JOHN M. M. TROUP LTD. AND NATIONAL PAINTING & DECORATING, LTD. (*Plaintiffs*)	APPELLANTS;	1962 *Mar. 12, 13 June 11
AND		
THE ROYAL BANK OF CANADA (*Defendant*)	INTERVENANT.	
AND		
THE ATTORNEY-GENERAL FOR ONTARIO	RESPONDENT;	

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Mechanics' liens—Statutory trust fund provisions—Payment to contractor deposited in current account—Deposit applied by bank to reduce contractor's overdraft—Unpaid accounts of sub-contractors—Extent of bank's knowledge as to breach of trust—No notice given of assignment of book debts held by bank.

*PRESENT: Taschereau, Locke, Cartwright, Abbott, Martland, Judson and Ritchie JJ.

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A cheque for $77,000 representing the greater part of a holdback on a contract for the construction of a public building was drawn by the County of Lambton in favour of the contractor of the project. The contracting company deposited the cheque in its current account with the defendant bank and the latter applied the deposit towards the reduction of the company's overdraft. The contractor was from time to time a borrower from the bank and these borrowings were secured by a general assignment of book debts from the contractor to the defendant, a guarantee by the president of the company, and the deposit of certain securities. Although registered, no notice of the assignment of book debts was given to anyone.

The plaintiffs were sub-contractors whose accounts remained unpaid. They claimed that they were beneficiaries of the trust created by s. 3(1) of *The Mechanics' Lien Act*, R.S.O. 1950, c. 227, as amended by 1952, c. 54, s. 1, and that the bank must account to them because it received their money, appropriated it to its own use and therefore participated in a breach of trust. The plaintiff's action was dismissed by the trial judge and this decision was affirmed by the Court of Appeal. The plaintiffs then appealed to this Court.

Held (Locke J. dissenting): The appeal should be dismissed.

Per Taschereau, Abbott, Judson and Ritchie JJ.: The only knowledge that the bank had of a possibility that the contractor was a trustee was imputed knowledge of the provisions of s. 3(1) of *The Mechanics' Lien Act*, assuming that the branch manager knew of this provision of the Act. But in the circumstances of the case, he did not know and had no reason to inquire into the possibility of a breach of trust. *Fonthill Lumber Ltd. v. Bank of Montreal*, [1959] O.R. 451, distinguished.

The basis of the plaintiffs' argument that they were entitled to succeed on the authority of *Minneapolis-Honeywell Regulator Co. Ltd. v. Empire Brass Mfg. Co. Ltd.*, [1955] S.C.R. 694, and *Canadian Bank of Commerce v. McAvity*, [1959] S.C.R. 478, was that the bank held an assignment of book debts from the customer and that this document provided that all moneys received by the customer from the collection of debts under the assignment should be received in trust for the bank, and that if the bank's trustee or agent received these moneys in trust for the bank, they were already subject to the prior statutory trust created by s. 3(1) in favour of the plaintiffs. The fallacy in the argument was that the contractor did not receive the cheque under the assignment of book debts as trustee for the bank. The bank made no use of this assignment and served no notice on the county under it. Until notice was given, the assignment could have no effect on a payment made in the ordinary course of business by the county to the contractor.

Per Cartwright and Ritchie JJ.: The evidence was clear that the bank manager did not know that the customer was committing a breach of trust and therefore could not have knowingly participated therein. The principle of law that where a trustee has overdrawn his banking account, his bankers have a first and paramount legal lien on all moneys paid in by him, unless they have notice, not only that they are trust moneys, but also that the payment to them constitutes a breach of trust, was applicable here.

The bank had no notice, actual or constructive, of any breach of trust committed by the construction company. The plaintiffs' argument, based on the existence of the assignment of book debts, that when

the bank acquired legal title to the $77,000 it did so with notice of the trust in favour of the plaintiffs was rejected. When the cheque was deposited in the overdrawn account neither the bank nor the construction company was acting in pursuance of the assignment; they were acting not as assignee and assignor or as *cestui que* trust and trustee but as bank and customer in the ordinary course of business. Neither the county nor the plaintiffs were aware of or parties to the assignment; the only parties to it were the bank and the construction company and the former did not act on it. In view of the manner in which the dealings between the bank and the construction company were carried on the existence of the assignment was irrelevant. *Minneapolis-Honeywell Regulator Co. Ltd. v. Empire Brass Mfg. Co. Ltd., supra* distinguished.

Per Martland and Ritchie JJ.: The situation which arose upon the contractor's receipt of the money, paid by the county, was that he became trustee thereof for competing beneficiaries; *i.e.*, the plaintiffs, as sub-contractors pursuant to s. 3 of the Act, and the defendant, by virtue of the clause in its assignment providing that all moneys received by the contractor from the collection of debts under the assignment should be received in trust for the bank. The contractor, who had an overdraft, then paid the money into his bank account. The defendant received the deposit in good faith and gave value for it. The defendant, therefore, which initially had only an equitable right, subordinate to that of the plaintiffs, acquired legal title to the money, *bona fide,* for value, without notice of any breach of trust on the part of the contractor.

