THE LEGAL PROBLEMS OF WHOLESALE FINANCING OF DURABLE GOODS IN CANADA

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I

The techniques and the legal problems involved in the instalment sale of durable goods at the retail level has long been familiar to lawyers, in Canada as elsewhere. Much less well understood, however, are the mechanics whereby the trader obtains the credit to finance his stock-in-trade and the considerably more complex problems to which this form of financing gives rise.[1] The fact remains, however, that the volume of wholesale financing accommodated by Canadian finance companies actually exceeds the volume of retail "paper" purchased by them in the course of a year;[2] and it has been estimated that, in the case of motor vehicles, the value of the wholesale paper represents over ninety per cent of the value of all vehicles produced in, or imported into, the Dominion.[3]

We may begin with a common datum. Just as the consumer needs financial assistance in the purchase of durable goods of high unit value, so in the same way—and for the same reasons—the retail merchant seeks massive financial support in procuring the stock-in-trade which ultimately he hopes to sell to the con-

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[1] There is no published Canadian study on these problems. This article is therefore exploratory in character. The American aspects are discussed in Kripke, Inventory Financing of Hard Goods (1957), 74 Banking L.J. 1013 and in Skilton, Cars for Sale: Some Comments on the Wholesale Financing of Automobiles, [1957] Wisconsin L. Rev. 352, and incidentally in articles on trust receipt financing. Isaacs, The Dealer-Purchaser (1927), 1 U. of Cinn. L. Rev. 373 was not available to me.

[2] For the year 1959 the respective figures were $1,294 and $1,252 millions: see Bank of Canada, Statistical Summary, May, 1960, p. 277.

[3] The figures are taken from a paper read by J. B. Pennefather, executive vice-president of the Industrial Acceptance Corporation, to the Ottawa chapter of the Canadian Political Science Association on March 19th, 1960. See also Canada Yearbook, 1957-58, Table 13, p. 943.

sumer. But there the analogy between the consumer and the dealer ends. Both the techniques of financing and the legal problems involved are entirely different in each case. The major differences are these:

1. The retail purchaser, generally speaking, is a "one time" purchaser. Between the dealer and the financing agency, on the other hand, there is a continuous flow of dealings, week in week out, so that the legal requirements concerning written contracts, registration procedures and so forth, that may be tolerable in the case of a retail conditional sale become an oppressive burden if equally applicable to wholesale financing.
2. The retail purchaser makes a substantial down payment, followed by instalments at regular intervals, and he is personally liable for the price. For these reasons the financer[3A] is not obliged to look exclusively, or even principally, to the goods purchased to secure payment of the debt. Moreover, the risk is spread over many thousands of contracts, and the financer is well compensated for his services through the substantial interest charges that are levied.

   The situation is very different in the case of wholesale financing. The dealer is usually a limited company with few assets; there is—in the case of new goods at any rate—no down payment and there are no regular instalments, and the financer makes no, or very little, profit on the transaction but is obliged to accommodate the dealer in order to obtain the lucrative "paper".[4] Above all, the risks are awesome: with values in the case of motor vehicles, for example, running to several thousand dollars per unit, it requires only a few wholesale purchases to absorb impressive amounts of capital.
3. The retail purchaser intends to use the goods he purchases, and ordinarily the financer can expect the goods to be paid for before, or at the time, any attempt is made to resell or to dispose of them. In any event, the chattels are readily identifiable and, if the worst comes to the worst, can be reclaimed in the hands of a third party. It is otherwise

[3A] The term is used throughout this article in the sense in which it is commonly employed in North American business literature, *i.e.*, to denote the supplier of a dealer's inventory finance.

[4] See Canadian Economic Research Associates, Sales Finance Companies in Canada (1958), Table VI-3, item 6, pp. 26-28.

> with the dealer. He is expected to sell the goods—that is his business—and indeed he must do so, for it is from the proceeds of such sales alone that he can hope to discharge his indebtedness to the financer. Thus the latter is immediately beset with two distinctive problems: (a) to what extent can he legally regulate the manner in which the dealer disposes of his secured stock, and (b) how can he ensure that the proceeds of sale will be used to repay his advances?

We are now in a position to state affirmatively what, from the wholesale financer's point of view, should be the desirable features of his agreement with the dealer and of any law which regulates inventory financing of durable goods in general.

First, the financer must be freed from the necessity of having to record every agreement securing an advance made by him. This introduces us to the concept of "notice filing".

Secondly, the recording law must accept one underlying, or master, agreement as sufficient written evidence of the financer's security interest in the goods acquired through his advances. The need for separate instruments evidencing each transaction must be dispensed with.

Thirdly, the agreement must provide, and the law should recognize, the financer's right to a "cross-over" security, that is to say, all of the trader's stock-in-trade, or at least that part of it which is financed by the financer, both present and future, must secure both present and future advances. Here we enter the realm of the "floating" lien or charge.[5]

Fourthly, the agreement must provide that the financer shall have a security interest in the proceeds of any sale to the extent of any outstanding advances. The function of a model law here is to ensure that the financer's claim to the proceeds will not come into conflict with any other recording law, such as a bills of sale act, an assignment of book debts act, and so forth.

Of course such a law must consider the rights of third parties as well as of the inventory financer. Thus at the crucial points where the two groups of interests come into conflict, we shall expect our law, if not to reconcile them, at least to recognize them and to set forth definitive rules for the parties' guidance. In particular, a well considered law will deal with such problems as:

[5] The term as used in the present context, and in North American literature generally, means something quite different from the "floating charge" employed in Anglo-Canadian corporate financing. See further, *infra*.

Ought one financer be permitted to enjoy a monopolistic position in financing a trader? And when will the inventory lien be cut off against (a) a purchaser from the trader in the ordinary course of business, or (b) another financer taking from the trader an assignment of the proceeds of such a sale?

From what has been said it will readily be appreciated that the problems of inventory financing cut across existing security concepts in Canadian law. The problems are functional in character and cannot be forced into the Procrustean bed of such traditional security devices as the conditional sale, the chattel mortgage, and even, as will be seen, the American trust receipt. What is needed is a law that is moulded around the specific features of inventory financing of identifiable goods, instead of requiring the businessman to conform to the lawyer's preconceptions of self-contained legal categories. It is all too true, however, that the existing Canadian law is entirely inadequate to meet these legitimate requirements. The present article, therefore, serves a twofold purpose. First, it attempts to ascertain how adaptable the existing security devices and the acts governing them are to the requirements of inventory financing. In the second place, it is hoped to show how the identical problems have been, or are being, solved in the United States.

The term "financer" has been used repeatedly in the preceding pages to denote the source of the dealer's wholesale credit, but a more precise identification of the sources in question is now called for. The financer may be either the manufacturer himself or a finance company which is anxious to discount the dealer's retail paper.[6] The manufacturer may extend an "open" (that is, unsecured) credit for thirty or sixty days, he may sell to the dealer on consignment, or again he may resort to a security device, such as a conditional sale or, less frequently, a chattel mortgage. As a method of inventory financing a sale on consignment has much to commend it,[7] although it also has its disadvantages.[8] Above all,

[6] Canadian bank participation in *this* form of inventory financing appears to be negligible and is actively discouraged by the Bank Act (S.C., 1953-4, c. 48), since, save for the exceptions provided for in s. 88 and some other immaterial exceptions, the Act prohibits the chartered banks from lending money on the security of goods (s. 75(2)) and a s. 88 security on durable goods can only be taken from a manufacturer (s. 88 (1)(b)). In this respect the Canadian position differs markedly from the American one.

[7] Some of the advantages as compared with the conditional sale method are:

1. Freedom from registration requirements.
2. The consignor's right to claim the proceeds as trust property without having to comply with the registration requirements of the

For footnote 8 see next page.

it enjoys the supreme advantage of being free from all registration requirements.[9] Moreover, since, *ex hypothesi*, the dealer is only selling as the manufacturer's agent, he becomes, at any rate where the agreement so provides, a trustee of the proceeds of any sale,[10] which the manufacturer will be able to trace into the hands of every person but a *bona fide* purchaser for value.

The characteristic fact is, however, and has been from the very beginning, that in North America the manufacturers of motor vehicles and of many other major durable goods are only prepared to sell for cash,[11] therefore leaving it to the finance companies to finance the dealer's inventory.[12] Thus, as has already been noted, the annual value of wholesale credit extended by these agencies actually exceeds the amount outstanding on retail paper. Moreover,

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Assignment of Book Debts legislation: *Re Rostron*, [1925] 4 D.L.R. 969 (Sask. C.A.).
3. The ability to impose price controls without coming into conflict with the federal anti-combines legislation. (It is for this reason, *inter alia*, that many oil companies sell gasoline on consignment to gas stations).

See generally, Macfarlane, Sale of Goods on Consignment (1937), 22 Proc. Can. Bar Ass'n 175.

[8] *E.g.*,
1. The necessity of maintaining stocks throughout the Dominion, thus involving the continuous tying up of capital.
2. The necessary maintenance of direct accounting staff to verify returns and proceeds received, as well as auditing and inspection staffs.
3. The danger that the consignor may be treated as carrying on business within the province: see *Humphries Patent Bracket & Scaffold Co.* v. *Ottawa Fireproof Supply Co.* (1908), 12 O.W.R. 501; *De Laval Separator Co.* v. *Walworth* (1908), 7 W.L.R. 395 (B.C.C.A.); *John Deere Plow Co.* v. *Agnew* (1913), 48 S.C.R. 208; *City of Halifax* v. *McLaughlin Carriage Co.* (1907), 39 S.C.R. 174.
4. The fact that the consignor is brought into direct contractual relationship with the consumer public, with all the consequences that this entails.

[9] See *Langley* v. *Kahnert* (1905), 36 S.C.R. 397; *Re Glaves* (1924), 27 O.W.N. 83; *Re Alcock* (1924), 53 O.L.R. 422; *In re Italian Trading Co. Ltd.* (1924), 27 O.W.N. 93; *In re Answell* (1959), 38 C.B.R. 39 (Ont.). The New Brunswick Commissioners in a 1938 report to the Uniformity Conference recommended that consignments should also be subject to registration requirements. The subject was referred to the British Columbia Commissioners for further study, but after desultory tinkering with it over the ensuing years, the question was dropped altogether in 1943. See Proceedings, (1938), p. 17, App. G; (1939), p. 37; (1942), p. 22; (1943), p. 18. *Cf.* Uniform Commercial Code (hereafter referred to as U.C.C.) 2-326, which subjects goods on consignment to the claims of creditors unless the transaction falls within one of three exceptions, of which one is a filing under Article 9. The references throughout this article are to the 1958 official text.

[10] *Re Rostron*, *supra*, footnote 7.

[11] For the reasons for this policy, see Canadian Economic Research Associates, *op. cit.*, footnote 4, pp. 5-9.

[12] It must be borne in mind that some finance companies are the wholly owned subsidiaries of manufacturers. With the exception of G.M.A.C., however, this is not true of the major Canadian finance companies.

even where the manufacturer is prepared to extend a short period of credit, the dealer may require the finance company to take the manufacturer's place when the period has expired. A finance company obviously cannot resort to the consignment method,[13] and equally it is not going to make unsecured advances; it must, therefore, (Canadian law being what it is) rely on the conditional sale and the chattel mortgage, with a "proceeds" clause as additional security. In practice the conditional sale appears to be used to secure advances on newly purchased inventory and the chattel mortgage for advances on used inventory, especially used motor vehicles. The financing of used inventory is, of course, a bilateral arrangement to which no manufacturer is a party, but the financing of new inventory does require his cooperation. This nowadays takes the form of an assignment of the conditional sale agreement from him to the finance company pursuant to a prior arrangement between the parties.

A different method for the financing of new inventory was, however, in vogue in the twenties and early thirties. The practice then[14] was for the automobile manufacturer, after the cars had been shipped, to forward the bill of lading with a sight draft drawn on the dealer to a collecting bank in the locality of the dealer's business. The dealer would then assign his contractual rights[15] to the finance company and immediately afterwards repurchase the cars from the company under a conditional sale agreement.[16] The latter would thereupon make available the funds necessary to honour the draft, and the dealer would take possession of the goods.

The present day method is for the finance company to establish direct relations with the manufacturer and to arrange to pay for the vehicles as soon as they are shipped. The actual mechanics of

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[13] Theoretically it might be possible, in the case of new inventory, to conjure up a consignment agreement whereby the trader either guarantees that the goods will be sold within a given period or, alternatively, undertakes to purchase the goods himself thereafter. However, so far as I am aware, no finance company has yet been bold enough to experiment with such an agreement.

[14] See, *e.g.*, *Re Smith & Hogan*, [1932] S.C.R. 661; *Commercial Finance Corp.* v. *Martin*, [1933] 4 D.L.R. 375 (S.C.C.).

[15] In *Re Smith & Hogan*, *ibid.*, it was described by the parties as a bill of sale, but, as the court pointed out, as the trader had not yet got title to the goods all he could assign was a chose in action.

[16] The arrangement was attacked in a number of cases as a disguised chattel mortgage, but was accepted as legitimate by the Supreme Court of Canada in *Martin's* and *Hogan's* cases, *ibid.* However, in *Martin's* case the court also held that the initial assignment from the trader to the finance company required registration as a sale of future goods not accompanied by a transfer of possession.

the operation are as follows.[17] The dealer signs an application for "floor plan accommodation" or some similar document. This does not oblige the finance company to extend any credit, but simply sets forth the procedure to be followed and the company's rights if, and to the extent to which, the company actually does so. The dealer places his orders with the manufacturer in the usual way, and when the vehicles are ready for shipment the manufacturer presents the local office of the finance company with a wholesale conditional sale contract[18] between himself and the dealer, together with an assignment of his rights in favour of the company. The dealer's signature will have been affixed to the contract by a local attorney in fact whom he will have specially appointed for this purpose.[19] The finance company thereupon issues its cheque to the manufacturer and forwards the documents to its branch located nearest to the dealer. The dealer will take possession of the vehicles on their arrival, and he is usually authorized to sell them in the ordinary course of his business (with or without the company's prior approval). He undertakes, however, to hold the proceeds of any sale on trust for the finance company. Legally, the amount owing under the wholesale contract is usually payable on demand, but in practice the company will be prepared to wait until the vehicles have been resold.

II

Before proceeding next to consider the specific legal problems of wholesale financing, it seems desirable to review briefly the principal security devices in Canada and the United States that have some bearing upon this form of financing, since the problems and their solution can only be understood in the context of the general security law of these countries.

(a) *The conditional sale.* When conditional sales first became common in the last century, there were no finance companies and traders generally purchased their modest amounts of inventory on

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[17] For a description of the very similar American techniques, see Skilton, *op. cit.*, footnote 1.

[18] In the United States, prior to the advent of the Uniform Commercial Code, the security agreement would take the form of a trust receipt in those states which had adopted the Uniform Trust Receipts Act (U.T.R.A.) or which recognized the validity of the trust receipt at common law. In the other states a chattel mortgage or conditional sale agreement would be used.

[19] The agent is usually an executive in the office of the finance company or of the manufacturer. The object of his appointment is to avoid the inconvenience and delays which would otherwise be caused by having to send the documents each time to the dealer for his signature. See further, Kripke, *op. cit.*, footnote 1, pp. 1016-1017.

a cash basis. This position appears to have remained true until the advent of the automobile in this century. Moreover, before the first world war the manufacturers of such durable goods as there were (for instance, of pianos, sewing machines, and so on) appear to have engaged in a substantial amount of direct selling to the consumer. When the American Uniform Conditional Sales Act was adopted by the National Conference in 1918 and the Canadian Act by the Uniformity Conference four years later,[20] the specific problems connected with the inventory financing of durable goods were almost entirely unknown.[21] It is scarcely surprising, therefore, that the only reference in either act to wholesale conditional sales is the provision safeguarding *bona fide* purchasers from traders to whom such goods are conditionally sold for resale.[22] In all other respects the provisions of both acts applied equally to wholesale agreements as well as to conditional sales at the retail level.

In the decade following the promulgation of the American Act, trust receipts were widely resorted to in the United States by financing agencies, first at common law and then, after 1933, under the aegis of the Uniform Trust Receipts Act which was adopted in that year. This development sufficiently explains the absence of any subsequent amendments to the American Uniform Conditional Sales Act. It fails to explain, however, why the 1947 and 1955 revisions of the Canadian Act completely ignored the new problems, since none of the Canadian provinces has a trust receipt Act and the common law trust receipt would almost certainly be treated by the Canadian courts as a chattel mortgage.[23] To some extent, however, the absence of special legislation reflects the care with which finance companies extend wholesale credit

[20] See Ziegel, Uniformity of Legislation—the Conditional Sales Experience (1961), 39 Can. Bar Rev. 165.

[21] See *passim*, Gilmore, On the Difficulties of Codifying Commercial Law (1948), 57 Yale L.J. 1341.

[22] U.C.S.A. (U.S.), s. 9; U.C.S.A. (Can.), s. 4.

[23] There appear to be only two reported decisions in which the validity of trust receipts has been considered. In the first, *Dominion Bank* v. *Davidson* (1885), 12 O.A.R. 90, the document was upheld on the ground that since the "trustee" had never had title to the goods he could not have given a mortgage on them. In the second, *Re Dominion Shipbuilding etc. Co.* (1923), 53 O.L.R. 485, Rose J., in a well-reasoned judgment, held the reverse, his reasoning being that the seller had transferred title to the entruster at the request of the buyer-trustee. *Cf. Motor Trader Finance Ltd.* v. *H.E. Motors Ltd.* (1926) H.L., unreported, discussed by Aubrey L. Diamond in (1960), 23 Mod. L. Rev. 516, at pp. 526-527. In the light of the almost consistent refusal of the Canadian courts to recognize a sale from A to B followed by a conditional sale from B to A as anything but a disguised chattel mortgage, it seems safe to predict that Rose J.'s decision would be preferred at the present day.

and the success of their policy of carefully policing the disposal of the proceeds of the dealer's sales.

(b) *The chattel mortgage.* It has been observed that in the United States it was the chattel mortgage legislation of the states which validated this security device,[24] since the American courts, basing themselves on the doctrine in *Twyne's* case as interpreted by Coke,[25] treated the chattel mortgage if not conclusively fraudulent at least presumptively so against creditors and *bona fide* purchasers. Moreover, even after the introduction of the validating legislation, a mortgage on inventory continued to be struck down, either on the ground that to leave goods for resale in the mortgager's hands was conclusive evidence of fraud or else because it was deemed inconsistent with the notion of the mortgagee's dominion over the mortgaged goods.[26] "After-acquired" property clauses, so essential for the mortgagee's security where he is financing inventory, were also, on independent grounds, frequently disallowed.[27] Likewise, "future advance" clauses were often fettered with various restrictions.[28] All in all, therefore, even if it had not been for the onerous registration requirements, the chattel mortgage in the United States was a very unsuitable and highly hazardous instrument for securing a financer's advances to retailers.

What of the Canadian position? It was, and is, very much more favourable. Chattel mortgage legislation was first introduced in Upper Canada in 1849 and spread very quickly to the newly emerging provinces. Today such legislation exists in all the common law provinces and territories. The Uniformity Conference adopted a Uniform Bills of Sale and Chattel Mortgages Act in 1928,[29] and this,

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[24] Glenn, The Chattel Mortgage as a Statutory Security (1939), 25 Va. L. Rev. 316, esp. at pp. 326-327, 338-339.

[25] (1601), 3 Co. Rep. 80b, esp. at p. 81a.

[26] Cohen and Gerber, Mortgages of Merchandise (1939), 39 Col. L. Rev. 1338; *Benedict* v. *Ratner* (1925), 268 U.S. 353. Note, however, that wholesale chattel mortgages with proceeds clauses were often excluded from the general rule on the rather spurious ground that in such cases the mortgagee was not holding out the trader as the owner of the goods. To come within the exception, however, under the doctrine of *Benedict*, v. *Ratner*, the financer had to exercise an actual and continuous control over the disposal of the proceeds. To overcome some of the above difficulties the ingenious "field warehousing" device was quite frequently used, but never apparently to secure inventory advances to retailers. See further, Friedman, Field Warehousing (1942), 42 Col. L. Rev. 991.

