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Memorandum

DRAFT

From: TOROG¹

Date: April 25, 2007

Subject: Investment Property Perfection and Priority Opinions under the *Securities Transfer Act, 2006* (STA) and the *Personal Property Security Act* (PPSA) as amended by the STA

The memorandum sets out some considerations and suggested language for giving perfection and priority opinions in secured transactions involving investment property under the PPSA as amended by the STA, which came into force January 1, 2007.

This memorandum is intended to suggest appropriate language for those circumstances where a perfection by control and/or priority opinion with respect to security interests in securities or other investment property might be appropriate. It is not intended to suggest that it is or should be standard practice to request or receive such opinions. In many secured financings where security interests will be perfected by registering financing statements and where there will be intercreditor agreements dealing with priorities, the opinion would likely not be of significant value; and market practice with respect to some types of structured transactions is not to require such opinions. On the other hand, there are certain types of transactions where they might be useful, such as takeover bid financings or defeasance transactions where securities comprise all or substantially all of the collateral.

¹ The Toronto Opinions Group (TOROG) is a group of lawyers, primarily from the Toronto offices of the larger Canadian law firms, with an interest in or responsibility within their firms for third party (or transaction) opinions. TOROG members meet regularly to discuss opinion issues and on occasion to commit to writing and publish what its members believe are acceptable positions on an opinion issue or appropriate language for a particular assumption, opinion or qualification. TOROG's recommendations have no official standing and are not binding on member firms but it is hoped that they will provide useful starting points or a common ground of understanding for transaction opinion negotiations.

This memorandum assumes that there is a valid security agreement pledging the investment property to the secured party (referred to generically in this memorandum as a “Lender”). It further assumes that there are no creditors’ rights or insolvency issues affecting the pledge other than those that are the subject of customary qualifications. These items would normally be opined upon, dealt with, assumed or qualified in other parts of an overall opinion as to the validity and enforceability of the security documents, including the pledge agreement.

The TOROG subcommittee that prepared this memorandum has not considered in depth certain other aspects of secured transaction opinions practice that may be affected by the STA. In particular, it may be necessary to consider whether the customary form of jurisdictional scope limitation commonly used in such opinions would still be acceptable in relation to opinions on security interests in securities. Such customary form, as set out in section 1.9 of the Illustrative Opinion in the *Personal Property Security Opinion Report* of the Business Law Section of the Canadian Bar Association – Ontario (1997) (the “PPS Opinion Report”), states that no opinion is expressed with respect to the laws of any other jurisdiction to the extent that they may govern the validity, perfection, effect of perfection or non-perfection or enforcement of the security interest as a result of Ontario conflict of laws rules, and further that no opinion is expressed whether Ontario law would apply. This qualification was premised on the uncertainty of the applicable Ontario conflict rules (PPS Opinion Report, section 7.7.1). Because the relevant Ontario conflict rules with respect to security interests in securities have now been clarified, this language may be resisted in future. However, the application of those rules is still fact dependent, and opinions will probably seldom be given on security interests in securities in isolation, so this issue must be considered in a broader context, taking into account other amendments in the PPSA conflict rules. In raising this issue, the subcommittee is not suggesting that new express or implied opinions on conflict of laws issues should be given in the future, merely that the basic language stating that the opinion is limited to Ontario and federal law may arguably be sufficient and that there may no longer, in this context, be a compelling reason to express uncertainty as to which law may apply.

This memo is divided into two parts: the first part deals with the pledging of certificated and uncertificated securities in the direct holding system, and the second part deals with pledges in the indirect holding system. References in the footnotes to the PPSA section numbers refer to those sections as amended by the STA.

Keep in mind that it may not always be obvious whether you are dealing with the direct or indirect holding system. For example, there are circumstances where a securities intermediary may be holding certificated securities for a customer, but for STA purposes, the customer is considered a direct holder.² On the other hand, there are circumstances where certificated securities are not held in a clearing system, are directly held by an agent or nominee of the Lender and which would, for STA purposes, be treated as a holding of a security entitlement by the Lender.

² STA Section 95(3). A security held by a securities intermediary is considered to be held directly by the customer if registered in the name of the customer and not endorsed to the intermediary.

