

### it pays to take a second look

Ontario Court of Appeal re-affirms the importance of correctly entering a debtor's name on a PPSA financing statement

Every day in Ontario secured parties and their lawyers spend endless hours and countless dollars drafting and negotiating financing documents to obtain the best terms and ensure the priority of their security interests over competing claimants. However, as a recent decision of the Court of Appeal confirms, all that effort may go to waste if the secured party does not take the extra step of double-checking the correct spelling of the debtor's name before registering the financing statement. *Fairbanx Corp. v. Royal Bank of Canada*<sup>1</sup> is an object lesson in the importance of minding your p's and q's – or in this case, a single “h” – when it comes to registering a security interest.

### the factual background and trial judgment

In February 2005, Friction Technology [sic] Consultants Inc. (“Friction”) entered into a factoring agreement with Fairbanx Corporation (“Fairbanx”) whereby Friction assigned all of its accounts receivable to Fairbanx. Fairbanx registered a financing statement under the *Personal Property Security Act*<sup>2</sup> (Ontario) (the “PPSA”) against Friction; however, Friction's name was misspelled on the financing statement. Unbeknownst to Fairbanx, the registered corporate name of the debtor was actually “Friction Technology Consultants Inc.”, spelling “tec[h]nology” without the “h”. Yet Friction carried on its business using the “corrected” – but legally incorrect – spelling of its name: “Friction Technology Consultants Inc.”. Friction used this incorrect spelling on its letterhead and invoices and on the factoring agreement that it entered into with Fairbanx. According to the trial judgment, Fairbanx neglected to undertake some basic due diligence to confirm the correct spelling of the debtor's name: “Fairbanx did not obtain a Status Certificate or Corporate Profile Report from the Ontario Ministry of Business and Consumer Services to verify the correct name nor did it conduct a *Business*

<sup>1</sup> 2010 ONCA 385, affirming 2009 CanLII 55376 (ON S.C.).

<sup>2</sup> R.S.O. 1990, Chapter. P.10.

*Names Act* search or examine the Minute Book of Friction Tecnology to determine the correct name for Friction Tecnology”.

In January 2008, Royal Bank of Canada (the “Bank”) registered a security interest under the PPSA against the correct name “Friction Tecnology Consultants Inc.” in all personal property of Friction, which included all of Friction’s accounts and book debts.

In March 2009, Friction declared bankruptcy. The Ontario Supreme Court was asked to determine which security interest of the two secured parties had priority with respect to Friction’s accounts receivable: Fairbanx or the Bank. In the result, the Court held that because of the error in the debtor’s name on the financing statement, Fairbanx’s security interest had not been perfected and consequently it ranked behind the Bank’s perfected security interest in the accounts receivable.

### the Court of Appeal decision

Fairbanx appealed the decision of the lower court on two grounds: it argued first, that a factoring agreement involves an absolute assignment of accounts that is not subject to the PPSA; and second, in the alternative, that the incorrect spelling of the debtor’s name did not invalidate the registration because it was cured by section 46(4) of the PPSA.

Relying on the Ontario *Conveyancing and Law of Property Act*<sup>3</sup> (the “CLPA”), Fairbanx argued that an absolute assignment of an account is effectively a sale of that account and therefore is not subject to the PPSA. However, the court noted that the PPSA applies to every transaction that in substance creates a security interest and also to “a transfer of an account or chattel paper even though the transfer may not secure payment or performance of an obligation”. To the extent that there is a conflict between legislation such as the CLPA and the PPSA, the PPSA provides that the PPSA will prevail.<sup>4</sup> Therefore, speaking for the Court of Appeal, Justice Feldman confirmed that the PPSA applies to the assignment of accounts effected by a factoring agreement.

Fairbanx argued in the alternative that although its registration against Friction contained a spelling error, the registration remained valid by virtue of section 46(4) of the PPSA, which provides in part that a financing statement is not invalidated by reason only of an error unless a reasonable person is likely to be misled materially by the error. To this end, Fairbanx maintained that since Friction had carried on business under the incorrectly spelled “Friction Tecnology Consultants Inc.”, a reasonable person would search under that name and therefore would not be materially misled by Fairbanx’s error in registering against that name. In fact, the Bank did search

<sup>3</sup> R.S.O. 1990, c. C.34.