[27] Cohen and Gerber, The After-acquired Property Clause (1939), 87 U. Pa. L. Rev. 635. The fear was that one financer might monopolize the borrower's total resources and that the borrower might sell himself into economic peonage.

[28] Blackburn, Mortgages to Secure Future Advances (1956), 21 Mo. L. Rev. 209; U.C.C., Comment 8 to Article 9-204(5).

[29] See (1928), 13 Proc. Can. Bar Ass'n, App. B, p. 267.

in its original form or in its revised version of 1955,[30] has found a wide measure of acceptance among the provinces.[31] Broadly speaking, it is true to say, however, that the purpose of these statutes is not to restrict the scope of the chattel mortgage, nor even to regulate the rights of the parties *inter se*, but primarily to prevent secret liens by introducing a system of public registration.[32] The parties are free to insert "after-acquired" property and, subject to what is said hereafter, "future advance" clauses,[33] and the Canadian courts, unlike the American courts, have never found anything fraudulent or incongruous about a mortgage on inventory intended for resale. It will be seen, therefore, that as a security device for inventory financing the "floating" chattel mortgage has considerable advantages over the conditional sale, and it is perhaps surprising that it is not used more extensively for financing the purchase of new goods.

Like the conditional sale legislation, however, the chattel mortgage Acts have a number of serious shortcomings from the wholesale financer's point of view. The more important ones are the following:

1. Each security agreement requires to be separately evidenced in writing and to be registered.[34]
2. Registration, except in British Columbia, Saskatchewan, and Newfoundland, is on a local basis and depends on the location of the chattels.[35] Moreover, agreements involving chattels which are subsequently removed to another registration district must be re-registered.[36] If a dealer carries on business in more than one locality (and many of the larger ones do) the financer is always under an obligation to check for possible movements of goods from one branch to another.

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[30] See Proceedings (1955), App. M, p. 131.

[31] All of the provinces and territories, except British Columbia and Ontario, have adopted, with or without modifications, one of the two versions of the uniform Act. For particulars, see Proceedings (1959), pp. 14-15.

[32] See *Scribner* v. *McLaren* (1883), 2 O.R. 265, *per* Cameron J., at p. 279; *G.T.P. Ry.* v. *Dearborn* (1919), 58 S.C.R. 315, *per* Davies C.J.C., at p. 321; *Jackson* v. *Bank of N.S.* (1893), 9 Man. R. 75 (C.A.).

[33] As to after-acquired property clauses, see *Coyne* v. *Lee* (1887), 14 O.A.R. 503. *Cf. Short* v. *Ruttan* (1854), 12 U.C.Q.B. 79 (C.A.); *O'Kell* v. *Bell* (1883), 16 N.S.R. 419. The original acts did not expressly deal with such clauses. It was, therefore, held that they were valid without registration. The cases are legion. See, for example, *Traves* v. *Forrest* (1909), 42 S.C.R. 514; *Gault Bros.* v. *Winter* (1914), 49 S.C.R. 541. They are now included. See *e.g.*, the Revised Uniform Act, s. 3.

[34] Revised Uniform Act, s. 4.

[35] *Ibid.*, s. 8.

[36] *Ibid.*, s. 11.

3. Each agreement must be accompanied by an affidavit of execution and *bona fides*.[37] These apparently innocuous requirements are rigorously enforced by the courts, and many a mortgagee has found his Waterloo on this battlefield.[38]
4. In so far as future goods are concerned, the mortgagee's equitable title[39] is cut off by a *bona fide* purchaser or subsequent legal mortgage of the goods, since the Canadian courts, like the English courts in similar circumstances, have refused to hold that registration constitutes constructive notice of the mortgagee's equitable interest vis-à-vis third parties.[40]
5. It is not clear to what extent "future advance" clauses which do not involve firm commitments on the part of the mortgagee are valid under the existing Acts. Some Acts, like British Columbia's, do not deal explicitly with such clauses; those which follow the Revised Uniform Act require the writing to set forth "the terms or substance" of the agreement in respect of the advances;[41] whereas the Ontario Act limits future advances to those which are to be repaid not later than a year from the making of the agreement. Furthermore, the supporting affidavit must state, *inter alia*, "the extent and amount of the advances intended to be made".[42] It would seem, therefore, that, under this Act at least, the agreement must involve firm commitments to make the advances.[43] Possibly, however, this fatal handicap could be overcome by the use of a debenture, since debentures are governed in Ontario, as in the other provinces, by other

[37] *Ibid.*, s. 6.

[38] The cases are collected in the Canadian Abridgment, *sub nom* "Chattel Mortgages". Despite the presence of curative sections in the Acts, the Canadian courts have been ungenerous in applying them.

[39] *Holroyd* v. *Marshall* (1862), 10 H.L.C. 191.

[40] *McAllister* v. *Forsyth* (1885), 12 S.C.R. 1; *Wallace* v. *Scott* (1907), 5 W.L.R. 341 (Man.); *Whynot* v. *McGinty* (1912), 7 D.L.R. 618 (N.S.). *Cf. Joseph* v. *Lyons* (1884), 15 Q.B.D. 280 (C.A.). In *Reporter Publishing Co.* v. *Manton Bros. Ltd.* (1961), 35 W.W.R. 498 (Man. C.A.), at pp. 507-508, Tritschler J.A. said: "The state of the law (as it appears to me to be) may be considered unsatisfactory. An 'equity' in chattels is mortgagable and an equitable mortgage is required to be registered, but registration is not notice. Should the effectiveness of an equitable mortgage depend on actual notice while the effectiveness of a legal mortgage does not?"

[41] S. 5(1)(c). None of the few decisions on this section involved future advances without firm commitments to make them. See, *In re Kendrew* v. *A.B. Cashing Mills Ltd.* (1946), 27 C.B.R. 272, aff'g 27 C.B.R. 252 (Alta. C.A.); *Newlands* v. *Higgins* (1907), 7 W.L.R. 59 (Alta.); *Goulding* v. *Deeming* (1888), 15 O.R. 201.

[42] S. 5.

[43] See *Robinson* v. *Paterson* (1859), 18 U.C.Q.B. 55.

provisions which, *semble*, are not subject to the same limitations.[44]

(c) *Assignment of book debts.* A sale on credit, secured or unsecured, creates a chose in action. Hence an inventory financer who is anxious to secure a lien on the proceeds of the sale of the goods financed by him is bound to pay heed to the provisions of the assignment of book debts Acts, which have now been enacted in all the common-law provinces and territories.[45] These Acts, like section 43 of the English Bankruptcy Act, apply to any assignment of present and future book debts, other than an assignment of book debts due at the date of the assignment from specific debtors "or becoming due under specified contracts".[46] Obviously, at the time when the finance company first advances its funds there are no specified debtors, since the goods have not yet been sold, nor, it would seem, can one say that the assignment represents book debts becoming due under "specified contracts". In *Lee* v. *Darling Co. of Canada Ltd.*,[47] the debtor made an assignment of all monies due to arise on the future sale of his tobacco crop. The Ontario court held that this was not an assignment of debts arising under "specified contracts", since at the time of the assignment there were no contracts *in esse*.[48] It follows, therefore, that unless the

[44] See, for example, the Ontario Corporation Securities Registration Act, R.S.O., 1960, c. 70, and the British Columbia Companies Act, R.S.B.C., 1948, c. 58, ss. 135-7. Neither Act deals expressly with debentures which secure future advances. S. 3(2)(a) of the Ontario Act requires the copy of the document or the filed particulars of the charge to show the total amount secured by the bonds. The British Columbia provisions, so far as debentures are concerned, are almost identical with the provisions in ss. 95-97 of the English Companies Act, 1948. Under the latter Act the Registrar of Companies is required to insert in the Register of Charges, "the amount secured by the charge" (s. 97(1)(b)). Does this exclude an "all-moneys" debenture? The point appears never to have been tested, although such debentures are common in England. See Holden, Securities for Bankers' Advances (3rd ed., 1961), pp. 331-332. An even greater difficulty arises, however, as to the meaning of "debenture", since this term is apparently not defined in the Canadian Acts. *Cf.* Waldock, The Law of Mortgages (2nd ed., 1950), pp. 152-154.

[45] They were made necessary because in 1919 the federal Bankruptcy Act was amended to provide that no such assignment was to be valid against a trustee in bankruptcy unless the debt had been paid at the time of bankruptcy or the assignment had been registered in conformity with provincial requirements. See S.C., 1919, c. 36, s. 30, am. by 1922, c. 8, s. 4, and 1932, c. 39, s. 27. See now R.S.C., 1952, c. 14, s. 64. The Uniformity Conference adopted a uniform Act in 1928 and a revised Act in 1955. See (1928), 13 Proc. Can. Bar Ass'n, App. C, p. 287, and Proceedings (1955), pp. 119 *et seq.* Only British Columbia has not adopted either of these versions, but its Act is similar in substance.

[46] Revised Uniform Act, s. 3(b), (c).

[47] (1959), 19 D.L.R. (2d) 268 (Ont.).

[48] The term is also considered in an unreported decision of the English Divisional Court in *Re Cornish, Ex p. First County Finance Ltd.* v. *Trustee*, (1955) December 21st, reported in Williams on Bankruptcy (17th ed.,

financer can show that the proceeds belonged to him all the time and that his title to them does not derive from the dealer—a question to be discussed presently—he must comply with the separate registration requirements applicable to such assignments.[49]

Even if he has complied, the rug may still be pulled from under his feet by a subsequent assignee for value who, by giving first notice to the debtor, will be able to defeat the prior assignment under the rule in *Dearle* v. *Hall*.[50] This is precisely what happened in *Snyder's Ltd.* v. *Furniture Finance Corp'n Ltd.*[51] There the plaintiff, a furniture manufacturer, sold goods to a trader and took from him a general assignment of book debts, which was duly registered. The trader sold the furniture by means of conditional sales and assigned the resulting agreements to the defendant finance company. The plaintiff now sought an accounting from the defendant of the monies collected by it under the specific assignments. The Ontario Appellate Division, however, rejected the claim on several grounds, the most important being that the defendant had acquired a superior equitable title by giving first notice to the debtors. It was also held that registration of the first assignment did not constitute constructive notice to the defendant.[52] The significance of this decision for inventory financers can scarcely be exaggerated.

(d) "*Section 88*" *assignments under the Canadian Bank Act*. This section has been described as the "key to the Canadian banking system"[53] and "one of its most distinctive features",[54] but its

1958), pp. 354-355. The court pointed out that "specified contracts" does not mean that the agreements giving rise to the debts must actually be identified in the assignment, and that "specific" would have been a more appropriate word. In *In re Sauder* (1958), 37 C.B.R. 68 (Ont.) the assignment read: "We agree to apply all funds received from the sale of lumber purchased from W.... to note given them (sc. W) until same is paid in full and at least $1,000 per month". Smily J., in a scantily reported judgment, held (1) this was an equitable assignment and, although not registered, outside s. 63 of the Bankruptcy Act, and (2) that, *semble*, the assignment might also come under the exception in s. 63(3) as being an assignment of a debt "growing due under a specified contract". The second ground is, with respect, unsound. *Lee's* case, *ibid.*, was not referred to. The first ground is difficult to follow and is inconsistent with the decision in *In re Fred's Farm Industries Limited* (1957), 36 C.B.R. 125 (Ont.), discussed *infra*. *In re Sauder* can only be supported on the assumption that the bankrupt was only acting as W's agent for sale—an unlikely hypothesis.

[49] *In re Fred's Farm Industries Ltd.*, *ibid.*

[50] (1823), 3 Russ. 1. The rule is not applied in the majority of American states.

[51] (1930), 66 O.L.R. 79 (C.A.).

[52] See judgment of Orde J.A., at pp. 86-87.

[53] Baxter, The Law of Banking (1956), p. 233.

[54] Jamieson, Chartered Banking in Canada (Rev. ed., 1957), p. 163.

significance in the field of inventory financing generally lies in the fact that it is the closest Canadian analogue to the American trust receipt. It may therefore serve as an important precedent for future legislation of a general character in Canada.

The origin of section 88 was an Act of 1859, but since then the section and its contiguous provisions have undergone many changes. Its essential purposes and its characteristic features are, however, still the same today, namely, to facilitate the production, manufacturing, and marketing of natural products by making it possible for the borrower to give security in "simple form".[55] The "simple form" is a short one page document, unaccompanied by any affidavit, in one of the statutory forms prescribed in a schedule to the Act whereby the borrower assigns to the bank all of his present and future goods falling within one of the categories enumerated in section 88 by way of security for any loan or advance made to him by the bank.[56] This document is not required to be registered, but, since 1923,[57] it has been necessary for the bank to file in the provincial office of the Bank of Canada a simple Notice of Intention[58] signed by the intending borrower to give the bank a section 88 security. The notice, once filed, is good for three years and may be renewed thereafter.

Other favourable features of the section 88 provisions are (a) that they provide explicitly as to when the bank may proceed to realize on its security;[59] (b) that they establish a simple procedure

[55] *Ibid.*

[56] See s. 88(2) and Schs C to J to the Act. The precise wording of these schedules need not be followed: *Royal Bank* v. *McKenzie*, [1932] S.C.R. 524. Actually, the importance of this aspect of a s. 88 security is easily exaggerated. It is possible—and it is being done—to produce wholesale chattel mortgage and conditional sale agreements which are equally short. Historically, however, the statutory forms must have seemed to the nineteenth century bankers a great improvement over the suspicion laden chattel mortgage with its burdensome affidavits and enormous superstructure of statutory and judicially created rules. The obvious need was to dissociate inventory financing by banks completely from this hostile environment, and in this section 88 was completely successful.

[57] S.C., 1923, c. 32.

[58] See Sch. K to the Act. The Notice reads as follows:

NOTICE OF INTENTION.

To Whom It May Concern:

.... hereby gives notice
(Name of person, firm or company. P.O. address)
that it is .... intention to give security under the authority of section 88 of the Bank Act to...................... Bank.

Dated at............this day of............19......

....

[59] S. 89(4).

for realization of the security;[60] and (c) that the bank, by virtue of the combined effect of sections 88(2)(c), 86(2)(a), and 89(1), acquires, *semble*, a legal title to the debtor's goods; hence, in principle, the bank's security should be perfected, even in the case of future goods, against everyone except, possibly, a *bona fide* purchaser from the debtor in the ordinary course of business.[61]

The shortcomings of section 88, apart from the obvious one that the type of security it sanctions is available only to banks and can only be taken from wholesalers or shippers of natural products or manufacturers generally,[62] are the following: 1. Filing of the Notice of Intention *per se* does not give the secured party priority over other security interests which may be created by the debtor subsequent to the filing;[63] hence, it would seem, to be on the safe side, a bank should always search before making any new advances to the debtor. 2. A section 88 security can only be taken for contemporaneous advances.[64] It is true that section 90(1)(b) of the Act enables a bank to take security after the advance has been made pursuant to a promise to give security given before the advance was made,[65] but it is not clear whether the converse also applies, that is, whether present security can be given for future advances.[66] 3. The Act confers no lien in favour of the bank on the proceeds of sale of any secured goods, thus leaving the bank to shift for itself as best it may under common-law rules or to fall back upon

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[60] *Ibid.* All that is required is that ten days' notice of the time and sale be given to the debtor, together with a specified amount of advertising of the intended sale. No rights of foreclosure are given.

[61] The general question does not appear to have been decided in any reported case. In *La Banque Provinciale du Canada* v. *Dionne*, [1957] C.S. 167, Lacroix J., in a sparsely reasoned judgment, held that the bank's title under s. 88 did not oust the rights of a *bona fide* purchase from the trader under art. 1489 of the Quebec Civil Code. A similar conclusion would probably be reached by common-law courts, either on the ground of an implied consent to the sale or on grounds of estoppel. *Cf. Bank of Montreal* v. *Guaranty Silk Dyeing & Finishing Co.*, [1935] 4 D.L.R. 483 (Ont. C.A.).

[62] S. 88(1)(a), (b). It follows, therefore, that, for example, a car dealer seeking wholesale credit from his bank can only offer the traditional securities. Note, however, that since 1944, a s. 88 security can be taken under s. 88 (e)-(i) on a farmer's or fisherman's equipment.

[63] *Cf. Bank of Montreal* v. *Guaranty Silk Dyeing & Finishing Co., supra*, footnote 61, esp. at pp. 502-503.

[64] S. 90(1)(a). The section was amended in important respects in 1934. Hence *Clarkson* v. *Dominion Bank* (1919), 58 S.C.R. 448 is now only of historical interest.

[65] The effect of such a promise is to create an equitable charge which will attach as soon as the goods are acquired by the borrower: *Re Central Bank of Canada* (*Re Shipping Co.'s Case*) (1891), 21 O.R. 515; *Can. Bank of Commerce* v. *Swanson & McMillan*, [1923] 1 W.W.R. 1201 (Man. C.A.).

[66] See, however, s. 90(1)(b) and the wording of the forms in Schs C and J. Space does not permit further examination of this important question.

one of the other security devices governed by provincial law.[67] The significance of these shortcomings, in the context of general inventory financing, will become apparent later in this article.

(e) *The "Floating Charge"*. This form of security, as understood in the specific sense of Anglo-Canadian corporation law and not in the looser American conception of any security on inventory,[68] is not apparently used in Canadian wholesale financing, and it is easy to understand why. For, according to the prevailing theory,[69] a floating charge "is not a specific mortgage of the assets plus a licence to the mortgagor to dispose of them in the course of his business",[70] but is a present security which "floats" over the assets secured without becoming a fixed security until the secured party takes some step to enforce his security or unless the debtor ceases to carry on business.[71] Until either of these events happens, the debtor is free to carry on his business—and "business" here is used in the widest possible sense—without interference from the secured party, and he may deal with the charged assets in any manner he sees fit. Thus he may sell, barter, or even mortgage them, unless prohibited from doing so, without being accountable for the proceeds to the secured party; and the assets may be seized in execution[72] or garnished.[73] Such freedom of action and exposure to general creditors' claims is quite incompatible with the form of security which the wholesale financer seeks. His margin of safety is generally so small, and the amount involved generally so large, that he must have the right to police the dealer's disposal of the goods, must have the right to make him accountable for the proceeds, and must be satisfied that his security will be immune from other potential claims.

This concludes our summary of the Canadian non-possessory security devices in the realm of personalty. In 1954, the five leading finance companies in Canada made representations to the Select Committee of the Ontario Legislative Assembly on the Central Registration of Documents of Title with respect to some of the

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[67] In practice banks insert a "proceeds" clause in a s. 88 assignment and also take an express assignment of book debts. The classification of such proceeds clauses is discussed in Part IV of this article.

[68] *Cf.* Coogan, (1959), 72 Harv. L. Rev. 838, at p. 839, footnote 2.

[69] There is, however, another theory: see Pennington, (1960), 23 Mod. L. Rev. 630, esp. at p. 644 *et seq.*

[70] *Evans* v. *Rival Granite Quarries Ltd.*, [1910] 2 K.B. 979, *per* Buckley L.J., at p. 999. *Cf. Meen* v. *Realty Development Co.*, [1954] 1 D.L.R. 649, esp. at p. 653 (Ont. C.A.).

[71] *Government Stock Co.* v. *Manila Ry.*, [1897] A.C. 81, at p. 86; *Evans* v. *Rival Granite Quarries Ltd.*, *ibid.*

[72] *Evans* v. *Rival Granite Quarries Ltd.*, *ibid.*

[73] *Kare* v. *North West Packers Ltd.*, [1955] 2 D.L.R. 407 (Man. C.A.).

shortcomings in the existing legislation from their point of view, and they recommended the adoption of a "notice" filing procedure for wholesale conditional sale agreements and chattel mortgages. A copy of the companies' brief is included as an appendix to this article. The recommendations have not so far been implemented, although they were favourably received by the Committee, and, in any event, they were only concerned with registration procedures in the case of inventory liens. They made no attempt to deal with the question of the financer's security interest in the proceeds resulting from the sale of the goods financed by him.

