CHRISTOPHER HENRY FLINTOFT, as Trustee in Bankruptcy of CANADIAN WESTERN MILLWORK LTD. } APPELLANT;

1964 *May 22 Oct. 6

AND

THE ROYAL BANK OF CANADA .....RESPONDENT.

ON APPEAL FROM THE COURT OF APPEAL FOR MANITOBA

Banks and banking—Debts arising from sale by bank's customer of goods covered by security under s. 88 of Bank Act—Claim by customer's trustee in bankruptcy—Whether bank entitled to debts notwithstanding failure of assignment of books debts due to lack of timely registration—Bank Act, R.S.C. 1952, c. 12, substituted 1953-54, c. 48—Bankruptcy Act, R.S.C. 1952, c. 14.

A dispute occurred between the respondent bank holding security under s. 88(1)(*b*) of the *Bank Act* and the appellant, the trustee in bankruptcy of the bank's customer, concerning the ownership of certain uncollected debts owing to the customer at the date of bankruptcy. These debts arose from the sale by the customer of goods covered by the bank's security. The trustee claimed that he was entitled to collect these debts for administration under the *Bankruptcy Act* because an assignment of book debts held by the bank was void for lack of timely registration. The bank claimed that the fact that these debts arose from the sale of the goods covered by the bank's security gave them to the bank notwithstanding the failure of the assignment of book debts. The judge of first instance declared that the trustee in bankruptcy was entitled to all book debts of the bankrupt unpaid at the date of bankruptcy. The Court of Appeal, in a majority judgment, held that to the extent that the book debts of the customer outstanding at the time of the bankruptcy represented debts owing to the customer for goods sold and covered by the bank's s. 88 security, these accounts went to the bank.

Held: The appeal should be dismissed.

By agreement in writing between bank and customer an express trust of the accounts in question was created in favour of the bank. In addition, the agreement rejected in advance any suggestion that the bank's right to these accounts would depend upon a valid assignment of book debts. The agreement did no more than set out the terms upon which a bank as holder of s. 88 security permits a customer to sell the property of the bank in the ordinary course of business.

The property rights of the bank are defined by ss. 88(2) and 86(2) of the *Bank Act*. Under s. 88(2) the bank gets the same rights and powers as if it had acquired a warehouse receipt or bill of lading in which the property was described. Under s. 86(2) it acquires all the right and title of the customer.

Section 88 permits certain classes of persons not of a custodier character, in this case a manufacturer, to give security on their own goods with the consequences as defined. Notwithstanding this, with the consent of

*PRESENT: Taschereau C.J. and Fauteux, Abbott, Martland, Judson, Ritchie and Hall JJ.

1964

FLINTOFT v. ROYAL BANK OF CANADA

the bank, the one who gives the security sells in the ordinary course of business and gives a good title to purchasers from him. But this did not mean that he owns the book debts when he has sold the goods. Here, the Court was not concerned with the rights of a purchaser for value without notice of the proceeds of the sale of the bank's security. It was true that s. 63 of the *Bankruptcy Act* avoided in favour of the trustee the assignment of book debts held by the bank because of defective registration. Subject to this, the trustee had no higher rights than the bankrupt and he took the property of the bankrupt merely as a successor in interest and not as an innocent purchaser for value without notice. He took the property of the bankrupt subject to the express trust created by the written agreement, which could not be characterized as an assignment of book debts in another form. When these debts, the proceeds of the sale of s. 88 security, came into existence they were subject to the agreement between bank and customer. As between these two the customer had nothing to assign to the bank. The actual assignment of book debts which was signed did no more than facilitate collection. Any other assignment, whether general or specific, of these debts by the customer to a third party would fail unless the third party was an innocent purchaser for value without notice.

Union Bank of Halifax v. Spinney and Churchill (1907), 38 S.C.R. 187; *Re Goodfallow, Trader's Bank v. Goodfallow* (1890), 19 O.R. 299; *Banque Canadienne Nationale v. Lefaivre et al.*, [1951] B.R. 83, referred to.

APPEAL from a judgment of the Court of Appeal for Manitoba[1], allowing an appeal from an order of Bastin J. Appeal dismissed.

