'A NEW LEASE ON LIFE' For Ontario lessors of personal property

Recent changes to the Ontario *Personal Property Security Act* (PPSA) will help to make the leasing process better for customers, sellers and their finance sources. The changes, which were made May 29, 2019, have yet to be put into force, but once implemented, should provide for a more streamlined and efficient leasing system for all concerned.

Each year, billions of dollars are financed through leases, whether to Ontario businesses for their equipment purchases, or consumers leasing automobiles or other consumer goods. A typical transaction involves the customer identifying something they need or want, approaching the seller and arranging to enter into leasing documentation for the finance of the good to be purchased. Typically, the seller will sign all the documentation with the customer, and then arrange to sell the lease to a third party finance source. This provides liquidity to the seller and establishes a leasing relationship between the customer (lessee) and the finance source (lessor).

The Current System

The document package the seller enters into with the customer and that is then assigned to the finance source is known as "chattel paper" under the PPSA. Currently, the PPSA definition for chattel paper states that the documents be 'in writing', implying that chattel paper must be in physical form.

Generally, priority under the PPSA is determined by who is first to perfect (generally, first to register). However, certain sections provide for secured creditors to take priority in specified circumstances. One such section provides in essence that a purchaser of chattel paper who takes (physical) possession of the chattel paper for value has priority over the interests of another secured creditor with rights in the chattel paper (like an earlier registrant).

Now, as one can appreciate, this is a very important provision to any third party finance source who is taking an assignment of the chattel paper from a seller of goods. However, having to transfer the actual documents in order to obtain priority adds costs to the process and often delays in the completion of the transaction. Typically, finance sources must wait for physical possession of the chattel paper before they conclude the transaction and provide funds to the seller. Additionally, Sellers do not want to conclude the transaction and deliver the goods until they are certain of payment being received. Also, the transfer of physical possession of the documents is usually made via post or courier, which can be slow and/or costly for all concerned.

The New System

The new provisions, which take effect on a date in future which has not yet been determined, will enable transactions like the one described above to become more efficient. In essence, the changes recognize that chattel paper can exist in either tangible or electronic form and provide that, in addition to the former rules dealing with physical chattel paper, a purchaser of electronic chattel paper will have priority if they have control of it.

Electronic chattel paper is defined as chattel paper that is created, recorded, transmitted or stored in digital or other intangible form by electronic or mechanical means. Control of electronic chattel paper is met by meeting all six of the following criteria:

1. A single authoritative record of the electronic chattel paper exists that is unique, identifiable, and, except as otherwise provided in 4, 5 or 6 below, unalterable.
2. The authoritative record identifies the secured party as the transferee of the record.
3. The authoritative record is communicated to and securely maintained by the secured party or the party's designated custodian.
4. Copies of or amendments to the authoritative record that add or change an identified transferee of the authoritative record can be made only with the consent of the secured party.

5. Each copy of the authoritative record and any copy of a copy is readily identifiable as a copy that is not the authoritative record.
6. Any amendment of the authoritative record is readily identifiable as to whether it is authorized or unauthorized.

As a result of these changes, a mechanism has been provided for lessees, as the assignee of chattel paper, to obtain priority without waiting for physical possession of the documents, thus speeding up the process and potentially leading to cost savings. For example, these changes would allow for the transmission of the electronic chattel paper to the finance source by electronic means, which is a much faster and more cost-effective delivery mechanism.

Caution

Third party lenders and/or lessors who anticipate relying on these new provisions should take note that there may be some risk. If the chattel paper exists in *both* physical and electronic form, the purchaser of the physical chattel paper will take priority (upon possession) over the interests of a purchaser of the electronic chattel paper who has control, unless the tangible chattel paper indicates it has been assigned to someone other than the purchaser of such tangible chattel paper. Accordingly, systems should be put into place to (1) ensure that the electronic chattel paper is the sole and definitive form, and (2) deter the seller from selling multiple copies of the same chattel paper to different finance sources.

Conclusions

These changes to the PPSA are an important step in modernizing the legislation to keep up with changes in digitization, industry practices and expectations. Though long overdue, these provisions are a welcome enhancement to the PPSA and should provide sellers, buyers and third party lenders with an option for a more streamlined and cost effective leasing process overall.

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