So long as the defendant was unaware that, by paying the money to it, the contractor was committing a breach of trust, the fact that the defendant had, itself, previously had an equitable interest in the money could not alter the application of the principle that where a trustee has overdrawn his banking account, his bankers have a first and paramount legal lien on all moneys paid in by him, unless they have notice not only that they are trust moneys, but also that the payment to them constitutes a breach of trust.

Per Locke J., *dissenting*: By virtue of the assignment of book debts from the contractor to the defendant, the moneys owing by the county to the contractor on the completion of the work were, as between the contractor and the bank, the property of the bank. When the cheque was issued payable to the contractor in satisfaction of part of that debt, it was received by it as trustee for the bank, subject to the statutory trust attaching to the moneys under the provisions of s. 3 of *The Mechanics' Lien Act*. The contractor *qua* trustee was obligated to transfer the cheque to the bank, which was done by endorsement and delivery. The right of the defendant to retain the moneys realized from the cheque was not as holder in due course of that instrument, but as owner of the debt by the county to the contractor which had been assigned to it. The fact that no notice of the assignment of book debts had been given to the county was aside from the point. The question was merely one of determining in what manner as between the bank and its customer it became entitled to these moneys.

The defendant's claim to the moneys was *qua* assignee and they were received by it subject to the statutory trust in favour of the plaintiffs by virtue of s. 3 of *The Mechanics' Lien Act*. *Minneapolis-Honeywell Regulator Co. Ltd. v. Empire Brass Mfg. Co. Ltd., supra,* referred to.

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Constitutional law—Constitutionality of s. 3 of The Mechanics' Lien Act, R.S.O. 1950, c. 227, as amended by 1952 (Ont.), c. 54, s. 1.

Per Taschereau, Abbott, Judson and Ritchie JJ.:

While the rights given by s. 3(1) of *The Mechanics' Lien Act* did not depend on the right to a lien, it was competent provincial legislation in relation to the obligations of a building contractor, which was clearly within s. 92 (13) of the *British North America Act*. There was no conflict with federal legislation in either of the fields of banking or bankruptcy.

Per Locke J.: The right of the legislature to enact s. 3 of *The Mechanics' Lien Act* was undoubted under s. 92(13) of the *British North America Act*. The legislative power to impose a lien upon the land by *The Mechanics' Lien Act* extended to declaring that, in addition, there was a charge upon the moneys in the hands of the contractor.

APPEAL from a judgment of the Court of Appeal for Ontario[1], affirming a judgment of Wells J. Appeal dismissed, Locke J. dissenting.

W. J. Smith, Q.C., R. E. Holland, and *P. G. Furlong,* for the plaintiffs, appellants.

P. B. C. Pepper, Q.C., and *Hugh Rowan,* for the defendant, respondent.

E. R. Pepper, Q.C., for the Attorney-General for Ontario.

The judgment of Taschereau, Abbott, Judson and Ritchie JJ. was delivered by

JUDSON J.:—The appellants claim against the respondent bank under s. 3(1) of *The Mechanics' Lien Act*, R.S.O. 1950, c. 227, as amended by 1952, c. 54, s. 1. Their claim was rejected at the trial and on appeal (Morden J.A. dissenting). Section 3 reads:

3. (1) All sums received by a builder or contractor or a subcontractor on account of the contract price shall be and constitute a trust fund in the hands of the builder or contractor, or of the subcontractor, as the case may be, for the benefit of the proprietor, builder or contractor, subcontractors, Workmen's Compensation Board, workmen and persons who have supplied material on account of the contract, and the builder or contractor or the subcontractor, as the case may be, shall be the trustee of all such sums so received by him, and until all workmen and all persons who have supplied material on the contract and all subcontractors are paid for work done or material supplied on the contract and the Workmen's Compensation Board is paid any assessment with respect thereto, may not appropriate or convert any part thereof to his own use or to any use not authorized by the trust, 1942, chap. 34, s. 21.

The appellants were sub-contractors of Town & Country Construction Limited, which company held the main contract from the County of Lambton for the construction of

[1] [1961] O.R. 455, 28 D.L.R. (2d) 257.

a public building. Their accounts remained unpaid but they omitted to file claims for liens against the building. On March 2, 1956, the contractor deposited a cheque for $77,000 in its current account with the respondent bank. This cheque was drawn by the County of Lambton in favour of the contractor and represented the greater part of the holdback on this contract required under *The Mechanics' Lien Act*. The appellants say that they are beneficiaries of the trust created by s. 3(1) of *The Mechanics' Lien Act* and that the bank must pay them because it received their money, appropriated it to its own use and therefore participated in a breach of trust.