To conclude this survey, something must now be said about the two major American legislative instruments designed to meet the needs of inventory financing, namely, (A) the Uniform Trust Receipts Act, and (B) the applicable provisions of Article 9 of the Uniform Commercial Code.

A. *The Uniform Trust Receipts Act.* The history of the trust receipt in American business law has been frequently told, and it is unnecessary to repeat it here.[74] Suffice it to say that the device first made its appearance towards the end of the last century in connection with the financing of imported goods and that, after World War One, it was extended to the financing of domestic goods. Although there can be little doubt that, in essence, the trust receipt was merely a disguised form of chattel mortgage,[75] the commercial need for a simple form of security was such that, in the import sphere, the device successfully survived judicial scrutiny. In the sphere of domestic goods, however, the state courts increasingly gave it the kiss of death by labelling it either as a conditional sale or a chattel mortgage, and thus subjecting

[74] See, *passim*, Frederick, The Trust Receipt as Security (1922), 22 Col. L. Rev. 395, 546; Hanna, Trust Receipts (1931), 19 Cal. L. Rev. 257. The reader should be cautioned against confusing the American trust receipt with the document by the same name used by English banks to finance import transactions. Although the two documents have some features in common, the English trust receipt is an integral part of a pledge transaction (see *North Western Bank* v. *Poynter* [1895] A.C. 56), whereas the American receipt never is (although it may follow one). See, *e.g.*, *In re Carl Dernburg & Sons Inc.* (1922), 282 F. 816, reprinted in Bogert, Cases and Materials on the Law of Sales (2nd ed., 1947), p. 317.

[75] *Cf.* Learned Hand C.J. in *Barrett* v. *Bank of Manhatten Co.* (1954), 218 F. 2d 763, at p. 765: ". . . In *Moors* v. *Kidder*, . . . the validity of such a receipt had, it is true, the assent of only four out of the seven judges of the Court of Appeals, and they based their ruling upon the purely verbal distinction that 'title' did not pass to the buyer, unlike a chattel mortgage. With deference we cannot understand how that difference could ever have been thought to disguise the patent character of the transaction as an unrecorded chattel mortgage; but as a prophetic step in advance, experience has amply justified it, for thirty states and two territories have passed the Act."

it to the statutory requirements regulating these instruments.[76] This led the National Conference to draft a Uniform Trust Receipts Act which was promulgated in 1933, and has since been adopted by thirty-six states.[77]

The Act fully recognized the legitimate function of the trust receipt as a vehicle, *inter alia*, for short term inventory financing, though in its anxiety to show how the device differed from the conditional sale and the chattel mortgage it developed a series of rather complex and technical rules.[78] The Act adopted[79] the concept of notice filing in a form practically identical with that conceived in the Canadian Bank Act ten years earlier, and expressly recognized[80] the right of the financer (called in the Act the "entruster") to a security interest in the proceeds of any sale. It made irrelevant the question so important to the validity of the common-law trust receipt, namely, the source of the entruster's title: all that was now required was that the entruster's security interest should be created prior to or contemporaneously with the delivery of the goods to the "trustee"[81] (that is, the debtor). On the other hand, the Act protected *bona fide* purchasers of the secured goods in the ordinary course of business by creating a wide statutory form of estoppel in their favour.[82] Despite all these favourable features, however, the Act also suffered from a number of serious shortcomings. The principal ones were the following:[83] 1. Sellers (which, from a practical viewpoint, meant manufacturers and distributors) were disqualified from being entrusters.[84] 2. The Act prohibited "cross-over" security clauses.[85] 3. The Act was limited to the financing of new acquisitions for purposes of sale.[86] It did not apply to the financing of existing stock, nor did it permit the financing of inventory held for use (for instance, demonstration

[76] Commissioners' Prefatory Note to the Uniform Trust Receipts Act, U.L.A. 9C, pp. 220-221.

[77] Since the Act has now been officially superseded by Article 9 of the Uniform Commercial Code, its provisions are referred to in the past tense in the rest of this article. However, it must be remembered that it still remains in force in many of the states which adopted it originally.

[78] "The Uniform Trust Receipt [*sic*] Act is a perplexing maze of technical phrases wholly incomprehensible without an extensive study of the background and development of the security device known as the trust receipt. To avoid trespassing upon the traditional and well defined fields of such common security devices as the pledge, conditional sale and chattel mortgage, most of the act is devoted to definition, limitation and restriction of the arena in which the new device is to play its part in the world of commerce." *In re Chappell* (1948), 77 F. Supp. 573, at p. 575.

[79] S. 13.

[80] S. 10.

[81] S. 2(1)(a).

[82] Ss. 9(2), 1 definition of "Buyer in the ordinary course of trade".

[83] See, generally, Skilton, *op. cit.*, footnote 1, p. 427.

[84] S. 1, definition of "Entruster".

[85] S. 14.

[86] S. 2(3).

models) or for rental. 4. Some of its provisions on important points, as will be seen, were obscure.[87]

B. *The Uniform Commercial Code*.[88] The Code adopts and continues the central policy of the Uniform Trust Receipts Act, but, in addition, removes many of its artificial limitations. Its significant and major contribution towards liberating inventory financing from all residual disabilities are the following:

1. It abolishes the distinction between all the traditional security devices and subjects every form of security to a single set of basic rules. There is only one concept — that of a "security interest".[89] The only differences which are respected are functional ones, that is, those between a security on inventory, on equipment and on consumer goods.
2. The concept of notice filing is extended to all forms of secured transactions.[90]
3. It allows every security agreement to be given effect to according to its terms.[91]
4. It expressly sanctions "after-acquired" and "future advance" clauses.[92]
5. It repeals the rule in *Benedict* v. *Ratner*[93] and freely permits a floating charge on shifting stock without requiring the debtor to account for the proceeds of any sale.[94]
6. It resolves a number of important ambiguities which had become apparent in the Uniform Trust Receipts Act.
7. It deals explicitly with the possibility of conflicting claims among successive financers and establishes, as a matter of policy, important rules of priority.[95]

It will be seen, therefore, that the Code affords maximum security for inventory financing under conditions of the utmost flexibility, with due regard, however, for the legitimate interests of third parties. But this is not the present position under Canadian law,

[87] Another complaint was (and for that matter still is) that there was a conflict between the respective provisions of the Act and the various motor vehicle certificate of title Acts. However, this problem is still premature in Canada and therefore is not discussed in this article.

[88] For a review of the history of the Code, see Braucher in (1958), 58 Col. L. Rev. 798. Nineteen states, including almost all the commercially important ones, have now adopted the Code or are in the process of doing so.

[89] S. 9-102.

[90] Ss. 9-302, 9-402.

[91] S. 9-201.

[92] S. 9-204.

[93] *Supra*, footnote 26. This case held that an assignment of accounts receivable which permitted the assignor to continue to collect the debts without accounting to the assignee for the proceeds was invalid as a matter of law, thus extending to the sphere of intangibles a rule which previously had been thought to apply only to a wholesale chattel mortgage of goods.

[94] Ss. 9-205, 9-201.

[95] S. 9-312.

and thus we must retrace our steps and discuss some of the more important of the outstanding problems and the possible solutions to them.

III. *Some Specific Problems in Wholesale Financing.*

1. *"Notice" filing* v. *filing of individual agreements.*

The disadvantages of requiring the financer to register separately each agreement evidencing an advance to the trader are so self-evident that they require no further elaboration. What third parties need to know is whether the trader's inventory is encumbered, and this information a system of notice filing provides as adequately as the other. Any further information they can then readily obtain from the financer.

As has been seen, the notion of notice filing is not new in Canada and the system has been adopted in the Uniform Trust Receipts Act and the Code. What both section 88 of the Canadian Bank Act and the Uniform Trust Receipts Act fail to make clear, however, is the effect of such filing upon the priorities of conflicting inventory liens. *Donn* v. *Auto Dealers Investment Co.*,[96] an Illinois decision, illustrates the problem. There the plaintiff company and the defendant company both filed a Statement of Intention to engage in trust receipt financing with the same dealer, but the plaintiff filed first. Both companies obtained a trust receipt on the same (used) car, but the defendant's receipt was given first. In the Illinois Appellate Division the plaintiff successfully argued that a filing under the Uniform Trust Receipts Act confers on the entruster an inchoate security interest in the goods which ripens into a full interest when the filer actually advances money on credit. The Supreme Court of Illinois disagreed, however, and held that, while filing was necessary to perfect a security interest, no interest of any kind vested in the entruster until the trust receipt had been given.

The difficulty about this decision was that, as a learned commentator has pointed out,[97] it gave the financer no benefit from his priority in filing. For this reason the Code rejects the rule in *Donn's* case. Section 9-312(5) provides that the priority of conflicting security interests in the same collateral shall be determined in the order of filing if both are perfected by filing. As the official comment on the subsection explains, " . . . The justification for the rule lies in the necessity of protecting the filing system—that is,

[96] (1944), 52 N.E. 2d 694, reversing 47 N.E. 2d 568.
[97] Kripke, *op. cit.*, footnote 1, at p. 1023.

of allowing the secured party who has first filed to make subsequent advances without each time having, as a condition of protection, to check for filings later than his". But the new rule, it will be appreciated, taken in conjunction with an "after-acquired property" clause, enables a first filer to monopolize, if he so wishes, the debtor's total assets. This danger—if danger it be—has aroused considerable discussion in the United States,[98] although it has never evoked any measurable apprehension in Canada or England. In the result the Code adopted a number of rules designed to modify the general rule in particular instances. The one of interest in the present context will be found in section 9-312(3), and reads as follows:

> (3) A purchase money security interest[99] in inventory collateral has priority over a conflicting security interest in the same collateral if
> (a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and
> (b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, has filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and
> (c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

It will be noted that these really quite simple provisions are broadly in accord with two common-law rules: first, the rule that an "after-acquired" property clause in a chattel mortgage does not attach to conditionally sold goods (except to the extent of the buyer's equity in the goods), since, *ex hypothesi*, the debtor has no title to the goods,[100] and, secondly, the rule that as between two or more successive mortgagees, the original mortgagee is not entitled to priority in respect of advances made by him after he receives notice of the subsequent mortgage.[101]

There are, however, also a number of significant differences between the Code's priority rules and the common-law position. The most important of these is that, under the Code, the original filer's priority is only displaced by a subsequent "purchase money

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[98] See Coogan, Article 9 of the Uniform Commercial Code: Priorities among Secured Creditors and the "Floating Lien" (1959), 72 Harv. L. Rev. 838.

[99] Defined in s. 9-107.

[100] See Comment 3 to s. 9-312.

[101] *Hopkinson* v. *Rolt* (1861), 9 H.L.C. 514; *Fraser* v. *Imperial Bank* (1912), 47 S.C.R. 313; *Pierce* v. *Can. Permanent Loan & Savings Co.*

security interest". In practical terms this means that an inventory financer who advances funds to a trader against the security of used goods (for instance, automobiles) cannot acquire priority, without his consent, over another financer who has previously filed his statement, even though the latter has been given express notice of the intended advance. Whether such a radical deviation from the common-law rule is necessary in order to protect a prior lender may well be doubted,[102] but in any event this particular policy question in no way affects the superiority of a "notice" filing system over one requiring the filing of individual lien agreements.

2. *Problems of execution of individual lien documents.*

Existing Canadian conditional sales and chattel mortgages legislation requires every conditional sale or chattel mortgage, as the case may be, to be evidenced in writing either prior to or within a few days following the delivery of the goods to the buyer, in the first case, or the granting of the mortgage in the second. In addition, if a chattel mortgage is involved, every province requires the document to be accompanied by an affidavit of *bona fides* and of execution. Thus there are at least five objections to the present system from the wholesale financer's point of view. First, it involves much unnecessary form filling. Secondly, there is the constant danger of clerical errors in the description of the parties, of the goods, and in the affidavits. Even if this does not prove fatal—and in the past it frequently has—it may involve an application to a court for leave to rectify or possible litigation as to the validity of the lien.[103] Thirdly, there may be physical difficulties in the way of the dealer signing the documents at the time the goods are shipped to him. This is especially true in the case of new inventory, where the manufacturer's plant may be, let us say, in Oshawa, Ontario, and the dealer's place of business in Nelson, British Columbia. To overcome this problem it is customary, as has already been noted,

(1894), 25 O.R. 671, aff'd 23 O.A.R. 516. In the last case it was held that the general rule is not affected by the fact that the second mortgage was registered before the first mortgagee made his advance. See now s. 176, Ontario Land Registry Act, R.S.O., 1937, c. 170, and, generally, Falconbridge, Law of Mortgages (3rd ed., 1942), pp. 139-141.

[102] *Cf.* Coogan, *op. cit.*, footnote 98, esp. at p. 873 *et seq.*

[103] Some American documents purport to authorize the financer to rectify any errors in the trust receipt on the dealer's behalf. But if the error is not discovered until after the statutory period for reducing the security agreement or filing the agreement or for both has elapsed, such a provision would not help the financer under the Canadian legislation, since, generally, except in the case of renewal statements, it contains no machinery enabling a financer to file an amended document without a court's leave.

for the dealer to confer a power of attorney on an employee in the office of the manufacturer or financer authorizing him to sign the conditional sale agreement on the dealer's behalf. It is unsatisfactory, however, that such a stratagem should have to be resorted to. Fourthly, there may be possible conflict-of-laws problems, since, if the goods are deemed to be delivered to the trader in one province and his place of business is in another,[104] the financer may find the legislation of both provinces applicable to the transaction.[105] Finally, the existing registration requirements enable competitors of the trader and the financer to obtain details of the parties' financial relationship which they would prefer to keep private.[106]

What is needed, then, is a statutory provision enabling a general underlying agreement to give security to take the place of individual lien documents. Section 2(1)(ii) of the Uniform Trust Receipts Act, as amplified in section 4 of the Act, permitted such an arrangement, although these provisions appear to have been invoked in only one reported case.[107] The Code has abandoned all need for a contemporaneous writing. All that it requires[108] is a simple security agreement,[109] signed by the debtor, which contains a description of the collateral.[110] These provisions must be read in conjunction with section 9-201, which provides that a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors.

3. *The protection of bona fide purchasers of the goods from the trader in the ordinary course of business.*

Whether the goods are new or used, and whether the financer's advance is secured by a conditional sale or a mortgage, the dealer, sooner or later, is expected to sell the goods, so that he may pay off the loan. If he does so and the financer is paid off, well and good. If he sells and keeps the proceeds, the financer may be faced with one of two alternatives: (a) to try and trace the proceeds, or (b) to impeach the sale. A third possibility, to sue the

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[104] In practice, in the case of vehicles, the goods are deemed to be delivered at the point of shipment: communication to the writer, dated 18/5/61, from Mr. J. D. Johnstone, of the legal department of the Canadian Acceptance Corporation.

[105] It was so held, for example, in *In re Steen* (1958), 257 F. 2d 297; the Canadian practice, however, is for the security agreements to be registered at the trader's place of business only.

[106] See Memorandum to the Ontario Select Committee.

[107] *In re Le Vee & Co.* (1958), 252 F. 2d 214.

[108] See s. 9-203.

[109] Defined in s. 9-105 as "an agreement which creates or provides for a security interest".

[110] Defined in s. 9-105(c) as the property subject to a security interest.

dealer, may be ignored, because at this stage the dealer is either insolvent or has absconded. The first problem will be discussed hereafter, but the second is our immediate concern.

It is of course clear that if the financer expressly authorizes the sale, there can be no question of impeaching it. But the wholesale agreements usually studiously avoid conferring a blanket power of sale on the dealer. They either say nothing about it, or they expressly prohibit a sale without the financer's consent. A typical clause of the latter type reads as follows:

> The Grantor [sc. of the mortgage] shall not mortgage, assign, encumber, sell or otherwise dispose of same [sc. the goods] without either having paid in cash all amounts secured hereby or having secured the express consent of Grantee.[111]

If the agreement is of the first type, it is well-established Anglo-Canadian law that the dealer will be assumed to have an implied power to carry on his business in the ordinary manner.[112] It is important to appreciate, however, that the power thus conferred rests not on any doctrine of estoppel, but on an assumed term in the agreement itself. The important consequences which flow from this distinction are clearly illustrated by a recent Ontario decision, *Insurance & Discount Corp'n* v. *Motorville Car Sales*.[113] Here the plaintiff finance company was providing wholesale finance for a dealer's used cars and discounting his retail paper. The advances were secured by a chattel mortgage on the cars. The dealer fraudulently disposed of several of the vehicles to another dealer, who bought them for cash in good faith and without actual notice of the plaintiff's lien. The evidence was that it was customary for dealers to sell cars to each other.[114] The plaintiffs deposed, however, that they did not know it and that they had not given, and would

[111] *Cf.* Condition 2 in C.A.C.'s Wholesale Conditional Sale Agreement: "The Dealer agrees . . . not to sell or mortgage or otherwise dispose of [the goods] or lose possession of same until payment of the unpaid balance is made in cash." In the next sentence, however, the dealer is enjoined "to report each sale promptly to Seller" and to account for the proceeds, thus suggesting either that the dealer may sell with the financer's consent (which is, of course, self-evident) or, *quaere*, even without. The second alternative is supported by clause 3 of the "Dealer's Application for Floor Plan Accommodation", which provides that the dealer shall be at liberty to exhibit and sell such merchandise in the ordinary course of trade.

[112] *E.g.*, *Dedrick* v. *Ashdown* (1888), 15 S.C.R. 227; *Delanoy* v. *Downey* (1912), 2 W.W.R. 599 (Sask.); *Brett* v. *Foorsen* (1907), 7 W.L.R. 13 (Man.); *Nourse* v. *Canadian Canners Ltd.*, [1935] O.R. 361 (C.A.). These cases involved either wholesale chattel mortgages or conditional sales.

[113] [1953] O.R. 16, aff'd [1953] O.W.N. 828 (C.A.).

[114] *Ibid.*, at pp. 19-20. In the United States used car dealers purchase about half their annual stocks of second-hand vehicles from new car dealers who received them in trade-ins: Phelps, Instalment Sales Financing: Its Services to the Dealer (1953), p. 35.

not have given, the trader permission to do so, since their reason for financing a dealer's inventory was to secure the resulting retail paper.

The court found it unnecessary to decide the disputed question of fact[115] and rested its decision on the sole, and no doubt self-evident, ground, that the trader had had no implied licence or authority to deal fraudulently with the goods. It was strongly argued that the test of the trader's implied authority was an objective one, but the argument was rejected by McRuer C.J. in the following passage:[116]

> Mr. P... argues that the test to be applied, as to whether a purchaser gets a good title or not, is whether the purchaser believed, or at least whether a reasonable man in the purchaser's position would have believed, that the sale was in the ordinary course of business. With great respect, I do not think that this contention is supported by authorities of long standing.[117] I think the test is — What is the "implied term" of the chattel mortgage or the "implied licence", and was the sale *in fact* made within the implied term or licence. This view of the law appears to me to be quite clear if the decided cases are reviewed and considered in their chronological order.[118]

This reasoning was followed and approved by the Ontario Court of Appeal in *MacDonald* v. *Canadian Acceptance Corp'n*,[119] where the facts were practically identical with those in the *Motorville* case,[120] the only difference being that the trader-mortgagor was not acting fraudulently in selling to the second trader. Unfortunately, in neither case was the problem examined in the light of estoppel principles, and whether the courts rejected their applicability *sub silentio* is a question which will be considered presently.

Even if the buyer from the dealer cannot prove an implied consent, he may still be able to repel the finance company's attack on one of the following grounds: 1. Waiver; 2. Estoppel; 3. The "trader's" section in the conditional sales Acts; and 4. The factors legislation.[120A] These defences must be considered in turn.

[115] *Ibid.*, at p. 20. [116] *Ibid.*, at p. 22.

