# CANADIAN CHATTEL SECURITY EXPERIENCE


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# Canadian Chattel Security Experience

## I. INTRODUCTION

In common with the U.S. and countries in Western Europe, Canada has experienced a phenomenal growth since the second World War in all forms of medium and short term credit, both for business and consumer purposes. A few figures will make this clear. At the end of 1966 the balance owing to Canadian banks, finance companies, and other credit grantors amounted to $15,716.2m, of which all forms of consumer credit accounted for $7,589m, and general bank loans and inventory finance provided by sales finance companies for the rest. Consumer credit alone has increased almost ninefold since 1948. Canada's gross national product in 1966 amounted to $57,781m. Long term credit made available in that year was proportionately much more modest - new real estate mortgage loans amounted to $1,309m, and net new issues of governmental, municipal, corporate and other securities for another $2,552m. What emerges from these figures is the fact that at the present time medium and short term credit equals over one-fourth of Canada's gross national product and greatly exceeds the annual value of the various forms of long term credit. While exact figures are not available, it is reasonable to assume that a large proportion of the medium and short term credit is secured by some form of security in personal property..

## II. THE LEGAL FRAMEWORK BEFORE 1967

These impressive facts would lead one to suppose that the Canadian law of chattel security is both sophisticated and very favourably disposed to encourage this branch of economic activity. The assumption however is largely unjustified and in many respects it is true to say that secured credit occupies its pre-eminent position in the Canadian economy not because of the law but frequently despite it.

Jurisdiction in this branch of the law is divided between the federal and provincial governments. The Provinces (in theory at any rate) enjoy the lion's share of the power by virtue of their authority to legislate in all matters affecting property and civil rights, but the federal government also possesses very extensive powers under several of the enumerated heads of jurisdiction in section 91 of the British North America Act. The list includes banks and banking, bills of exchange and promissory notes, the regulation of interest rates, bankruptcy, and companies incorporated under federal law.

### 1. Federal Law

On the whole, however, the federal government has so far exercised its powers very sparingly. There are a dozen or so acts which contain some provisions affecting the law of chattel security, but only one has significantly affected the development of this branch of the law. The exception is in the banking sphere. It was a widely held dogma in Canada in the last century that the only forms of security suitable for banking loans were those which were highly liquid in character and easily realisable in an emergency. Goods and merchandise did not fall into this category and, accordingly, the banks were prohibited from taking this form of collateral as security. The prohibition threatened to impede the development of the important agricultural and extractive industries. To meet their needs for working capital, an exception was made covering their products as early as 1859 and the exception was gradually expanded over the succeeding years to include manufacturers' and wholesalers' inventory but not, it should be noted, the stock-in-trade of merchants or retail stores generally.

The section of the Bank Act containing these exceptions is s.88, and the security taken pursuant to it is generally referred to as a "Section 88" security. The Bank Act was completely revised last year, but the section 88 provisions were left unaltered.

From the legal point of view the special significance of the section resides in its perfection requirements. Originally all that

was required was a short document signed by the borrower granting the bank a section 88 security interest in the goods, present or future, which could be described in the most general terms. The effect of the agreement was to vest in the bank a legal title in the collateral which took priority over all subsequently created security interests. Until 1923 nothing was required to be filed, but since that time the bank's security interest is not perfected until a "notice of intention to give a section 88 security" has been filed in one of the regional offices of the Bank of Canada.

This one-page document is even briefer than the agreement to which it relates and is a model of simplicity. Those familiar with the American Uniform Trust Receipts Act will recognise in this requirement the Canadian origin of "notice filing" and the immense importance which it plays in facilitating that branch of secured credit known as inventory financing. So far as I know, Canada was the first, and perhaps still is the only, Commonwealth country to adopt notice filing.