The facts are fully stated in the judgments of the learned trial judge and the Court of Appeal. I will summarize them briefly. The contractor's head office was in the Town of Brampton and its account was carried in the branch of the respondent bank in that town. The contractor was engaged on several important contracts at one time in widely separated parts of the province. It did not open a separate account for each contract. All its receipts went into one current account and its disbursements were paid from the same account. As far as I can see from the evidence, all its receipts were from owners for whom it was building and its disbursements were to sub-contractors, material men and wage-earners and for the other ordinary expenses of a firm of contractors. Its volume of business was large and its account was very active as is shown in the statement for the period December 15, 1955, to April 8, 1957, contained in the reasons of Porter C.J.O. On December 15, 1955, the overdraft was approximately $70,000. It reached almost $109,000 immediately before the payment in question in this action. The $77,000 deposit reduced the overdraft to $36,000. There was a credit balance in the account on March 13, 1956, because of the sale on instructions of the customer of $50,000 Dominion of Canada bonds held as security. After this date there was a credit balance in the account except for the period April 12 to April 20, 1956, when the overdraft was approximately $7,000. The account remained active until September 1956.

As security for the overdraft the bank held Government of Canada bonds of the face amount of $95,000, a general assignment of book debts, a guarantee of another company, a personal guarantee from the principal shareholder of the

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customer, and an assignment of a life insurance policy on that shareholder's life. After the sale of the $50,000 Dominion of Canada bonds on the customer's instructions and the establishment of a credit balance in the current account, the customer asked for and received the return of the remaining $45,000 Dominion of Canada bonds held as security. Both the trial judge and the Court of Appeal reviewed in detail the dealings between bank and customer and came to the conclusion that the $77,000 deposit of March 2, 1956, was made and received in the ordinary course of business. These are concurrent findings of fact and should not be disturbed.

What was the extent of the bank's knowledge when the customer made the deposit? It knew that the cheque for $77,000 had been received by the customer as part of the contract price on the construction project in the County of Lambton. It knew that this cheque represented a substantial part of the holdback. Payment by the county was therefore very strong evidence that the officials of the county thought that there were no enforceable mechanics' liens except those that had been provided for in the rest of the holdback. The bank had no knowledge of any unpaid accounts of the plaintiffs or of any other sub-contractors. The bank was in a fully secured position and had no knowledge of any financial difficulties of the customer and had no reason to suspect that the deposit in the current account of the customer was an appropriation or conversion of any part of the contract price to any use not authorized by the trust created by s. 3 of *The Mechanics' Lien Act.*

On these facts, with an amply secured overdraft and no reason to press for payment, a bank does not participate in a breach of trust merely because it receives payment by a cheque drawn by a third party in favour of the customer and deposited in the customer's current account. It seems to me that in the circumstances, the bank cannot be chargeable with notice of breach of trust. The strongest evidence of good faith is that the cheque was taken for value in the ordinary course of business and that as a result of the reduction in the overdraft and the sale of the securities to liquidate the remaining overdraft, the bank surrendered the balance of its security. It did not matter to the bank whether it was paid in the ordinary course or by a realization of

security and the absence of benefit to the bank from the deposit is cogent evidence, on which the trial judge was entitled to act, of non-participation in a breach of trust.

The only knowledge that the bank had of a possibility that the contractor was a trustee was imputed knowledge of the provisions of s. 3(1) of *The Mechanics' Lien Act* and I make the same assumption as the Court of Appeal in this respect and take it that the branch manager knew of this provision of *The Mechanics' Lien Act*. But in the circumstances of this case, he did not know and had no reason to inquire into the possibility of a breach of trust and he is not chargeable with notice of a breach of trust. I agree with the judgment in the Court of Appeal and at trial in distinguishing this case from *Fonthill Lumber Ltd. et al. v. Bank of Montreal*[1], which is based on proof of knowledge of the existence of the trust under s. 3(1) and knowledge of the commission of a breach of trust.

The appellants also argued that they were entitled to succeed on the authority of *Minneapolis-Honeywell Regulator Co. Ltd. v. Empire Brass Mfg. Co. Ltd.*[2] and *Canadian Bank of Commerce v. McAvity*[3]. The basis of this argument is that the bank held an assignment of book debts from the customer and that this document provided that all moneys received by the customer (*i.e.*, the contractor) from the collection of the debts under assignment should be received in trust for the bank, and that if the bank's trustee or agent received these moneys in trust for the bank, they were already subject to the prior statutory trust created by s. 3(1) in favour of the appellants.