[117] Some of the authorities earlier reviewed at length by the court were: *Walker* v. *Clay* (1880), 49 L.J.C.P. 560; *Taylor* v. *McKeand* (1880), 5 C.P.D. 358; *Payne* v. *Fern* (1881), 6 Q.B.D. 620; *Musgrave* v. *Stevens & Bradbury* (1883), C. & E. 38; *Dedrick* v. *Ashdown*, *supra*, footnote 113.

[118] For a much earlier Canadian decision to the same effect, not referred to in McRuer C.J.'s judgment, see *J.I. Case Threshing Machine Co.* v. *Gouley* (1914), 7 W.W.R. 584 (Sask.).

[119] [1955] O.R. 874. [120] *Supra*, footnote 113.

[120A] In view of the surprising decision in *Century Credit Corp.* v. *Richard*, [1962] O.R. 815, 34 D.L.R. (2d) 291 (C.A.), one must now also add the Canadian equivalents of s. 25(2) of the Imperial Sale of Goods Act, 1893, so far as its applicability to conditional sales has not been expressly excluded in the Canadian legislation. It will be noted, in any event, that the interpretation of s. 25(2) raises similar problems to those posed by the

1. *Waiver.* Although the wholesale document may require the dealer to obtain the financer's consent before selling, the evidence may show that in practice this requirement has been dispensed with. There appears to be no Canadian case where the conflicting claims have been decided on this ground alone,[121] but, as Skilton points out,[122] "Restrictive provisions obviously interfere with the orderly and fluent conduct of the dealer's business. It is a reasonable suspicion that they are more frequently honoured in the breach than in the observance. The statement was made to me (by one in a position to know what he was talking about) that automobile dealers in practice never get the consent of their financer before sale." *Hare & Chase of Toronto Ltd.* v. *Commercial Finance Corp'n Ltd.*,[123] though not turning on the provisions of any wholesale contract, illustrates the principle. In that case the plaintiff finance company repossessed an automobile from a defaulting buyer under a conditional sale agreement, and, not having any facilities of its own for storing and selling cars, left the vehicle with the dealer who had assigned the agreement to them in the first place. The dealer then sold the car under another conditional sale agreement, which he assigned to the defendant finance company. It was held that, while the plaintiff company had given the dealer no express instructions to sell this particular vehicle, the whole course of dealing between them made it clear that the dealer was expected to sell the cars left with him "on the floor".

2. *Estoppel or ostensible authority.* Despite the manifestation of a continuous legislative intention to reverse the common-law doctrine of *nemo dat quod non habet* in commercial transactions, the English courts in particular have shown little inclination to abandon the rule in cases not governed by a clear statutory mandate.[124] Nevertheless, encroachments upon the rule have succeeded in selected spheres under the guise of estoppel or ostensible authority. The question, therefore, is whether such an estoppel should also be created against a financer who entrusts a trader with goods subject to a security agreement, knowing that they are to

"trader's" section in the Canadian conditional sales statutes, which are discussed in the text, as well as several additional ones.

[121] See, however, Mellish J. in *The Commercial Credit Co. of Canada Ltd.* v. *Fulton Bros.* (1922), 55 N.S.R. 208, at pp. 237-238.

[122] *Op. cit.*, footnote 1.

[123] (1928), 62 O.L.R. 601 (C.A.), foll'd in *Vancouver Motors Ltd.* v. *Lord* (1955), 17 W.W.R. (N.S.) 81 (B.C.).

[124] For recent comprehensive judicial discussions of the applicable principles, see *Mercantile Bank of India Ltd.* v. *Central Bank of India Ltd.*, [1938] A.C. 287 (P.C.), and *Central Newbury Car Auctions Ltd.* v. *Unity Finance Ltd.*, [1956] 3 W.L.R. 1069 (C.A.).

be exhibited for sale and kept as part of the trader's stock. Looked at from the point of view of mercantile convenience, one would not have thought that the question admitted of much doubt. As McPhillips J.A. said in one case:[125] "It would be intolerable and work grave injustice indeed, if motor cars in open display in the show windows of dealers, and publicly sold in the ordinary course of business, should notwithstanding be held to be the property of (one) other than the purchaser, who in good faith has become the purchaser thereof." Thus there are two, self-contained, grounds upon which the protection of the innocent purchaser can be justified: first, he is misled into believing that the retailer is the owner of the goods, or, at any rate, is empowered to sell, and, in the second place, even if he does know that the goods are subject to an inventory lien, it would be an intolerable hindrance to free trade if, before consummating a purchase, he had to make inquiries into the retailer's powers of sale.

In England there appears to be no direct authority on the point in question, presumably because the combined effect of the factors' legislation and section 25 of the Sale of Goods Act make reliance upon any common-law form of estoppel unnecessary. There are, however, a number of dicta which support the estoppel position,[126] of which perhaps that of Lord Ellenborough in the early case of *Pickering* v. *Busk*[127] is the best known. He said:

> If the principal send his commodity to a place, where it is the ordinary business of the person to whom it is confided to sell, it must be intended that the commodity was sent thither for the purpose of sale. . . . When the commodity is sent in such a way and to such a place as to exhibit an apparent purpose of sale, the principal will be bound, and the purchaser safe.

If the principle expressed in this dictum is a valid one, then of course it should apply whatever the character of the owner— whether he be a conditional seller, a consignor, a mortgagee, or a principal—and Ewart, for one, was prepared to draw this conclusion.[128] In fact, however, in subsequent cases[129] Lord Ellen-

[125] *Albutt & Co.* v. *Continental Guarantee Corp'n*, [1930] 1 D.L.R. 26, at p. 30 (B.C.). For a similar representative American statement, see *Hostetler* v. *Nat. Acceptance Co.* (1930), 172 N.E. 851 (Ohio), quoted in Mechem, Outlines of the Law of Agency (4th ed., 1952), pp. 79-80.

[126] See *Meggy* v. *The Imperial Discount Co.* (1878), 3 Q.B.D. 711, *per* Bramwell L.J., at p. 717; *Weiner* v. *Harris*, [1910] 1 K.B. 285, *per* Farwell L.J., at p. 295; and *Weiner* v. *Gill*, [1905] 2 K.B. 172, aff'd on other grounds, [1906] 2 K.B. 574, at p. 581.

[127] (1818), 15 East 38, at p. 43, also cited in Ewart on Estoppel (1900), p. 299.

[128] *Ibid.*

[129] See *Shipley* v. *Kymer* (1813), 1 M. & S. 484; *Cole* v. *N.W. Bank* (1875), L.R. 10 C.P. 354; *Johnson* v. *Crédit Lyonnais* (1877), L.R. 3 C.P.D.

borough's judgment has been carefully confined to the particular facts of *Pickering* v. *Busk*, and the English courts have so far shown no disposition whatever towards accepting anything like the full implications of the dictum.

The position is rather less uncertain in most of the Canadian provinces. There are many strong dicta, especially in a series of Western cases decided in the late twenties and early thirties, which affirm the proposition that a financer who leaves goods under a conditional sale agreement with a dealer will be estopped from denying the dealer's authority to sell them in the ordinary course of his business.[130] Moreover, Dysart J. rested his decision on this ground in three Manitoba cases,[131] and in the third of them, *Imperial Finance Corp'n Ltd.* v. *Fidelity Trust Co.*,[132] the Manitoba Court of Appeal affirmed his judgment without additional reasons of its own. Again, in *Commercial Credit Corp'n* v. *Fulton Bros.*,[133] two of the judges[134] of the full court of Nova Scotia had no doubts about the applicability of estoppel principles in this type of situation.

It is important, however, not to read these judgments and dicta out of their context, despite the sweeping language which appears in some of them. In each case the parties contemplated that the dealer should sell, the only reservation being that he should not sell without the financer's consent. Interpreted in this light there is no difficulty about reconciling them with the decision of the British Columbia Court of Appeal in *Whitney-Morton Co.* v. *Short*[135] and the Saskatchewan decision in *Schafhauser* v. *Shaffer & National Finance Co.*[136] In both these cases the finance company

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32; *Biggs* v. *Evans*, [1894] 1 Q.B. 88; *Weiner* v. *Gill*, *supra*, footnote 126; *cf.* *Weiner* v. *Harris*, *supra*, footnote 126.

[130] *Brett* v. *Foorsen*, *supra*, footnote 112, esp. at p. 18 (Man.); *Wesbrook* v. *Willoughby* (1895), 10 Man. R. 690, at pp. 692-693; *Commercial Securities Ltd.* v. *Johnson*, [1931] 1 D.L.R. 861, *per* McPhillips J.A., at p. 863 (B.C.C.A.); *Hunter* v. *Trans-Canada Finance Corp'n*, [1930] 3 D.L.R. 275, rev'g [1929] 3 W.W.R. 503, *per* Fullerton J.A., at pp. 282-283. Unfortunately, in many of these cases questions of an implied licence, waiver and estoppel are considered together, so that it is not always easy to disengage one ground from the other. The majority of American cases also apply estoppel principles against the seller. Many of the earlier authorities are reviewed in an admirable judgment in *Fogle* v. *Gen. Credit Inc.* (1941), 122 F. 2d 45, 136 A.L.R. 814.

[131] *Hunter* v. *Trans-Canada Finance Corp'n*, *ibid.*; *Ashmore* v. *Trans-Canada Finance Corp'n* (1931), 39 Man. R. 52, aff'd on other grounds, [1930] 4 D.L.R. 982; *Imperial Finance Corp'n* v. *Fidelity Trust Co.*, [1930] 4 D.L.R. 827, 39 Man. R. 573, aff'd [1931] 3 D.L.R. 801.

[132] *Ibid.*

[133] (1922), 55 N.S.R. 208.

[134] *Ibid.*, *per* Mellish J., at pp. 238 and 242, and Ritchie E.J., at p. 228. See also, *The People's Bank of Halifax* v. *Estey* (1904), 34 S.C.R. 429, *per* Nesbitt J., dissenting, at pp. 447-448.

[135] (1922), 67 D.L.R. 573.

[136] [1943] 3 D.L.R. 656.

had repossessed cars and then left them for storage and repairs with the dealer who had discounted the retail agreement with them in the first place. In both instances it was held that since the dealer had been given no authority to sell, the third party, even though a buyer in ordinary course of business, got a defective title. The decisions actually turned on the applicability of the Factors Acts, but, as illustrations of the rule that leaving goods with a merchant for bailment only will not endow him with an authority to sell them, the decisions are in accord with the leading case of *Johnson* v. *Credit Lyonnais Co.*[137] and of the Supreme Court of Canada's decision in *Forristal* v. *McDonald.*[138] It is to be hoped, however, that the facts in these repossession cases will be scrutinized carefully in the future. The dividing line between bailment *solus* and bailment with a power of sale *sub modo* is a thin one, and in many instances the dealer will in fact be expected to sell at the appropriate time. Where this is so, the facts are practically indistinguishable from those cases where the goods are sold to the dealer under a wholesale agreement, and the same principle of estoppel should be applicable to both.

The question remains, however, whether the general rule enunciated in the wholesale conditional sale cases also applies to the wholesale chattel mortgage cases. As has been noted, the point was not raised in the *Motorville*[139] and *MacDonald*[140] decisions. Even more striking is the fact that the defence appears not to have been relied upon in the long line of precedents cited in the *Motorville* case. It may be thought, therefore, that this militates against an affirmative answer. This conclusion does not necessarily follow, however, since it is believed it will be found in all these cases that the buyer from the trader or merchant was either protected because he *was* a buyer in the ordinary course of business or that he lost because he was not. Hence, even if estoppel principles had been applied, the result would still have been the same, although, admittedly, the reasoning would have been different. It would be unfortunate, moreover, if a distinction were to be drawn for this purpose between a wholesale conditional sale and a wholesale chattel mortgage, since there is nothing to distinguish the two situations in principle, and the American authorities do not do so.[141] In both cases the trader is permitted to include the goods among his stock-in-trade and to exhibit them to the public. In

[137] *Supra*, footnote 129.
[138] (1883), 9 S.C.R. 12.
[139] *Supra*, footnote 113.
[140] *Supra*, footnote 119.
[141] *Fogle's* case, *supra*, footnote 130, for example, was a chattel mortgage case.

both he is expected to sell. Furthermore, in the chattel mortgage situation the buyer would be left entirely without protection, since none of the provincial chattel mortgage Acts contains a "trader's" section comparable to that found in the conditional sales legislation.

3. *The "trader's" section.* The history of this section, which now appears in all the conditional sales Acts and ordinances but two,[142] is shortly as follows. It was first adopted in Ontario in an amending Act of 1892,[143] which provided that "an agreement for the sale or transfer of merchandise of any kind to a trader or other person[144] for the purpose of resale by him[145] in the ordinary course of business" . . . , "though signed and filed, shall not affect purchasers from the trader or person aforesaid in the usual course of business". No other province or territory had any comparable provisions when the first Uniform Conditional Sales Act was being drafted and section 4 of the uniform Act was, therefore, inspired by the Ontario model, though its actual wording closely followed section 9 of the American Act.[146] Section 4 read as follows:

> If the goods are delivered to a trader or other person and the seller expressly or impliedly consents that the buyer may resell them in the ordinary course of business, and such trader or other person resells the goods in the ordinary course of his business, the property in the goods shall pass to the purchaser notwithstanding the other provisions of this Act.

There have been only minor changes in the section since then. Section 8 of the 1955 Revised Uniform Act now reads:

> Where a seller of goods expressly or impliedly consents that the buyer may sell them in the ordinary course of business and the buyer so sells the goods, the property in the goods passes to the purchaser from the buyer notwithstanding the other provisions of this Act.

It will be seen that the only difference between the two sections is that "trader or other person" in the 1922 Act is replaced by "buyer" in the 1955 Act. Both sections, however, are poorly drafted and leave a great many questions unanswered. Some of the more important ones which will now be briefly considered

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142 B.C., s. 5; N.B., s. 9; Nfld., s. 8; N.W.T., s. 5; N.S., s. 5; Ont., s. 3(3), (4); P.E.I., s. 4; Sask., s. 10; Y.T., s. 5. The Alberta and Manitoba Acts are the exceptions.

143 55 Vict., c. 26, s. 5.

144 Construed literally and not *ejusdem generis* with "trader" in *Dominion Lock Jt. Pipe Co.* v. *York*, [1929] 4 D.L.R. 806, 64 O.L.R. 365 (Ont. C.A.).

145 Construed liberally in *York's* case, *ibid.*, and in *International Business Machines* v. *Guelph*, [1928] S.C.R. 200, so as to cover a conditional sale to a contractor who delivered the goods to a third party under a contract to supply labour and materials.

146 See (1921), 6 Proc. Can. Bar Ass'n, 346.

are: (a) the meaning of "expressly or impliedly consents"; (b) the meaning of "ordinary course of business"; (c) whether the purchaser from the trader must be a "buyer" in the technical sense; (d) whether the purchaser from the buyer must be a purchaser "in good faith" and "without notice" of the outstanding security interest; (e) whether (i) title or (ii) possession of the goods, or both, must have passed to the purchaser; (f) whether the dealer must have sold the goods only after they were delivered to him and whether the purchaser must have seen the goods at the time of the sale; and (g) whether the consideration must have passed before the purchaser receives notice of the trader's defective title. There are only a few decisions on the uniform and the Ontario trader's sections, and not many on the American section, and therefore the answers to many of these questions, insofar as they cannot be deduced from general principles of law, are still largely conjectural.

(a) *The meaning of "expressly or impliedly consents"*. Read literally these words are tautologous, but it is clear from the Ontario derivation of the uniform sections, and especially from section 9 of the American Act from which the quoted words were taken, that they were intended to have the same meaning as the following italicized words in the Ontario section, "Where the delivery is made to the trader or other person for *the purpose of resale* by him . . . .": that is to say, if the inventory financer knows that the trader intends to resell the goods, he will not be allowed to blow hot and cold and to assert limitations on the trader's power of sale.[147] It is unfortunate, however, that the draftsmen could not have expressed their meaning as clearly as does the Uniform Trust Receipts Act. Section 9(2)(ii) of the latter Act provides, "No limitations placed by the entruster on the liberty of sale granted to the trustee shall affect a buyer in the ordinary course of trade, unless the limitation is actually known to the latter." But even when interpreted in this common sense manner the Canadian provisions do not cover all the situations in which

[147] *Cf.* Middleton J.A. in *York's* case, *supra*, footnote 144, at p. 368 (O.L.R.): "The intention of the Legislature was to protect those who buy in good faith from one to whom the goods have been entrusted under such circumstances that a resale by him is contemplated." See further, Bogert's commentary on s.9, U.L.A., 2A, p. 111, and the Commissioners' Note to the section: "That the goods have been put into the retailer's stock with the consent of the wholesaler is conclusive evidence that they are there for sale and the retailer has title or the right to convey". See also, *Finance Corp'n of New Jersey* v. *Jones* (1922), 119 Atl. 171 (N.J.) and *Troy Savings Bank* v. *Carobene Apts.* (1956), 146 N.Y.S. 2d 268. Mr. Andrew Joanes, in interpreting section 4 literally in (1959), 1 U.B.C. Law Notes 23, at p. 48 *et seq.* would appear, with respect, to have overlooked the origins of the section.

a purchaser needs protection, as *Dulmage* v. *Bankers' Financial Corp'n*[148] shows. The car conditionally sold to the trader in that case was intended to be used for demonstration purposes. It was therefore, strictly speaking, not delivered to him "for the purpose of resale". And so the Ontario court held that the purchaser was not protected. The result is obviously unjust, for to the outside world a demonstration car is as much part of the dealer's stock-in-trade as are the cars in his show-room. Accordingly, the meaning of "liberty of sale" is suitably widened in section 9(2)(c) of the Uniform Transfer Receipts Act to meet this kind of situation. It provides that, "If the entruster consents to the placing of goods subject to a trust receipt transaction in the trustee's stock in trade or in his sales or exhibition rooms, or allows such goods to be so placed or kept, such consent or allowance shall have like effect as granting the trustee liberty of sale."

The Code carries the policy of protection still further. It provides, simply and elegantly, that "A buyer in ordinary course of business . . . takes free of a security interest created by his seller, even though the security interest is perfected . . . .",[149] "a buyer in ordinary course of business" being defined as a person who in good faith "buys in ordinary course from a person in the business of selling goods of that kind . . .".[150] Thus it will be seen that the buyer no longer has to show that the financer consented to the sale or acquiesced in the goods being exhibited for sale, and so on. His conduct is immaterial. What matters are the objective facts. Is the retail buyer likely to be deceived? Does he need protection? A policy choice has to be made as to which of two persons is to bear the loss resulting from the fraud of a third, the trader. The Code, like the Factors Acts and similar legislation preceding it, has said it is the one who entrusts the trader with possession of the goods. And this is just, since he is in a much better position than the buyer to weigh the risks.[151] That we are dealing not with

[148] [1923] 1 D.L.R. 1185, aff'g 67 D.L.R. 594 (Ont. C.A.).

[149] S. 9-307(1).

[150] S. 1-201(9).

[151] *Cf. Freudenheim* v. *Gutter* (1911), 201 N.Y. 94, Bogert, *op. cit.*, footnote 74, p. 110: "How did the statute meet this danger? What is the nature and theory of the remedy provided? The legislature did not simply make the fraudulent disposition of property by the agent a crime, for that would have been of slight value, as doubtless it was a crime at common law. It went much farther and made possession, under certain circumstances, conclusive evidence of ownership to the extent necessary to protect a purchaser or a lender who acted in good faith and without notice. . . . The real theory of the act is that the selection of the faithless agent and intrusting him with the property is the cause of the loss, and hence, that loss is placed not on the third party who is wholly innocent, but upon the owner, because by appointing and trusting a dishonest agent he brought about the loss."

strict estoppel but with mercantile policy is shown by the fact that neither the Canadian nor the American legislation protects a mortgagee of the goods in the trader's hands. If the conduct of the wholesale financer were the sole guiding principle, then logically he should be since the former's conduct has not changed. The answer is, of course, that the legislature thinks it not unreasonable that the mortgagee should be expected to search the public records before making his advance. He is himself a financer, and business will not be impeded by exacting this requirement from him.