V. Simonsen, for the appellant.

W. P. Fillmore, Q.C., and *A. R. Philp,* for the respondent.

The judgment of the Court was delivered by

JUDSON J.:—The contest in this litigation is between a bank holding security under s. 88(1)(*b*) of the *Bank Act,* R.S.C. 1952, c. 12, substituted 1953-54, c. 48, and a trustee in bankruptcy of the bank's customer concerning the ownership of certain uncollected debts owing to the customer at the date of bankruptcy. These debts arose from the sale by the customer of goods covered by the bank's security. The trustee says that he is entitled to collect these debts for administration under the *Bankruptcy Act,* R.S.C. 1952, c. 14, because an assignment of book debts held by the bank was void for lack of timely registration. The bank says that the fact that these debts arose from the sale of the goods covered by the bank's security

[1] (1963), 47 W.W.R. 65, 44 D.L.R. (2d) 47.

gives them to the bank notwithstanding the failure of the assignment of book debts. There is no dispute about the facts. It is admitted that the bank's security under s. 88 (1)(*b*) was a valid security and that the assignment of book debts held by the bank is void for want of timely registration.

The judge of first instance declared that the trustee in bankruptcy was entitled to all book debts of the bankrupt unpaid at the date of bankruptcy. The Manitoba Court of Appeal[1] held that to the extent that the book debts of the customer outstanding at the time of the bankruptcy represented debts owing to the customer for goods sold and covered by the bank's s. 88 security, these accounts went to the bank. Freedman J. A. dissented and would have held that the proceeds of these sales must come under the assignment of book debts, that the bank could only claim in its capacity as holder of this assignment and that, therefore, its claim failed.

My opinion is that the majority judgment is correct. By agreement in writing between bank and customer an express trust of these accounts was created in favour of the bank in the following terms:

> The proceeds of all sales by the Customer of the property or any part thereof, including, without limiting the generality of the foregoing, cash debts arising from such sales or otherwise, evidences of title, instruments, documents and securities, which the Customer may receive or be entitled to receive in respect thereof, are hereby assigned to the Bank and shall be paid or transferred to the Bank forthwith, and until so paid or transferred shall be held by the Customer in trust for the Bank. Execution by the Customer and acceptance by the Bank of an assignment of book debts or any additional assignment of any of such proceeds shall be deemed to be in furtherance hereof and not an acknowledgment by the Bank of any right or title on the part of the Customer to such book debts or proceeds.

In addition to the creation of the trust, the agreement rejects in advance any suggestion that the bank's right to these accounts will depend upon a valid assignment of book debts. This agreement does no more than set out the terms upon which a bank as holder of s. 88 security permits a customer to sell the property of the bank in the ordinary course of business.

The property rights of the bank are defined by ss. 88(2) and 86(2) of the *Bank Act*. Under s. 88(2) the bank gets

[1] (1963), 47 W.W.R. 65, 44 D.L.R. (2d) 47.

1964

FLINTOFT v. ROYAL BANK OF CANADA

Judson J.

the same rights and powers as if it had acquired a warehouse receipt or bill of lading in which the property was described. Under s. 86(2) it acquires all the right and title of the customer.

86. (2) Any warehouse receipt or bill of lading so acquired shall vest in the bank, from the date of the acquisition thereof,

(*a*) all the right and title to such warehouse receipt or bill of lading and to the goods, wares and merchandise covered thereby of the previous holder or owner thereof, or

(*b*) all the right and title to the goods, wares and merchandise mentioned therein of the person from whom such goods, wares and merchandise were received or acquired by the bank, if the warehouse receipt or bill of lading is made directly in favour of the bank, instead of to the previous holder or owner of such goods, wares and merchandise.

Section 88 is a unique form of security. I know of no other jurisdiction where it exists. It permits certain classes of persons not of a custodier character, in this case a manufacturer, to give security on their own goods with the consequences above defined. Notwithstanding this, with the consent of the bank, the one who gives the security sells in the ordinary course of business and gives a good title to purchasers from him. But this does not mean that he owns the book debts when he has sold the goods. To me the fallacy in the dissenting reasons is the assumption that there is ownership of the book debts in the bank's customer once the goods have been sold and that the bank can only recover these book debts if it is the assignee of them.