The fallacy in this argument is that the contractor did not receive this cheque under the assignment of book debts as trustee for the bank. The bank made no use of this assignment and served no notice on the County of Lambton under it. The assignment of book debts, it is true, was registered but until notice was given, it could have no effect on a payment made in the ordinary course of business by the County of Lambton to the contractor. Both judgments in the courts below properly distinguish a claim by the bank as assignee from the present one. There was no stakeholder against whom competing claims were being made by the

[1] [1959] O.R. 451, 19 D.L.R. (2d) 618.
[2] [1955] S.C.R. 694, 3 D.L.R. 561.
[3] [1959] S.C.R. 478, 17 D.L.R. (2d) 529.

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bank as assignee of book debts and by s. 3(1) claimants as beneficiaries of a trust. The appellants' claims on this ground were properly rejected.

The respondent bank also submitted that this legislation was unconstitutional. While it is true that the rights given by s. 3(1) do not depend on the right to a lien, it is competent provincial legislation in relation to the obligations of a building contractor, which is clearly within s. 92(13) of the *British North America Act*. If there is any force in the submission, it must be because competent provincial legislation comes into conflict with and to that extent is overborne or rendered inapplicable by valid federal legislation. It is suggested that the legislation is in conflict with federal legislation on banking and bankruptcy but in my opinion the conflict does not exist in either field. The bank is in the same position with this trust as with any other trust and the ordinary principles must apply. The fact that it may make it difficult for the bank to deal with one particular class of customer does not raise a question of conflict. Nor does difficulty of dealing bring the legislation within the principles stated in *Reference re Alberta Statutes*[1].

As to bankruptcy, the creation of the trust by s. 3(1) does affect the amount of property divisible among the creditors but so does any other trust validly created.

I would dismiss the appeal with costs.

LOCKE J. (*dissenting*):—The claims of the appellant companies against the respondent bank are for moneys due to them for services rendered under contracts with Town and Country Construction, Ltd. (hereinafter referred to as the contractor) in connection with the building of a home for the aged in Petrolia, Ont. That work was done pursuant to a contract made between the contractor and the Corporation of the County of Lambton.

The contractor had been for several years prior to the performance of the work in question a customer of the branch of the bank at Brampton. By an instrument dated September 9, 1952, executed at Brampton and duly registered in the office of the County Court for Peel County as permitted by *The Assignment of Book Debts Act*, R.S.O. 1950, c. 25, the contractor assigned to the respondent "all book accounts and book debts and generally all accounts,

[1] [1938] S.C.R. 100, [1939] A.C. 117.

debts, dues and demands of every nature and kind howsoever arising or seecured and now due, owing or accruing or growing due, or which may hereafter become due, owing or accruing or growing due,". The assignment declared that the debts should be held by the bank as general and continuing collateral security for the fulfilment of all obligations of the customer to the bank and authorized the bank to collect, sue for and recover such debts and to give valid and binding receipts therefor. Paragraph 5 of the assignment read:

> All moneys received by the undersigned from the collection of the debts or any of them shall be received in trust for the Bank.

In the year 1955 the contractor was engaged in the construction under various contracts of nine buildings, including the one in question.

The contractor was from time to time a borrower from the bank and these borrowings were secured by the general assignment of book debts above referred to, a guarantee by the president of the company, and the deposit of certain securities as to the nature of which we are not concerned.

By reason of the provisions of s. 11 of *The Mechanics' Lien Act*, R.S.O. 1950, c. 227, the County of Lambton was required to retain 15 *per cent* of the value of the work, service and material done, placed or furnished by the contractor, and this was done. The work having been completed, upon the expiry of the time limited by that section the county, at the solicitation of the contractor, delivered to it a cheque payable to the contractor's order for $77,000 which bore on its face the notation "Payment on Contract." That cheque was endorsed in blank by the contractor and deposited on March 1, 1956, in its current account with the respondent, in accordance with its obligations under the assignment. The cheque did not represent the entire amount held back by the county but the evidence is lacking as to the disposition that was made of the balance.

No notice had been given by the respondent to the County of Lambton that the account owing to it by the contractor had been assigned to it, which, no doubt, accounts for the fact that the contractor was named as the payee of the cheque.

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By virtue of the provisions of s. 3 of *The Mechanics' Lien Act* the sum received by the contractor constituted a trust fund in its hands for the benefit, *inter alia,* of the appellants who had performed services or done work upon the premises, that section declaring, *inter alia,* that the contractor shall be:

> the trustee of all such sums so received by him, and until all workmen and all persons who have supplied material on the contract and all subcontractors are paid for work done or material supplied on the contract . . . may not appropriate or convert any part thereof to his own use or to any use not authorized by the trust.

The appellants contended before the learned trial judge that the moneys received by the respondent from the County of Lambton, in payment of the cheque, were so received by it *qua* assignee of the contractor and that, in such capacity, the moneys in its hands were impressed with the same trust as that imposed upon it in the hands of the contractor.