## 2. Provincial Law

All the common law Provinces in Canada have inherited the security devices known to English law, but the statutory developments in Canada have differed in many important respects from the English legislation. Our institutional structure is also different. The earliest provincial legislation dates from 1859 and affected bills of sale and chattel mortgages. By the turn of the century all the Provinces had adopted such legislation, which followed a common pattern. First, it required all absolute bills of sale and chattel mortgages, not followed by an actual and open transfer of possession of the chattels comprised in the security agreement, to be registered in a designated, usually city or county based, office. Secondly, it established a cumbersome and complex system of affidavits of bona fides and execution, and these have provided a recurring and, from the creditor's point of view, fatal source of litigation. Chattel mortgages are very widely used in Canada to secure loans for business and consumer purposes and, unlike in the United Kingdom, no stigma attaches to this form of security device.

Instalment sales of durable goods of high unit value are usually secured in Canada by a conditional sale. Hire-purchase agreements are not commonly used, although in the business equipment field a close cousin, the so called "equipment lease", is beginning to assume increasing importance. Legislation requiring conditional sale (and, later, hire-purchase) agreements to be registered was adopted in Nova Scotia as early as 1882 and was quickly copied in the other Provinces.

By the turn of the century, then, most Provinces had two basic registration statutes and this number has since been augmented by two further statutes, an Assignment of Book Debts Act and a Corporate Securities Registration Act. In 1918 the Provinces also established a body known as the Conference of Commissioners on Uniformity of Legislation in Canada which has drafted a widely adopted uniform act in each of these areas. The Uniform Acts, however, involve no conceptual departure from the Acts which they replace and they share their strengths and weaknesses. Apart from these developments, a very considerable and increasingly complex body of consumer credit legislation has been enacted in many of the Provinces during the last forty years, though most of it is of post-war origin.

## 3. The Shortcomings of the Canadian Law

This thumbnail sketch does less than justice to the complexity of the law of chattel security in Canada today, but a detailed knowledge of its history is less important than an appreciation of its shortcomings. Its major defects are these:

a. It lacks a generic concept of a security interest in personal property.

The result is that we have a large and growing number of devices which are designed to serve an identical end but which, in point of

law, are either not recognised as security devices or, if they are, exhibit important differences from one another. In the former category fall such familiar devices as conditional sale agreements, hire-purchase agreements, equipment leases with an option to purchase and, less commonly, consignment agreements. In the latter category belong the pledge, the chattel mortgage, the floating charge, and a "section 88" security. The status of other important devices such as certain types of equipment leases, trust receipts (when used for internal trade), and "field warehouse" receipts is still largely unsettled in Canada.

Some of these devices are recognized in equity but not by the common law; some convey title to the secured party, others merely vest in him a special property. One (the section 88) security is the creature of statute; others are not regulated by statute at all.

The confusion which presently prevails can be illustrated by a simple example. John wishes to buy a car on secured credit. He may do it in one of two ways. He can borrow the purchase price from a bank, small loans company or credit union, and pay the dealer in cash. In the alternative he can purchase the goods on a time basis from the dealer. If he uses one of the lending agencies his security must, of course, assume the form of a chattel mortgage. If he uses the dealer the security may be either a chattel mortgage or a conditional sale agreement. In both cases, however, the security fulfills an identical function - it is what North American lawyers call a "purchase money security interest". It would be reasonable to expect, therefore, that whether a chattel mortgage or a conditional sale is used the legal consequences will be the same. But this is not at all true in any of the common law Provinces today. The common law and statutory rights of the parties differ markedly under each of the two forms of agreements, and in most Provinces the registration requirements are not the same. Mortgaged goods are subject to the ordinary law of fixtures whereas the conditional sales legislation generally safeguards the rights of the conditional seller. In the same way goods subject to a conditional sales agreement have been excluded by statute from the reach of the landlord's lien for arrears in rent. The same is not true of mortgaged goods.

b. Most of the existing security statutes were first enacted in the 19th century or have been patterned along legislation first adopted during the Victorian era. In the last century the granting of security in personal property was the exception rather than the rule and, as often as not, was regarded as a sign of incipient insolvency and as an attempt to mislead or defraud general creditors. It was treated as a disease rather than as a healthy phenomenon and the thrust of the legislation, particularly in the area of chattel mortgage agreements, was to discourage the practice as much as possible. Since then there has been a complete economic revolution, and it is the exceptional enterprise today which does not borrow extensively and continuously against the security of its assets. The business attitude, therefore, has changed, but the legal attitude remains the same. This accounts for the survival of highly technical affidavits of bona fides and execution, of exacting description requirements, and the obligation by the secured party to register the security agreement within a fixed number of days following its execution on pain of losing his security entirely if he fails to comply.

