THE UNION BANK OF HALIFAX (PLAINTIFFS) ... APPELLANTS;

AND

EDGAR K. SPINNEY AND GEORGE B. CHURCHILL (DEFENDANTS) .. RESPONDENTS.

1906
*Dec. 10, 11.
*Dec. 26.

ON APPEAL FROM THE SUPREME COURT OF NOVA SCOTIA.

Banks and banking—Security for advance—Assignment of goods—Claim on proceeds of sale—53 V. c. 31, s. 74 (D.).

A bank to which goods have been transferred as security for advances under sec. 74 of the Bank Act, 1890, can follow the proceeds of sale of said goods in the hands of a creditor of the assignor to whom the latter has paid them when the purchaser knew, or must be presumed to have known, that the same belonged to the bank.

APPEAL from a decision of the Supreme Court of Nova Scotia reversing the judgment at the trial in favour of the plaintiffs against the defendant Spinney.

The defendant Churchill carried on business at Yarmouth, N.S., as a wholesale purchaser of corn, manufacturing the same into cornmeal and other products and selling the same. He formerly did his banking business with the Bank of Nova Scotia and the Bank of Yarmouth, and raised money there by the indorsements of three persons of whom the defendant, Spinney, was one.

On the death of one of the three of these endorsers, he applied in June, 1902, to the manager of the plain-

*PRESENT:—Fitzpatrick C.J. and Davies, Idington, Maclennan, and Duff JJ.

1906
UNION BANK OF HALIFAX
v.
SPINNEY.

tiff bank for accommodation, and it was agreed that the plaintiff bank should advance money to Churchill on the security of the corn purchased by him, the bank taking security under section 74 of the "Bank Act," on the corn and on the indorsements of the defendant, Spinney, and two others, Wyman and Stoneman.

Advances were made by the bank to Churchill from time to time on the security of corn under section 74 of the Bank Act. The bank allowed Churchill to grind the corn into cornmeal and sell the meal for the bank, and take drafts, which were deposited with the plaintiff bank by Churchill and collected by the bank.

About the 26th September, 1903, Churchill was told by Allen, the agent of the plaintiff bank, that he would have to reduce his account, and the last of September or first of October he applied to Allen for a further advance on corn and was informed by Allen that he was instructed not to advance him any more money. At this time a cargo of corn had just arrived and there was a draft for $5,487.47 for this cargo in the Bank of Nova Scotia. Churchill urged Allen to pay this draft and said that he would pay in some securities and that he had accounts on his customers, which he would hand into the bank to cover the advance. Allen, relying on this promise paid the draft. At this time Churchill owed the bank a large sum and there was a large shortage in the corn which, however, was not known to the bank. Churchill had ground up the corn, sold the meal and applied the proceeds for other purposes, and he was then and for a long time had been insolvent.

On the same day that he induced Allen to pay the draft for $5,487.47, Churchill immediately went to Stoneman, one of his indorsers and told him how he

was situated and sold Stoneman a large quantity of meal, the product of corn pledged to the bank, a much larger quantity than Stoneman had been in the habit of buying—for the sole purpose of protecting Stoneman against his liability as indorser of a note then held by the plaintiff bank, and also, either on the same day or the next day he went to the defendant, Spinney, and says he reported to Spinney the position of affairs, and arranged to give Spinney drafts on the people to whom the corn meal of the bank had been sold for the amount due for such meal. Spinney knew that he had pledged all his corn to the bank—that he was short in his account and had not the corn—that Churchill was insolvent and that Churchill had induced Allen to pay the $5,487.47 draft by promising to hand in drafts for the corn meal that had previously been sold.

Churchill and Spinney thereupon arranged that Churchill should, instead of drawing the drafts payable to the bank on the form supplied by the bank, draw drafts to the order of Spinney, and instead of handing them to the bank hand them over to Spinney to secure him against his liability as indorser of a note then held by the plaintiff bank. There was no other consideration. Accordingly a number of drafts were drawn by Churchill on the persons who had purchased the bank's meal and these drafts were turned over and collected by Spinney to the amount of $2,011.77. This action is brought by the bank to recover these moneys so collected.

The action was tried at Yarmouth by Mr. Justice Graham without a jury, and he gave judgment for the plaintiff bank for the amount of the drafts, $2,011.77 with interest and costs. From this judgment an

1906

UNION BANK OF HALIFAX v. SPINNEY.

appeal was taken to the Supreme Court of Nova Scotia *en banc* and the appeal was allowed and the judgment of Mr. Justice Graham set aside.

The plaintiff bank appealed to the Supreme Court of Canada.

Harris K.C. for the appellant.

J. J. Ritchie K.C. for the respondents.

The judgment of the court was delivered by

DAVIES J.—This was an action brought by the bank against Spinney to recover from him the proceeds of certain drafts or bills of exchange drawn by one Churchill on certain of his customers for the price of meal sold to them and which drafts or bills had been handed by Churchill to Spinney, under the following circumstances and by him had been collected.