We are not concerned here with the rights of a purchaser for value without notice of the proceeds of the sale of the bank's security. It is true that s. 63 of the *Bankruptcy Act* avoids in favour of the trustee the assignment of book debts held by the bank because of defective registration. Subject to this, the trustee has no higher rights than the bankrupt and he takes the property of the bankrupt merely as a successor in interest and not as an innocent purchaser for value without notice. He takes the property of the bankrupt subject to the express trust created by the agreement noted above, which, in my opinion, cannot be characterized as an assignment of book debts in another form. When these debts, the proceeds of the sale of the s. 88 security, come into existence they are subject to the

agreement between bank and customer. As between these two the customer has nothing to assign to the bank. The actual assignment of book debts which was signed does no more than facilitate collection. Any other assignment, whether general or specific, of these debts by the customer to a third party would fail unless the third party was an innocent purchaser for value without notice.

In *Union Bank of Halifax v. Spinney and Churchill*[1], the proceeds of the sale of the bank's security came into the hands of Spinney, a third party, who was a guarantor of the customer's account with the bank. The proceeds were in the form of drafts drawn in favour of the guarantor instead of the bank, as they should have been. Spinney took with knowledge that the drafts were in payment for meal, ground from corn, on which the bank held security and he was held liable to account. I can find in the report no mention of any written agreement similar to the one in existence in the present case but it is clear that the oral understanding between bank and customer was to the same effect. Any other understanding would be inconceivable in commercial dealings. Why would any lender who lends for the purpose of enabling another to acquire and manufacture goods, permit the sale of goods on which he holds security except on terms that the borrower must bring in the proceeds of the sale of those goods?

Re Goodfallow, Traders' Bank v. Goodfallow[2] is a similar case. The contest there was between the bank and the administrator of the deceased customer. The customer was a miller who had given a warehouse receipt to the bank. At the date of his death there was found to be a shortage of wheat which had commenced shortly after the warehouse receipt had been given. During the period of shortage some of the wheat had been converted into flour and sold. The proceeds were paid to the administrator, who was compelled to pay the money to the bank. The ratio of the judgment of Boyd C. is contained in the following short extract from his reasons: "As long as the 'product' of this wheat can be traced, whether it be in flour or in money, it is recoverable by the bank as against the deceased and his administrator."

[1] (1907), 38 S.C.R. 187.

[2] (1890), 19 O.R. 299.

1964

FLINTOFT v. ROYAL BANK OF CANADA

Judson J.

Again, I can find in the report no mention of any agreement in writing, but even in its absence the principle is plainly to be spelled out that if you sell my goods with my consent, it is on terms that you bring me the money in place of the goods. Although the bank's customer does not sell as agent for the bank, he does not sell free of the bank's claim to the proceeds. There is an analogy with the case where goods are consigned to a factor to be sold by him and reduced to money. There has never been any doubt of the right of the owner to trace the money or any other form of property into which the money has been converted. (Underhill's Law of Trusts and Trustees, 11th ed., p. 561.)

The only other case to which I wish to refer is *Banque Canadienne Nationale v. Lefaivre et al.*[1], where the Quebec Court of Appeal, on facts which cannot be distinguished from those of the present case, anticipated the judgment of the Manitoba Court of Appeal. In the Quebec case the bank and customer had executed an agreement in the following terms:

> Art. 5: dans le cas de vente par le client des effets, en tout ou en partie, le produit de cette vente y compris les espèces, les effets de commerce, les billets à ordre, titres et valeurs qui en seront la considération de même que les créances contre les acheteurs, appartiendront à la banque à qui ils devront être immédiatement versés ou remis, et jusqu'à ce versement ou cette remise le client ne les détiendra qu'en fidéicommis pour la banque. L'exécution par le client et l'acceptation par la banque des transports de dettes de livres seront censés résulter de la présente convention et ne constitueront pas une reconnaissance de la part de la banque que le client a des droits ou un titre quelconque à ces dettes de livres.

The contest was between the bank and the trustee in bankruptcy of the customer. The trustee contended that the accounts of the customer representing the proceeds of the sale of the s. 88 security were part of the assets of the bankrupt estate because they had not been validly transferred to the bank in acordance with Art. 1571 of the *Civil Code*. It was held that the use of the words "en fidéicommis" was merely an attempt to translate the English expression "in trust". The majority judgment is founded squarely on the ground that the claims against the buyers of the goods became the property of the bank by virtue of its s. 88

[1] [1951] Que. K.B. 83, 32 C.B.R. 1.

security and never were the property of the customer so as to be affected by the assignment in bankruptcy.

I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Scarth, Honeyman, Scarth & Simonsen, Winnipeg.

Solicitors for the respondent: Fillmore, Riley & Company, Winnipeg.