ANOTHER APPEAL FOR PRAGMATIC REFORM: THE FUTURE OF SECTION 427 BANK ACT SECURITY AND CANADIAN PERSONAL PROPERTY SECURITY LAW

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> "A basic assumption is that the best system is one that facilitates the greatest amount of competition and efficiency in the market."
>
> Ronald C.C. Cuming

I. INTRODUCTION

In my last paper (herein referred to on occasion as "A Critical Examination"),[1] I conducted a critical examination of recently proposed amendments to the *Bank Act*[2] security provisions set forth (i) by Bradley Crawford[3] (herein referred to as the "Crawford Solution"), and (ii) the federal government pursuant to the *Financial System Review Act*[4] (herein referred to as the "Government Solution"). In carrying out my analysis, I measured both proposed solutions against certain evaluation

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[1] Clayton D. Bangsund, "A Critical Examination of Recently Proposed Amendments to the *Bank Act* Security Provisions" (2012) 75(2) Sask. L. Rev. 211.

[2] S.C. 1991, c. 46 (the "*Bank Act*").

[3] Bradley Crawford, "In Defence of Secret Liens; or How the Supreme Court Presses Parliament to Harmonize Section 427 of the Bank Act with the PPSA's" (2011) 26 B.F.L.R. 305.

[4] *An Act to Amend the Law Governing Financial Institutions and to Provide for Related and Consequential Matters*, S.C. 2012, c. 5.

benchmarks set out by the Law Commission of Canada.[5] Having regard for the Law Commission's evaluation benchmarks, I concluded that both the Crawford Solution and the Government Solution were inadequate. I further posited that no amount of "tinkering" to the *Bank Act* security provisions could reconcile the separate and incompatible personal property security regimes currently in effect in each Canadian jurisdiction.

Since I penned A Critical Examination, the federal government has pushed ahead with the Government Solution; Parliament passed the *Financial System Review Act* in early 2012. The legislation received Royal Assent on March 29, 2012, and now has force of law across Canada. In my view, the government's course of action was unwise. The Government Solution is a mere "band-aid" solution that fails to address the fundamental problems associated with the coexistence of two incompatible personal property security regimes.[6] Fortunately, there is a silver lining. It is not too late for the federal government to recognize its error and implement further legislative reform to create fairness, cost-efficiency, predictability and commercial sensibility in Canadian personal property security law.

[5] Law Commission of Canada, *Modernizing Canada's Secured Transactions Law: The Bank Act Security Provisions* (Ottawa: Law Commission of Canada, 2004).

[6] Under the Government Solution, the advantages of *Bank Act* security over PPSA security have been enhanced, thereby giving banks further incentives to utilize the former regime over the latter.

Rather than lamenting the government's poorly chosen course of action,[7] this paper focuses on the future of Canadian personal property security law. Indeed, Crawford acknowledges that the piecemeal amendments implemented by the federal government should merely be viewed as penultimate in nature.[8] As such, discussion of the "ultimate" solution continues to be of major import.

In this paper, I propose an additional set of amendments to the *Bank Act* security provisions (herein referred to as the "Proposed Solution") and defend my proposal by measuring it against the Law Commission's evaluative benchmarks. Simply put, I support the Law Commission of Canada's recommendation that the *Bank Act* security provisions be repealed.[9] However, I envision some complicating factors that may make the Law Commission's proposed approach[10] (herein referred to as the "Law Commission Solution") difficult to implement. Therefore, I offer the Proposed Solution as an alternative approach for repeal of the *Bank Act* security provisions. Simplicity is the hallmark of the Proposed Solution. The next paragraph sets out a "roadmap" of how the paper addresses the relevant issues.

Part II assists the reader in understanding the *Bank Act* security regime and the *Personal Property Security Act*[11] regime by providing a concise summary of each.

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[7] For a detailed critique of the Government Solution, see Roderick J. Wood, "Bank Act – PPSA Interaction: Still Waiting for Solutions" (2012) 52 C.B.L.J. 248; Bangsund, *supra* note 1.
[8] Crawford, *supra* note 3 at 313-314.
[9] Law Commission of Canada, *supra* note 5 at 30.
[10] *Ibid*. at 26-30.
[11] R.S.A. 2000, c. P-7 (Alberta); R.S.B.C. 1996, c. 359 (British Columbia); C.C.S.M. c. P35 (Manitoba); S.N.B. 1993, c. P-7.1 (New Brunswick); S.N.L. 1998, c. P-7.1 (Newfoundland); S.N.W.T. 1994, c. 8 (Northwest Territories); S.N.S. 1995-96, c. 13 (Nova Scotia); S.N.W.T. 1994, c. 8 (Nunavut); R.S.O. 1990, c. P.10 (Ontario) ("OPPSA"); R.S.P.E.I. 1988, c. P-3.1 (Prince Edward Island); S.S. 1993, c. P-6.2

Part III identifies the two philosophical approaches to implementing meaningful legislative reform in this muddled area of law. Part IV briefly describes both the Proposed Solution and the Law Commission Solution. Part V measures the Proposed Solution against the evaluative benchmarks set out by the Law Commission of Canada, and Part VI contrasts the Proposed Solution with the Law Commission Solution. Part VII sets out my conclusions.

