security interest in the collateral (which is normally permitted unless the parties agree otherwise), and selling or otherwise dealing with the collateral in any manner that might be construed as going beyond “creating a security interest” such as repo and securities lending transactions. These require an agreement, which is consistent with market practice

### **CCPPSL Model Act s. 28(1.1)**

[11] It was brought to the attention of the Committee that the broadened definition of “proceeds” in the context of investment property catches property like securities lending or repo “fees”. Consequently, it runs afoul of the Working Group’s proposed limited exemption to APPSA s. 28(1) because the proceeds are generally not investment property. This exception provides:

*28 (1.1) the limitation of the amount secured by a security interest as provided in subsection (1) does not apply where the collateral and proceeds are both investment property.*

[12] After extensive discussion it was agreed [Professor Walsh dissenting] that the 2003 Report be amended to recommend the following CCPPSL Model Act s. 28(1.1):

*28(1.1) The limitation of the amount secured by a security interest as provided in subsection (1) does not apply where the collateral is investment property.*

### **Cut-Off Rules: CCPPSL Model Act ss. 30(10) and (12); : OPPSA ss. 28**

[13] The Committee reviewed its decisions set out in the June 2003 Report dealing with the position of buyers of securities. The Committee decided to substitute the following provisions for those set out in the Report:

*CCPPSL Model Act*

*30(9) A buyer of a certificated security or an uncertificated security who*

*(a) gives value;*

*(b) does not know that the sale constitutes a breach of a security agreement in which a security interest was granted in the certificated security or the uncertificated security; and*

*(c) obtains control of the certificated security or the uncertificated security,*

*acquires the certificated security or the uncertificated security free from the security interest.*

*(10) A buyer referred to in subsection (9) is not required to determine whether a security interest has been granted in the certificated security or the uncertificated security or whether the acquisition constitutes a breach of a security agreement.*

*(11) An action based on a security agreement creating a security interest in a financial asset, however framed, may not be asserted against a person who acquires a security entitlement under section 106 of the Uniform Securities Transfer Act for value and did not know that there has been a breach of the security agreement.*

*(12) A person who acquires a security entitlement under section 106 of the Uniform Securities Transfer Act is not required to determine whether a security interest has been granted in a financial asset or whether there has been a breach of the security agreement.*

*(13) If an action based on a security agreement creating a security interest in a financial asset could not be asserted against an entitlement holder under subsection (11), it may not be asserted against a person who purchases a security entitlement, or an interest in it, from the entitlement holder.*

Parallel changes were recommended for OPPSA s. 28(6)-(7).

**Future Work of the Committee**

[14] The recommendations for harmonization of the PPSAs developed by the Committee and set out in the June 2003 Report have received very little recognition outside a very narrow range of interested persons. Several members of the Committee have reached the

conclusion that the approach to harmonization employed by the Committee during the period 2001-2003 is not likely to have a significant effect for the foreseeable future on the further development of Canadian secured financing law. As a result, early in the 2003-04 work period, the Committee reassessed its approach to harmonization of Canadian secured financing law. It concluded that its primary objective for this period should be to complete its work in the interface between the PPS Acts and the Uniform Securities Transfer Act. It would then determine what alternative approach might be employed to encourage harmonization of provincial secured financing law.

[15] There remains support among several members of the Committee for a continued effort to develop a Uniform Personal Property Security Act that can be adopted by the ULCC. However, the prevailing view is that there is no urgency associated with the task. As matters now stand, all provinces and territories other than Ontario, Quebec and Yukon have substantially uniform Acts (based on the CCPSL Model Act). While improvement should be made in these Acts in the foreseeable future, this is not a high priority for provincial legislators.

[16] While the Ontario Act is principal source of disharmony in personal property security legislation of the common law provinces, there is little evidence of support in Ontario for change in the Ontario Act<sup>\*</sup> either to implement the Committee's recommendations or to bring its Act in line with that of the rest of common law Canada.

[17] The Committee was mandated at past meetings of the ULCC to continue work on modernization and harmonization of Canadian secured financing law on the basis of the report presented by Professors Cuming and Walsh to the ULCC at its 2002 meeting. A significant number of Committee members are of the view that this part of the mandate should now be pursued with a view to developing an Uniform Personal Property Security Act over a period of two or three years. Should this approach be adopted, it may be

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\* It has been brought to the attention of the chairperson that the Personal Property Security Law Committee of the Business Law Section of the Ontario Bar Association was recently informed by a representative of the Ontario Ministry of Consumer and Business Services that consideration of the Committee's 1998 recommended changes to the OPPSA will not occur for at least another two years.



necessary to reconstitute the Committee to ensure that it reflects representatives from a larger number of provinces that have adopted the CCPPSL Model Act.

This Report was prepared by Ronald Cuming and approved by the Committee.