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Just Because You Own It, Doesn't Mean It's Yours – Always Register True Leases That Have a Term of More Than One Year

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A recent decision by the Ontario Court of Appeal serves as an important reminder that lessors cannot rely on title and ownership alone nor rely on the distinction of a "true lease" vs a "finance lease" to determine whether the *Personal Property Security Act* (PPSA) is applicable. A lease for a term of more than one year is a "security interest" within the meaning of the PPSA and the validity and perfection rules set out in the PPSA must be followed to protect that security interest against other creditors.

In *Royal Bank of Canada v. Cutler Forest Products Inc*. (2024 ONCA 118), the Ontario Court of Appeal ruled that the perfected security interest of Royal Bank of Canada (RBC) ranked in priority to the unperfected security interest of PACCAR Leasing Company Ltd. (Paccar), the owner of certain equipment, despite Paccar retaining title pursuant to a "true lease."

The Court of Appeal reviewed the Superior Court's discussion of the 2007 amendments to the PPSA and analysis that such amendments set aside common law title and ownership in favour of a priority system. The Court of Appeal further upheld the Superior Court's conclusion that the effect of such amendments is that a "true lease" of goods is to be treated by the law "as though the parties had intended the property to serve as security for the amounts owing by the lessee."[1] As a result, Paccar's failure to obtain a valid purchase-money security interest (PMSI) under the PPSA rendered their interest in the lease subordinate to RBC's.

The Facts

In 2007, RBC served as senior lender to Cutler Forest Products Inc. (Cutler) and registered a first-ranking security interest in Cutler's present and after acquired personal property pursuant to a general security agreement (the GSA).

In October 2020, Paccar leased three trucks to Cutler under the terms of a vehicle lease and service agreement (the VLSA). The VLSA was determined by the Superior Court to be a "true lease," as it did not secure payment or performance of an obligation by Cutler to Paccar. Paccar did not perfect a valid PMSI in the leased equipment under the VLSA.

Subsequently, Fuller Landau Group Inc. was appointed as receiver for Cutler (the Receiver) and sought the Court's direction regarding the relative priority of RBC and Paccar in respect of the leased equipment. The Superior Court held that irrespective of whether the VLSA was a "true lease", it will still be governed by the PPSA. RBC was held to have priority, and the Receiver was permitted to take possession of and sell the leased equipment.

Paccar appealed to the Ontario Court of Appeal.

The Decision

The Court of Appeal found in favour of the Receiver, dismissing the appeal. Paccar failed to obtain a valid PMSI in the leased equipment which, had it done so, would have ranked in priority to RBC's previously registered GSA. The 2007 amendments to the Ontario PPSA displaced common law title and ownership in favour of priority.[2] Irrespective of the lease being a "true lease," ownership is no longer relevant in this context under the modern PPSA. Accordingly, as "the legislation provides a mechanism for the lessor to protect its interest by adhering to the statutory requirements for registration and perfection,"[3] common law notions of ownership and title cannot be relied on.

Takeaways

Regardless of the classification of a lease as a "true lease" or a "finance lease," the PPSA is clear that if a lease has a term of more than one year, it is subject to the PPSA. The lessor must register against the lessee under the PPSA for the lessor to perfect its security interest and obtain priority over subsequent secured creditors in the same collateral.

A lessor must also be mindful of the comprehensive definition of a "lease for a term of more than one year" in the PPSA. The definition also includes (i) a lease for an indefinite term even if cancellable by one party, (ii) a lease for a term of less than one year but, with the lessor's consent, the lessee has substantially uninterrupted possession of the leased goods for a continuous period of more than one year, and (iii) a lease for a term of one year or less, if the lease is renewable at the option of one of the parties and it is possible for the total of the original term and renewal terms to exceed one year.

The PPSA is distinct from lease treatment under Article 9 of the Uniform Commercial Code which generally applies only to those leases that create a security interest in the goods and are secured transactions. As such, this is an important reminder to US lessors to seek advice of Canadian counsel to ensure that security interests created under leases are not inadvertently left unsecured.

Please reach out to a member of the Cassels team for more information on whether a lease would be

classified as a “security interest” under the PPSA and necessitate perfection steps under the PPSA.

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[1] *Royal Bank of Canada v. Cutler Forest Products Inc.* 2024 ONCA 118 at para 15.

[2] *Royal Bank of Canada v. Cutler Forest Products Inc.* 2024 ONCA 118 at para 38.

[3] *Royal Bank of Canada v. Cutler Forest Products Inc.* 2024 ONCA 118 at para 27.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.