II. OVERVIEW OF THE TWO INCOMPATIBLE SYSTEMS

A concise summary of the PPSA, on one hand, and the *Bank Act* security provisions, on the other, allows an understanding of the basic workings of both systems and sets the stage for the presentation of the Proposed Solution.[12] The remainder of this Part II, largely reproduced from A Critical Examination, *supra*, provides such a summary.

A. OVERVIEW OF PPSA SECURITY

The PPSA governs the creation of consensual security interests and their enforcement and priority ordering. The term "security interest" is broadly defined

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(Saskatchewan) ("SPPSA"); R.S.Y. 2002, c. 169 (Yukon) (individually and collectively, as the context requires, the "PPSA"). In this paper, unless otherwise specified, PPSA statutory references are to the provisions of the SPPSA.

[12] A comprehensive summary of the federal and provincial/territorial personal property security regimes is unnecessary because they have been described in great detail by leading experts in numerous other publications. See, for example, Ronald C.C. Cuming and Roderick J. Wood, "Compatibility of Federal and Provincial Personal Property Security Law" (1986) 65 Can. Bar Rev. 267; Marc-Alexandre Poirier, "Analysis of the Interaction between Security under Section 427 of the Bank Act and Provincial Law: A Bijural Perspective" (2003) 63 R. du B. 289; M.H. Ogilvie, *Bank and Customer Law in Canada* (Toronto: Irwin Law, 2007) at 160-165.

in the PPSA, and generally includes all interests in personal property that secure payment or performance of an obligation as well as several other deemed interests that do not necessarily secure payment or performance of an obligation (e.g. the interest of a lessor under a lease for a term of more than one year).

Priorities are addressed through a set of internal priority rules contained in Part 3 of the PPSA. As a general rule, the first perfected secured party to register a financing statement in the Personal Property Registry enjoys priority over other perfected secured parties.[13] The PPSA's priority regime obviously contains more complicated and nuanced rules (including other methods of perfection), but the residual priority rule described above assists in understanding the basic priority concepts contained within the PPSA.

The Personal Property Registry is a notice registration system. Unlike some of the provincial/territorial registration systems that preceded it, registration of the actual security agreement is not required or even permitted under the PPSA. Rather, secured creditors are simply required to register notice of their prospective or existing interest in the debtor's collateral. Financing statement registrations can be made for an infinite period, or for between one and twenty-five years inclusive, in which case they can be renewed.

Registration of a financing statement in the Personal Property Registry allows a secured party to "perfect" its security interest, which in turn allows it to set up rights in the collateral against third parties (eg. other secured creditors,

[13] PPSA, s. 35(1).

purchasers, trustees in bankruptcy, etc.). Failing to register a financing statement in the Personal Property Registry and not taking another available perfection step will leave a secured party unperfected and vulnerable to the rights of third parties. Failure to perfect, however, does not negate the existence of the security interest. The disastrous consequences that befall unperfected secured parties generally flow from the detailed priority rules contained within the PPSA.[14]

B. OVERVIEW OF *BANK ACT* SECURITY

The *Bank Act* security provisions permit chartered banks to take security from certain classes of debtors in certain categories of collateral. Thus, unlike the PPSA (which applies equally to all creditors and debtors, and most types of personal property collateral), the *Bank Act* creates a restricted system of secured lending.

To grant *Bank Act* security in favour of a bank, a debtor must sign and deliver a security agreement.[15] The bank must register a "notice of intention" with the office of the Bank of Canada in the jurisdiction of the debtor's principal place of business not more than three years immediately before the security is given.[16] The notice of intention sets out the names of the debtor and the bank, and is signed by the debtor. In this regard, the *Bank Act* registries are dissimilar from the Personal Property Registries, which simply require the filing of an electronic financing statement and

[14] Of course, given the recent implementation of the Government Solution, an unperfected PPSA security interest is now vulnerable to the not-so-detailed priority rules contained in the *Bank Act*.
[15] *Bank Act*, s. 427(1).
[16] *Bank Act*, s. 427(4). Interestingly, earlier versions of the *Bank Act* did not require banks to register notice of their *Bank Act* security interests in any registry. Indeed, a different variation of the "hidden interest" problem existed up until 1923, when the *Bank Act* was amended to impose a registration requirement on banks holding *Bank Act* security.

do not require or permit the filing of an executed document. Notices of intention registered in the appropriate Bank of Canada office are automatically cancelled after five years, but may be extended annually by the bank to avoid cancellation.[17] Failure to register a notice of intention before the agreement is signed is fatal to a bank's rights against third parties. Professors Cuming, Walsh and Wood aptly describe this principle in the following excerpt:

> The rights and powers of a bank are void as against creditors of the debtor and against subsequent purchasers or mortgagees in good faith unless a notice of intention is registered not more than three years immediately before the security was given. A failure to register a notice of intention before the security is given cannot be cured by late registration.
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> Registration does not confer any positive priority status; it simply protects the bank from subordination to creditors and subsequent purchasers or mortgagees.[18]

Subsection 427(2) of the *Bank Act* provides that upon acquiring an interest in the collateral, the bank obtains the same rights as if it had acquired a bill of lading or warehouse receipt in which such property was described. For certain types of collateral, the bank acquires a first and preferential lien and claim on such property by virtue of its *Bank Act* security. Until very recently, the provisions did not contain a rule that gives validly taken *Bank Act* security priority over previously taken unperfected PPSA security. However, the amendments implemented under the *Financial System Review Act* have introduced such a rule. Specifically, subsection 428(1) provides that the bank has priority over all rights subsequently acquired in, on or in respect of the property subject to the bank's interest, and also over the

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[17] *Registration of Bank Special Security Regulations*, SOR/92-301, s. 7 (the "*Bank Act Regulations*").