(b) *The meaning of "ordinary course of business"*. The principal difficulty here is to decide whether a dealer who buys goods from another is a purchaser "in ordinary course of business". The point was raised, but not decided, in the *Motorville*[152] and the *MacDonald*[153] cases. MacDonald J. in *Albutt & Co.* v. *Riddell*[154] expressed the opinion that the trader's section was intended to protect members of the public and not another trader, but it is difficult to see why this limitation should be read into it.[155] The question is surely a simple one of fact, as MacDonald J. himself realized, namely: was the transaction one "in ordinary course of business"? If so, the identity of the purchaser should make no difference. The evidentiary issue has, as a matter of fact, been decided repeatedly in favour of the trader-purchaser in a growing number of American decisions.[156] Whether such a trader buys in good faith is, of course, quite a separate question.

(c) *Must the purchaser from the trader be a "buyer" in the technical sense?* A sale, in Anglo-Canadian law, is a transfer of

[152] *Supra*, footnote 113. [153] *Supra*, footnote 119.

[154] [1930] 2 D.L.R. 166, rev'd on other grounds, [1930] 4 D.L.R. 111 (B.C.).

[155] In *Gen. Finance Corp'n* v. *Krause Motor Sales* (1939), 23 N.E. 2d 781, the Illinois Appellate Court refused to read such a restriction into s. 9(2) of the U.T.R.A. To the same effect, see *Stemmons Inc.* v. *Universal C.I.T. Credit Corp'n* (1956), 301 P. 2d 212 (Okl.), interpreting the Oklahoma chattel mortgage statute.

[156] See cases cited in previous footnote, and, in addition, *Colonial Finance Co.* v. *De Benigno* (1939), 7 A. 2d 841 (Conn.) reprinted in Bogert, *op. cit.*, footnote 74, p. 292 and *People's Finance & Thrift Co. of Visalia* v. *Bowman* (1943), 137 P. 2d. 729 (Cal.). In *Stemmons*' case, *ibid.*, the court said: ". . . most particularly since the end of the last war, it is known and recognized that automobile dealers generally transfer, trade and sell automobiles among themselves as a matter of convenience. Not only is this the common practice between so-called authorized dealers, but the practice is even more prevalent between authorized dealers and the licensed used car dealers. And, whether such transactions are for convenience in reducing a stock of merchandise, by way of financial retrenchment, or because of the opportunity for profit, the one fact remains that in every instance there was a complete sale to a purchaser who gave value to a dealer, who made advantageous disposition of a unit of merchandise

property for "a money consideration, called the price".[157] Hence, for example, a barter of automobiles between two dealers is not a sale,[158] nor, it has recently been decided in England, is a promise to transfer land in exchange for the extinguishment of a debt.[159] The "value", on the other hand, that is necessary to constitute a person a "purchaser for value" for the purpose of defeating another person's claim to the same goods is, both at common law and in equity, any consideration sufficient to support a simple contract.[160] This, of course, includes a barter and, it is now well settled, an antecedent debt.[161] It matters then considerably whether the purchaser protected by the trader's sections must be a buyer in the technical sense or only a "purchaser for value".

If the literal words of the Canadian statutes are attended to, the answer should be that he must be a buyer in the technical sense, since not only must the conditional seller consent that the trader "may sell" the goods in the ordinary course of business, but the trader must so "sell". Consequently, MacDonald J. was on firm ground when he held in *Albutt & Co.* v. *Riddell*[162] that what he regarded as a barter transaction between the trader and his purchaser[163] was not protected by the trader's section in the British Columbia Act. This conclusion can be justified not only verbally but also on grounds of policy, since both the Uniform Trust Receipts Act and the Code also draw a distinction between a buyer in the ordinary course of business[164] and purchasers for

which he handled in the ordinary course or conduct of his business. The situation disclosed by this appeal epitomizes the matters mentioned above."

[157] *Cf.* Sale of Goods Act, s. 1 (Imp.). See also *Robshaw Bros. Ltd.* v. *Mayer*, [1956] 3 All E.R. 833 for a general discussion of the meaning of "sale". The American definition is wider. The Uniform Sales Act, s. 1, provides that "A contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for a consideration called the price" and, by virtue of s. 9(2), "The price may be made payable in any *personal property*". This definition was intended to bring exchanges of property within the Act. See Williston, Sales (Rev. ed.), s. 166, p. 433 *et seq.*

[158] *Albutt & Co.* v. *Riddell*, *supra*, footnote 154.

[159] *Simpson* v. *Connolly*, [1953] 1 W.L.R. 911 (Finnemore J.).

[160] *Williams* v. *Leonard & Sons* (1896), 26 S.C.R. 406; Jones, *Bona Fide* Purchaser of Goods (1921), p. 25.

[161] *Williams* v. *Leonard & Sons*, *ibid.*; *Leask* v. *Scott* (1877), 2 Q.B.D. 376. See also *Thorndike* v. *Hunt*, 3 De G. & J. 563; *Taylor* v. *Blakelock* (1886), 32 Ch.D. 560. There was formerly a strong division of opinion among the American courts as to whether an antecedent debt constituted "value", but the question has now been resolved in favour of the English view by virtue of the definition of "value" in the Uniform Sales Act, s. 76. See Williston, *op. cit.*, footnote 157, s. 620, pp. 397-398.

[162] See, *supra*, footnote 154.

[163] There was actually an exchange of cheques, thus leaving a small balance payable to the second trader, but MacDonald J. treated this as only colourable; *sed quaere*.

[164] U.T.R.A., ss. 9(2), 1; U.C.C. ss. 9-307, 1-201(9).

value, not being buyers in the ordinary course of business.[165] Whereas the former must give "new value", satisfaction of a pre-existing claim suffices for the latter.

MacDonald J.'s attention, however, does not appear to have been drawn to the apparently contrary decision of the Ontario Appellate Division in *Dominion Lock Joint Pipe Co.* v. *York*.[166] In that case the plaintiff conditionally sold some pipes to a contractor who installed them in the defendant's sewerage system. Not having been paid for the goods, he now sought to recover them from the defendant. The latter maintained, *inter alia*, that it was protected by the trader's provisions of the Ontario Act,[167] but this the plaintiff denied on the ground that there was no sale between the contractor and the defendant. Middleton J.A., speaking for the court, rejected the argument, saying:[168]

> It was argued that the contract was not a contract for the sale of the goods, but a contract for the construction of the sewer. While this is in one sense so, it was unquestionably part of the contract that the title to the goods should pass to the municipality, and this amounts to a resale within the meaning of the statute. This view is, I think, in accordance with that entertained by this court in *International Business Machines* v. *Guelph Board of Education*, [1927] 4 D.L.R. 632. . . .

Although the learned judge relies on the *Guelph* case, the point in issue was in fact neither raised nor discussed in that case. The true reason for his conclusion, however, appears to have been, as he pointed out in an earlier passage in his judgment, that the trader's section was introduced for the protection of innocent transferees and therefore should be interpreted liberally in their favour. There was, of course, a money consideration in the *York* case,[169] and, it should be noted, the court did not go so far as to say that *any* purchaser for value was protected by the section.

The position, then, is ambiguous and needs to be clarified by a more carefully drafted section. In such an event, two questions will have to be considered by the draftsman. First, should all transferees for value be protected? Secondly, must they give "new value"? It is submitted that the American precedents in the Uniform Trust Receipts Act and the Code should not be followed in their entirety, and that the first question should be answered affirmatively and the second in the negative for the following reasons.

As the *York* case shows, dispositions of goods in the ordinary

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[165] U.T.R.A. ss. 9(3), 1 (definition of "value"); U.C.C. ss. 9-301 (1)(c), 1-201(44).

[166] *Supra*, footnote 144.

[167] Ss. 3(3), (4).

[168] *Supra*, footnote 144, at p. 808 (D.L.R.)

[169] *Ibid.*

course of business, other than by means of a technical sale, are very common, and there is no reason why such transferees should not be protected as much as any buyer. The opportunities for deception are, after all, the same in both cases. The question of value may appear to be more controversial. It may be said that the absence of the requirement of "new value" will encourage frauds and that, in any event, a transfer in settlement of an antecedent debt is out of the ordinary course of business. The fear of fraud has been responsible for many extravagant doctrines in the past, and the net result has almost invariably been to hamper legitimate transactions. It is time it was given a decent burial, not because frauds do not occur at infrequent intervals but because there are better ways of combating it. In any event, if the fear is well founded, it should logically be applied to the whole doctrine of purchaser for value, not just to those who are dealing with a trader.

The second objection answers itself. If in a given situation the transfer of property in satisfaction of a pre-existing claim is outside the ordinary course of business,[170] then why the need to prescribe "new value"? Conversely, if it is not out of the ordinary, why proscribe it? The difficulties about the definitions in the Code and the Uniform Trust Receipts Act are that they attempt to freeze commercial practices by indirectly defining what is done in the ordinary course of business and what is not. Surely the expression can be allowed, in conjunction with the other requirement of "good faith", to find its own level?[171] It is uncommon, for example, for automobile dealers in North America to offer their customers "credit certificates" when buying a car, which may be used in part payment on the purchase of another vehicle. Suppose one of these certificates is so used. Why should it not be recognized as satisfactory value?

Finally, it may be said that one who has not given new value is not really prejudiced, since he has lost nothing by being required to surrender the goods he received from the trader. Similar argu-

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[170] As, for example, it was held to be in *Meen* v. *Realty Development Co.*, *supra*, footnote 70.

[171] *Cf.* the history of s. 5 of the Imperial Factors Act, 1889. Its predecessor, s. 4 of the Factors Act, 1842, only protected a disposition by a factor made in exchange for "an advance". S. 5 now extends this to "a payment in cash, or the delivery or transfer of other goods, or of a document of title to goods, or of a negotiable security or *any other valuable security*". See Chalmers, Sale of Goods (13th ed., 1957), p. 206. *Quaere* whether the emphasized words must be read *ejusdem generis* with the preceding species, so that a disposition in satisfaction of a pre-existing claim would be excluded?

ments were advanced when the question arose whether an antecedent debt constitutes any "value". It was rejected then because, as an old Illinois decision pointed out,[172] the creditor is lulled into a false sense of security. "He rests on the belief that his debt is paid, and in that belief foregoes all effort to seek other payment." This reasoning would appear to be just as apposite to the present situation as it was to the other.

(d) *Must the purchaser be a "bona fide" purchaser and one "without notice"?* At first sight the absence of these familiar landmarks may militate against an affirmative answer, especially as they appear in other parts of the Acts where the protection of third parties is also involved.[173] *Expressio unius exclusio alterius.* It is suggested, however, that this reasoning is rebutted by two factors of greater weight. In the first place, the doctrine of "good faith" is much too deeply imbedded in the common law, the law merchant, and equity to be upset by a side wind, and evidence of a much clearer character than the mere omission of these words ought to be required of a legislative intent to repeal so basic a test. Secondly, the trader's section enacts a form of statutory estoppel. It says to the buyer, "You may assume that the dealer owns the goods in his stock, or at any rate that he is authorized to sell them". But it is only a presumption. Once the buyer knows the real facts he is no longer deceived by appearances and therefore has no need of the statutory protection. The same result may be reached by a literal interpretation of the words of the Acts. The seller, it will be recalled, must "expressly or impliedly consent" to the goods being resold. The onus is on the purchaser to prove the consent.[174] Suppose he knows there is no consent. How, then, can he bring himself within the statute?

Once the requirement of "without notice"[175] is conceded, that of "good faith" follows, in Canada at any rate,[176] almost automatically. This is because, after considerable judicial conflict,[177] the Supreme Court of Canada finally held in *The Canadian Bank*

[172] *Butters* v. *Haughwort* (1886), 42 Ill. 18, 89 Am. Dec. 401, cited by Jones, *op. cit.*, footnote 160, p. 28.

[173] *E.g.*, 1922 U.C.S.A., s. 3; 1955 R.U.C.S.A., s. 3.

[174] *Cf.* s. 30(2) of the Bills of Exchange Act, 1882 (Imp.) and *In re Nisbet & Potts' Contract*, [1905] 1 Ch. 391, *per* Farwell L.J., at p. 402.

[175] *I.e.*, actual not constructive notice, because the doctrine of constructive notice does not apply to commercial transactions. See *The Manchester Trust Co.* v. *Furness*, [1895] 2 Q.B. 539; *Joseph* v. *Lyons*, *supra*, footnote 40.

[176] But not in England: see *Edwards* v. *Edwards* (1876), 2 Ch.D. 291 (C.A.), and *In re Monolithic Building Co.*, [1915] 1 Ch. 643.

[177] See *Moffat* v. *Coulson* (1860), 19 U.C.Q.B. 341; *Roff* v. *Krecker* (1892), 8 Man. R. 230; *Ferrie* v. *Meikle* (1915), 23 D.L.R. 269 (Sask.).

of Commerce v. *Munro*[178] that a person who has notice of an outstanding security interest and yet buys (other than in the ordinary course of business) cannot be acting in good faith.

The purchaser, then, who is protected by the trader's section is one who acts in good faith and without notice of any defect in the dealer's title. But this disposes only of some of the difficulties. It is in fact common knowledge that automobile dealers are financed by outside agencies. Is this sufficient notice? Surely not, because the buyer must have actual knowledge of the security interest, not merely the means of knowledge,[179] and the Uniform Trust Receipts Act so provides.[180] Suppose, however, the buyer has actual knowledge. Even this fact, it is submitted, ought not to prove fatal, for he ought to be entitled to assume that the dealer is selling with the financer's consent,[181] just as a person dealing with a company may, under the rule in *Royal British Bank* v. *Turquand*,[182] assume that the internal rules of the company have been complied with. It is quite different where the buyer knows that the dealer is *violating* the terms of his security agreement. Hence the Code, differing in this respect from the definition in section 1 of the Uniform Trust Receipts Act, defines a buyer in ordinary course of business as a person who buys "in good faith and without knowledge that the sale to him is *in violation* of the ownership rights or security interest of a third party in the goods".[183] The two Ontario cases to which reference has already been made illustrate the distinction. Evidence was given in them that the financer would never have consented to the cars being sold to another dealer, because the purpose of the financing was to enable

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[178] [1925] S.C.R. 302. See also *The Lanstone Monotype Machine Co.* v. *Northern Publishing Co.* (1922), 63 S.C.R. 482.

[179] See the cases cited, *supra*, footnote 175.

[180] S. 1, definition of "Buyer in the ordinary course of business". See also, *Colonial Finance Co.* v. *De Benigno*, *supra*, footnote 156 and *Krause's* case, *supra*, footnote 155. In the *De Benigno* case, the court said at p. 844: "As to the claim that the knowledge of the subdealer that his distributor was engaged in automobile financing constituted knowledge that the automobile in suit was subject to trust receipt financing, the finding is that the defendant had no actual knowledge of any limitation placed by the defendant on the liberty of sale of Bethel Motors, and the trial court concluded that the defendant had no notice actual or constructive of the trust receipt transaction between the parties. Whether or not the term 'actual knowledge' in the statute (sc. the Trust Receipts Act) is restricted to knowledge in fact as distinguished from knowledge imputed by reason of acts and circumstances known to the purchaser, at least the conclusion of the court that the defendant did not have constructive notice in this case is one which it could reasonably reach."

[181] *Cf. First National Bank* v. *Arthur Hermann Co.* (1949), 90 N.Y.S. 2d 268.

[182] (1856), 6 El. & Bl. 327, 119 E.R. 886.

[183] S. 1-201(9). Emphasis added.

the financer to secure the resulting retail paper. Therefore, although the sale to the second dealer might have been in the ordinary course of business, the trader-purchaser—assuming he knew the cars were subject to an inventory lien and assuming he knew the financer's motive in making the advance—ought to have realized that the sale to him was unauthorized.

(e)-i *Must title have passed to the purchaser?* Since the sections say "the property in the goods shall pass (or "passes" in the 1955 version) to the purchaser" notwithstanding registration of the wholesale contract, this might lead one to suppose that the purchaser is not protected unless there is an outright sale to him. Clearly the quoted words were not intended to confer on the purchaser greater rights than his contract with the dealer gives him. Moreover, such a construction would be in accord with the well-established rule that equity will not compel specific performance of a contract where this would involve assisting a breach of trust. In the absence of any Canadian authority[184] on the point it is suggested, however, that these arguments ought not prevail—at any rate not where, as in a conditional sale, possession has passed to the purchaser—for the following reasons. First, because these trader's sections were intended to establish a general statutory estoppel and a person may obviously act to his detriment even before title has passed to him.[185] Secondly, because in a conditional sale the seller really only retains a security interest in the goods. Thus the Code provides that, " 'Buying' may be on *secured* or unsecured credit".[186] It is true that a conditional sale in Canadian law is not generally regarded as a secured transaction,[187] but the conditional buyer does have a statutory interest in the goods[188] which ripens upon completion of his payments into full ownership without further action on the seller's part. Hence the buyer need not, and is not asking for, any judicial assistance to perfect his title.

(e)-ii *Must the purchaser have acquired possession?* The sections do not stipulate this requirement, and in principle it is difficult to see why it should be implied.[189] It is obviously possible for the

[184] Under s. 9 of the American U.C.S. Act it has been held that a conditional buyer is protected: *De Cozen Motor Co.* v. *Kaufman* (1934), 174 A. 893 (N.J.).

[185] In *Kaufman's* case, *ibid.*, the court said at p. 895: ". . . the prevalence of installment sales of automobiles is a matter of common notoriety. To us it is inconceivable that the Legislature intended to protect the cash purchaser . . . and leave unprotected the less opulent purchaser who had signed an installment contract. . . ."

[186] U.C.C. s. 1-201(9), lines 5-7. Emphasis added.

[187] *Humphrey's Motors Ltd.* v. *Ells*, [1935] S.C.R. 249.

[188] *R.* v. *Hemingway*, [1955] S.C.R. 712.

[189] *Cf.* Bogert, U.L.A. 2A, p. 78.

purchaser to have changed his position prejudicially in reliance on the dealer's possession of the goods even before the goods have been transferred to him. *Ashmore* v. *Trans-Canada Finance Corp'n*[190] illustrates the point. The purchaser there saw the car on the dealer's premises and paid for it,[191] but never received possession of it. Dysart J., invoking principles of common-law estoppel, held[192] that, since the purchaser had changed his position detrimentally, the financer was estopped from denying the dealer's authority to sell the car.[193] It should be noted, on the other hand, that the Uniform Trust Receipts Act[194] and other statutes *in consimili casu* require possession to be vested in the purchaser. Why this requirement was inserted, is not clear.

(f) *Must the dealer have sold the goods only after they were delivered to him, and must the purchaser have seen the goods at the time of the sale?* It is quite common for a dealer in new goods, especially in the automobile field, to sell an article before it has yet been delivered to him by the manufacturer, and for a purchaser to pay for it without seeing it beforehand. Consequently the two questions are of practical importance. In principle, there is only one question, the second, and the only justification for looking at the position from the dealer's as well as the purchaser's point of view is the particular wording of section 4 of the 1922 Act and section 3(3) and (4) of the Ontario Act (the two subsections of which, it is submitted, must be read together). Section 4 reads, "If the goods are delivered to a trader or other person, and the seller expressly or impliedly consents that such buyer may resell them . . . AND such trader or other person resells the goods . . .". Section 3(3) of the Ontario Act provides, "Where the delivery is made to any person for the purpose of resale . . ." then, by virtue of section 3(4), "Where such person resells the goods" the purchaser obtains a good title. *Prima facie*, therefore, these provisions seem

[190] *Supra*, footnote 131.

[191] Actually payment was by way of a set-off and a cheque for the balance. The cheque, however, was later returned.

[192] *Supra*, footnote 131, at p. 61 (Man. R.).