I. SECURITIES - DIRECT HOLDINGS

A. Certificated Securities

Apart from some special rules, there are three methods to perfect a security interest in a certificated security in the direct holding system:

1. *Registration*: A secured party can continue to perfect its security interest by registering a financing statement against the debtor.³
2. *Control*: A security interest in any investment property may be perfected by “control”⁴, which is the best method to perfect a security interest. For a bearer security, a secured party obtains control by taking possession of the certificate. For a registered security, a secured party obtains control by taking possession of the certificate, together with (i) an appropriate endorsement (which is defined to include a separate instrument of transfer or stock power), or (ii) arranging for the issuer to register the security in the name of the secured party.⁵ These steps correspond to some of the same steps that would have been taken under the prior law for the secured party to acquire the status of a “good faith purchaser” of a certificated security.
3. *Delivery (Possession)*: A secured party can continue to perfect a security interest in a certificated security in registered form by obtaining simple possession (strictly speaking, the PPSA and STA use the word “delivery”) of the security certificate (either directly or through someone acting on behalf of the secured party) in accordance with the rules set forth in section 68(1) of the STA.⁶ With an appropriate endorsement, the secured party obtains “control” of that security.

A priority opinion in respect of pledged securities in directly held certificated form will likely most often be requested in connection with secured transactions involving subsidiaries within a corporate group and individual shareholders of privately held corporations. Most of the issuers of such certificated securities will have restrictions on transfers in the governing documents (including unanimous shareholders agreements), which will usually be referred to on the certificates themselves, in accordance with section 56(3) of the *Business Corporations Act* (Ontario) (“OBCA”).

In general, a security interest in a certificated security perfected by control has priority over a security interest perfected by other means, including delivery.⁷ A security interest

³PPSA Section 23.

⁴ PPSA Section 22.1(1).

⁵ STA Section 23(2).

⁶ PPSA Section 22.1(1) AND STA Section 23(2).

⁷ PPSA Section 30.1(2).

in a certificated security perfected by delivery has priority over one perfected by a method other than control such as registration.⁸

With respect to directly held securities, the concept of “good faith purchaser” in the OBCA and PPSA is replaced in the STA and the PPSA with the concept of “protected purchaser” as the status that a secured creditor must achieve to be protected from adverse claims asserted by third parties other than other secured creditors. The Lender is a protected purchaser if it has a security interest (and so is a “purchaser”), has given value, has no notice of any adverse claim and has obtained control of the security.⁹ The interest of a protected purchaser takes priority over an earlier security interest, even if perfected.¹⁰

(a) Previous Standard Opinion

The PPS Opinion Report provides an example of a “good faith purchaser opinion” for certificated securities as follows:

Provided that the [Lender] is acting in good faith and has no notice of any adverse claim affecting the Pledged Shares, the security interest of the [Lender] in the Pledged Shares has priority over any other security interest in the Pledged Shares perfected by registration or temporarily perfected under the PPSA, and the [Lender] has acquired the Pledged Shares free of any adverse claim.¹¹

(b) Possible Opinion

Subject to appropriate diligence, assumptions and qualifications, a lawyer may consider giving the following perfection and priority¹² opinion with respect to certificated securities:

The security interest of the Lender in the Pledged Securities represented by the Certificate (“Certificated Pledged Securities”) has been perfected by control¹³ and accordingly has priority over any other security interest to which the PPSA applies¹⁴ in the

⁸ PPSA Section 30.1(3).

⁹ STA Section 1(1).

¹⁰ PPSA Section 28.1(2).

¹¹ PPS Opinion Report, s. 5.6.

¹² PPSA Section 30.1(2) – priority over other security interests.

¹³ PPSA Section 11 – pledge agreement is in place; STA Section 23(2) and Section 68(1) – delivery to secured party.

¹⁴ The qualifier “to which the PPSA applies” is intended to clarify that the priority opinion speaks only to having priority over the security interests contemplated under the PPSA, and not necessarily about having priority over other types of competing claims to the collateral such as statutory liens or deemed trusts or “debtor in possession” financing in insolvency proceedings. See footnote 17 below.