Wells J., who found against the appellants, was of the opinion that, since no notice of the assignment of book accounts had been given by the respondent to the County of Lambton and the cheque had been deposited to the contractor's credit in the ordinary course of business, the moneys were not subject to the trust in the hands of the bank.

In the judgment of the majority of the Court of Appeal[1], delivered by the Chief Justice of Ontario, no mention is made of this assignment and its bearing upon the question of the appellants' rights was, apparently, not considered. In the reasons delivered by the late Mr. Justice Morden the fact of the making of the assignment is mentioned, but the effect of that fact upon the legal rights of the parties is not discussed.

The facts to be considered in disposing of the issue are undisputed. By virtue of the assignment of September 9, 1952, the moneys owing by the County of Lambton to the contractor on the completion of the work were, as between the contractor and the bank, the property of the bank. When the cheque was issued payable to the contractor in satisfaction of part of that debt, it was received by it as trustee for the bank, subject to the statutory trust attaching to the moneys under the provisions of s. 3 of *The Mechanics' Lien*

[1] [1961] O.R. 455, 28 D.L.R. (2d) 257.

Act. The contractor *qua* trustee was obligated to transfer the cheque to the bank, which was done by endorsement and delivery. The right of the respondent to retain the moneys realized from the cheque was not as holder in due course of that instrument, but as owner of the debt due by the county to the contractor which had been assigned to it. The fact that no notice of the assignment of book debts had been given to the county is aside from the point. The question is merely one of determining in what manner as between the bank and its customer it became entitled to these moneys.

As pointed out by Rand J. in delivering the judgment of the majority of this Court in *Minneapolis-Honeywell Regulator Co. Ltd. v. Empire Brass Mfg. Co. Ltd.*[1], sub-contractors and workmen may not be deprived of the charge in their favour upon moneys in the hands of the principal contractor by the simple expedient of assigning those moneys to someone else. The respondent's claim to these moneys is *qua* assignee and they were received by it, in my opinion, subject to the statutory trust in favour of the appellants by virtue of s. 3 of *The Mechanics' Lien Act*.

Much stress has been laid in the argument before us upon the fact that no notice of the assignment of book accounts had been given to the County of Lambton, that the deposit of the cheque was made in the ordinary course of business and that an examination of the contractor's account with the bank discloses this, that the bank manager did not know that the sub-contractors were unpaid, that the bank had no notice that the contractor was in financial difficulties and that the manager did not know that, in failing to pay the claims of the appellants out of the moneys to be realized from the cheque given by the county, the contractor was committing a breach of trust and acting in a manner contrary to the prohibition in s. 3, which is above quoted.

Assuming all these facts to be proven by the evidence, with the greatest respect for the learned judges who have upheld the claim of the respondent and for those in this Court who have contrary views, none of them are relevant or have any bearing on the question to be decided, in my opinion.

[1] [1955] S.C.R. 694 at p. 697.

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Had the County of Lambton paid to the contractor the sum of $77,000 in currency instead of by cheque, the money would have been, in its hands, impressed with a trust in favour of, *inter alia,* the sub-contractors and, until they were paid, the contractor would have been prohibited from converting it to its own use. When the money was so received by the contractor it would have been held by it, by virtue of s. 5 of *The Assignment of Book Debts Act,* in trust for the bank, subject to what is, in effect, a statutory lien. Would any one seriously suggest in these circumstances that, had the currency then been paid over by the contractor to its *cestui que trust,* the bank, as would have been its duty by reason of—and only by reason of—the assignment, it would be freed of this lien or charge? The right of the sub-contractors is not "an equitable right" as has been suggested. It is a statutory right conferred by s. 3.

How then is the situation altered when the county paid the $77,000 by cheque? That cheque and the moneys realized from it were subject to the same charge and, unless the bank should attempt to support its claim on the ground that it became holder in due course of the cheque—and no such insupportable claim has been advanced on its behalf—the situation would, of necessity, be exactly the same as if the amount had been paid in currency. It is perhaps unnecessary to point out that, but for the assignment of book debts, the contractor, after satisfying the claims of the sub-contractors, could have used the moneys for its own purposes and deposited it elsewhere. But as between the contractor and the bank the latter was the *cestui que trust,* the former merely holding the cheque on its behalf. Since as between the contractor and the bank the cause of action in respect of which the cheque was given was the property of the bank, the latter could not attain the position of the holder in due course of the cheque as defined by s. 56 of the *Bills of Exchange Act,* R.S.C. 1952, c. 15, for obvious reasons.

While the facts in the *Minneapolis-Honeywell* case differed from those in the present matter, the statement of Rand J. to which I have above referred is, in my opinion, directly applicable.