[18] Ronald C.C. Cuming, Catherine Walsh & Roderick J. Wood, *Personal Property Security Law* (Toronto: Irwin Law, 2005) at 588.

claim of any unpaid vendor or of any person who has a security interest in that property that was unperfected at the time the bank acquired its security in the property. Note that the priority rule does not reference the date of registration of the bank's notice of intention, but rather the date of creation of the bank's security interest. In this sense, the *Bank Act* priority rules are fundamentally distinct from those contained in the PPSA.[19]

III. THE FORK IN THE ROAD

As discussed in A Critical Examination, the Supreme Court of Canada decisions in *Innovation Credit Union v. Bank of Montreal*[20] and *Radius Credit Union v. Royal Bank of Canada* [21] made federal legislative reform imperative. [22] Fundamentally, Parliament had two choices available to it in introducing legislative reform.

Choice 1. Harmonization: Repairing the Bank Act Security Provisions

Parliament chose to introduce patchwork solutions to address the problems prevalent in the incompatible personal property security systems. Under the Government Solution, Parliament amended the *Bank Act* in a manner that generally gives validly taken *Bank Act* security priority over previously taken unperfected

[19] *Nemo dat quod non habet* (i.e. one cannot give what one does not have) is the foundational principle of the *Bank Act* priority regime.
[20] 2010 SCC 47 ("*Innovation*").
[21] 2010 SCC 48 ("*Radius*").
[22] Bangsund, *supra* note 1; Crawford, *supra* note 3 at 312, where the author states, "With the Supreme Court adding its own impetus for legislative action, a previously compelling case becomes imperative."

PPSA security. In A Critical Examination, I explained why this simplistic approach to reform is wholly inadequate. In a nutshell, the Government Solution focuses on a single issue while ignoring all others, and arguably fails to fully achieve its narrow objective.[23] In light of the demonstrated inadequacy of the Government Solution, it is worthwhile considering further solutions that may plausibly be implemented to bring about fairness, cost-efficiency, predictability and commercial sensibility in Canadian personal property security law.

As an alternative to piecemeal amendments, but still under the heading of "harmonization", Parliament could have elected to completely overhaul the *Bank Act* security provisions to address their deficiencies and make the federal regime more compatible with its provincial/territorial counterparts.[24] This option is still available to Parliament if it so chooses. Of course, a comprehensive "harmonization" solution, if proposed, would need to be evaluated on its individual merits.

However, before we go too far down the path of enacting more expansive federal personal property security provisions, we must consider a more fundamental question: Should we continue with a dualistic system at all? Many believe that maintaining two systems – one federal system for banks, and one provincial/territorial system for all creditors including banks – is unnecessary and

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[23] Bangsund, *supra* note 1 at 243.

[24] Roderick J. Wood, "The Nature and Definition of Federal Security Interests" (2000) 34 Can. Bus. L.J. 65 at 113; Also see Law Commission of Canada, *supra* note 5, which subdivides this option for reform into two alternative options for reform: 1. Substantially amend the *Bank Act* security provisions; or 2. Create a federal PPSA statute. In the Law Commission Report, the authors discuss and evaluate the advantages and disadvantages of both of these options, and ultimately conclude that suspension or repeal of the *Bank Act* security provisions is preferable.

unwise.[25] What is the objective of maintaining two separate systems? The PPSA contains a comprehensive set of rules that apply to all creditors, banks and non-banks alike. Whereas there may once have been good reason to maintain a dualistic personal property security regime, there is no more.[26] In my opinion, creditors (including banks) and debtors will be better served by a unified[27] personal property security regime. The Law Commission of Canada shares this view and identifies the conceptual pitfalls that necessarily accompany a harmonization approach.[28]

Choice 2. Unification: Suspending or Repealing the Bank Act Security Provisions

To achieve unification, Parliament could suspend or repeal the *Bank Act* security provisions thereby leaving the personal property security regime wholly under the domain of the provinces and territories. Many leading commentators favour this solution because it will (i) create a "level playing field" for chartered banks and non-bank lenders, and (ii) create a unified personal property security regime in each Canadian jurisdiction, thereby eliminating the uncertainty prevalent

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[25] Ronald C.C. Cuming, "Case Comment: *Innovation Credit Union v. Bank of Montreal* – Interface between the *PPSA* and Section 427 of the *Bank Act*: Desirable Policy vs. Hard Legal Analysis" (2008) 71 Sask. L. Rev. 143 at 151.

[26] See Law Commission of Canada, *supra* note 5 at 27-30; Also see Ronald C.C. Cuming, "The Position Paper on Revised *Bank Act* Security: Rehabilitation of Canadian Personal Property Security Law or Curing the Illness by Killing the Patient" (1992) 20 Can. Bus. L.J. 336 at 355.

[27] In this paper, as in my previous article, the terms "unify", "unified", "unification" and other variations thereof are used in the sense of creating a single personal property security regime in a particular jurisdiction, and not in the sense of "combining" or "amalgamating" two substantive regimes to create a hybrid regime.

[28] Law Commission of Canada, *supra* note 5 at 23-26.

in the existing incompatible systems and reducing credit transaction costs. I favour this approach, and offer the Proposed Solution as a potential unification solution.