*Certificated Pledged Securities.*¹⁵ ***[If the Lender had no notice of any adverse claim¹⁶ at the time of obtaining control of the Certificated Pledged Securities, the Lender acquired its security interest in the Certificated Pledged Securities free of any adverse claim.]***¹⁷

(c) Due Diligence

Diligence should include:

- (i) *Location of Certificate:* For an Ontario opinion, confirm that the Certificate is located in Ontario at the time of attachment (for validity) and at the time the opinion is given (for perfection and priority).¹⁸
- (ii) *Control:* Confirm or assume that Lender has taken delivery¹⁹ of the Certificate and, if the Certificate is in registered form, it must be endorsed to the Lender or accompanied by a signed instrument of transfer or power of attorney, or a new Certificate must be issued in name of the Lender.
- (iii) *Security:* Confirm that the Certificated Pledged Securities are “securities” for the purposes of the STA (remember that issuers are not restricted to bodies corporate); see Section 1(1) of the STA for full definition of “security”²⁰. In appropriate cases, consider standard corporate diligence to

¹⁵ PPSA Section 30.1(2) if Lender has control of the Certificate, it has priority against all other secured creditors regardless of whether it has knowledge of other interests; see Official Comment 3 to Rev. Article 9 - 328.

¹⁶ PPSA Section 22 – registrations alone do not constitute notice of adverse claims; PPSA Sections 18-21 – no notice of adverse claims.

¹⁷ While the law is not clear, there are potential adverse claims which arguably may have priority, such as statutory liens and deemed trusts in favour of the Crown or other protected groups (i.e. employees and retirees), and court-ordered priming charges in an insolvency proceeding. Amendments to the *Bankruptcy and Insolvency Act* S. C. 2005 c. 47 (formerly Bill C-55) will also create super-priority rules for certain types of obligations if and when the amendments are proclaimed into force. If this part of the opinion is to be given, it would be necessary to include a qualification to this effect. To avoid these issues, some law firms may resist giving the “protected purchaser” opinion.

¹⁸ PPSA Sections 7.1(1)(a) and 7.1(5)(a) – conflict rules – if you are concerned or are on notice that the certificate may be removed from Ontario, you may wish to consider adding a qualification or advisory to the effect that the law governing perfection and priority of the Lender’s security interest will change if the Certificate representing the Pledged Securities is no longer located in Ontario; otherwise, this qualification is not necessary.

¹⁹ PPSA Section 46 – delivery of Certificate must take place in Ontario. The opinion giver would normally verify that delivery has taken place; in the absence of that verification, an assumption to this effect should be made. See (d) below for suggested for of assumption.

²⁰ STA Section 1(1) defines “security” to mean “except as otherwise provided in sections 10 to 16, an obligation of an issuer or a share, participation or other interest in an issuer or in property or an enterprise of an issuer, (a) that is represented by a security certificate in bearer form or registered form, or the transfer of which may be registered on books maintained for that purpose by or on behalf of the issuer, (b) that is one of a class or series, or by its terms is divisible into a class or series, of shares, participations, interests or obligations, and (c) that, (i) is or is a type, dealt in or traded on securities exchanges or securities markets, or (ii) is a medium for investment and by its terms expressly provides that it is a security for the purposes of this Act. Be sure to review the rules in STA Sections 10 to 16 which address (among other things) business trusts, mutual funds, partnerships, limited liability

confirm underlying existence of the Certificated Pledged Securities or opinions from counsel for foreign issuers. Among other things, the Certificated Pledged Securities need to represent an obligation of or interest in issuer or its property.

- (iv) *Restriction on Transfers:* As under the prior law, for private issuers, if there is a restriction on transfers, you will have to ensure that the resolution authorizing the Pledge addresses this issue so as to permit the Pledge (including any future transfer as a result of realization by the Lender) and you may wish to include a qualification or advisory regarding whether the current board has the ability to bind a future board to this action (see PPS Opinion Report, section 6.5). However, private issuers' securities are clearly "securities" despite a restriction on transfer.²¹

(d) Assumption

Depending on the circumstances,²² an assumption along the following lines could be made in respect of a perfection and priority opinion with respect to a security interest in certificated securities perfected by control:

For the purposes of the opinions set forth in paragraph ●, the Lender or another person (other than a securities intermediary, as defined in the STA) on behalf of the Lender has acquired possession of the security certificates representing the Pledged Certificated Securities and such security certificates have been endorsed to the Lender or such other person or in blank by an effective endorsement within the meaning of the STA, or such security certificates have been registered in the name of the Lender or such other person.

companies. By way of example of relevant issues, a bankers acceptance would not be a security because it does not satisfy the requirement in clause (b) of the definition of "security" and because it is a bill of exchange excluded by STA Section 13. A unit in a limited partnership, even if certificated, would not be a "security" unless it is publicly traded, its terms provide that it is a security for the purposes of the STA or it is an open-end mutual fund security (STA s. 12(1)).

²¹ STA Section 10.

²² This assumption would appear to be necessary only where the opinion giver is unable to verify that an endorsed share certificate has actually been delivered to the Lender or its agent, for example, where the share certificate is delivered to counsel for the Lender at a closing at which the opinion giver is not physically present, no representative of the Lender is physically present or no document evidences the authority of counsel for the Lender to take possession of the certificate on behalf of the Lender for the purposes of establishing control.

B. Uncertificated Securities

Uncertificated securities are simply securities that are not represented by a physical certificate. The term is not synonymous with indirectly held securities or “book-based securities” since indirectly held securities may be either certificated or uncertificated. Currently, this is not a common form of direct pledge. Securities which are not traded on an exchange are generally certificated. However, pledges of uncertificated securities may become more common now that the OBCA authorizes Ontario business corporations to issue certificated or uncertificated securities. A shareholder will not be entitled to demand a certificate if the directors pass a resolution to issue only uncertificated securities.²³ Mutual fund units are now a common example of uncertificated securities.²⁴

Apart from some special rules, there are two methods to perfect a security interest in an uncertificated security in the direct holding system:

1. *Registration:* A secured party can continue to perfect its security interest by registering a financing statement against the debtor.²⁵
2. *Control:* A security interest in any investment property may be perfected by “control”²⁶, which is the best method to perfect a security interest. Control of an uncertificated security²⁷ in the direct holding system is obtained by (i) arranging for the issuer to register the security in the name of the secured party,²⁸ (ii) obtaining a control agreement from the issuer under which the issuer agrees to comply with instructions originated by the secured party without the further consent of the registered owner²⁹; or (iii) having someone else (other than a securities intermediary) become the registered owner on behalf of the secured party, or if already the registered owner, acknowledging that it holds on behalf of the secured party.³⁰

The concepts of “protected purchaser” and the priority rules relating to control outlined in I.A above also apply to uncertificated securities except that the secured party obtains control either by becoming the registered owner of the security or by entering into a “control” agreement with the issuer whereby the issuer agrees to comply with instructions from the secured party without the further consent of the registered owner.³¹

²³ OBCA Section 54.

²⁴ See Section 11. Most mutual fund units are not evidenced by a certificate.

²⁵ PPSA Section 23.

²⁶ PPSA Section 22.1(1).

²⁷ PPSA Section 1(2)(b).

²⁸ PPSA Section 22.1(1) and STA Section 24(1)(a) and 68(2)(a).

²⁹ PPSA Section 22.1(1) and STA Section 24(1)(b).

³⁰ PPSA Section 22.1(1) and STA Section 24(1)(a) and 68(2)(b).

³¹ STA Sections 24(1) and 68(2).

(a) Previous Standard Opinion

As this type of opinion was rarely given, no market standard opinion has been established.

(b) Possible Opinion

Subject to appropriate diligence, assumptions and qualifications, a lawyer may consider giving the following perfection and priority opinion with respect to uncertificated securities:

The security interest of the Lender in the Pledged Securities that are uncertificated (the “Uncertificated Pledged Securities”) has been perfected by control and accordingly has priority over any other security interest to which the PPSA applies³² in the Uncertificated Pledged Securities.³³ [If the Lender had no notice of any adverse claim³⁴ at the time of obtaining control of the Uncertificated Pledged Securities, the Lender acquired its security interest in the Pledged Securities free of any adverse claim.]