The decisive point in the case is that as between the contractor and the bank the cheque and the moneys realized from it, subject to the statutory trust created by s. 3 of *The*

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Mechanics' Lien Act for the benefit of workmen, supply men and sub-contractors, were the property of the bank, and the endorsement and delivery of the cheque merely passed the legal title to it.

The fallacy of the proposition that by failing to notify the County of Lambton of the assignment and requiring it to pay the moneys directly to the bank, or by failing to expressly require the contractor to endorse the cheque to it under the assignment, the sub-contractors may be deprived of their statutory rights appears to me to be demonstrated by stating it.

It was contended before us that s. 3 of *The Mechanics' Lien Act* was *ultra vires* the Legislature of Ontario. As to this, it is sufficient to say that, in my view, the right to so legislate is undoubted under head 13 of s. 92 of the *British North America Act*. The legislative power to impose a lien upon the land by *The Mechanics' Lien Act* extends, in my judgment, to declaring that, in addition, there is a charge upon the moneys in the hands of the contractor.

I would allow this appeal and direct that the respondent account to the appellants for the amounts of their respective claims, together with interest at the legal rate in the case of the appellant John M. M. Troup Ltd. from the date upon which the demand for payment was made by its solicitors on its behalf, and in the case of the appellant National Painting and Decorating Ltd. from the date of the issue of the writ. I would allow the appellants their costs throughout.

The judgment of Cartwright and Ritchie JJ. was delivered by

CARTWRIGHT J.:—The relevant facts are set out in the reasons of other members of the Court. While endeavouring to avoid repetition I wish to refer shortly to some of the findings made in the courts below.

The manager of the respondent's branch at Brampton stated that he was familiar with the terms of s. 11 of *The Mechanics' Lien Act* requiring the owner to retain 15 per cent of the value of the work done for a period of 37 days after the completion of the work but that he was not aware of the provisions of s. 3 of the Act constituting sums paid to a contractor a trust fund for the benefit of sub-contractors

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and others. However, the case was dealt with in the courts below and argued before us on the assumption that knowledge of the terms of s. 3 should be imputed to the manager, and it is unnecessary to consider whether his ignorance in fact of the terms of that section might otherwise have been relevant.

The following findings of fact made by the learned trial judge appear to me to be fundamental:

> In my opinion, on a fair valuation of the evidence there is no evidence to show that any of these moneys were ever paid in to the defendant bank by virtue of the general assignment of book debts which the bank took from the Construction Company. It is quite clear I think, that no notice was ever given of the assignment by the bank to anyone or that it ever relied on the general assignment or acted on it. While it was taken at an early stage, it was never used or acted upon.
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> * * *
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> It is also argued on behalf of the plaintiffs that there is here a trust which the bank manager at Brampton had knowledge of and that his knowledge was the knowledge of the bank. In my view, the evidence falls very far short of establishing anything of the sort.
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> * * *
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> The moneys (scil. the cheque for $77,000) were unquestionably deposited by the Construction Company in the ordinary course of business in their account and the bank, which at that time had no question in its mind as to the solvency of that Company, went on paying the cheques of the Construction Company and in fact, raised the overdraft. As I have already indicated, there was no suggestion at this time that the bank had any knowledge of the accounts of the plaintiff which are the subject of this action.

In the reasons of the majority in the Court of Appeal delivered by the learned Chief Justice of Ontario the first of the three findings of the learned trial judge set out above is not dealt with but, in my view, that finding is supported by the evidence and is clearly right. The second and third findings are concurred in by Porter C.J.O.

The late Mr. Justice Morden, in his dissenting judgment, quoted at length from the evidence of the manager and reached the conclusion which he expressed as follows:

> This evidence makes it abundantly clear that the bank knew that the $77,051.84 was part of the hold-back and that at the time it was deposited and set-off by it against the contractor's indebtedness to it, subcontractors were unpaid.

There is no doubt that the manager knew that the cheque for $77,000 was part of the hold-back but, with the greatest respect, after reading all the evidence, I am unable to agree with the finding that at the time the cheque was deposited the manager knew that sub-contractors were unpaid.

I agree with the view which Porter C.J.O. summarized in the following passage:

> The test to be applied is whether the Bank manager knew that the customer was committing a breach of trust and he knowingly participated therein. In my view it has not been clearly demonstrated on the evidence that to the knowledge of the Bank manager there were unpaid accounts of workmen and for supplies or that they would not be paid. The evidence in this case is clear that at all material times he did not know and therefore could not have participated in any breach of trust.

The law applicable to this branch of the matter is, in my opinion, accurately stated in the following passages in Underhill on Trusts, 11th ed., 1959, at pp. 565 and 566:

> Where, however, a trustee has overdrawn his banking account, his bankers have a first and paramount lien on all moneys paid in if they have no notice that they are trust moneys; for where the equities are equal the law prevails, and, in the case supposed, the bankers have in point of law received the money in payment of their debt.

and at p. 606:

> So, as has been already stated, where a trustee has overdrawn his banking account, his bankers have a first and paramount legal lien on all moneys paid in by him, unless they have notice, not only that they are trust moneys, but also that the payment to them constitutes a breach of trust.