[193] To the same effect, see Fullerton J.A. in *Hunter* v. *Trans-Canada Finance Corp'n*, *supra*, footnote 130, at p. 283: "Had he gone into the Motors Co., selected a car and paid for it without knowing that it was subject to any lien, *Brett* v. *Foorsen*, cited above would apply to this case". It may, of course, be argued that where title has passed to the purchaser he has as a matter of law the right to possession.

[194] S. 1. *Quaere* the position under the Code? Unlike s. 1 of the U.T.R.A., s. 1-201(9), which defines a "buyer in ordinary course of business", does not expressly require delivery to the buyer, but the Comment accompanying the definition explains that it is based on the U.T.R.A. Presumably, therefore, no change was intended *sub silentio*. See also lines 6-8 of the definition.

to set up a chronological sequence of delivery followed by a resale. Such an interpretation, however, although it is supported by the judicially construed meaning of "subsequent purchasers and mortgagees" as used in other parts of the conditional sales Acts,[195] is much too mechanical and ought not to prevail, and in any event could not be applied to those provincial Acts that follow the 1955 revised uniform Act.[196] The only reason for attaching a temporal significance to the conjunctive "and" can be that, if the trader does not have the goods in his possession at the time he purports to sell them, the purchaser cannot have been misled by any appearance of ownership, but this merely states the second question in another way and it would be better to consider that question unencumbered by any too refined reading of the trader's provisions.

The problem posed by the second question is nicely illustrated by the facts in *Hunter* v. *Trans-Canada Finance Corporation*.[197] The purchaser there paid for the car without seeing it and before it had been delivered to the dealer. However, at the time the purchaser received delivery of the car he knew that the dealer was not authorized to sell it. The Manitoba Court of Appeal therefore held that the financer's lien on the car remained unimpaired, since the purchaser had done nothing in reliance on the dealer's possession of the chattel. It does not, however, follow from this decision — nor did the Manitoba court claim it to be so — that the purchaser must have seen the goods at the time of the original purchase. It is well settled that the detriment to a representee in an estoppel situation may consist either of some action on his part or simply of inaction[198] — by being lulled into a false sense of security. A purchaser, on the strength of the delivery of the goods to him, may desist from taking action that would otherwise have been open to him, had the delivery not taken place, to recover any money he may have paid over or any goods he may have traded-in. It is no doubt for this reason, among others, that the Uniform Commercial Code[199] provides that "buying" "includes receiving goods or documents of title under a pre-existing contract for sale".

In any event, it will be noticed that none of the trader's pro-

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[195] *Liquid Carbonic Co.* v. *Rountree*, [1924] 1 D.L.R. 1092 (Ont. C.A.); *Warner* v. *Foster*, [1934] 3 D.L.R. 665 (Ont.); *Welsh* v. *Gen. Refrigeration*, [1929] 3 W.W.R. 660 (B.C.).

[196] *E.g.*, the Newfoundland Act. S. 7 of the 1955 Act omits the opening clause in s. 4 of the 1922 Act and starts off, "Where the seller of goods . . . consents that the buyer may sell them", *etc.*

[197] *Supra*, footnote 130.

[198] Ewart, *op. cit.*, footnote 127, p. 133 *et seq.* See also, for example, *Gordon* v. *James* (1885), 30 Ch. D. 249.

[199] S. 1-201(9).

visions expressly states that the purchaser must have altered his position prejudicially in any respect, and even less in any particular respect.[200] The detriment is no doubt assumed.

(g) *Must the purchaser's consideration be executed?* This is another point on which the sections offer no guidance, nor do the decided cases throw any light on it. In equity it is not the making but the performance of the promise which constitutes "value".[201] Nor does partial payment suffice.[202] The position at common law is vague, but has been claimed to be the same.[203] The Uniform Trust Receipts Act set out consciously to reject the equitable doctrine[204] and expressly provided that a purchase on credit shall constitute a purchase for value.[205] These provisions are re-enacted in the Code.[206] Thus in the United States a conditional buyer from a trader is protected. It is suggested that, even in the absence of express language to support it, a similar intention should be attributed to the trader's provisions in the Canadian Acts. The draftsmen of the uniform Acts must clearly have had in contemplation the possibility, if not the probability, of the trader reselling on instalment credit and could not have intended to leave a conditional buyer unprotected. In most cases, however, the question is not likely to be of any practical importance, since the conditional buyer is usually required to sign a promissory note, which is then transferred to a holder in due course. Where this occurs, "value" will have been given even according to the equitable test.[207]

Conclusion: From this somewhat detailed examination of the provisions of the trader's sections, it will be seen how much they leave to be desired in the way of clarity. Sometimes a literal reading favours the purchaser, at other times the financer. Fortunately,

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[200] *Cf. Commercial Credit Company of Canada, Limited* v. *Fulton Bros.*, [1923] A.C. 798, *per* Lord Sumner, at p. 805.

[201] *Hardingham* v. *Nicholls* (1745), 3 Atk. 304; Scott on Trusts (2nd ed., 1956), vol. 3, s. 302.

[202] *Tourville* v. *Naish* (1734), 3 P. Wms. 307; Scott, *op. cit.*, *ibid.*, s. 303.

[203] Jones, *op. cit.*, footnote 160, p. 29. See also, Williston, *op. cit.*, footnote 157, s. 620, pp. 400-401.

[204] See Commissioners' Prefatory Note, U.L.A. 9C, p. 227.

[205] See s. 9(3) and s. 1 (definition of "Buyer in the ordinary course of trade").

[206] S. 1-201(9).

[207] Scott, *op. cit.*, footnote 201, s. 302.4: *McMillan* v. *Pierce*, [1917] 3 W.W.R. 614. (Alta. C.A.). S. 1(11) of the 1955 U.C.S.A., like s. 76 of the American Uniform Sales Act, defines "valuable consideration" as any consideration sufficient to support a simple contract, including an antecedent debt. Williston, *op. cit.*, footnote 157, s. 620, interprets the definition in s. 76 as impliedly repealing the equitable rule. If a similar construction of the Canadian definition is adopted, this provides further support for the submission in the text, since the draftsmen could hardly have intended to repeal the equitable rule in some cases and not in others.

there are few insuperable policy conflicts, and both the Code and the Uniform Trust Receipts Act offer useful precedents for solving particular problems. It is to be hoped, therefore, that they will be consulted if a serious revision of the Canadian provisions should ever be contemplated.

4. *Protection under the factors legislation.* Dealers who rely on wholesale financing cannot ordinarily be described as "mercantile agents" within the meaning of the Imperial Factors Act, 1889,[208] since their normal business is to sell as principals and not on behalf of others. This is true, for example, in North America, of automobile dealers.[209] Moreover, even if they could be so described, the goods are in their possession *qua* buyers under a wholesale conditional sale agreement or *qua* mortgagors under a wholesale chattel mortgage, and it is now settled that if goods are entrusted to a mercantile agent in a capacity other than that of mercantile agent the factors legislation does not apply.[210] These points appear to have been overlooked by Gregory J. and McPhillips J.A. in *Commercial Securities Ltd.* v. *Johnson.*[211] Nevertheless, the legitimate possibility of the trader being treated as a mercantile agent ought not to be excluded entirely. This possibility will arise where the wholesale contract contains a "proceeds" clause and the agreement is construed as authorizing the dealer to dispose of the secured goods on the financer's behalf.[212] This question is more fully dealt with under the heading of the financer's right to follow the proceeds of a sale, a subject to which we must next turn our attention.

IV. *The "Financer's" Right to the Proceeds of Sale.*

At the outset a distinction must be drawn between three possible types of situations: 1. Those in which the trader has fraudulently

[208] The Act has been adopted in all the common-law provinces save Newfoundland.

[209] *Cf. Schafhauser* v. *Shaffer, supra,* footnote 136, at p. 667.

[210] *Jenkyns* v. *Usborne* (1844), 135 E.R. 273, ref'd to with approval in *Fuentes* v. *Montis* (1868), L.R. 3 C.P. 268, at pp. 278-279; *Joseph* v. *Lyons, supra,* footnote 40, esp. at pp. 282, 285 (C.A.); *Staffs Motor Guarantee Ltd.* v. *British Wagon Co. Ltd.,* [1934] 2 K.B. 305; *Olds Discount Co.* v. *Krett,* [1940] 3 All E.R. 36; *Schafhauser* v. *Shaffer, ibid.; Eastern Distributors Ltd.* v. *Goldring,* [1957] 2 Q.B. 600 (C.A.). These cases surely answer the query raised in Chalmers, *op. cit.,* footnote 171, p. 202, as to whether s. 2 of the Act applies to a case where the goods are delivered to a mercantile agent in a capacity other than that of mercantile agent.

[211] (1931), 43 B.C.R. 61, at pp. 63-64 and [1931] 1 D.L.R. 861, at p. 863.

[212] See, for example, *Handy* v. *C.I.T. Corp.* (1935), 197 N.E. 64 (Mass.), where it was held that a trustee in a trust receipt transaction was the entruster's agent for sale and the buyer from the trustee was therefore protected under the Massachusetts factors legislation.

sold the goods subject to the security interest but in which the financer is estopped from impeaching the sale; 2. Those in which the financer has authorized the sale but in which the contract contains no "proceeds" clause; and 3. Those in which the sale is authorized and where the contract does contain the clause. In the first type of situation, the financer has a legal right to follow the proceeds,[213] so long as they have not assumed the form of money which has become mixed with other funds, in which event the financer will have to resort to an equitable tracing order.[214] In the second situation, since by consenting to the sale the financer has relinquished his security interest in the goods, he is left with only a personal claim against the dealer. It is the third type of situation that, in Canada, raises the most acute problems and which will form the principal subject for discussion in the ensuing pages.

Two common forms of proceeds clauses currently in use by two major finance companies in Canada read as follows:

> *Form 1.*[215]
> Dealer agrees to report each sale promptly to Seller and immediately to hand all cash proceeds, and all other proceeds, if any, to Seller, and to hold all proceeds of the sale in trust for Seller separate from its funds. At Seller's election, in the event of a sale, Seller may require the aforementioned sale price of any property sold to be paid to Seller in cash plus unpaid charges.
> *Form 2.*[216]
> In the event of said chattels or any of them being sold by Grantor before the payment in full in cash of all sums due hereunder, all moneys, goods, and securities paid or delivered on such sale shall be the property of Grantee, and Grantor shall hold same in trust at Grantor's risk for the Grantee, separate from any property of the Grantor, and shall promptly pay over, assign and deliver the same unto Grantee.

The proceeds may take the form of a "trade-in", a simple debt, a negotiable note, a conditional sale agreement, cash, or a combination of two or more of these. A car dealer, for example, will frequently receive on the sale of a vehicle a "trade-in", a small amount of cash, and a conditional sale agreement accompanied

[213] *Taylor* v. *Plumer* (1815), 3 M. & S. 562; *Sinclair* v. *Brougham*, [1914] A.C. 398, 441; *Re Diplock*, [1948] Ch. 465, at pp. 518-519 (C.A.); Nathan's Equity Through the Cases (4th ed., 1961), p. 483. These authorities appear to have been overlooked in *Imperial Finance Corp.* v. *Fidelity Trust Co.*, *supra*, footnote 131, where the financer's rights were treated as exclusively equitable in character.

[214] *Re Hallett's Estate* (1880), 13 Ch. D. 696; *cf.* (American) Restatement on Restitution (1937), ss. 202, 203.

[215] Canadian Acceptance Corporation, Wholesale Conditional Sale Agreement, "Conditions of Sale", clause 2.

[216] Industrial Acceptance Corporation, Wholesale Chattel Mortgage Agreement, unnumbered clause.

by a promissory note. Hence, it will be seen, the financer's success in following the proceeds of a sale depends to a substantial extent on the nature of the proceeds. Even more fundamental, however, for the determination of his rights, is the answer to the question as to the capacity in which the trader disposes of the secured goods. There are three possible answers:

(a) that he sells as the financer's agent and holds the proceeds on trust for the financer;
(b) that he sells as trustee and holds the proceeds on trust for the financer; and
(c) that he sells as principal, but again agrees to hold the proceeds on trust for the financer.

Before discussing the cases that illustrate the highly important consequences which flow from whichever of these theories is adopted, it is necessary to refer briefly to two other suggestions which, if sound, would eliminate this particular problem altogether. The first of these is that, even in the absence of a proceeds clause, a trader who lawfully disposes of goods subject to an inventory lien is merely acting as the financer's agent. The second is that proceeds clauses which seek to establish a trust in favour of the financer are either void for uncertainty or contrary to public policy.

The first suggestion has been adopted in a number of Vermont cases, although generally, as Professor Bogert points out,[217] there has been surprisingly little discussion by the courts of the exact theory on which the conditional sale for resale operates. In *Lewis* v. *McCabe*[218] the question was whether a wholesale conditional sale was void as against attaching creditors of the trader. It was held not, on the ground that the rule relating to wholesale chattel mortgages[219] did not apply to conditional sales. The court justified the distinction on the following grounds:[220]

> If however the contract in question must be construed to mean that the plaintiff authorized [the trader] to sell the property as his own, we should be constrained to hold it so absolutely inconsistent with the retention of the title in the plaintiff as to waive or make void the condition. But in this case the condition that no title was to pass until payment is so clear, express and positive in its terms that we are inclined to give it full effect, and to construe what is afterwards said of the understanding of the parties relative to a sale as the court in *Rogers* v. *Whitehouse* . . . did, that is, not as authority to sell as his own (having nothing himself) but as authority simply to transfer the title of the plaintiff in the manner authorized.

[217] U.L.A., 2A, s. 79.
[218] (1881), 49 Conn. 141.
[219] See *supra*.
[220] *Supra*, footnote 218, at p. 155.

Whatever may be thought of the general policy of distinguishing, in so far as creditors are concerned, between a wholesale conditional sale and a wholesale chattel mortgage, the suggestion that the trader is acting as the financer's agent is as untenable in this situation as it is, as will be submitted later, where the agreement contains a proceeds clause. In the first place, the agreement nowhere so states. Secondly, the fact the seller reserves title in himself until the price is paid is no more inconsistent with an implied licence to sell the goods as his own than it is with the theory that he is acting as an agent for sale, and it is the former position which has been consistently adopted in the long line of Anglo-Canadian cases dealing with wholesale chattel mortgages.[221] Thirdly, and most importantly, a trader cannot be a buyer and an agent at the same time. If he sells as agent—and, it must be remembered, almost invariably the goods are sold by the trader before they have been paid for—he ceases to be a buyer, and, *ex hypothesi*, is no longer bound to pay the purchase price. It cannot be seriously suggested, however, that the seller intends to release the trader from his original obligation in this off-handed way.

The thesis that the proceeds clause is a nullity was seriously propounded at successive levels by the Appellate and the Supreme Court of Illinois in *Kilgore* v. *State Bank of Colusa*.[222] Here there was a contest between a judgment creditor of a trader and his wholesale financer as to certain funds in the trader's bank account, the financer claiming to be entitled to them on the ground that they represented the proceeds of certain goods delivered by him to the trader under a wholesale conditional sale. The agreement provided, *inter alia:*

> That the proceeds of all resales shall be considered the property of the company in lieu of the goods so sold, and held in trust for it and subject to its order as provided in paragraph 4 hereof, until all sums due under conditional sale contract [sic] have been fully paid.

Paragraph 4 read:

> Upon request by the company at any time the purchaser agrees to turn over, endorse, and assign to the Company a quantity of customers' notes, or, if notes are not available, then customers' accounts, sufficient to fully cover and secure all indebtedness of the Purchaser

[221] See *supra*. In *Joseph* v. *Lyons, supra*, footnote 40, at p. 282, the following dialogue occurred. Lindley L.J.: "How can a mortgagor of chattels to be sold in the course of a trade be the agent of the mortgagee?" Counsel: "Manning [the trader-mortgagor] was an agent for sale for the benefit of the plaintiff [mortgagee]." *Per Curiam:* "The second point which is now urged before us, cannot be sustained."

[222] (1939), 21 N.E. 2d 9, aff'd 25 N.E. 2d 39, and noted in (1940), 28 Ill. Bar J. 154.

hereunder, such notes and accounts to be held as collateral security to said indebtedness.

The Appellate Court held these clauses void on grounds of uncertainty and as against public policy, although both grounds are closely interwoven in its judgment. After enumerating the essential elements of a trust,[223] the court continued:[224]

> Upon the most casual consideration, it is readily apparent that the contracts in question meet none of the cardinal principles laid down by the law governing express trusts. To hold that a valid trust exists under the contract and circumstances in this case would invade a wholly new field for the law. Every manufacturer and wholesaler in selling merchandise to retail dealers that was for resale to the consuming public would have a precedent whereby they could rubber stamp on their invoices or delivery receipts the words, "on resale, proceeds to be held in trust". The law would then have the task of attempting to follow these proceeds into the merchant's bank account and separate them into the various trust accounts. This is a new and unknown field in law and commerce, and would lead to much confusion and an unwarranted extension and annexation governing conditional sale contracts that is for the legislature to extend rather than the courts.

In the Supreme Court the second ground was not pursued, but the court gave some additional reasons for refusing to give literal effect to the proceeds clauses:[225]

> The object of the contracts under consideration was to secure [the trader's] debt to the Company. It was a security arrangement as contrasted to a trust. [The trader] was not a trustee in the accepted sense of the word. He was a debtor and was bound by his agreement to turn over the notes and accounts of his customers to the Company to secure the unpaid balance to it.

The court then proceeded to discuss the differences between a trust relationship and a debtor and creditor relationship.

None of these reasons for disregarding the terms of the contract are persuasive. To be sure, the word "trust" is used in many different senses,[226] and sometimes quite misleadingly so,[227] but this does

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[223] *I.e.*, subject matter, beneficiaries of the trust, nature and quantity of beneficiaries' interest and manner in which the trust is to be performed: 21 N.E. 2d 9, at p. 11.

[224] *Ibid.*, at pp. 11-12.

[225] 25 N.E. 2d 39, at p. 42.

[226] "There is a vast difference between things to which we give the same denomination, I mean trusts. You have a trust expressed: you have a trust implied: you have relations formed between individuals in the matters in which they deal with each other in which you can hardly say that one of them is a trustee and the other a *cestui que trust;* and yet you cannot deny that to some intents and for some purposes one is a *cestui que trust* and the other a trustee.": *Cholmondely* v. *Clinton* (1821), 4 Bligh 1, at p. 96, cited in Maitland on Equity (Brunyate's ed., 1949), p. 228.

[227] The most notorious example, of course, is the American trust receipt, in which the "trustee" acknowledges that he holds the goods "on trust", although it is not intended that he should acquire any legal title to the property .

not justify the Supreme Court's failure to attach any meaning whatever to the word. Moreover, contrary to the court's suggestion, there is nothing incompatible between a trust (in the sense to be presently explained) and a security agreement, provided it is understood that the trust is subordinated to the basic debtor and creditor relationship. In *R.* v. *Townshend*, an English decision,[228] the defendant pledged certain bills of lading with a bank. They were subsequently released to him against a "letter of hypothecation", by the terms of which he undertook to hold the proceeds of the sale of the goods on trust for the bank. The defendant, however, converted the proceeds to his own use, and Day J. held that he could be convicted under section 80 of the Larceny Act of converting trust property to his own use.

Reading together the two above cited clauses which appeared in the agreement in *Kilgore's* case,[229] it seems reasonably clear that what they mean to say is that the equitable title to the proceeds shall be held by the seller as security for the buyer's debt in place of the goods which had previously served that purpose, and that the seller might call for the specific assignments of ascertained notes and accounts to reinforce his security.[230] In such a situation —a familiar one in chattel mortgages with an "after-acquired property" clause—the debtor has been called a bare trustee, because he holds the legal title while the equitable title is vested in the creditor.[231]

The suggestion by the Appellate Court that such proceeds clauses set up a new and unknown field "in law and commerce" seems surprising, to say the least. Such clauses have been a common feature in inventory financing in the United States (and, to a limited extent, in England) for over sixty years, and, far from being an unwarranted extension of the law, it is American law itself which, under the rule in *Benedict* v. *Ratner*,[232] has made the trader's accountability for the proceeds of sale a prerequisite to the recognition of inventory liens in many states.