(c) Due Diligence

Diligence should include:

- (i) *Jurisdiction of Issuer:* For an Ontario opinion, confirm that the issuer’s jurisdiction is Ontario³⁵; remember that Ontario priority rules apply only so long as the issuer’s jurisdiction is in Ontario³⁶. Ontario is the issuer jurisdiction in the following circumstances:
- If the issuer is a Canadian or provincial corporation with its registered or head office in Ontario or Ontario is specified as the applicable jurisdiction, Ontario law applies³⁷;
 - If the issuer is any of the federal Crown or the Commissioner of a Canadian territory, Ontario is specified as the applicable jurisdiction,

³² See footnote 14.

³³ See footnote 12.

³⁴ See footnote 17.

³⁵ PPSA Section 7.1(2)(b) – perfection and priority of the security interest in uncertificated security is governed by law of the issuer’s jurisdiction. Must be Ontario in order for us to provide this opinion.

³⁶ PPSA Section 7.1(7) – perfection and priority not determined solely at time of attachment – if you are concerned that the issuer’s jurisdiction may change, you may wish to add a qualification or advisory to the effect that the law governing perfection and priority of the Lender’s security interest will change if the issuer’s jurisdiction is no longer Ontario. However, like other warnings as to possible future events, this should not be necessary.

³⁷ It will be highly unusual to give an opinion about any uncertificated Crown security, as their securities will invariably be held through CDS and governed by the indirect holdings rules. See (d) below for suggested form of assumption.

or if the issuer is the Ontario Crown, Ontario law applies unless otherwise specified; or

- Other issuers: Ontario is the law of incorporation or organization (unless other jurisdiction specified) or if it is a non-Ontario issuer, Ontario is specified as the applicable jurisdiction.

(ii) *Control*: Confirm or assume that:

- The issuer has agreed to comply with instructions from the Lender (without the further consent of the registered owner/Borrower)³⁸, or
- The Lender (or agent/nominee) becomes registered owner of record.

(iii) *Security*: Confirm that the collateral is a “security” as defined in the STA (issuers are not restricted to bodies corporate); See Section 1(1) of the STA for full definition of “security” (refer to footnote 20 for definition); standard corporate diligence to confirm underlying existence of “security” or obtain opinions from counsel for foreign issuers. The security must represent an obligation of or interest in the issuer or its property.³⁹

(iv) *Restriction on Transfers*: As under the prior law, for private issuers, if there is a restriction on transfers, you will have to ensure that the resolution authorizing the Pledge addresses this issue so as to permit the Pledge (including any future transfer as a result of realization by the Lender) and you may wish to include a qualification or advisory regarding whether the current board has the ability to bind a future board to this action.⁴⁰

(d) Assumptions

Depending on the circumstances, assumptions along the following lines could be made in respect of a perfection and priority opinion with respect to a security interest in uncertificated securities perfected by control:

- (i) [if the Collateral includes directly held uncertificated securities and the security interest is perfected by control through delivery:]

For the purposes of the opinions set forth in paragraph ● [perfection of security interest in uncertificated securities by control], the [Issuer] has registered the Lender or another person

³⁸ It would be prudent to obtain a representation from the issuer that it does not have instructions from other parties or the opinion should include an assumption to address this point. Suggestion is that a tri-party agreement (issuer, Borrower and Lender) should be entered into to govern control of uncertificated security.

³⁹ Same as for certificated securities.

⁴⁰ Same as for certificated securities. See PPS Opinion Report, section 6.5.

*on behalf of the Lender as the registered owner of the Pledged Uncertificated Securities;*⁴¹

- (ii) [if the Collateral includes directly held uncertificated securities and the security interest is perfected by control through agreement with the Issuer:]

For the purposes of the opinions set forth in paragraph ● [perfection of security interest in uncertificated securities by control], [(i) the [Control Agreement] is a legal, valid and binding obligation of the [Issuer] enforceable against the [Issuer] in accordance with its terms⁴², and (ii)] other than the [Control Agreement], there exists no agreement between the Issuer and any other person pursuant to which the Issuer has agreed to comply with instructions originated by such person with respect to the Pledged Uncertificated Securities without the further consent of the Debtor.⁴³

II. SECURITIES - INDIRECT HOLDINGS

A. Background on the Indirect Holding System

Based on Revised Article 8 of the U.S. *Uniform Commercial Code*, the STA adopts modernized rules to reflect the fact that a significant amount of trading of securities on public exchanges is settled in book-based indirect holding systems. The investor's interests in securities are recorded on the books of the securities intermediary (for example, a securities dealer, bank or trust custodian). All of these settlements are in turn reflected in records of a centralized clearing agency in which the securities intermediaries are the participants and which is the securities intermediary of those participants. In this system, the investor's only direct link is with its securities intermediary. The investor has no link to other participants in the system or the issuer and is not registered as owner of securities with the issuer.

