

Greater Clarity for Secured Lenders: New Rules taking effect December 31

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You lend money to a technology company so that it can research, develop and market a new software package. As security for your loan, you take a security interest in that company's intellectual property and accounts receivable. The company runs into trouble. You conclude, reluctantly, that recovering your investment will require enforcement of that security interest.

This enforcement will require that the security interest was registered properly. The path to proper registration in Ontario will be clearer starting the last day of this month, and even clearer yet if and when other provinces and territories change their related laws.

Ontario's new regime for registering a security interest in certain personal property flows from a statute to modernize a variety of provincial rules that was given Royal Assent nine years ago. Some of those rules, including changes to the *Personal Property Securities Act* (PPSA), are only coming into force now.

Perhaps one of the most welcome of the amendments to the PPSA is the change of the definition of "location of debtor".

Location of Debtor – Then and Now

Up to now (and until the last day of this month), Section 7 (3) of the PPSA has provided that, in the case of

- (a) intangibles (which include, among other things, intellectual property accounts receivable);
- (b) goods that are designed to be used in more than one jurisdiction (also referred to as "mobile goods", e.g. transport trucks and trailers), and

(c) a security interest in an instrument (e.g. a cheque) or chattel paper (e.g. a lease), where the secured party does not have possession of the instrument or the chattel paper

the perfection and priority of a security interest is determined by the “location of the debtor”.

In short, if a secured party has wanted an enforceable security interest in one of the categories of collateral above, it has had to “perfect” its security in the appropriate jurisdiction. The most common method of perfection in Ontario has been the registration of a financing statement with the province’s personal property security registration system.

Location of the debtor has been defined as follows: “...a debtor shall be deemed to be located at the debtor’s place of business if there is one, at the debtor’s chief executive office if there is more than one place of business, and otherwise at the debtor’s principal place of residence”.

This definition created great uncertainty and led to two or more registrations in various jurisdictions.

Consider this scenario. The technology company you lent money to is an Ontario subsidiary of an American parent incorporated in Texas and you need to perfect your security interest in the Ontario company’s accounts receivable. There is a “token” Canadian director at the Ontario location, but all officers of the Ontario company are employees of the American parent. Does the Ontario subsidiary have only one business location or is the Ontario’s “chief executive office” in Texas, as all the executives of the Ontario subsidiary are located there? Rather than guess, many secured creditors would simply register in Ontario and Texas.

Other confusions surrounded the location of an individual. If an individual ran a business as a sole proprietor in Hull, Quebec but lived across the river in Ottawa, would a secured creditor register in Quebec or Ontario? Again, out of an abundance of caution, most secured creditors would register in both jurisdictions.

So certain sections of the *Modernization Act, 2006*, which will be proclaimed into force on December 31, 2015, will substantially alter the location-of-debtor definition and create greater certainty as to where one should register their PPSA financing statement to perfect their security interest.

The following business entities have the following “location” for the purposes of the PPSA after December 31, 2015:

- Individuals -- their place of residence;
- General partnerships -- determined by the governing law chosen in the partnership agreement;
- Limited Partnerships -- jurisdiction where the partnership is organized and the public record is filed
- Provincial corporations -- jurisdiction where incorporation, continuance or amalgamation occurred
- Federal corporations -- jurisdiction where the registered office is located
- US corporation -- State where the corporation is incorporated¹

- Trusts -- jurisdiction identified in the trust instrument as being the governing law or, if silent, jurisdiction in which the administration of the trust is carried on
- If none of the above -- jurisdiction where the chief executive office is located

Transitional Rules

As part of the amendments coming into force at the end of the year, transitional rules will be implemented to allow creditors the necessary time to ensure that their prior financing statements remain perfected, or to take additional steps to continue the perfection of those statements.

As of December 31, 2015 all new PPSA security interests must be perfected using the new location of debtor rules.

All existing security interests which were perfected by registration under the prior law will continue as perfected under the new law until the earlier of the expiration date of the original financing statement or December 31, 2020.

Subject to the December 31, 2020 deadline, all existing PPSA financing statements can be amended or renewed so long as a security interest in additional collateral is not claimed by way of an amendment. (If new collateral is claimed and the location of the debtor has altered as a result of the amendments, then a fresh PPSA financing statement should be registered in the appropriate jurisdiction).

Still Some Issues

The reason that these provisions of the *Modernization Act, 2006* took so long to be proclaimed in force is that Ontario was waiting for the other provinces to amend their location-of-debtor provisions so as to create a uniform system in all provinces and territories except Quebec. Unfortunately, to date, the other provinces and territories have not responded.

Accordingly, there may still be instances where perfecting in two jurisdictions will be required. For example, suppose you had a debtor whose jurisdiction of incorporation is Ontario, but there is a business location in Calgary. Factually, there are more “executives” operating out of the Calgary office so you can determine that the chief executive office is in Alberta. The new Ontario rules provide that you must perfect in Ontario. However the Alberta Personal Property Security Act provisions are the same as Ontario’s used to be, and hence, will require that you perfect your security in Alberta. Accordingly, you must register a financing statement in Ontario and Alberta.

So, while Ontario’s forthcoming changes to the location-of-debtor rules are welcome, their full effect, expediency and certainty will not be realized fully until the other PPSA provinces follow suit.

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i Different rules will apply for federally incorporated US corporations