IV. THE PROPOSED SOLUTION & LAW COMMISSION SOLUTION

A. THE PROPOSED SOLUTION

Despite its legislative gaffe, Parliament still has a wonderful opportunity to cure the deficiencies prevalent in the separate and incompatible personal property security regimes, and thereby level the playing field for all creditors. This opportunity, however, comes with attendant complications. I propose a simple, practical and efficient method of ultimately establishing a unified system of personal property security law in Canada that addresses the aforementioned complications.

1. THE STARTING POINT

What is meant when we call for the repeal of *Bank Act* security? After all, achieving unification will not be as simple as repealing the *Bank Act* security provisions and forgetting they ever existed. Indeed, the many banks currently holding *Bank Act* security should not be prejudiced by the implementation of legislative reform.[29] How do we preserve their legal rights while at the same time forging a new path?

2. DESCRIPTION OF THE PROPOSED SOLUTION

[29] *Ibid.* at 33.

The Proposed Solution would see the enactment of a new provision in the *Bank Act* that would prohibit banks from taking *Bank Act* security from and after a specified date (herein referred to as the "Implementation Date"). To clarify, even after the Implementation Date, banks would continue to be able to extend their existing *Bank Act* security with the appropriate Bank of Canada office, and to register certificates of release in the normal course. The statutory prohibition would only apply to the creation of new *Bank Act* security from and after the Implementation Date.

The vast body of jurisprudence that has developed over the last several decades (except to the extent inconsistent with the recent *Bank Act* security amendments brought about by the enactment of the *Financial System Review Act*) would continue to apply and may even continue to expand to resolve conflicts between PPSA security, whenever taken, and *Bank Act* security taken prior to the Implementation Date.[30] In this sense, *Bank Act* security would not simply disappear overnight. Rather, it would slowly "fade into the sunset" as PPSA-*Bank Act* disputes become less frequent.

Eventually, when the last *Bank Act* security registration is cancelled, *Bank Act* security would be a mere footnote in Canadian personal property security law textbooks. At that point, the Bank of Canada would no longer be required to maintain the *Bank Act* registries and parties would no longer need to search for

[30] As a point of clarification, banks holding *Bank Act* security taken prior to the Implementation Date would continue to enjoy the priority advantages conferred upon them by virtue of the enactment of the *Financial System Review Act*.

Bank Act registrations.[31] The personal property security regime would be unified in each province and territory.

From the Implementation Date forward, all creditors, including chartered banks, would have only one option when taking personal property security from their borrowers – to line up in the queue in the PPSA system. Fairness, predictability and commercial sensibility would naturally follow. The Proposed Solution would not unduly prejudice banks given that they are already familiar and conversant with PPSA security.[32]

B. THE LAW COMMISSION SOLUTION

The Proposed Solution varies from the proposal set forth by the Law Commission of Canada, although both solutions are conceptually similar and ultimately achieve the same substantive result. Specifically, the Law Commission of Canada advocates for the repeal of the *Bank Act* security provisions and a three-year transition period for banks to rely on their existing *Bank Act* security.[33] During this three-year transition period, banks would be required to take provincial security interests in the collateral, in which case their priority status would be "preserved".

V. EVALUATING THE PROPOSED SOLUTION

[31] *Bank Act* registrations may be extended in perpetuity so, in theory, the lapse of all such registrations could occur well into the future. On a practical level, however, most loans secured by *Bank Act* security would be paid off over their respective amortization periods, which could potentially result in the decommissioning of the *Bank Act* registries in a relatively short timeframe.
[32] Law Commission of Canada, *supra* note 5 at 28.
[33] *Ibid.* at 30-34.

The Proposed Solution sufficiently addresses all the categories of problems currently caused by the *Bank Act* security provisions, as identified by the Law Commission of Canada.[34]

A. STATUTORY OBSOLESCENCE

The Proposed Solution would eliminate the *Bank Act's* archaic concepts when all *Bank Act* registrations lapse or are cancelled. All legal uncertainty stemming from the lack of interface between the PPSA and the *Bank Act* regime, including expensive litigation to resolve this uncertainty, would vanish concurrently with existing *Bank Act* registrations.

The second problematic aspect of statutory obsolescence has already been resolved through the enactment of modern PPSA statutes, which offer banks the option of taking a comprehensive security device under provincial/territorial law. Moreover, this second problematic aspect would continue to be resolved under the regime offered by the Proposed Solution. Banks would continue to be permitted to take PPSA security (including the comprehensive security device in which a debtor grants to the creditor a security interest in all present and after-acquired personal property) from and after the Implementation Date.

B. COMPETING FEDERAL-PROVINCIAL/TERRITORIAL PRIORITIES

[34] *Ibid.* at 9. The four general categories of problems with the *Bank Act* security provisions are described as follows: (i) statutory obsolescence, (ii) competing federal-provincial/territorial priorities, (iii) dual registry, and (iv) pre-emption of provincial/territorial legislative objectives. The Law Commission of Canada provides an expansive description of the four categories of problems.

The Proposed Solution addresses the problem of competing federal-provincial/territorial priorities. It would eliminate the possibility of creditors encountering legal uncertainty (stemming from the lack of interface between the PPSA and *Bank Act* regimes) in respect of any security granted *after* the Implementation Date because all creditors, including banks, would be required to take personal property security under the PPSA after that date. In addition, the Proposed Solution would fully eradicate the legal uncertainty problem when the last *Bank Act* registration is cancelled, and the Canadian personal property security systems become wholly unified. All the priority problems identified by the Law Commission of Canada would be addressed by virtue of the Proposed Solution.