Churchill was a dealer in corn, in Yarmouth, N.S., which he placed, as purchased in his warehouse or small elevator and ground into meal, which meal he, afterwards, sold in lots to suit purchasers.

To enable him to make the necessary purchases of corn he obtained advances from the plaintiff bank from time to time, which advances he secured by signing to the bank, at the time they were made, the security provided for under section 74 of the "Bank Act" and by depositing his own notes for the amount of each advance and also notes indorsed by third parties, of whom Spinney was one, as collateral security.

The course of business followed for some year and a half between the bank and Churchill was for the latter to grind the corn into meal, sell the meal on

time to his customers and make drafts on them for the amount of their purchases in forms supplied him by the bank, and which drafts were made payable to the order of the bank. As between the bank and its customer it was well understood that the bank was entitled to these drafts, they representing the proceeds of the sale of the corn and meal which they held as security for their advances.

These drafts were accordingly, from time to time, deposited by Churchill with the bank and collected by it and the proceeds placed to Churchill's credit. As between the bank and Churchill it was the right of the bank to receive these drafts and, as between it and Spinney and the other indorsers of Churchill's notes held as collateral security it was the duty of the bank to place the proceeds of these drafts to the credit of the advances on the corn made by it.

About the beginning of October, 1903, Churchill was notified by the bank that the state of his account was unsatisfactory and that further advances would not be made to him. A cargo of corn had about that time arrived and a draft dated 2nd October, for $5,487 for its price was lying in another bank and, after some negotiations and relying upon certain promises made by Churchill, the plaintiff bank advanced the money to pay this draft. At this time Churchill was hopelessly insolvent and there was a large shortage in the corn and meal which should have been in the warehouse, but although these facts were known to himself the bank was in ignorance of both of them.

About a fortnight previously to this advance being made, namely, on the 26th September, 1903, Spinney had renewed in the bank, for three months, his indorsement of a note of Churchill's for 2,800, he had and which was then lying in the bank, overdue.

1906

UNION BANK OF HALIFAX v. SPINNEY.

Davies J.

He alleges that he was only induced by Churchill to indorse this renewal note by the latter's promise "to give him security of drafts for the payment of it." Churchill, on the contrary, says that his only promise was in general terms to "protect him (Spinney) in case I got into difficulties."

Immediately, however, Churchill obtained the advance of $5,487 from the bank, or within a few days afterwards, he went directly to Spinney and, after talking his financial condition over with him, and especially those with the bank, returned to his mill, made drafts upon his customers for meal sold by him to them sufficient to cover the amount of Spinney's liability and handed these drafts to Spinney which the latter, subsequently, collected and with the proceeds paid off the note for $2,990 which he had indorsed to the bank about a fortnight previously.

Churchill also took care, after getting the latter advance of $5,487, by similar and analogous practices to protect his other indorsers and creditors, thus leaving the bank with only a fraction of the grain and meal they should have had as security and a similar fraction of the proceeds of the sales of the meal.

The learned trial judge found, on evidence which to my mind fully justified his finding, that Spinney knew from the first that the bank held security upon Churchill's corn and meal and that

> he was being paid out of corn the price of every particle of which should have been applied to the reduction of Churchill's indebtedness to the bank. He knew it was the bank's corn, that money had been obtained from the bank's agent to pay for the cargo of the "Josie" on a special promise to repay the advance by collections, and he diverted those collections to his own pocket at the expense of the bank. He knew that Churchill was insolvent and could not pay off the bank in any other way; that he had been making losses.

The question is whether these findings are sustainable by the evidence. It seems quite clear and to be the only fair and reasonable inference to be drawn from the evidence of both Spinney and Churchill, or at any rate from their evidence if read both together, that almost immediately after the large advance of $5,487.47 was made to Churchill he, knowing the desperate condition of his affairs, went to Spinney and discussed his whole financial situation with him. Spinney had been intimately connected with Churchill in business and had been indorsing Churchill's notes to the bank for advances made to buy this corn for over a year. Spinney then knew of the bank's security on the corn and meal, knew Churchill was then hopelessly insolvent and it was, then and there, arranged between them that Churchill should make drafts on his customers for meal sold them and hand them to Spinney to secure him as Churchill's indorser.

Churchill expressly states that after his conversation with Spinney he returned to the mill, made the drafts, of course payable to Spinney's order and not to the bank's, and handed the drafts over to Spinney by whom they were collected and who, with their proceeds, paid off the collateral note he had indorsed to the bank.

The only conclusion I have been able to draw is that a gross and manifest fraud was carried out by Churchill upon the bank and that the proceeds of the meal which Churchill was bound to pay over to the bank were fraudulently diverted from the bank to Spinney and Churchill's other indorsers and creditors, and that, so far as Spinney is concerned, with whom alone we have to deal, he had either full knowledge of all the essential facts which went to make up the

1906

UNION BANK OF HALIFAX v. SPINNEY.