The degree of obsolescence in our legislation is particularly obvious in the important area of inventory financing. Few retailers and manufacturers can pay cash for their inventory, and they rely to the tune of several billion dollars annually on their suppliers and the banks and sales finance companies to provide them with lines of credit. Inventory financing differs fundamentally from the financing of a single item for use, but when one examines our chattel mortgage and conditional sales legislation one finds that it is not at all adapted to meet these special requirements. So the lawyer has to wrestle with a number of makeshift and highly vulnerable devices whose validity and effectiveness are always open to doubt. In the banking sphere, it is true, we have the "section 88" security which goes a long

(but by no means all the) way to meeting the financer's requirements, but this security is only available to the banks.

c. As security device has been heaped on security device, each governed by its own set of common law, equitable and oft amended statutory rules, it is understandable that the courts should have experienced much difficulty in keeping them distinct. More often than not, confusion has been the result. To add to the difficulties new problems, not foreseen in earlier years, have arisen on which the judges, lacking clear statutory guidance, have spoken with divided voices. Sometimes they have not spoken at all and the legal adviser has to guess at the possible answers.

## III THE ONTARIO PERSONAL PROPERTY SECURITY ACT, 1967

This then, to greater or lesser extent, was the position in all the Provinces until last year, when Ontario ushered in a new era of security legislation in Canada by its adoption of the Personal Property Security Act, 1967.

The Act was drafted by a committee of practising lawyers and law teachers, which began its work as early as 1960. The committee was originally formed under the auspices of the Ontario Commercial Law Section of the Canadian Bar Association, but as the scope and importance of the task it had assumed became clearer the committee sought and obtained the endorsement of the then Attorney General of Ontario and it has operated under his aegis ever since. The original terms of reference of the committee were to make recommendations with respect to the revision of Ontario's principal security acts. The committee had two alternatives. The first, the traditional one, was to amend the statutes yet again and to try to remove some of their more serious blemishes on an ad hoc, piecemeal basis. The committee tried this approach but saw that it merely led into a new wilderness. They then turned to Article 9 of the American Uniform Commercial Code and found that it contained the key to the only workable solution. They therefore adopted it as the basis of their draft Bill.

Perhaps this is an opportune moment for me to say a few words about the Code. It was produced under the joint sponsorship of the American Law Institute and the National Conference of Commissioners on Uniform State Laws and represents the fruit of many years of intensive labour of numerous scholars and committees of experts. The Code has rightly been hailed as the most important commercial law development to take place in the common law world in this century. The idea of the Code was first mooted in 1942, but serious work on it did not commence until after the war. The first version of it was completed in 1948, and it has since been revised on a number of occasions. The current version is known as the "1962 Official Text", and an Editorial Committee has been entrusted with the task of proposing further changes and, not least important, of discouraging unilateral changes by the adopting states. The Code has now been adopted by all the states with the exception of Louisiana, which is a remarkable achievement.

It will therefore be seen that the Ontario committee was on very sound ground in adopting Article 9 as a model. The Code is divided into ten parts or articles, as they are called. Article 1 deals with definitions and Article 10 with transitory provisions. Each of the other articles deals with a major branch of commercial law. Article 9 is devoted to Secured Transactions. Pre-Code American security law differed from Canadian law both doctrinally and in points of detail, but it shared with it one feature of overwhelming importance - it was equally in need of modernization and rationalization. How Article 9 accomplishes these twin objectives I shall explain presently, but let me note for the moment that, with very few exceptions, Article 9, along with the other articles of the Code, appears to be working very well and has so far produced surprisingly little important litigation.