C. DUAL REGISTRY

1. THE DUAL REGISTRY PROBLEM

As described in A Critical Examination, the "continued existence of separate *Bank Act* registries has frustrated the provincial and territorial legislators' objective of creating a single registry for the benefit of all claimants to personal property."[35]

2. PROPOSED SOLUTION: ADDRESSING THE DUAL REGISTRY PROBLEM IN DUE COURSE

The Proposed Solution would address the dual registry problem, albeit not immediately. The Proposed Solution would require the continued maintenance of

[35] Bangsund, *supra* note 1 at 221.

the *Bank Act* registries until such time as all "grandfathered" *Bank Act* security registrations are cancelled. At that point, the Bank of Canada would no longer be required to maintain the *Bank Act* registries, and the dual registry problem would cease to exist.[36]

3. COMBINING THE REGISTRIES: A PANDORA'S BOX

Consideration was given to the implementation of a system (within the framework of the Proposed Solution) that would resolve the dual registry problem immediately upon the Implementation Date.[37] For example, I considered the possibility of causing the "replication" of existing *Bank Act* registrations in the Personal Property Registries of the appropriate provinces and territories.[38] However, I concluded that attempting to "dovetail" the registries would be unduly expensive and extraordinarily time-consuming and complicated. And perhaps more

[36] In the interim, administration and maintenance costs for the *Bank Act* registries may be reduced by virtue of the prohibition imposed under the Proposed Solution. However, *Bank Act* searches would still need to be conducted for the foreseeable future, so cost savings may be negligible.

[37] If one corollary goal of unification is to reduce transaction costs for borrowers after the Implementation Date, then we should aim to eliminate the need to conduct due diligence searches in both the federal and provincial/territorial registries. Is it possible to unify the registries as of the Implementation Date in order to eliminate the need to conduct due diligence searches in both *Bank Act* registries and PPSA registries after the Implementation Date? Can the federal and provincial/territorial governments collaborate in an effort to necessitate the ordering of only one due diligence search by a prospective creditor, purchaser, sheriff or trustee in bankruptcy? Ideally, we should aim to achieve unification, not only of the substantive law governing personal property security transactions, but also of the procedural and mechanical framework in which the substantive law operates.

[38] It may be possible (depending on the technology in use by (or available to) the provinces and territories under their Personal Property Registries) to devise a system in which notices of intention registered under the *Bank Act* security provisions prior to the Implementation Date are "transferred" into financing statements registered at the Personal Property Registries of the appropriate provinces and territories (without any involvement by the banks actually holding the *Bank Act* security), thereby replicating the contents of the *Bank Act* registries at the provincial/territorial level.

importantly, the scheme carries the potential of being counter-productive. Assuming it is possible to implement such a scheme on a "technological level",[39] consider the following series of questions:

Would the replicated registrations in the Personal Property Registries have the same effect as the underlying notices of intention originally registered with the Bank of Canada? Recall that the *Bank Act* registries require registration of a signed notice of intention, whereas the Personal Property Registries do not require or permit the registration of a signed document. Under this scheme, the Personal Property Registries would be serving a function they were not intended or designed to serve, so careful attention would be required by legislators. For example, legislators would need to decide whether the replicated *Bank Act* registrations could be discharged in a manner similar to financing statements (a relatively simple task that does not involve government oversight), or whether the protocol for discharge of these replicated *Bank Act* registrations would require a government official to effect the discharge (similar to the procedure currently set out in the *Bank Act*). If the former, what would the legal result be if a replicated registration was discharged in error from the Personal Property Registry? Would this invalidate the *Bank Act* security in the same manner as registering a certificate of release under the current *Bank Act* rules? The latter option would require provincial/territorial officials to administer a federal program.

[39] It should be noted that implementing such a scheme would require extensive collaboration between administrative and technical staff at both levels of government in every Canadian jurisdiction, for which there may be neither an appetite nor a budget.

In what manner would the PPSA statutes and the *Bank Act* be amended to facilitate the above scheme? Would the Bank of Canada be required to maintain back-up records of *Bank Act* registrations in effect as of the Implementation Date in order to provide evidence that such *Bank Act* security actually existed prior to the Implementation Date (if this became an issue in a priority dispute)? If so, it would appear to be more sensible to continue administering the *Bank Act* registries in the normal course until such time as all registrations are cancelled.

In considering the above scheme, it becomes apparent that the potential complications that would accompany its implementation are innumerable, and seemingly compound on themselves. In other words, the cure may be worse than the disease, not to mention more expensive. Ultimately, we may be wiser to let the *Bank Act* registries "die a slow death", as described in the Proposed Solution. As observed in footnote **[X]**, *supra*, the decommissioning of the *Bank Act* registries may occur in a relatively short timeframe in any event due to the amortization periods of loans secured by personal property. Moreover, after the Implementation Date, banks may voluntarily allow their *Bank Act* registrations to lapse and re-finance their loans under provincial/territorial law thereby hastening the decommissioning of the *Bank Act* registries.