What the investor has in the system is a securities account with the broker, custodian or other securities intermediary. In accordance with the terms of that relationship, the investor has an entitlement to receive the benefits of the securities which are held in the system for an amount and type credited to his securities account, and this bundle of rights

⁴¹ In lieu of this assumption the opinion giver could rely on a certified copy of the securities register if available at closing.

⁴² Where the opinion giver also acts for the Issuer and the Issuer is related to the debtor, the opinion recipient may consider requiring the opinion giver to give an opinion as to the enforceability of the Control Agreement against the Issuer. However, in other circumstances such an opinion would likely be difficult and expensive to obtain, in which case an assumption as to enforceability would seem appropriate.

⁴³ This assumption (which goes to the priority of perfection by control) may well be the subject of a representation and warranty by the debtor, but unless the opinion giver is permitted to assume the truth of such representation and warranty, an express assumption is still appropriate. In the alternative a statement to this effect may be included in the officer's certificate upon which the opinion giver expressly relies.

is known as a “security entitlement” and the investor is known as the “entitlement holder”. It is a pooled system.

When investors pledge their securities, they are dealing with the rights to their securities accounts and the entitlements which the securities account gives them. To perfect the security interest by control, the investors do not deliver the underlying securities to the Lender nor even transfer the security entitlements. Instead, (apart from some other possible means of perfection, such as registration under the PPSA), the Lender perfects by control. A lender can obtain control of a security entitlement (i) by becoming the entitlement holder (in which case the investor’s security entitlements are extinguished), (ii) by arranging for the securities intermediary to agree with the Lender that it will act on instructions (known as “entitlement orders”) originated by the Lender without the further consent of the debtor, or (iii) by another person with control of the security entitlement acknowledging that it has control on behalf of the Lender.⁴⁴

B. Security Entitlements and Security Accounts Opinions

The protected purchaser rules under the STA and in Section 28.1 of the PPSA apply only to directly held certificated or uncertificated securities. However, there are analogous rules relating to security entitlements that operate to cut off the remedies of adverse claimants to the underlying financial asset. Section 28(8) of the PPSA provides that an action based on a security agreement creating a security interest in a financial asset may not be brought against a person who acquires a security entitlement under Section 95 of the STA for value without knowledge of a breach of the security agreement. Section 96 of the STA provides that a legal proceeding based on an adverse claim to a financial asset may not be asserted against a person (including a secured party) that acquires a security entitlement for value and without notice of the adverse claim, and s. 97(7) provides that a legal proceeding based on the entitlement holder’s property interest with respect to a financial asset may not be brought against a purchaser who gives value, obtains control of possession of the financial assets and does not act in collusion with the securities intermediary in violating the intermediary’s statutory obligations.⁴⁵

In addition, a security interest in a “financial asset” such as a security entitlement or securities account perfected by control has priority over security interests not perfected by control.⁴⁶ This priority rule does not turn on either the temporal sequence of perfection or awareness of conflicting security interests. Rather, it is a structural rule based on the principle that a lender should be able to rely on collateral without question if the lender has taken the necessary steps to assure itself that it is in a position to realize on its security interest without further action by the debtor.⁴⁷ However, a securities

⁴⁴ PPSA Section 22.1(1) and STA Section 25. It is also possible to perfect by registration of a financing statement – PPSA Section 23.

⁴⁵ See also rules in STA Sections 104(1) and (3), which deal with cases not covered by the priority rules under the PPSA.

⁴⁶ PPSA Section 30.1(2).