To sum up, therefore, it is submitted that, in the absence of a proceeds clause, the trader is not acting as the financer's agent

[228] (1884), 15 Cox C.C. 466. [229] *Supra*, footnote 222.

[230] It may be asked what the financer has to gain by such specific assignments, since he already holds the equitable title. The answer is, first, that he thereupon also obtains the legal title, and, secondly, that without the documents he would not be able to realize the security, since he would not know to whom the goods had been sold.

[231] ". . . the assignor was the bare trustee of the assignee to receive and hold the property for him when it comes into existence": *In re Lind*, [1915] 2 Ch. 345, *per* Bankes L.J., at p. 374.

[232] *Supra*, footnote 26.

in reselling the goods, and that there is nothing repugnant or impossible about a proceeds clause. With these preliminary observations, we turn now to consider some English and Canadian cases in which the courts have recognized the validity of a proceeds clause, but in which they have differed as to the capacity in which the trader sells the encumbered goods.

1. In *In re David Allester Limited*[233] a limited company pledged bills of lading with a bank to secure an overdraft. When it was time to sell the goods, the company, in accordance with established mercantile practice, obtained the bills of lading from the bank for realization on the terms stated in the following usual, letter of trust:

> TO BARCLAYS BANK, LIMITED.
>
> Gentlemen,
>
> I/we have to acknowledge receipt of invoice, ...
>
> I/we receive the above in trust on your account, and I/we undertake to hold the goods when received, and the proceeds when sold as your trustees. I/we further undertake to keep this transaction separate from any other and to remit you direct the entire net proceeds as realized, but not less than £1200 within 28 days from this date. . . . .

The company went bankrupt and the bank claimed to be entitled to certain funds in the liquidator's hands as representing the proceeds from the sale of the goods pledged to them. Astbury J. held, *inter alia*, that as the letter of trust merely recorded the terms on which the company was authorized to realize the goods on the bank's behalf, and did not really create any charge at all, it did not require registration under the Companies (Consolidation) Act, 1908, either as a bill of sale or as a charge on book debts. Accordingly, the bank's claim was superior to that of the liquidator. The learned judge summed up his conclusions in the following passage:[234]

> Here, if I may repeat myself again, the bank as pledgee created a trust agency in the company for the purpose of the realization of the bank's security. That trust agency was acknowledged and recorded in the letters of trust. That is the whole of the transaction.

It will be seen, therefore, that it was Astbury J.'s opinion that the bank was merely realizing its security via the company.

2. In *Banque Canadienne Nationale* v. *Lefaivre*,[235] a Quebec decision but based on common-law principles, the bankrupt company gave the plaintiff bank a section 88 security on its inventory. The security agreement contained the following proceeds clause:

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233 [1922] 2 Ch. 211.

234 *Ibid.*, at p. 219.

235 [1951] Que. K.B. 83, criticized on other grounds by Fenston in (1951), 11 R. du B. 298.

> Dans le cas de vente par le client des effets en tout ou en partie, les produits de cette vente, . . . 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 detiendra qu'en fideicommis pour la banque.

At the time of its bankruptcy, proceeds from the sale of the secured goods were in the company's hands, and a majority of the Quebec Court of Appeal held that the bank was entitled to the money, even though the bank had not complied with article 1571 *et seq.* of the Quebec Civil Code.[236] Casey J., one of the majority judges, reasoned, *inter alia*, as follows:[237]

> At this point reference may be made to the agreement entered into at the time of the creation of the security. By this agreement appellant, without abandoning any of its rights and without changing its position or relationship with its debtor, by necessary implication at least, gave to its debtor permission to sell these goods for its, appellant's, account. With all deference, I cannot view this agreement as one covered by C.C. 1570 and following. It simply regulated the operations of Bank and client, operations arising out of the relationship between the Bank as the owner of the goods and client as its agent for the purpose of their disposal.

Galipeault J. arrived at the same conclusion:[238]

> L'appelante, dans mon humble opinion encore, a raison de prétendre que son droit aux créances repose sur son droit de propriété des marchandises et non sur une cession des dites créances. Elle dit: aucun transport n'était nécessaire parce que l'emprunteur n'avait rien à transporter. Lorsque la cédante a vendu à ses clients les choses sujettes à l'article 88, elle a fait la vente, tout en agissant en son nom, de choses qui ne lui appartenaient pas mais qui appartenaient à la banque, pour et au nom de la banque, dans l'accomplissement du mandat qu'elle avait assumé envers cette dernière . . . .

Both these judgments, if one may say so, involve a logical fallacy. Both appear to proceed on the assumption that since the bank had title to the goods, and since it was consenting to their sale by the borrower, that therefore the borrower *must* have been acting as the bank's agent. This conclusion does not necessarily follow. The bank could just as logically have agreed to waive its lien, thus giving the borrower a clear title to the goods, on the understanding that the bank would have a *new* lien on the proceeds. The court's decision was not wrong; it merely shows that, for no doubt sound policy reasons, the court preferred to adopt that theory which preserved the bank's lien against the proceeds without the need for new registrations.

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[236] Art. 1571 deals with the perfection of assignments of debts and, in the case of "a class of rents", with registration procedures (art. 1571c).

[237] *Supra*, footnote 235, at p. 95. [238] *Ibid.*, at pp. 91-92.

3. These two decisions, which are merely representative of a larger number,[239] should be contrasted with that of Smily J. in *In re Fred's Farm Industries Limited.*[240] The facts were that in January, 1951, the bankrupt company gave a general assignment of its present and future book debts to the claimant bank, which was duly registered. In December, 1953, the bankrupt purchased certain equipment from M, a manufacturer, under a wholesale conditional sale agreement, which authorized the bankrupt to sell the equipment in the ordinary course of its business. Clause 7 of the agreement further provided that the proceeds of such a sale "shall be deemed to be the property of the company in lieu of the goods so sold by the Dealer and shall be held in trust for the company and subject to its order", but in clause 17 it was made clear that "The Dealer is not and shall not be an agent or servant of the Company in any respect, . . .". The bankrupt sold the equipment, and the question arose whether the bank or M was entitled to the proceeds which, *semble*, had been collected and were in the hands of the trustee in bankruptcy.

Smily J. held that the debt arising on the resale of the equipment enured in favour of the bank, which could not be deprived of it by the subsequent purported "assignment" to M. He reasoned briefly as follows:[241]

> The dealer having assigned to the bank by a valid assignment duly registered all debts owing to him and this being a debt owing to him it could not be affected by an agreement made by the dealer with the Company subsequent to such assignment. There was no power in the dealer to unilaterally take away the title of the bank to this debt....

Unfortunately, the learned judge's attention does not appear to have been drawn to the earlier cases, and in particular not to *In re Niagara Peninsula Music Co.*,[242] nor is it clear to what extent

[239] See, for example, *Union B. of Halifax* v. *Spinney* (1907), 38 S.C.R. 187, *per* Davies J., at p. 196; *Can. Hart Products Ltd.* v. *Royal Bank*, [1924] 4 D.L.R. 225, at p. 230; *Re Toronto Speciality Mfrs. Ltd.* (1933), 14 C.B.R. 77, at p. 78. In none of these cases, however, was the capacity in which the bank's debtor sold the goods discussed.

[240] *Supra*, footnote 48.

[241] *Ibid.*, at p. 129.

[242] (1929), 11 C.B.R. 66 (Reilley R., Ont.). The contest here was between the wholesale financer and the trader's trustee in bankruptcy, the latter's position being that that financer's claim to the proceeds was invalid because the assignment had not been registered under the Assignment of Book Debts Act. The Registrar found for the financer, his judgment proceeding as follows (at p. 68): "The agreement [between the financer and the trader] is most carefully drawn in very simple and plain language, and although it may be regarded as very ingenious in its effect, it is in no way misleading. At the same time, it must be read and interpreted as a whole to find the general intention and the intention herein is plain, that the applicant intended to retain the legal ownership in the goods until that was substituted on a resale by their acceptance of the debtor company

his decision was influenced by clause 17 of the agreement. What is quite clear, however, is the fact that he treated the bankrupt trader as having sold the goods as principal and not as agent for the wholesale financer.[243]

To return to our original question, the theory that a dealer holding goods subject to a security agreement with a proceeds clause sells them as agent for the secured party is open to several strong objections. In the first place, the agreement nowhere so states and sometimes indeed, as in *Fred's* case,[244] expressly avers the contrary. Duff J. in *The John Deere Plow Company* v. *Agnew*,[245] speaking of a wholesale conditional sale agreement with a proceeds clause, said:

> I see nothing in these provisions requiring or, indeed, justifying the inference that the respondent [sc. the trader] in carrying out the agreement was acting as the agent or representative of the appellant's business.

Moreover, to impute such an intention to the parties would ordinarily be in the interest of neither. The financer would not be pleased to know that he could be held liable for the dealer's torts or breaches of contract, nor would the trader welcome the suggestion that his financers, as alleged principals, could interfere in the operation of his business. Indeed, if the agency theory were to be taken literally, it would transpire that the chartered banks in Canada and the major finance companies between them were operating most of the nation's businesses! It is, no doubt, for reasons such as these that section 12 of the Uniform Trust Receipts Act expressly provided that the entruster shall not, merely by virtue of his security interest or of his having given the trustee liberty of sale or other disposition, be responsible as principal or as vendor under any sale or contract to sell made by the trustee.[246]

The second objection is that, as has already been pointed out, the trader cannot be both a buyer and an agent for sale at one and the same time. In this respect the wholesale conditional sale differs

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as their trustee. The applicant, by giving up its title and right of ownership, gave ample consideration for the rights it obtained by the dealer becoming its trustee, and if the applicants saw fit in this way to protect its rights and obtain payment therefor, it was doing no more or no less than it could have done had it required the lien note given on the resale to be made in its own name and the dealer act as its agent only for collection." It may be felt that this passage merely skirts the problem: either the trader is acting as the seller's agent or he is not. There is no half-way house.

[243] It is understood that, in order to overcome the effect of this decision, it is customary for financers to obtain waivers from the dealer's bank with respect to any assignment of book debts which the bank may hold.

[244] *Supra*, footnote 48.

[245] *Supra*, footnote 8, at pp. 231-232.

[246] See also Gilmore in (1949), 57 Yale L.J., at p. 764.

decisively from a chattel mortgage, "section 88" or trust receipt transaction. In the latter instances, since the financer has performed his part of the contract, the trader owes him an absolute debt and there is no necessary inconsistency between his status as a debtor and as an agent for sale. Thirdly, the wholesale financer almost invariably provides the trader with retail conditional sale forms in anticipation of the trader assigning the completed agreements to him in due course. In these forms the trader is described as "vendor" of the goods, and they further provide that "ownership" or "title" in the goods shall remain in the vendor until the purchase price has been paid. Now it is settled law that where a person describes himself as an "owner", there is an implied condition that he is not acting as an agent for an undisclosed principal.[247]

The second alternative, that the trader sells the goods as trustee and holds the proceeds as trustee, is as theoretically tenable as the first and rather less objectionable from either party's point of view. In fact, as has been seen, the agreement in *In re Allester*,[248] described the merchant as holding the goods as trustee both before and after their sale.[249] Nevertheless, even this classification of the trader is forced and artificial. The parties do not really intend that he should be clothed with the fiduciary duties and functions of a trustee. Moreover, one is again faced with the objection that the trader cannot be a buyer and a trustee at one and the same time. To overcome this obstacle, one would have to argue that as soon as he is ready to conclude a sale, title to the goods passes to him absolutely (thus providing the consideration for his debt), and that a fraction of a second later he agrees to hold the property and its proceeds on trust for the financer. This mental exercise,

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[247] *Humble* v. *Hunter* (1848), 12 Q.B. 310. The later cases are collected and discussed in Powell, Law of Agency (2nd ed., 1961), pp. 129-132.

[248] *Supra*, footnote 233.

[249] Yet, surprisingly, in *Lloyds Bank, Ltd.* v. *Bank of America Nat. Trust & Savings Ass'n*, [1938] 2 All E.R. 63, where there was a similar trust clause, the Court of Appeal appears to have ignored it almost completely and to have simply treated the bank's customer as an agent with fiduciary duties. An "agent-trustee", however, is not vis-à-vis third persons in the same position as a fiduciary agent. He actually holds legal title to the goods and sells them in his own name, though he is subject to the principal's directions and accountable to him. For further discussion of his status, see Restatement on Agency 2d (1958), s. 14B, Restatement on Trusts 2d, s. 8, Comment (h). This hybrid form of agency does not appear to be well understood in England, although it must be quite common; at any rate, it is not referred to in the standard texts on trusts and agency, except, now, Professor Powell's, *op. cit.*, footnote 247, p. 26, para. (b). It must be added, however, that disposals by a pledgee pursuant to the pledge agreement raise special problems, not germane to this article, since the pledgee only has a qualified title in the property and the pledgor, *ex hypothesi*, retains the legal title.

however, would defeat its own purpose. In the first place, it would not prevent other liens attaching to the property—say under an after-acquired property clause[250]—between the however short period of metamorphosis from absolute owner to trustee, and, secondly, it would not avoid the registration requirements relating to trusts under the bills of sale Acts.

The third alternative, that the trader sells as principal but holds the proceeds on trust for the financer, surely represents the true intentions of the parties. What the parties seek to accomplish is a simple transfer of the financer's lien from one bundle of assets to another. Nevertheless, this perfectly legitimate aim cannot be realized under existing Canadian security law (except, to a very limited extent, by means of an after-acquired property clause in a wholesale chattel mortgage) without the financer complying with all the vexatious registration procedures of at least two and possibly three statutes. Hence the no doubt intentional ambiguities in the wording of the proceeds clauses. What is plainly required is an amendment in the form of section 10 of the Uniform Trust Receipts Act and section 9-306 of the Code recognizing the financer's right to a continuous security interest in the goods themselves and in the proceeds realized from their sale, without the fictitious assumption of an agency relationship.

With these somewhat lengthy prefatory remarks about the general problem of establishing the financer's claim to the proceeds, we turn now to discuss some special problems attaching to specific forms of proceeds.

1. *Cash.* Tracing cash where it has been commingled with other funds of the trader is such an involved and expensive procedure that both the Uniform Trust Receipts Act[251] and the Code[252] have circumvented the equitable rules entirely. They provide instead that, in the event of insolvency proceedings being instituted against the debtor, the secured party shall have "priority"[253] or a security interest in such commingled funds to the extent of the value of such cash proceeds received by the debtor or his trustee within ten days of the institution of the insolvency proceedings.

2. *Negotiable instruments.* Where these have passed into the

[250] *Cf. In re Fred's Farm Industries Ltd., supra,* footnote 48.

[251] S. 10(b).

[252] S. 9-306(4).

[253] Since the federal Bankruptcy Act exclusively determines the priorities of unsecured creditors in a bankruptcy, the question has arisen whether s. 10 of the U.T.R.A. creates a "priority" or a "lien". In *In re Harpeth Motor Inc.* (1955), 135 F. Supp. 363, the first view was adopted, but this decision was disapproved in *In re Crosstown Motors* (1960), 272 F. 2d 224, cert. denied 363 U.S. 811, where the second view was upheld.

hands of a holder in due course the financer cannot, of course, trace them. This is equally true in Canada[254] and the United States, and the Uniform Trust Receipts Act[255] and the Code[256] expressly so provide. A question which the Uniform Trust Receipts Act did not deal with was the position of a third party who held a note attached to a conditional sale agreement, both of which had been assigned to him by the trader. At common law the transfer of the two instruments would be governed by separate principles, so that theoretically the transferee might obtain a good title to the note but not to the paper. The problem, however, appears not to have arisen in practice.[257] A solution is now provided in the Code, section 9-105(1)(b) of which, in defining "chattel paper", states that where a transaction is evidenced both by a security agreement of the kind that constitutes "chattel paper" (for instance, a conditional sale or a chattel mortgage) and by an instrument or a series of instruments, the group of writings taken together shall constitute chattel paper—and, therefore, of course, governed by a single set of rules.

The Canadian position has not been judicially determined, but in principle it ought not to admit of much doubt. Ever since the decision of the Supreme Court of Canada in *Monticello State Bank* v. *Killoran*[258] it has been settled law that, in a contest between a holder in due course of the note and the buyer from the retailer, the holder holds his note free of equities, even though he is also an assignee of the conditional sale agreement which is subject to equities. If that is so, then logically such a holder ought also to prevail against a wholesale financer who is attempting to trace proceeds, even though the latter may succeed in his claim to the conditional sale agreement itself. This is, of course, an unsatisfactory solution, since it satisfies neither party and, moreover, puts the retail buyer in a most invidious position. Hence the Code's treatment of the problem has much to commend it.

3. "*Trade-ins*". The Canadian financer here is on a sticky wicket, whichever theory of his relationship with the trader is adopted. If the "agency-trust" or "double trustee" theory applies, the financer, *ex hypothesi*, holds only an equitable title which can be cut off by a subsequent *bona fide* purchaser from the trader. The same holds true if the "trader as trustee of the proceeds only"

[254] See Bills of Exchange Act, s. 57 (Can.).
[255] S. 9(1)(a). [256] S. 9-309.
[257] Skilton, *op. cit.*, footnote 1, at pp. 416-417, n. 108.
[258] (1921), 61 S.C.R. 528. (*Cf.*, however, *Federal Discount Corp. Ltd.* v. *St. Pierre*, [1962] O.R. 310.

theory is adopted, even if the financer has filed a mortgage with an after-acquired property clause, since, as has already been noted, registration does not constitute constructive notice of his equitable interest. Furthermore, if the trader has given a prior mortgage to another creditor, the "trade-ins" may be caught by an after-acquired property clause in that instrument.[259]

4. *Accounts receivable.* The problems here are similar to those with respect to "trade-ins", but there are two complications which, paradoxically, could improve the financer's position. Both of them arise out of the limitations to the rule in *Dearle* v. *Hall.*[260] The first is that the rule does not apply where the assignor never had any beneficial interest in the chose in action.[261] If the trader is merely regarded as the financer's agent for sale, then he would *prima facie* come within this exception, since, in that event, his only beneficial interest in the proceeds would be proportional to the small equity (if any) he held in the original goods. The second limitation is that the rule does not apply where the competing claims are between a beneficiary under a trust fund and a subsequent assignee claiming under the trustee. This was decided in *Hill* v. *Peters.*[262] As the court there pointed out, a beneficiary under a trust is not an assignee. Consequently the ordinary equitable rule *Qui prior in tempore prior est in jure* applies, since both parties hold only an equitable interest.[263] Under the common form of proceeds clause, if its words are interpreted literally, the trader becomes a trustee of the proceeds, and it would seem to follow that the wholesale financer should be able to assert a superior title to the debt created by a sale to that of an assignee to whom the trader may have wrongfully purported to assign the chose in action.[264] However, this conclusion appears to be unsound for the following reasons. In the first place, the precise limits of this exception to the rule in *Dearle*

[259] *Cf. In re Fred's Farm Industries Limited, supra,* footnote 48.

[260] (1823), 3 Russ. 1.

[261] *B.S. Lyle, Ltd.* v. *Rosher,* [1959] 1 W.L.R. 8 (H.L.).

[262] [1918] 2 Ch.D. 273.

[263] It is assumed that statutory forms of assignment of choses in action effect only procedural changes and do not alter the substantive rights of an assignee. This is certainly true in Canada, see *Trubenizing Process Corp.* v. *John Forsyth Ltd.,* [1943] S.C.R. 422, at p. 428; *Slattery* v. *S.,* [1945] O.R. 811, at p. 822; *Pettitt & Johnson* v. *Foster Wheeler Ltd.,* [1950] O.R. 83, at p. 88, and it appears to be implicit also in Channell J.'s judgment in *Marchant* v. *Morton, Down & Co.,* [1901] 2 K.B. 829; but see book review in [1951] S.P.T.L. 480 and Snell's Equity (25th ed., 1960), p. 65, where the position is questioned. For an admirable discussion of the problem, see Williston, Contracts (rev. ed.), ss. 438, 447.