4. SUMMARY: MAINTAINING THE BANK ACT REGISTRIES

Maintaining the *Bank Act* registries runs the least risk of creating new and unforeseen problems and uncertainties. In order to preserve the legal rights of

banks holding *Bank Act* security prior to the Implementation Date, I am of the view that the continued maintenance and administration of the *Bank Act* registries is warranted until all registrations are cancelled (either due to lapse or the registration of a certificate of release).

D. PRE-EMPTION OF PROVINCIAL/TERRITORIAL LEGISLATIVE OBJECTIVES

1. ADDRESSING THE PRE-EMPTION PROBLEM

As described in A Critical Examination, the *Bank Act* security provisions arbitrarily interfere with valid provincial/territorial legislative objectives by offering banks competitive advantages over their non-bank industry competitors.[40] The Proposed Solution would eliminate these advantages and create fairness and equality among all lending institutions. If the Proposed Solution is implemented, banks will no longer have access to a security device that is unavailable to their non-bank industry competitors. This is eminently fair, and addresses the pre-emption of provincial/territorial legislative objectives problem identified by the Law Commission of Canada.

2. FEDERAL LEGISLATIVE OBJECTIVES

a. A Pre-emptive Response to the "Hypocrisy Argument"

Opponents of unification might argue that the Proposed Solution pre-empts a *federal legislative objective* (as opposed to a provincial/territorial legislative

[40] Bangsund, *supra* note 1 at 235.

objective).[41] For example, they may suggest that proponents of unification (whether they prefer the Proposed Solution, the Law Commission Solution or some other unification solution) are hypocritical in citing "pre-emption of provincial/territorial legislative objectives" in support of their argument for unification. After all, implementing either the Proposed Solution or the Law Commission Solution would effectively pre-empt the federal government's general objective of providing banks with a unique federal security device. Unification proponents must concede the point. However, on closer review, this concession neither weakens the argument for unification nor bolsters the argument for continued dualism.

b. False Equivalence

I only raise the hypothetical "hypocrisy argument" in order to dismiss it. The concern about pre-empting federal legislative objectives is readily distinguishable from the Law Commission's concern about pre-emption of provincial/territorial legislative objectives. This is because the "pre-emption of provincial/territorial legislative objectives" problem is inextricably linked to the doctrine of federal paramountcy. The Law Commission of Canada posited that because federal legislation may "trump" provincial/territorial legislation, it should only do so to further a specific identifiable federal objective. Of course, because paramountcy is a "one-way street", federal legislation is not susceptible to pre-emption. Indeed, Parliament alone holds the power to introduce legislative amendments to the *Bank Act*.

[41] Crawford, *supra* note 3 at 309, where the author touches on this issue.

c. Appropriateness of Legislative Objectives

Consider the more fundamental question: Is it appropriate for the federal government to insist on a system that affords banks a competitive advantage over their non-bank industry competitors? In other words, should the federal government pick winners and losers in the secured credit marketplace?[42] In an honest discussion of the subject, this issue should not be downplayed or avoided. Unification creates equality, while the existing system perpetuates inequality.

Proceed on Professor Cuming's basic assumption that "the best system is one that facilitates the greatest amount of competition and efficiency in the market."[43] If one accepts another basic assumption that fairness (i.e. equality among all secured lenders) begets competition, one must conclude that unification is the optimal approach to reform. Indeed, observations by leading economists support the notion that a vibrant and competitive credit marketplace enhances the economic development of a nation:

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[42] To be clear, I am not mounting a constitutional challenge. Questions are not being raised about Parliament's ability to legislate in this area (in an analysis of "pith and substance"). Indeed, these questions have already been answered by the Supreme Court of Canada in *Bank of Montreal v. Hall*, [1990] 1 S.C.R. 121 ("*Hall*") at para. 52 where LaForest J. concluded that the *Bank Act* security provisions are *intra vires* the federal legislative power.

[43] Cuming, *supra* note 26 at 346: "A basic assumption is that the best system is one that facilitates the greatest amount of competition and efficiency in the market. When one applies a competitive market test, it is difficult to make a case for the type and degree of federal involvement suggested in the Paper. Why should two types of participants in the same market (eg. banks and credit unions) be subject to different legal regimes? Why should a debtor have different rights depending on whether he or she borrows from a bank or a credit union? How can credit users do any "comparison shopping" for a product (financing) when there is artificial product differentiation resulting from differences in the legal regimes applicable to the various sources of financing?"

> Credit and debt, in short, are among the essential building blocks of economic development, as vital to creating the wealth of nations as mining, manufacturing or mobile telephony. Poverty, by contrast, is seldom directly attributed to the antics of rapacious financiers. It often has more to do with the lack of financial institutions, with the absence of banks, not their presence.[44]

Marc-Alexandre Poirier eloquently observes that, while the *Bank Act* security device once furthered the objective of enhancing credit availability to industry (a laudable federal legislative objective), it no longer furthers this objective:

> The original objective of the section 427 security was to foster the development of certain primary industries by providing an incentive to banks to make loans to persons engaged in these industries. At the time of its enactment, the provincial secured lending regimes were in a confused and complicated state. A national security device was needed in order to achieve Parliament's objectives of providing primary industries nationwide with an injection of capital "that would not have otherwise been available, or available only at a much higher cost." The section 427 security thus provided the most effective and inexpensive way of allowing targeted classes of borrowers to give security in order to obtain bank loans. Up until recently, this was still the case. But today, a highly effective and efficient secured lending regime exists in every province and territory in Canada. These regimes allow borrowers engaged in *any industry* to give security and obtain credit from *any kind of lender* at reasonable rates of interest. In fact, in most cases provincial security rights are now considered to be the banks' primary security; the section 427 security is generally viewed as a backup that will be relied upon only if it provides some special advantage. Consequently, the original justification that is behind the creation of this unique feature of Canadian banking legislation no longer holds true. Although the Bank Act security regime has in the past played a pivotal role in the development of the Canadian economy, it is difficult to find any current justification for the continued existence of a separate personal or movable property security regime for banks.[45]