And now let me return to the Ontario Committee. The committee completed the first version of its Bill early in 1964, and it was then printed and distributed for further study and consideration by the legal profession and other interested parties. On May 1st and

2nd, 1964, the Bill was the central theme of a well attended conference of American and Canadian lawyers at Osgoode Hall and its structure and basic philosophy won the warm support of those present. Although the conference was much too brief to permit a clause by clause examination of the Bill, a number of detailed recommendations did emerge from it. Many of them were subsequently incorporated in the Bill by the Catzman committee. The basic scheme of the Bill, however, was left intact. In the meantime, the Ontario Law Reform Commission had been established by an Act of the Ontario legislature, and in December, 1964, the Commission was invited to review and report on the draft Bill in its then amended state. This the Commission did on May 28th, 1965, in a disappointingly short ten-page report. The Commission reported that it was convinced that the draft Bill was useful and constructive legislation and that it believed it would serve to modernize the branch of commercial law covered by it. The Commission made numerous verbal changes in the Bill and also introduced a small number of substantive amendments of major significance.

In the view of the Catzman Committee and other interested parties they would have involved some undesirable departures from the principles of the Bill. Vigorous representations were therefore made to the Ontario government and this led to the issue of another report by the Commission in 1966. In this report the Commission modified or withdrew some of its earlier recommendations but remained firm with respect to the rest. The Commission made a further recommendation at a later date with respect to the scope of the Bill, but this recommendation was never incorporated in a published report.

The Catzman Bill, as amended by the Commission, was given its first reading in the Ontario legislature in 1966 but was not proceeded with at the time. After several delays the Bill was re-introduced in April 1967 and, much to everyone's surprise and relief, proceeded through all its stages and received the royal assent on the 15th of June. Ontario is thus the first Province in Canada to have adopted an Article 9 type law concerning security in personal property.

The Ontario developments have been followed with close interest in other parts of Canada and there is reason to believe that the Ontario Act may be copied in three of the Western Provinces (Manitoba, Saskatchewan and Alberta) in the near future. In 1963 the Commercial Law Section of the Canadian Bar Association also established a special committee with the object of making recommendations with respect to the advisability and the form and content of a uniform act on security in personal property. The Hon.R.L. Kellock, Q.C., a former judge of the Supreme Court of Canada, was appointed first chairman of the committee. The committee reported in September 1964 that it was convinced that the law of the common law Provinces was badly in need of modernization, rationalization and integration, and it warmly endorsed the principles underlying the then draft Ontario Bill. At the 1967 annual meeting of the Commercial Law Section of the Canadian Bar Association the committee presented its proposals with respect to the content of a draft uniform act. These were that the Ontario Act should be adopted as the basis for a Uniform Act, subject to the introduction of a number of minor changes and a few major ones. The committee's recommendations are now being studied in different parts of the Dominion.

## IV THE STRUCTURE OF THE ONTARIO ACT

The basic concepts of the Ontario Act, and therefore also of Article 9 of the Uniform Commercial Code, are as simple as they are effective. The first concept is that every security device serves an identical object - to secure performance of an obligation by a debtor. You do not therefore need a proliferation of acts all dealing with same subject matter. One act will suffice and it can cover all security agreements, regardless of the nature of the collateral involved so long as it is still personal property or fixtures. Section 2 of the Ontario Act accordingly provides that:

Subject to subsection 1 of section 3, this Act applies,

(a) to every transaction without regard to its form and without regard to the person who has title to the collateral that in

substance creates a security interest, including, without limiting the foregoing,

(i) a chattel mortgage, conditional sale, equipment trust, floating charge, pledge, trust deed or trust receipt, and

(ii) an assignment, lease or consignment intended as security; and

(b) to every assignment of book debts not intended as security, but not to an assignment for the general benefit of creditors to which The Assignments and Preferences Act applies.

"Security interest" is defined in Section 1(y) as:

an interest in goods, other than building materials that have been affixed to the realty, fixtures, documents of title, instruments, securities, chattel papers or intangibles that secures payment or performance of an obligation, and includes an interest arising from an assignment of book debts; absolute bills of sale, lease and consignment agreements.

There are, it is true, some justifiable differences between various security agreements, but the differences are functional in character and do not turn on the legal nature of the agreement. The Act recognizes this fact by distinguishing for certain purposes between different types of collateral and establishing separate rules for them.