<sup>4</sup> With the exception of the *Consumer Protection Act*, 2002, S.O. 2002, c. 30, Sch. A.

under the incorrect “corrected” version of the debtor’s name and turned up the Fairbanx registration.

The Court of Appeal cited the decision in *Re Lambert*<sup>5</sup> for the proposition that a creditor’s subjective knowledge of the existence of a financing statement or its registration is irrelevant and that whether a reasonable person would be materially misled by an error should be an objective test. However, it was also noted that a registered financing statement with an error is *prima facie* effective and that a registered financing statement loses its effect only if a reasonable person would be materially misled by the error.

The Court of Appeal recognized that registrations may contain information which may contain an error, such as an outdated address, but noted that pursuant to section 46(4) of the PPSA, it would be for the court to decide, based on the objective criteria, whether a reasonable person would be materially misled about the identity of the debtor in that case. The court contrasted that situation with one where the error in the debtor’s name in the registered financing statement would not be disclosed by a search of the correct name. Justice Feldman concluded that section 46(4) could not properly apply in that case because the issue of whether the error would materially mislead a reasonable person would never arise where the person searching would not find the registration that contains the error.<sup>6</sup>

The court further noted that even where a reasonable person who searches actually finds the registration against the incorrectly spelled name of the debtor (as was the case here), that person would not be able to know whether the misspelled name is an error or the correct spelling of the name of another similarly named person or corporation. Again, the test is an objective one – whether a hypothetical “reasonable person” *would be* misled, not whether the particular secured party actually was misled.<sup>7</sup> A registration that contains an incorrect spelling of the debtor’s name in the financing statement will therefore not perfect the creditor’s security interest in the assets of the debtor.

In the result, the appeal was dismissed and the Bank’s priority over Fairbanx was confirmed.

### why this decision is important

While *Fairbanx* may be a simple case about one of the most basic elements of secured financing, the decision is an excellent reminder to secured creditors that they must take care to ensure that the debtor’s name is recorded in the financing

<sup>5</sup> (1994), 20 O.R. (3d) 108, leave to appeal to S.C.C. refused, [1994] S.C.C.A. No. 555 [*Re Lambert*].

<sup>6</sup> Since corporate debtor name searches of Ontario’s computerized personal property security registry disclose only exact matches, the extra “h” was fatal.

<sup>7</sup> Clearly the Bank itself was not confused as to the name of its borrower since the Bank required the debtor to cease factoring its accounts receivable with Fairbanx.

statement exactly as it appears in the debtor’s legal constating documents (articles, limited partnership declaration, etc.), in order for the security interest to be perfected in the applicable assets of the debtor. Do not rely on the debtor for this information since, as here, the debtor may be carrying on business under a variant or “correction” of its legal name. For a corporate debtor, the best practice is to conduct a corporate file search and obtain a certified copy of the articles, with all amendments, and a certificate of status to confirm that the corporation still exists. A minute book review would also be in order. Because the search function used in the Ontario PPSA registry uses an exact match system (except for legal elements such as “inc.” or “Ltd.”), getting the name “almost” right is not good enough – even when it seems to be correct.

This case is also a useful reminder of another trap for the unwary: the PPSA applies to certain transactions that may not seem to involve security interests at all because they do not secure anything. However, as defined in the PPSA a “security interest” includes some transactions that do not secure an obligation, including, as Fairbanx found out, an absolute assignment of an account receivable.<sup>8</sup> If you do not register these “deemed” security interests, you may have to step to the end of the queue if your debtor goes under.

by Amanda E. Sutton

<sup>8</sup> The definition of “security interest” also includes the interest of a transferee of an account or chattel paper and the interest of a lessor of goods under a lease for a term of more than one year.

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#### a cautionary note

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