For the reasons given by my brother Judson I agree with his conclusion that the bank had no notice, actual or constructive, of any breach of trust committed by the construction company, subject only to one argument put forward on behalf of the appellants which remains to be considered.

This argument is based on the existence of the assignment of book debts. Reliance is placed particularly on para. 5 of the assignment which reads:

> All moneys received by the undersigned from the collection of the debts or any of them shall be received in trust for the Bank.

There is no doubt that the debt owing by the County of Lambton to the construction company, in part payment of which the cheque for $77,000 was delivered, was covered by the assignment in the sense that the bank, had it seen fit to do so, could have given notice to the county to make payment to it instead of to the construction company, or could have called upon the construction company (if that company had retained the proceeds of the cheque instead of endorsing and delivering it to the bank) to account to it for the proceeds of the cheque as being trust moneys in

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its hands to which the bank was beneficially entitled. It is equally clear that the bank did not follow either of these courses and that the county, the construction company and the bank all acted in the transaction without reference to, and probably without any thought of, the existence of the assignment.

It is argued that, (i) although the bank gave no notice of the assignment to anyone and did not at any time seek to enforce or make use of it, the assignment was none the less an existing and valid instrument which by its express terms created the relationship of trustee and *cestui que* trust between the construction company and the bank, (ii) that the construction company received the $77,000 from the county as trustee for the bank, (iii) that as trustee for the bank it was also agent for the bank, (iv) that the construction company knew that the accounts of the two plaintiffs were unpaid and that consequently the $77,000 was, by virtue of s. 3 of *The Mechanics' Lien Act,* impressed with a trust in their favour, (v) that notice to its agent or trustee was in law notice to the bank and (vi) that, therefore, when the bank acquired the legal title to the $77,000 it did so with notice of the trust in favour of the plaintiffs and must account to them for the amount of the debts due to them.

This argument, if valid, would destroy the bank's defence that when it obtained the legal title to the $77,000 it did so without notice of the beneficial interests of the plaintiffs therein. Among the authorities on which the appellants rely in support of this argument are the case of *Minneapolis-Honeywell Regulator Co. Ltd. v. Empire Brass Mfg. Co. Ltd.*[1], and the following passage in Scott on Trusts, 2nd ed., vol. 3, pp. 2231 and 2232:

> In considering whether a transferee of trust property has notice that the transfer is in breach of trust, the general principles of agency are applicable. Thus if a third person purchases trust property through an agent, the purchaser is chargeable with notice that the trustee is committing a breach of trust in making the sale if the agent has such notice.

The *Minneapolis-Honeywell* case is distinguishable on the facts. The judgment proceeds on the view that the

[1] [1955] S.C.R. 694, 3 D.L.R. 561.

respondent had notice of the appellant's claim. Rand J. with whom Kellock, Estey and Fauteux JJ. agreed said in part at p. 698:

> The respondent, knowing all the facts, was therefore properly found liable as for a breach of trust.

Rand J. adopted the statement of the facts contained in the reasons of Locke J. who reached the same result. Locke J. said, at pp. 700 and 701:

> Upon obtaining this assignment the respondent gave notice of it to the general contractors and thereafter payments by the general contractors, other than those for small amounts, were made by cheques made payable jointly to the respondent and the sub-contractor. These payments included the entire amounts payable to the sub-contractor on its contracts for the four schools mentioned, which included the automatic heat control system supplied and installed by the appellant at the request of the sub-contractor. By virtue of the manner in which these payments were made, the respondent obtained what amounted to complete control over the financial operations of the sub-contractor. When cheques payable to their joint order were received, it was necessary for the sub-contractor to obtain the consent of the respondent to the payment of any sums, other than the small amounts referred to which do not enter into the matter, to its other creditors.

and at p. 705:

> The claim of the respondent to moneys payable by the contractor to the sub-contractor depended entirely on the terms of the written assignment of February 4, 1950.

This case does not appear to me to be of assistance in the case at bar in which I have already expressed my agreement with the concurrent findings of fact in the Courts below that the bank obtained legal title to the $77,000 without notice of the equitable rights of the plaintiffs, unless it can be said, as is argued by the appellants, that because of the terms of para. 5 of the assignment the notice of the plaintiffs' claims which the construction company undoubtedly had must be imputed to the bank.

