

LEGAL EYE

by Michael Bergman

Suppliers beware

Most investors like to receive some sort of guarantee or security to protect their investment. This is particularly true of lenders of funds. Similarly suppliers of goods and equipment on credit expect to be protected. These are natural inclinations in a financial world where the absence of security can mean receiving a few cents on a dollar should the debtor fall on hard times.

The law has provided many mechanisms to protect the interest of creditors from mortgages to conditional sales contracts, from the assignment of receivables to the pledge. Each of these mechanisms is effected by a traditional format of contract often subscribed to a registration process, depending on which province the transaction is made in. There are certain provinces, though, where special legislation has in the last decade or so, established new and important rules virtually across the board for the protection of the so-called security interest. Provinces such as Ontario and Manitoba have enacted Personal Property Security Act legislation.

This statute is of immediate concern to all creditors who wish to protect their security. While failure to comply with this legislation would not entail the nullity of the contract between a creditor and a debtor, it would seriously affect the creditor's right to receive in priority over other creditors the intended security should the debtor default. This concept of priorities among creditors competing for the right to have access to the debtor's property for payment is one of the essential ingredients of any security worth its name.

Personal property securities legislation generally seeks to subject all contracts whereby the parties intend to create a security interest to a series of rules and regulations which establish the ranking or priority of different creditors' rights and the method by which those rights may be exercised.

Every security agreement which gives rise to a form of security, that is to say a security interest in the wording of the statute, must be followed up within 30 days of the conclusion of the agreement by the registration of what is known as a financing statement. This financing statement is a form which specifies quite meticulously the name of the

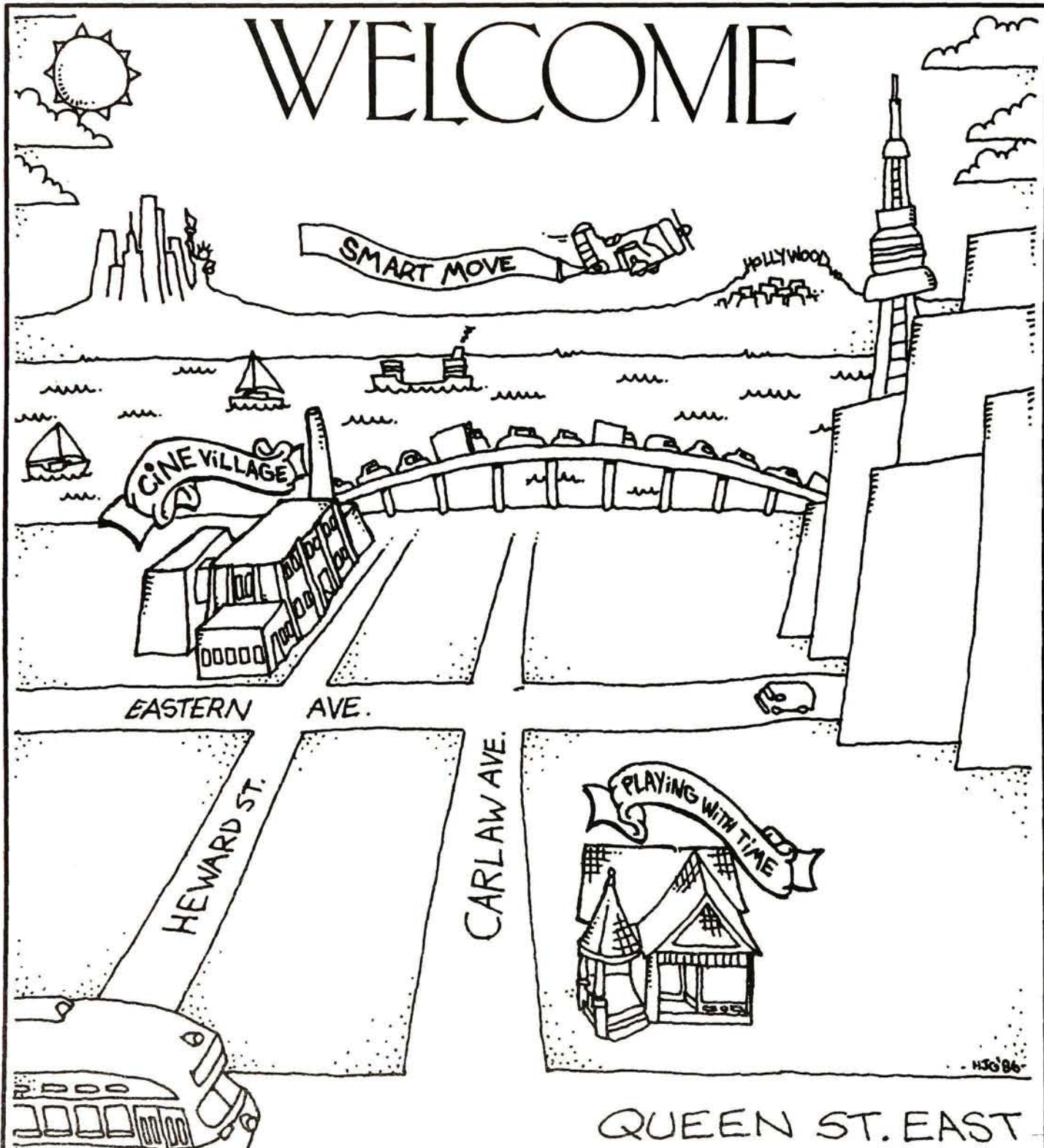
debtor, his address and in a very general way, the security