The fact that the federal government has been unable to articulate a coherent objective for maintaining *Bank Act* security raises serious questions about the appropriateness of the *Bank Act* security regime in Canada's modern-day legal

[44] Niall Ferguson, *The Ascent of Money: A Financial History of the World* (New York: Penguin Books, 2008) at 65.

[45] Poirier, *supra* note 12 at 396.

framework. The *Bank Act* security provisions no longer enhance credit availability in any meaningful way. They merely create an uneven playing field whereby chartered banks enjoy a competitive advantage over their industry competitors. In re-evaluating its legislative objectives, the federal government should recognize that unification (as opposed to harmonization) optimally promotes efficiency, fairness and competition within the secured credit marketplace.

E. SUMMARY

In addition to addressing the four categories of problems currently caused by the *Bank Act* security provisions, the Proposed Solution also observes the three guiding principles for reform as enunciated by the Law Commission of Canada.[46] After the Implementation Date, banks would be required to play on the same field as the rest of their credit granting industry competitors. In other words, the field of play would no longer tilt in the banks' favour.[47] Whatever analogy one prefers, unification of the existing incompatible systems is the most sensible solution for all affected parties.

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[46] Law Commission of Canada, *supra* note 5 at 21. The three guiding principles for reform are as follows: "Principle 1: The problems associated with the co-existence of two legal regimes governing security interests in personal property should be addressed to increase the predictability of outcomes and to ensure that the legal regimes governing secured credit are efficient and effective. Principle 2: Federal secured transactions law should utilize terminology and concepts that are compatible with both the civil law system of Quebec as well as the common law systems of the other provinces and territories. Principle 3: Federal secured transactions law should not interfere with valid provincial and territorial legislative measures that are generally applicable within the provinces and territories unless it is necessary to achieve an identified federal objective."

[47] Eventually, banks would no longer be able to circumvent provincial exemption protection and certain realization procedures (by which non-bank lenders are bound) by relying on the *Bank Act* security provisions.

F. PROTOTYPE LEGISLATIVE PROVISIONS

Appendix "A" contains prototype legislative provisions that could be introduced to the *Bank Act* to implement the Proposed Solution. I am not formally trained in statutory drafting, and therefore welcome suggestions for improvements to these draft legislative provisions.

VI. CONTRASTING THE PROPOSED SOLUTION WITH THE LAW COMMISSION SOLUTION

As discussed above, the Proposed Solution varies from the Law Commission Solution, although both solutions are conceptually similar and ultimately achieve the same substantive result. Since the Law Commission Solution achieves the same substantive result as the Proposed Solution, it necessarily addresses each of the categories of problems associated with the existing *Bank Act* security provisions, so a detailed evaluation (using the same framework for evaluation used in respect of the Crawford Solution, Government Solution and Proposed Solution) is unnecessary.

The Law Commission Solution, if effectively implemented, would be ideal because it would result in the decommissioning of the *Bank Act* registries from the outset (and much sooner than the Proposed Solution addresses the dual registry problem). This is the one chief advantage the Law Commission Solution offers over the Proposed Solution. However, a potential issue that would need to be addressed is how the priority status of existing *Bank Act* security would be "preserved"

through registration in the provincial/territorial registries. In the event of a priority dispute, would the courts resort to the traditional legal principles applicable to the interaction of PPSA security and *Bank Act* security? If so, would the Bank of Canada be required to keep record of the *Bank Act* registrations in effect prior to the expiry of the transition period (i.e. to verify that the bank actually *had acquired a valid Bank Act interest that was capable of being preserved* under the transition rules)? If so, the *Bank Act* registries would require a certain amount of maintenance and administration, which would potentially eliminate any advantage the Law Commission Solution offers over the Proposed Solution (i.e. addressing the dual registry problem more expediently). Furthermore, under the Law Commission Solution, amendments would be required, not only to the *Bank Act*, but also to each of the PPSA statutes and to the *Civil Code of Quebec*,[48] to ensure preservation of the priorities. Additional difficulties, including some of those described under the subheading "Combining the Registries: A Pandora's Box," *supra*, may also arise under the Law Commission Solution.

The above issues could certainly be addressed, but they would require more complicated statutory amendments and more expensive implementation procedures than those required under the Proposed Solution. Fundamentally, the Proposed Solution and the Law Commission Solution, if properly implemented, would achieve the same objective. But in some instances, the best solution to a problem is the simplest solution, and I suggest that this is one of those instances –

[48] S.Q. 1991, c. 64 (the "*Civil Code*").

and the Proposed Solution is the "simplest". Indeed, simplicity is the one key advantage the Proposed Solution offers over the Law Commission Solution.