The second basic concept of the Act arises from the fact that every security agreement raises the same four basic questions. First, how do you create the security interest and what restrictions should be imposed upon its effectiveness between the parties to the security agreement (secs. 9-20)? Secondly, what steps must the secured party take to perfect his security interest so as to protect it against attack by creditors and purchasers (other than purchasers in ordinary course of business), and what is the order of priorities where other persons claim a conflicting interest in the same collateral (secs. 21-40)? Thirdly, if the security interest is perfected by registration, when, where, and what document must be filed and what information must it contain (secs. 41-54)? Finally, what are the secured party's rights and remedies if the debtor defaults in his obligations (secs. 55-62)? Under each of these headings the Act elaborates an appropriate set of rules which apply to all security interests regardless of the nature of the instrument by which they were created, save where the nature of the collateral or the value given by the secured party requires or justifies special rules.

The cumulative effect, then, of these two basic concepts is to sweep aside the bewildering variety of statutory, common law and equitable rules which have developed around the existing security devices. Although the parties are free to continue to use the old nomenclature if they wish, there is in substance now only one security device - the "security agreement", and every security agreement is governed by the same basic set of rules. When one considers that, with very few exceptions, the Act regulates security agreements covering every possible form of collateral this is an impressive achievement.

A simple example will illustrate the operation of the Act. Dealer A sells vehicles on a conditional sale basis. Bank B extends "purchase money" loans to borrowers and takes a chattel mortgage as security. Under the Act the dealer and the bank will both become "secured parties", and they will both have a "purchase money security interest" in the vehicles which they have helped to finance. Both will have to comply with identical filing requirements in order to perfect their security interests, and the documents filed by them will be registered in the same office and indexed in the same book. Both will occupy the same positions towards third parties and both will enjoy the same rights and remedies, and be subject to the same duties, if they wish to enforce their security interests.

We have seen how the Ontario Act has rationalized the law of security in personal property. How does it accomplish its other objective of modernizing and clarifying the law, in so far as this

end is not already attained through the integration of all the existing security devices? Space does not permit me to enter into details but here is a list of some of the improvements introduced by the Act.

(a) The legal aspects of inventory and accounts receivable financing have been greatly simplified. In particular, the rights of the financer of such collateral to the proceeds resulting from their disposal or collection have been spelled out in detail (sec.27)

(b) Section 9 lays down the fundamental rule that, unless otherwise provided in the Act, a security agreement is effective according to its terms and against third parties. The Act further expressly provides that a security interest may cover present and after-acquired property and may secure present and future advances.

(c) The conflict between equitable and legal securities has been explicitly and implicitly eliminated (secs. 21,35,53).

(d) A clear, though not exhaustive, set of conflict of laws rules have been introduced, thus removing the uncertainty in the present case law (secs. 5-8).

(e) No affidavits are required at any time or for any purpose.

(f) Rules are established concerning the status and priorities of fixtures, artisans' liens, accessions and commingled goods (secs. 32,36-38).

(g) "Chattel Paper", that is, a writing that expresses both a monetary obligation and a security interest, is for the first time in Canada given a separate legal status. This greatly simplifies the use of such agreements for security purposes [secs.1(c), 24(a), 25(1)(a), 30(2)].

(h) The rights of debtors are strengthened (secs. 57-62). It should be emphasized, however, that the Act is not a consumer protection act and is not intended to supersede special legislation of this character.

## V SOME DIFFERENCES BETWEEN THE ONTARIO ACT AND ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE

The Ontario Act is a much more succinct document than Article 9 and it lacks the Official Comments which are such a helpful feature of the Uniform Commercial Code. There are also many other differences in point of detail between the Canadian and American Acts, which need not however detain us here. What I should like to do in the remaining pages at my disposal is to discuss briefly some major differences between the Code and the Ontario Act and to refer to some other unresolved issues which arise out of the provisions of the Ontario Act.