⁴⁷ See Official Comment 3 to Revised Article 9-328.

intermediary has priority over other secured parties with respect to security entitlements created by it, unless the intermediary otherwise agrees.⁴⁸

(a) Previous Standard Opinion

The PPS Opinion Report suggested a form of priority opinion for the book-based system as follows:

Upon payment of all amounts which are owing (contingently or otherwise) by [the CDS participant to whom the Pledged Shares are being delivered] in connection with the operation of The Canadian Depository for Securities Limited and which are secured by the security interest referred to in section 85(1.1) of the OBCA, and provided that the Secured Party is acting in good faith and has no notice of any adverse claim affecting the Pledged Shares, at that time the security interest of the Secured Party in the Pledged Shares will have priority over any other security interest in the Pledged Shares perfected by registration or temporarily perfected under the PPSA, and at the time the Secured Party will have acquired the Pledged Shares free of any adverse claim.

Although occasionally given, this form of opinion did not receive much market acceptance.

(b) Possible Opinion

Subject to appropriate diligence, assumptions and qualifications, a lawyer may consider giving the following perfection and priority opinion where the Lender perfects by becoming the entitlement holder:⁴⁹

The security interest of the Lender in the Securities Account and the security entitlements carried in the Securities Account (collectively, "Pledged Security Entitlements") has been perfected by control⁵⁰ and accordingly has priority over any other security interest to which the PPSA applies⁵¹ in the Pledged Security Entitlements.

Subject to appropriate diligence, assumptions and qualifications, a lawyer may consider giving the following priority opinion where the Lender achieves control by entering into a control agreement with the Securities Intermediary:

⁴⁸ PPSA Section 30.1(5).

⁴⁹ This is the preferred method of perfection where feasible.

⁵⁰ STA Sections 25(1), 26, 104(4) - control means when the Lender becomes the entitlement holder to the Pledged Securities or when the securities intermediary agrees to accept entitlement orders from the Lender without the further consent of the Borrower.

⁵¹ See footnote 14.

The security interest of the Lender in [the Securities Account and the security entitlements [carried in the Securities Account] [(collectively,)]⁵² the “Pledged Security Entitlements”) has been perfected by control⁵³ and accordingly has priority over any other security interest to which the PPSA applies⁵⁴ in the Pledged Security Entitlements other than any security interest of the Securities Intermediary.⁵⁵

It will be noted that neither of the suggested opinions addresses whether the Lender’s security interest is taken free of adverse claims. Such an opinion could be requested on the basis of the STA provisions relating to adverse claims in the indirect holding system that parallel the protected purchaser provisions relating to directly held securities.⁵⁶ However, since the operation of these rules is complex and fact specific and could be affected by at least three other “cut-off” rules,⁵⁷ the number of assumptions and qualifications required to give such an opinion and the degree of analysis required would arguably render it expensive and of little real value.

(c) Due Diligence

Diligence should include:

- (i) *Jurisdiction of Securities Intermediary:* For an Ontario law opinion, confirm that the securities intermediary’s jurisdiction is Ontario.⁵⁸ remember that Ontario priority rules apply only so long as the securities intermediary’s jurisdiction is Ontario. If the Lender is perfecting by way of control agreement, consider reviewing the securities account documentation of the Borrower to confirm that the securities account agreement expressly selects Ontario as the securities intermediary’s jurisdiction for purposes of the STA or is expressed to be governed by Ontario law, or if Ontario or other law is not expressly selected as set out above, that the account agreement specifies that the securities account is

⁵² Insert reference to Securities Account only where it is the entire securities account which is the subject of the Pledge.

⁵³ STA Section 25(1), 26, 104(4) control means when the Lender becomes the entitlement holder to the Pledged Securities or when the securities intermediary agrees to comply with entitlement orders from the Lender without the further consent of the Borrower.

⁵⁴ See footnote 14.

⁵⁵ PPSA Section 30.1(2) – see also Official Comment 3 to Revised Article 9 – 328 and PPSA Section 30.1(5). Securities intermediary has first priority over other security interests unless it agrees to subordinate its security. The securities intermediary would not have priority over a Lender who perfects by becoming the entitlement holder.

⁵⁶ STA Sections 96 and 97(7).

⁵⁷ STA Sections 104(1) and 104(3), PPSA Section 2.8(8). See discussions in text associated with footnote 45.