granted. The financing statement is registered with the appropriate authority and is put on a computerized register. This registration constitutes notice to all other persons of the existence of the security interest; it also gives the right to the creditor to priority from the date of registration over every other subsequent cre-

ditor as regards the security granted. The financing statement may be corrected to right errors contained therein. However, this is subject to certain statutory provisions and not all errors may be corrected. Consequently it is important to complete the form as correctly as possible the first time round. It has been held

that even spelling errors in the debtor's name or the absence of the middle initial may adversely affect the validity of the registration.

The registered financing statement is valid for three years. Prior to the end of the three years, a renewal statement must be registered in



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order for the security to continue to have valid priority over other creditors. Where a change occurs in a contract between parties or the name of the debtor is changed, a financing statement must be filed and registered within 15 days of the creditor first having knowledge of such change. In the absence of the registration of this financing change statement, the earlier registration although valid is deemed to be of no effect. It is evident then

that prudent creditors will take reasonable steps to monitor the activities of the debtor. The failure to maintain the priority status will not only mean that other creditors may acquire a priority right over the security but worse, in the event of bankruptcy, the trustee on behalf of the other creditors will acquire a priority right over a creditor whose registration becomes unperfected.

Where the debtor defaults,

and the creditor wishes to take advantage of his right over the security, the Personal Properties Security Act provides special rules as to the means by which the recourse is exercised. An appropriate notice must be given whereupon the creditor may take possession of this security and dispose of it subject to certain rules of accountability. Where the debtor disputes the validity of this collection process he may apply for an order from the appropriate

court to resolve the issue. Two examples serve to illustrate the real effect of such legislation. A lender of money loans to a feature film producer the sum of \$250,000. Among the provisions of the loan are guarantees by which the lender receives an assignment of receivables that is the revenue of the picture and a mortgage over the negative of the film. In Ontario to protect these two security rights, the creditor will then proceed to

register the financing statement within 30 days of the contract of loan being executed. Where the negative is transported outside of the province (Ontario, for example) the lender would be wise to have his security interest over that negative registered in every other province (or state) where the negative may be located and in which jurisdiction there is a registration process. In this example the lender would probably also be wise to register in conformity with any Corporation Securities Registration Act, legislation which covers debentures and certain other forms of security granted by corporations.

A second and perhaps more mundane example is the case of the supplier who leases camera equipment to the producer with an option to purchase at the end of the lease. Leases per se are not necessarily covered by personal properties security legislation. However, where in substance the purpose of the lease is to grant a security interest, that is to say, the format is a mechanism really designed to protect the creditor against the other creditors of the debtor, then compliance with the statute will be necessary. In our example of the supplier of cameras with an option to purchase, the financing statement should be registered. This kind of transaction could easily be interpreted as an indirect conditional sales contract.

Suppliers and investors would find it prudent to check with the registrar under the statute before investing or supplying goods to determine if any other creditors have prior and registered rights.

The speed with which a feature film is shot may delude some suppliers, particularly smaller ones, to overlook the necessity for registration compliance. Similarly even members of the cast and crew who defer a portion of their remuneration may not consider or even know about the effect of the legislation on their right to receive their deferred remuneration in priority to another creditor (assuming that this is the case). It behooves all creditors including participants in the feature film industry to appreciate the effect of personal property securities legislation on their interest in provinces where such legislation exists.

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