### 1. The Scope of the Act - Corporate Securities.

Like Article 9, the original Catzman Bill made no distinction between security given by individuals and security given by companies, or between corporate security given to secure an issue of bonds or debentures and other forms of corporate indebtedness. However, the Ontario Act has excluded those forms of corporate security (that is, secured bonds and debentures) which are presently covered by the Ontario Corporate Securities Registration Act. This very important change was recommended in an unpublished report by the Ontario Law Reform Commission. The Commission's reasons were that corporate securities were a different breed of animal from other forms of security in personal property, that they were not previously subject to renewal requirements, and that it would be difficult, and might be unfair from the bondholders' point of view, to impose such a requirement now. It was also pointed out that the abstracting of information from corporate securities required a special skill which might not be possessed by the staff which would be handling the other registrations, and that any mistake could lead to multi-million dollar claims being made on the assurance fund to be established under the Act.

However, these reasons failed to convince the committee of the Canadian Bar Association, as they had also failed to convince the

Catzman committee. The C.B.A. committee has suggested a compromise which we hope will prove acceptable to the Ontario government and the other provincial governments. This compromise is, first, that those corporate securities which presently are subject to the provisions of the Corporate Securities Registration Act or equivalent acts in other Provinces shall continue to be registered in the office of the provincial secretary or registrar of companies, as the case may be, which shall then forward an abstract of the document to the central registration office. Secondly, the renewal provisions in the Ontario Act shall not apply to such securities.

These proposals may not satisfy the purists and it must be admitted that they could raise some new difficulties of their own. In my opinion, however, their advantages greatly exceed the damage which would be done to the Act if secured bonds and debentures were to be excluded entirely from its scope.

2. The Place of Filing

There are a number of ways in which a filing system can be organized. It can be organized on a city or county basis or all filings can be required to be made in a single central office. In the alternative, one could adopt a combination of both systems by permitting certain documents to be filed locally and requiring others to be deposited in the central office. In the case of motor vehicles, it could be decided that because of their importance as an object of commerce any system of filing - central or local - was inadequate and that one should adopt, as many American states have done, a certificate of title system along the lines adopted for dealings in land in the Torrens land title system.

The serious shortcoming of a local filing system is that because of the mobility of many chattels and the frequency with which, in North America at any rate, many individuals change their residence one can never be sure that all the transactions affecting a particular item have been registered in the same office. If you are dealing with a business you might find that it has branches in several registration districts and you would then have to decide whether the security agreement should be required to be filed in all the districts or only in one and, if so, which one. Still further complications arise if the collateral is kept or used in one district and the debtor has his residence or place of business in another, or perhaps has no residence or place of business in the state at all.

For all these reasons it is obvious that a central filing system is much superior to a local system. The sponsors of the Uniform Commercial Code fully realised this but they also appreciated that it would be impossible to impose a single system of filing in each of the fifty states of the Union. They therefore compromised by offering a series of alternatives which you will find in Section 9-401 of the Code.

The early Canadian security statutes all adopted a city or county based filing system. With the growing importance of motor vehicles several provinces switched in the thirties to a central filing system with respect to such chattels, and in the last decade this system has been extended by them to all forms of collateral. Given the availability today of highly sophisticated electronic data and computer equipment a central system of filing is now easy to operate as well as a practical necessity.

The Ontario Act ingeniously combines the best features of both systems. Under the Act a series of branch offices will be established across the Province and they will be electronically linked to a central office which will be located in or near Toronto. Any person wishing to register a document will be free to use any of the branch offices or to deal directly with the central office. If he elects the former method the document will remain on file in the branch office, where it may be inspected by any interested party, and an abstract of the most important information contained in the document will be immediately

transmitted to the central office and recorded there. Searches will be able to be made in a similar manner. The possibility is also envisaged that creditors willing to pay for the service may be electronically linked from their offices to the centrally located computer system and thus be in a position to conduct searches without going through any intermediary.

3. Notice Filing v. Filing of Individual Agreements

Without exception all the provincial security acts prior to 1967 required the original or a copy of the security agreement to be filed where filing was a prerequisite to perfection of the security interest. On the other hand, as I have earlier noted, the Canadian Bank Act has used a system of notice filing since 1923. Under that system the agreement itself is not registered but only a short document indicating that the debtor intends to give security in a type or types of collateral described in the document, and the document may be filed at any time - before or contemporaneous with the execution of the security agreement. Apart from this feature, the great advantage of a notice filing procedure is that it enables the parties to change the underlying security agreement at will, and that it dispenses with the need to file many documents. All these considerations loom very large where the parties are engaged in a continuous series of credit transactions.