Davies J.

fraud, or, at the very least, such knowledge as put him upon inquiry. The authorities seem to be quite plain that, when it is said a person is from the circumstances put to inquiry, as Lord Herschell said in *London Joint Stock Bank* v. *Simmons*(1), at page 220:

> the reason in point of law is that he is deemed to know the facts which he would have ascertained if he had made inquiry. He cannot better his position by abstaining from doing so.

See, also, *The Earl of Sheffield* v. *London Joint Stock Bank*(2); and *Boursot* v. *Savage*(3).

I am utterly unable to agree with the following statement of the law by Russell J., in his reasons for judgment:

> Assuming it to be true that Spinney knew down to the minutest particular, the method by which the bank was accustomed to recoup itself for the moneys advanced on the security of the corn and thus effect the object for which the Bank Act is, in itself, not sufficient, namely, that of extending the lien of the security to the proceeds of the sale as well as to the property itself in specie, I do not yet see under what principle the possession of this knowledge would prevent him from competing with the bank in the effort to secure a share of these proceeds.

I should say that the principle was that his knowledge of the facts made it inequitable and unjust for him to conspire with Churchill to divert the proceeds of the meal sold by Churchill from the bank where he should have placed them and where he was bound by his obligation to the bank to place them, to the pockets of a third person. Churchill's action in so diverting these proceeds was, in my judgment, fraudulent, and the knowledge which Spinney either actually had or which the law imputes to him under the circum-

(1) (1892) A.C. 201 (2) 13 App. Cas. 333.
(3) L.R. 2 Eq. 134.

stances makes it contrary to all equity that he should be allowed to retain moneys which he knew or ought to have known belonged to the bank.

The meal being admittedly the bank's, the conditional authority it gave to Churchill to sell the same to his customers and turn over, either the moneys received in payment or the drafts made upon the customers for the price of the meal sold them, gave the bank an equitable right to these proceeds and these drafts as between it and Churchill.

A payment to Churchill either of the price of meal bought or the draft given for the price by a *bonâ fide* purchaser for value without notice would, no doubt, discharge the purchaser from further liability.

But Spinney was not such a *bonâ fide* purchaser or a purchaser at all. He was a volunteer simply. A man who had incurred a collateral liability to the bank for advances made on the security of certain meal, the proceeds of the sale of which he knew or must be held under the circumstances to have known, the bank was entitled to receive from Churchill whom they had authorized to sell the meal and, with this knowledge, conspired with Churchill to divert these proceeds into his own pocket without, as far as I can see, any consideration.

The authorities, English, United States and Canadian, are alike uniform and I think conclusive upon the law.

As Mr. Justice Brewer says in delivering the judgment of the court in *The Union Stock Yards Bank* v. *Gillespie*(1):

> Justice demands that the bank receiving from a factor in payment of a debt from the factor to itself, moneys which it must have

(1) 137 U.S.R. 411.

1906

UNION BANK OF HALIFAX v. SPINNEY.

Davies J.

known were the proceeds of the property received from his consignor and principal account to that principal for the money so received and appropriated.

See, also, Lewin on Trusts (11 ed.), pp. 1074-5; *Re Hallett's Estate*(1); *Harris* v. *Trueman*(2), *per* Manisty J., at page 356; *Hancock* v. *Smith*(3); *Trader's Bank* v. *Goodfallow*(4).

The cardinal error, if I may say so, underlying the judgments of the court below is that the bank's security did not, under the circumstances, cover the proceeds of the sale of their corn and meal, but only the corn and meal in specie. They failed to appreciate the effect of the conditional authority to sell given to Churchill upon those persons who were either purchasers of the meal without valuable consideration or with notice actual or legal of the facts or were mere volunteers, such as Spinney was here.

The full protection of the court will be extended to *bonâ fide* purchasers without notice either express or constructive, but it will not be extended, under such circumstances as exist in this case, to persons who purchase with full knowledge of the facts or obtain, as Spinney did, the proceeds of the sales with such knowledge.

If Churchill had held this meal subject to the bank's claim, as is admitted, or the proceeds of the meal, when sold, subject to his obligation to pay them to the bank as the owner of the meal, as I hold he then did, it is clear beyond reasonable doubt that no one, not being a *bonâ fide* purchaser for value and without notice, could succeed by an agreement with Churchill in diverting such proceeds into his own pocket. It

(1) 13 Ch. D. 696, 707.
(2) 7 Q.B.D. 340.
(3) 41 Ch. D. 456.
(4) 19 O.R. 299.

would be a fraud, deliberate and manifest, on Churchhill's part, and ignorance alone would enable the party agreeing with him to escape liability for the fraud; but if the alienee was a mere volunteer, such as Spinney, he would be liable for the funds which came to his hands, with or without notice.

I think the appeal should be allowed with costs and the judgment of Graham J. restored.

Appeal allowed with costs.

Solicitor for the appellant: *Lewis Chipman.*

Solicitor for the respondents: *Sandford H. Pelton.*