VII. CONCLUSION

For many years, Canada's leading experts have called for meaningful legislative reform to eliminate the incompatible personal property security systems and create a unified system.[49] In the aftermath of the Supreme Court of Canada decisions in *Innovation* and *Radius*, the federal government was compelled to act.[50] Unfortunately, the legislative reform it chose to introduce is woefully inadequate.[51]

Understandably, banks prefer to maintain a competitive advantage over their non-bank competitors. But the banking industry's desire for continued imbalance does not constitute justification for the perpetuation of the existing regime.[52] Ziegel offers an elegant critique of the banking industry's stance in the following excerpt:

> The Canadian chartered banks have long sought expanded power to compete on a more equal footing with their non-bank competitors in the equipment leasing and insurance areas. In the writer's view, the banks would have greatly improved their case if they played a consistent tune. Had they urged the federal government to accede to the CBA's submissions and to agree to the suspension of the s. 427 provisions, they would have proven their commitment to a level playing field and won the plaudits of the legal

[49] A good summary of the numerous calls for reform is contained in the Law Commission of Canada's report, *supra* note 5 at 29; Also see a more recent call for reform in Cuming, *supra* note 25 at 151.
[50] See note 50.
[51] *Supra* notes 1 and 7.
[52] See Jacob Ziegel, "Ottawa Rejects Reform of Section 427 of the Bank Act" (2007) 45 Can. Bus. L.J. 123 at 127: "The Ministers' letters fail to explain why, alone among commercial lenders, the banks should have the best of both worlds while other commercial lenders, performing exactly the same economic function, are confined in their choice to a provincial PPS regime. Do the virtues of a level playing field among competitors not also apply in this area of the economy?"

> community. Instead, one is left with the uncomfortable feeling that the banks' motto is: "What is Mine is Mine and what is Thine is Mine as well."[53]

It is disappointing that Canada, a nation that prides itself on the predictability, efficiency and fairness of its commercial laws, still has two incompatible personal property security systems despite repeated calls for meaningful reform from both practitioners and leading scholars. Efficiency, simplicity, balance and common sense dictate that Parliament should implement legislative reform to achieve a unified personal property security regime in Canada.

[53] *Ibid.* at 127.

APPENDIX "A"
PROTOTYPE LEGISLATIVE REVISIONS TO THE *BANK ACT*

Section 427.1

(1) In this section:

"applicable common law" means the principles of the common law,[54] equity and the law merchant that apply to security taken under section 427 and personal property security law and other similar law in the common law jurisdictions, and includes, for greater certainty, the principles of the common law, equity and the law merchant that continue to develop in relation to security taken under section 427 and personal property security law and other similar law in the common law jurisdictions both prior to and after the implementation date;[55]

"applicable law" means applicable common law and applicable Quebec law, as applicable in the Canadian jurisdictions;

"applicable Quebec law" means the principles of the civil law that apply to security taken under section 427 and personal property security law and other similar law in Quebec, and includes, for greater certainty, the principles of the civil law that continue to develop in relation to security taken under section 427 and personal property security law and other similar law in Quebec both prior to and after the implementation date;[56]

"Canadian jurisdictions" means the provinces and the territories, and "Canadian jurisdiction" includes any of them;

"common law jurisdictions" means the common law provinces and the territories, and "common law jurisdiction" includes any of them;

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[54] A specific definition may be required for Quebec because it is a civil law jurisdiction. If it is practical and possible to combine applicable Quebec law with applicable common law in the same defined term, then they should be combined. If, however, it is necessary to draw a distinction between common law and civil law, separate defined terms can be utilized. The main thrust is that the law as it relates to the *Bank Act* will continue to apply in Canada from and after the implementation date insofar as it relates to *Bank Act* security taken prior to the implementation date.

[55] This latter concept within the definition is important because the law must be able to develop as between *Bank Act* security taken prior to the implementation date and other security taken prior to or after the implementation date. This is simply an affirmation that applicable law continues to exist and will develop uninterrupted.

[56] Given my lack of familiarity and conversance with civil law, I welcome suggestions for improvement to this defined term.

"common law provinces" means all of the provinces except Quebec, and "common law province" means any of the provinces except Quebec;

"implementation date" means [INSERT ARBITRARY IMPLEMENTATION DATE];

"provinces" means the provinces of Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland, Nova Scotia, Ontario, Prince Edward Island, Quebec and Saskatchewan, and "province" includes any of them;

"Quebec" means the province of Quebec;

"territories" means the Northwest Territories, Nunavut and Yukon Territories, and "territory" includes any of them;

(2) Security Taken Under Section 427 Prohibited From and After the Implementation Date. From and after the implementation date, no bank shall be permitted to take security pursuant to section 427, and for greater certainty, security taken pursuant to section 427 shall be prohibited from and after the implementation date.[57]

(3) Applicable Law Continues to Apply to Security Taken Under Section 427 Up to the Implementation Date. Applicable law continues to apply to security taken pursuant to section 427 prior to 12:00 am (EST) on the implementation date, and for greater certainty, from and after the implementation date security taken pursuant to section 427 prior to the implementation date will continue to be governed by applicable law.

(4) Extension of Existing Security Taken Under Section 427. Any bank that took security pursuant to section 427 prior to the implementation date, which remains in effect on the implementation date, shall be permitted to extend the security or cancel the security in accordance with the *Registration of Bank Special Security Regulations* from and after the implementation date.

[57] Parliament may wish to introduce an additional clause that authorizes the decommissioning of the *Bank Act* registries after all "grandfathered" registrations have been cancelled.