In the U.S., notice filing was first widely adopted with the introduction of the Uniform Trust Receipts Act of 1933, and it has worked very well. The Uniform Commercial Code has retained the concept and indeed expanded it, for under Article 9 the secured party is always free to file <u>either</u> a copy of the security agreement <u>or</u> a "financing statement", i.e., a notice containing the names of the parties and a description of the collateral which has been or may be given as security. In practice a copy of the agreement is usually filed in single transactions (e.g., the financing of a specific piece of equipment) and the financing statement is used for inventory and accounts receivable financing.

Despite these weighty precedents, a majority of the members of the Catzman committee were opposed to the introduction of notice filing in the Ontario Bill in any form and for any purpose. They apparently feared that the procedure might be used for fraudulent purposes and that the parties might be tempted to concoct a fictitious security agreement. However, at the committee stage of the Bill representations were made by a group of sales finance companies and this resulted in the adoption of an important amendment to Section 47 of the Bill. The effect of the amendment is to permit notice filing where the collateral comprises goods to be held for sale or lease - in other words, the type of transactions where a dealer or merchant wishes to finance his inventory or stock-in-trade. In the opinion of the committee of the Canadian Bar Association the amendment does not go far enough. It does not cover other important types of inventory financing (as, for example, the financing of a manufacturer's or producer's stock-in-trade) and it excludes entirely accounts receivable financing, which is as important and as common in Canada today as inventory financing. The committee has therefore recommended that the proposed Uniform Act should permit notice filing in all cases where the collateral consists of inventory (whether it is held for sale or otherwise) or accounts receivable.

4. The Time of Filing

From the beginning the almost universal rule in the Canadian security acts has been that the security agreement must be filed within a short period following the execution of the agreement. Here again Section 88 of the Bank Act was an important exception, and in the nature of things had to be, because the notice of intention may be filed before a security agreement has been executed and therefore the filing requirement cannot realistically be related to the date of

execution of the agreement. Section 88(4) therefore permits the notice to be filed at any time not exceeding three years before the security was given. The Uniform Commercial Code even dispenses with this modest restriction and the copy of the agreement or the financing statment may be filed at any time.

Apart from the particular requirements of a notice filing system, there are two other reasons which militate in favour of an open-ended filing period. The first is that if you impose a fixed time for filing you must also add provisions permitting a designated official - usually a judge - to extend the time for filing. In the view of many Canadian practitioners this is a time consuming and wasteful procedure since in what is invariably an ex parte application the judge is really not in a position to segregate the meritorious applications from the non-meritorious ones. The second reason is that no third party is prejudiced by permitting an unlimited filing period. The Canadian security acts usually provide that if the security agreement is not filed within the prescribed period it shall be void vis-à-vis subsequent purchasers, mortgagees, execution creditors and trustees in bankruptcy. If the secured party therefore delays in perfecting his security interest he runs the risk of losing it in favour of these classes of persons. Conversely, if no third party interests have intervened it makes no difference whether the security agreement is filed thirty, sixty or ninety days after its execution.

It is conceivable, of course, that a secured party, acting in collusion with the debtor, may deliberately postpone filing the security agreement so as to mislead the debtor's general creditors. Whatever may have been the risks of this happening in the last century it is no longer a serious threat, and to the extent that it still poses a danger it can probably be dealt with most effectively by treating it, as the Americans do, as a fraudulent preference under the bankruptcy law.

The aforegoing considerations were carefully weighed by the Catzman committee and the committee strongly favoured an open-ended filing period. The Ontario Law Reform Commission just as adamantly insisted on retaining the principle of a fixed filing period and it is this point of view that has prevailed in the Ontario Act. The Canadian Bar Association Committee, on the other hand, has endorsed the position of the Catzman committee, and there the matter rests for the moment.