⁵⁸ See STA Section 45(2). If you are concerned that the securities intermediary’s jurisdiction may cease to be Ontario, you may wish to add a qualification or advisory to the effect that, perfection and priority of the Lender’s security interest may be affected if the securities intermediary’s jurisdiction is no longer Ontario. However, such a warning as to the effect of possible future changes in facts should not be necessary.

maintained in Ontario. In any event, include in the control agreement a representation or agreement by the Lender and debtor about those matters.

- (ii) *Control*: Confirm or assume that the Lender has control of security entitlement and that control has not been given to any other party.⁵⁹
- (iii) *Securities Account*: Confirm or assume that it is a “securities account”,⁶⁰ and that the financial assets have been properly credited to the securities account.
- (iv) *Clearing Agency Rules*: If the security interests are granted by a participating securities intermediary to the clearing agency or to another participant, add an assumption that the rules of the clearing agency have been complied with as such rules will prevail if there is a conflict with the priority rules of the STA or PPSA.⁶¹

(d) Assumptions

Depending on the circumstances, assumptions along the following lines could be made in respect of a perfection and priority opinion with respect to a security interest in security entitlements perfected by control:

- (i) [if the Collateral includes security entitlements and the security interest is perfected by control through agreement with the securities intermediary:]

For the purposes of the opinions set forth in paragraph ● [perfection of security interest in security entitlements or security accounts by control], (i) the Securities Intermediary is acting as a “securities intermediary” (as defined the STA) in maintaining the securities accounts in which the Pledged Security Entitlements are carried; (ii) the [Control Agreement] is a legal, valid and binding obligation of the Securities Intermediary enforceable against the Securities Intermediary in accordance with its

⁵⁹ Control of a security entitlement is established if the Lender is the securities intermediary, or if the “securities” are credited to the Lender’s securities account, or the party having control acknowledges that it has control on behalf of the Lender, or if securities intermediary agrees to comply with entitlement orders originated by the Lender without further consent of the pledgor. Remember that the jurisdiction of the securities intermediary must remain in Ontario for the Ontario conflict rules to apply, so if you are concerned that this may cease to be the case, you may wish to add a qualification or advisory to the effect that, perfection and priority of the Lender’s security interest in the Pledged Security Entitlements may be affected if the Securities Intermediary’s jurisdiction moves out of Ontario. However, such a warning as to the effect of possible future changes in facts should not be necessary. See (d) below for suggested form of assumption.

⁶⁰ STA Section 1(1) - An account to which financial assets are credited in favour of the account holder with the intermediary establishing the account and where the intermediary agrees to treat the account holder as entitled to exercise all rights that constitute the financial assets credited to that account. Note that a deposit of certificated securities for safekeeping with a securities intermediary is not a “securities account” if the certificate is in the name of the holder, payable to the order or specifically endorsed to the holder (Section 95(3)); a regular bank account is not a “securities account” – it is an “account” under the PPSA and not an investment property.

⁶¹ STA Section 7(1).

terms;⁶² (iii) other than the [Control Agreement], there exists no agreement between the Securities Intermediary and any other person pursuant to which the Securities Intermediary has agreed to comply with entitlement orders (as defined in the STA) originated by such person with respect to the Pledged Security Entitlements without the further consent of the Debtor;⁶³ (iv) the Collateral does not include any securities that are registered in the name of, payable to the order of or specially endorsed to the Debtor and that have not been endorsed to the Securities Intermediary or in blank; and (v) as to any credit balance in the [Securities Account], the Securities Intermediary and the Debtor have not agreed that such credit balance is not to be treated as a financial asset under the STA.

- (ii) [if the Collateral includes a “security entitlement” or a “securities account” and control is by entitlement]:

For the purposes of the opinions set forth in paragraph ● [perfection of security interest in security entitlements or securities accounts by control], all Collateral that is a “security” or a “financial asset” (as defined in the STA) has been credited to one or more securities accounts maintained in the name of the Lender or an agent of the Lender.

⁶² In most cases it will not be practicable to obtain a separate opinion of counsel to the Securities Intermediary that the Control Agreement is enforceable against it.

⁶³ Under PPSA Section 30.1(4)(b)(ii), priority would go to the secured party that entered into a control agreement first.