The answer to this argument of imputed notice appears to me to be that made by the learned trial judge in the passage from his reasons firstly quoted above. When the $77,000 was deposited in the overdrawn account neither the bank nor the construction company was acting in pursuance of the assignment, they were acting not as assignee and assignor or as *cestui que* trust and trustee but as banker and customer in the ordinary course of business. It appears that the cheque was endorsed by the construction company

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and handed to the bank with a deposit slip directing the bank to credit it to the construction company's account, and this was done. At the moment of deposit in point of law the money was received by the bank in part payment of its customer's debt. The argument that the bank received it *qua* assignee or *qua cestui que* trust appears to me to fail on the facts. Neither the county nor the plaintiffs were aware of or parties to the assignment; the only parties to it were the bank and the construction company and so long as the former saw fit to refrain from acting upon it I am unable to see how the mere fact of its existence could improve the position of the plaintiffs. In view of the manner in which the dealings between the bank and the construction company were carried on the existence of the assignment appears to me to be irrelevant.

If, contrary to the view I have just expressed, it should be held that the $77,000 was paid by the construction company in the capacity of agent or trustee and was received by the bank in the capacity of principal or *cestui que* trust it would be necessary to consider whether on the facts the case falls not within the general rule that notice to an agent is notice to his principal but within the exception illustrated by the decision in *Cave v. Cave*[1], in which it was held that knowledge of an agent will not be imputed to his principal where the agent is party to a fraud of which the principal is ignorant and innocent and which would be exposed if the agent communicated the notice to his principal. However, as, in my view, on the facts of the case at bar this question does not arise I do not pursue it.

I do not find it necessary to express an opinion on the constitutional points which were so fully and ably argued before us.

For the reasons given by my brother Judson and those stated above I would dismiss the appeal with costs.

Since writing these reasons I have had the opportunity of reading those of my brother Martland; I agree with them and wish to found my judgment upon them as well as on what I have said above.

[1] (1880), 15 Ch. D. 639.

The judgment of Martland and Ritchie JJ. was delivered by

MARTLAND J.:—I agree with the reasons given by my brothers Cartwright and Judson, and wish only to make some comment regarding the effect of the general assignment of debts.

The evidence makes it clear that the money which came into the respondent's hands was not received by it by the operation of that assignment. Although registered, no notice of the assignment was given to anyone. The County of Lambton was unaware of it, and did not pay the money owing to Town and Country Construction Ltd. (hereinafter referred to as "the contractor") to the respondent, but directly to the contractor. The debt had been paid before the money came into the respondent's hands from the contractor.

The assignment contained in clause (5) a covenant by the contractor that: "All moneys received by the undersigned (the contractor) from the collection of the debts or any of them shall be received in trust for the Bank." The application of that covenant in the present case would mean that, upon receipt of the money paid to it by the County of Lambton, the contractor would become trustee of the money for the benefit of the respondent.

At the same time, by virtue of the operation of s. 3 of *The Mechanics' Lien Act*, R.S.O. 1950, c. 227, the contractor became a trustee of the same money for the benefit of unpaid sub-contractors, etc. This section does not purport to do more than to create a trust for the benefit of the class named in it. It does not create a statutory lien upon the sums received by a contractor. It makes him a trustee of that fund. Although the trust is created by statute, it thereupon becomes subject to the application of the rules of equity applicable to trusts.

The situation which arose upon the contractor's receipt of the money, paid by the County of Lambton, was that he had become trustee thereof for competing beneficiaries; i.e., the appellants, as sub-contractors, pursuant to s. 3 of the Act, and the respondent, by virtue of clause (5) of its assignment. At that stage there were two competing equities and, while the money remained in the contractor's hands, I have no doubt that the appellants had the superior claim.

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However, the matter did not end there. The contractor, who had an overdraft with the respondent, paid the money into his bank account. The respondent received the deposit in good faith and gave value for it. A study of the evidence satisfies me that the finding of Porter C.J.O. is correct when he said that the evidence did not demonstrate that the bank manager knew there were unpaid accounts of workmen and for supplies when the money was received by the respondent and that he did not know of any breach of trust by the contractor.

What has occurred, therefore, is that the respondent, which initially had only an equitable right, subordinate to that of the appellants, has acquired legal title to the money, *bona fide,* for value, without notice of any breach of trust on the part of the contractor. The proposition stated in Underhill on Trusts, 11th ed., 1959, at p. 606, cited by my brother Cartwright, is applicable; *i.e.,*

> So, as has been already stated, where a trustee has overdrawn his banking account, his bankers have a first and paramount legal lien on all moneys paid in by him, unless they have notice, not only that they are trust moneys, but also that the payment to them constitutes a breach of trust.

The fact that the respondent had, itself, previously had an equitable interest in the money cannot, in my view, alter the application of this principle, so long as it was unaware that, by paying the money to it, the contractor was committing a breach of trust.

I would dismiss the appeal with costs.

Appeal dismissed with costs, LOCKE J. *dissenting.*

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