5. Customary hire-purchase agreements and security interests in consumer goods

Any consideration of a well drafted personal property security act must necessarily raise the question to what extent filing should be made obligatory to perfect security interest in consumer goods, or for that matter any other type of goods that are commonly sold on the instalment plan.

Subject to a number of important exceptions, the Uniform Commercial Code does not require a purchase money security interest in consumer goods to be perfected by filing, whereas the Ontario Act draws no distinction for this purpose between consumer goods and other types of corporeal moveables. In this respect the Act merely continues a tradition established in the older Canadian conditional sales acts. The foreign observer might be tempted to conclude that a common policy underlies the Code provisions and the exemptions from registration requirements accorded customary hire-purchase agreements in the New Zealand Chattels Transfer Act, and that there is a great practical difference between the Ontario Act and the American Code. In fact neither assumption is justified.

The rationale of the Code provision is not that consumers dislike the world being made privy to their credit transactions, for the average Canadian and American is quite indifferent about it. Nor is it based on the reasoning which apparently inspired the original New Zealand provisions, that if certain types of goods are notoriously

bought on credit terms the third party should not deal with them without first satisfying himself as to the state of the title. The reason, or at least one of the principal reasons, was that creditors of a consumer do not normally rely on his household goods as a means of satisfying their unpaid claims or to establish his credit worthiness. In any event most household goods are exempt from execution in many states. The Code, however, draws a distinction between the position of a creditor and a person who buys goods subject to a purchase money security interest for his own personal, family or household purposes. In the latter cases the buyer takes free of the security interest if it was not perfected by filing, the reasoning apparently being that he may be misled by the absence of a filing whereas a kind of irrebuttable presumption (justified or otherwise) appears to operate against creditors.

The Code's exception from the filing requirements also does not apply to motor vehicles and fixtures, nor does it apply to a non-purchase money security interest. When these exclusions are taken into consideration very little remains of the apparent difference in approach between the Ontario Act and the Code. In principle the Ontario philosophy seems to me to be sound. A person who is sufficiently interested to wish to ascertain the state ot title with respect to a particular consumer item should be in a position to do so. He should not have to speculate about it or take a calculated risk. If the item is too small in value to warrant the expense of filing the security agreement, then the seller should be willing to accept the risk of a possible loss of his security interest as an incident of doing business.

## VI CONCLUSION

The feature that commends itself most strongly about Article 9 of the Uniform Commercial Code is that its rational and coherent structure enables it to be used as a model in other jurisdictions whose chattel security law is also in need of modernization. The Ontario Personal Property Security Act proves this. But inspiration is not to be confused with blind imitation, and local conditions and local experience may dictate different solutions with respect to particular policy questions from those adopted in the Code. In this quest, however, care must be taken not to undermine the basic concepts of Article 9 lest the shortcomings of the old law be re-introduced through the back door.

The other point to bear in mind is that an Article 9 type law cannot be viewed in isolation from related parts of the commercial law. It is obvious, for example, that the consumer credit legislation of the adopting jurisdiction must be reviewed at the same time to ensure that there is no conflict between the two enactments, and important provisions in the Sale of Goods Act and Factors Act will have to be scrutinized to the same end. It would also seem desirable to consider the possible impact of the recommendations in the 12th Report of the English Law Reform Committee on the Transfer of Title to Chattels.

Less obvious but no less important may be the need to revise the existing moneylenders' legislation. The combined effect in England of the Moneylenders' and Bills of Sale Acts has been to severely discourage what would otherwise be quite legitimate loans to individuals and unincorporated businesses. In jurisdictions with similar provisions it would therefore not suffice merely to modernize the law of chattel mortgages. Canada's moneylending legislation differs in important respects from the English law and we have largely been spared this particular problem. We have found that the (comparatively recent) entry of Canadian banks into the consumer loan field has been wholly beneficial. By providing instalment purchasers with an alternative source of finance they have injected a very desirable note of competition and substantially reduced the cost of credit for large numbers of consumers.

This paper has been concerned with Canadian experience in the chattel security field. I do not doubt, however, that we in Canada can benefit at least as much from your experience as you may be able

to benefit from ours , and you may be sure that we shall follow with the greatest interest your own efforts in this important branch of commercial law.

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