[264] Presumably the rule in *Dearle* v. *Hall, supra,* footnote 260, would apply again as soon as the trader has actually assigned the debt to the wholesale financer, but that would not matter, since the latter would ordinarily notify the debtor immediately anyway.

v. *Hall*[265] have not so far been defined, and *Hill* v. *Peters*,[266] so far as the writer is aware, has never been applied to an inventory situation. There is obviously a world of difference between a trust created under a will or settlement in which the beneficiary has no right to call for the transfer to him of the trust *res* and a "trust" created under a wholesale financing arrangement in which the "trustee's" functions, at any rate where the proceeds take the form of an account receivable, are confined to a simple transfer of the proceeds to the wholesale financer. In the second place, as Professor Scott and the Restatement on Agency point out,[267] the relationship between an agent (assuming, contrary to our submission, that a trader under a wholesale agreement is the financer's agent for sale) who holds property on trust and his principal is governed by the law of agency and not the law of trusts.

On both these grounds, therefore, it may be felt that the present situation falls within the spirit of the rule in *Dearle* v. *Hall*.[268] On the other hand, it is no less evident that the rule should have no place in commercial transactions of this character. How, it may be asked, can a financer give notice to a non-existent debtor of a future chose in action? Here, as elsewhere, the *via media* between conflicting interests is a registration requirement upon compliance with which the wholesale financer would acquire a perfected security interest in future choses in action. This is the position under the Code,[269] and it would require but a small amendment to the existing Canadian legislation to bring about the same result.

5. "*Chattel paper*". The term is used here in the sense in which it is defined in the Code, that is, as "a writing or writings which

[265] *Supra*, footnote 260.

[266] *Supra*, footnote 262. In *B.S. Lyle, Ltd.* v. *Rosher*, *supra*, footnote 261, Lords Kilmuir, Morton and Cohen left open the question whether *Hill* v. *Peters* was correctly decided on this point, but Lord Reid thought it was: see at pp. 15, 17, 22-24.

[267] *Supra*, footnote 249.

[268] *Supra*, footnote 260. American Law, *semble*, reaches an answer favourable to the retail financer but by a different route. First, a subsequent assignee of a chose in action is not bound by latent equities (Restatement, Contracts (1932), s. 174) and, secondly, an undisclosed principal is only deemed to hold an equitable interest in the contract made by his agent. Hence the latter, who holds the legal title, can cut off the principal's interest by assigning the paper to a *bona fide* purchaser for value. This, of course, assumes that the purchaser gets a *legal* title to the debt, which apparently he does. See Restatement, Agency 2d, s. 302. The rule in *Dearle* v. *Hall* does not apply in many American jurisdictions.

[269] U.C.C., s. 9-306(3) provides that the security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected, but ceases to be a perfected security interest ten days after receipt of the proceeds by the debtor unless, *inter alia*, a filed financing statement covering the original collateral also covers proceeds.

evidence both a monetary obligation and a security interest or a lease of specific goods".[270] Typically, therefore, it includes a conditional sale agreement and a chattel mortgage. Since in practice the proceeds from the sale of the dealer's inventory are more likely to take the form of a retail conditional sale agreement, the ensuing discussion, unless otherwise indicated, will be concerned with this type of chattel paper, and it will be further assumed that the inventory financer's security interest also takes the form of a conditional sale. The American position under the Code and the Uniform Trust Receipts Act is very different from that under the Canadian common law, and hence the two must be kept rigidly separated.

Under the Canadian common law, an assignment of a conditional sale agreement involves two distinct rights:[271] (a) the assignor's property rights in the goods which are the subject of the conditional sale, and (b) his rights in the chose in action, to wit, the promise to pay. In *Imperial Finance Corp'n Ltd.* v. *Fidelity Trust Co.*,[272] however, Dysart J. appears to have given a conditional sale agreement some of the qualities of a negotiable specialty, but, if that was the basis of his decision, it is opposed to the overwhelming weight of Canadian authority. The facts were that several cars were held by a dealer under a wholesale conditional sale agreement which had been assigned to the plaintiff. The dealer fraudulently sold the cars in the ordinary course of his business and assigned the resulting retail conditional sale agreements to the defendant, who received them in good faith and for value. Dysart J. held that the dealer was a constructive trustee of the retail agreements for the plaintiff and that the assignment of the debts only vested an equitable right in the defendant, which was subsequent in time to the plaintiff's equitable rights. He then continued:[273]

> But the defendant acquired more than that equitable right. It acquired legal title to those payments. By getting possession of the conditional sale agreement by assignment and delivery, it reinforced its equitable right. Besides having a right, as well as the plaintiff, to those payments when collected, it alone now has the right to collect them; it alone has the possession and the right to retain possession of the agreement.

Whilst the decision cannot be justified on the grounds assigned by the learned judge, it may perhaps be justified on the ground

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[270] S.9-105(b).

[271] *Cf. Tudhope-Anderson Co.* v. *Kerr* (1913), 5 W.W.R. 1352 (Sask.); *Kilgour* v. *White*, [1923] 3 W.W.R. 229 (Man. C.A.); *Re Premier Electric Co.* (1930), 11 C.B.R. 267, aff'd 11 C.B.R. 481 (Ont.).

[272] *Supra*, footnote 131.

[273] [1930] 4 D.L.R. 827, at p. 832.

that the defendant had given first notice to the debtors. This view assumes, of course, that the rule in *Dearle* v. *Hall*[274] applies to this type of situation.

We return, then, to our original statement that an assignment of a conditional sale agreement involves the assignment of two distinct rights, and that these, in terms of the wholesale financer's right to follow them, must be considered separately. His right to follow the account receivable component of the conditional sale has already been considered, but his rights with respect to the goods themselves remains to be discussed. As long as the buyer under the retail agreement maintains his payments, the problem of course does not arise. It arises only if the agreement has been determined and the goods repossessed by the assignee of the retail agreement. This happened, for example, in *Commercial Finance Corp'n* v. *Capital Discount Corp'n Ltd.*[275] and in *Globe Financial Corp'n* v. *Sterling Securities.*[276] In each of these cases, however, the decision ultimately turned on other points, although conflicting opinions were expressed on the problem under discussion. In the *Commercial* case the county court judge would have been prepared to find in favour of the purchaser of the retail paper, were it not but for the fact that the conditional sale between the trader and the retail buyer had been fraudulent. In other words, the lower court proceeded on the assumption that the assignee of the retail agreement derived whatever title to the car it possessed through the *retail buyer*, a line of reasoning which also appealed to Riddell J.A. in the Appellate Division. He said:[277]

> Unless our statute [sc. the Bills of Sale Act] changes the legal position, it would seem that, the car being left with [the trader] by direction of the [wholesale financer] for sale in the ordinary way of business, the [retail buyers] would have acquired title if the alleged sale to them were a real one and not fictitious. In that case, the [assignee of the retail agreement], as assignee of the agreement given to [the trader] would have a clear title to the car . . . .

There was, and is, however, as Orde J.A. pointed out in the same judgment, a fatal flaw in this reasoning, because "The [retail buyer] acquired no title to the car whatever. It still remained in [the trader], subject to their rights as conditional purchasers. [The trader], for value, sold the car and the obligation of the [retail buyers] to pay for it to the [assignee of the retail agreement]. Its

[274] *Supra*, footnote 260.
[275] [1931] O.R. 22, [1931] 1 D.L.R. 1007 (C.A.).
[276] [1932] 1 W.W.R. 347 (Sask. C.A.). See now also *Re Jull et al.* (1962), 38 W.W.R. 174 (Alta.).
[277] *Supra*, footnote 275, at p. 30 (O.R.).

rights are derived from [the trader] and not from the [retail buyers] at all, and it is of no consequence, in my opinion, that the bargain between [the trader] and the [retail buyers] may have been a fraudulent one."[278] In the *Globe* case, the Saskatchewan Court of Appeal arrived—correctly, it is submitted—at the same conclusion as Orde J.A. as to the basis of the assignee's derivative rights to the chattels.[279]

The assignee's rights being dependent on the trader's, our enquiry, next, must be as to the latter's relationship to the goods. Three possible situations must be distinguished: (a) The wholesale agreement gives the trader no power of sale, but he does wrongfully resell, although not in the ordinary course of his business. *Ex hypothesi*, the "trader's" section does not apply to this set of facts, and it follows that the wholesale financer should be entitled to invoke his common-law rights as owner and to follow the car into the assignee's hands. (b) Here again the trader is given no power of sale, but this time the resale is in the ordinary course of business. The financer is therefore estopped from claiming the goods in the retail buyer's hands. Is he also estopped from claiming them in the hands of the retailer's assignee? The answer should be no, because the "trader's" provisions are only intended to protect buyers in the ordinary course of business.[280] Hence the wholesale financer should not be prevented from setting up the true position as against a purchaser of the retail paper. (c) The trader has a power of sale, which he exercises legitimately, but he fails to account to the wholesale financer for the proceeds of the sale.

The answer in this type of situation, it is submitted, depends on the capacity in which the trader enters into the conditional sale agreement with the retail buyer. If he is merely acting as the financer's agent, the title, *ex hypothesi*, remains in the wholesale financer until the retail buyer is entitled to have it transferred to him, and it follows that the trader is incapable of transferring it to the purchaser of the retail paper. If, however, the trader is selling the goods as principal or as trustee for the financer, in either event he has a legal title which can be transferred to the purchaser of the retail paper.[281]

[278] *Ibid.*, at p. 28.

[279] *Supra*, footnote 276, *per* Mackenzie J.A., at pp. 353-354 and Turgeon J.A., at p. 350. See also *Re Jull et al.*, *supra*, footnote 276, at p. 178. For an American case expressing the same point of view, see *Nat. Bond & Investment Co.* v. *Union Investment Co.* (1932), 244 N.W. 483 (Mich.).

[280] *Cf. Globe Financial Corp'n* v. *Sterling Securities*, *ibid.*

[281] There is a further theoretical possibility, namely, that the trader sells in his own right but that title is not released to him until he is himself obliged to transfer title to the retail buyer (unless, of course, he has dis-

The American position. As has already been noted, the Uniform Trust Receipts Act, whilst expressly recognizing the entruster's rights to the proceeds realized from the sale of the secured goods, did not interfere with the rights of the purchaser of a negotiable instrument or document from the trader which the latter might have received in the form of proceeds. Section 9(1)(a) of the Act extended this protection by providing that "purchasers taking from the trustee for value, in good faith, and by transfer in the customary manner instruments in such form as are by common practice purchased and sold *as if negotiable*, shall hold such instruments free of the entruster's interest".[282] It was further provided that, insofar as such persons were concerned, they were not deemed to have constructive notice of the entruster's interest in such instrument by reason of the entruster's filing. However, despite this invitation to the American courts to bring legal theory into line with commercial practice, they have so far been divided in their application of the subsection to "chattel paper", some treating it "as if negotiable" and others not.[283]

The Code, however, has now resolved any lingering doubts. Section 9-308 lays down two rules applicable to the transfer of chattel paper, the first of a general character and the second restricted to the transfer of chattel paper which is claimed merely as proceeds of inventory subject to a security interest. The general rule provides that a purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business and without knowledge that it is subject to a security interest takes priority over a prior security interest perfected by filing.[284] It will be seen therefore that purchasers of retail paper in the ordinary course of business are now placed on a similar footing with the buyers of the goods themselves. In this way the Code shows its appreciation of the fact that chattel paper has become a common

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charged his liability to the financer earlier), but it appears to be unsound for substantially the same reason as the suggestion that the trader sells as agent for the financer.

[282] Emphasis added.

[283] *Pro negotiability: Citizens Nat. Trust & Savings Bank of Los Angeles* v. *Beverley Finance Co.* (1954), 273 P. 2d 714 (Cal.); *Dart Nat. Bank* v. *Mid-States Corp'n* (1959), 97 N.W. 2d 98 (Mich.). *Contra: Canandaigua Nat. Bank & Trust Co.* v. *Commercial Credit Corp'n* (1954), 135 N.Y.S. 2d 66; *G.M.A.C.* v. *Associates Discount Corp'n* (1942), 38 N.Y.S. 2d 972, rev'd on other grounds (1944), 48 N.Y.S. 2d 242.

[284] Under Article 9 an interest in chattel paper can be perfected either by taking possession of it (s. 9-305) or by permissive filing under s. 9-304. Loss of possession (other than to a bailee who is not also the debtor) results in loss of the security interest. See further, Kripke, (1949), 35 Va. L. Rev. 577, at p. 588.

article of commerce in its own right.[285] Moreover, since such paper is given a separate status in Article 9,[286] it follows that the transferee of the paper no longer has to worry about the double character of the conditional sale at common law. He gets all, or he gets nothing. This, if one may say so, is an eminently sensible solution to an awkward problem.

The second rule proclaimed by section 9-308 protects a purchaser for new value of the paper *even though he knows* that the paper represents the proceeds from the sale of an inventory lien. This rule reflects a deliberate policy choice on the part of the Code's sponsors to prevent an inventory financer securing a monopoly over the retail paper.[287] Although the policy behind the rule may be unexceptionable,[288] the wisdom of the rule itself is open to question, and it may be doubted whether it will in fact accomplish its objective. On the one hand, a wholesale financer who finds his trader assigning too large a proportion of his retail paper to a competitor is not likely to remain his wholesale financer for very long. On the other, even under the old law (and it is still true of Canada) there was nothing to prevent a competitor from poaching on the wholesale financer's territory, provided he made sure that the proceeds lien attaching to any retail agreement was discharged first. Finally, the new rule appears to be an open invitation to a retailer to perpetrate frauds on his wholesale financer.[289]

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[285] S. 9-105(b). [286] S. 9-102.

[287] See Kripke, *op. cit.*, footnote 1, at p. 1032; Coogan, *op. cit.*, footnote 98, at p. 872; Dunham (1949), 62 Harv. L. Rev. 588, at pp. 605-607.

[288] A number of states, even prior to the Code, enacted special laws designed to preserve and promote competition in the purchase of retail instalment sales contracts: see, for example, Acts of Indiana, 1953, c. 207, and Acts of Indiana, 1935, c. 231, ss. 9, 22-4 (as amended in 1947).

[289] Dr. Kripke takes a more lenient view. In a letter to the writer, dated 21/8/61, he observes: "The policy of the second sentence of 9-308 was never vigorously debated. The persons who might have debated it were the representatives of finance companies who were in the committees, and there were several of us who would not have hesitated to be vocal. However we saw no reason to debate this. Either rule could be justified with arguments of policy, and I actually think the present rule is the better one. In purely mercenary terms, the situation is that the banks have taken a strong position in the automobile installment finance industry in the United States; and, among the finance companies, General Motors Acceptance Corporation almost exclusively dominates the business available to finance companies for General Motors cars, which are about half of all the cars sold. The other finance companies are interested in getting some retail paper by "sniping", which means that the dealer will occasionally sell them an item of retail paper rather than sell it to the inventory financer who gets the bulk of his paper. True, this practice works both ways and other people are able to snipe against the inventory position of C.I.T., Commercial Credit or any of the other independents. But on balance the rule which permits them freedom to snipe gives them access to more potential dealer business than the opposite rule could do.

The rule does help the dealer somewhat because he can shop his paper

Conclusion

If the preceding survey has shown anything, it is the complexity of the problems involved in wholesale financing and the total inadequacy of existing Canadian legislation to deal with them— whether from the point of view of the financer, the dealer, the retail buyer in ordinary course of business, or a purchaser of the retail paper. New legislation is therefore needed, but it can hardly be said that the proposals of the major finance companies to the Ontario Select Committee (although they undoubtedly remove one of the major grievances of wholesale financers) go anywhere near far enough. In particular, they appear to be deficient in the following respects:

1. They would perpetuate, quite needlessly, the meaningless distinctions between a wholesale chattel mortgage and a wholesale conditional sale agreement.
2. They do not resolve the problem of establishing priorities between successive "notice" filings.
3. Nor do they clarify the existing confusion as to the extent to which "future advance" clauses are permissible.
4. They continue to require—at least in the case of wholesale conditional sales—the execution of individual agreements.
5. The "retail buyer's" section (section 6), while resolving some of the ambiguities in the present legislation, still leaves many of the questions discussed earlier in this article unanswered. It is also unsatisfactory from other dealers' point of view, since it would deny them protection where they have purchased goods, subject to a wholesale lien, in the ordinary course of business.
6. The proposals make no attempt to grapple with one of the most difficult aspects of wholesale financing—the financer's lien on the proceeds and the extent of his right to follow them. No doubt the problem is still more important qualitatively than quantitatively, but, since remedial legislation is contemplated, there appears to be no sound reason why it should not be made comprehensive.

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around to finance companies who will take more speculative paper than the larger ones who do the inventory financing. This gives him a certain freedom of action in his sales, where otherwise he would not dare make a sale that the inventory financer would not approve in advance. Where the dealer does make some higher speculative sales of this nature, the finance company may condone diversion of the paper to other outlets; but apart from this, of course the dealer will lose his inventory finance source if the finance company does not get a fair penetration of retail paper."

All of the above problems have received attention in the Uniform Commercial Code. Some of the solutions may not be entirely appropriate to Canadian conditions, and in other cases a different common-law background may lead to a preference for other solutions on points of detail. But as to the soundness of the Code's approach in principle, there can be little doubt. It is to be hoped, therefore, that its provisions will be carefully studied before any province commits itself to any new legislation.

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APPENDIX

SUBMISSIONS RELATING TO THE ADVANTAGES OF THE CENTRAL REGISTRATION OF WHOLESALE LIEN DOCUMENTS MADE BY CANADIAN ACCEPTANCE CORPORATION LIMITED, COMMERCIAL CREDIT CORPORATION LIMITED, GENERAL MOTORS ACCEPTANCE CORPORATION OF CANADA LIMITED, INDUSTRIAL ACCEPTANCE CORPORATION LIMITED AND TRADERS FINANCE CORPORATION LIMITED TO THE SELECT COMMITTEE OF THE ONTARIO LEGISLATIVE ASSEMBLY ON THE CENTRAL REGISTRATION OF DOCUMENTS OF TITLE AND PLEDGE RESPECTING CHATTELS AND CERTIFICATES OF TITLE OF OWNERSHIP OF MOTOR VEHICLES.

1. As previously indicated to the Select Committee, the companies associated in presentation of this addendum to the submission in respect of Central Registration of lien documents and a Certificate of Title Law, are sales finance companies carrying on business in practically all of the provinces of Canada. The preceding discussion relates solely to *retail* liens and recommends a Certificate of Title law in preference to Central Registration of *retail* lien documents. This addendum discusses *wholesale* liens and Central Registration of *wholesale* lien documents.

2. Wholesale financing plays an important part in the economy of Canada in that it provides a service to merchants which enables them to handle large inventories of motor vehicles, appliances, and other consumer goods, as well as commercial and industrial goods that otherwise would not be possible due to limited liquid capital.

3. This service is reflected in the productive capacity of manufacturers throughout Canada by enabling them to mass produce consumer goods for which they receive immediate payment. Manufacturers have expanded production and have provided an even flow of goods to the ultimate consumer in far greater quantities than otherwise would have been possible if their merchants had been limited to purchases in an amount commensurate to their limited working capital.

4. Wholesale financing is a simple operation which involves three parties to the transaction. The merchant wishes to buy goods from the manufacturer but he does not have the necessary funds to do so. By prearrangement the sale finance company pays the manufacturer immediately for these goods upon shipment from the factory and takes for security a

lien document covering the units in the shipment. This lien remains in force until the units are sold by the merchant to the ultimate consumer. This practice of financing of consumer goods on a merchant's floor is known as "floor planning".

5. When any unit is sold by the merchant to a retail purchaser, the merchant pays the sales finance company the cost of the unit, either in cash or by assigning to the sales finance company a retail instalment contract from the purchaser to the merchant if he has made a time sale. The wholesale lien no longer attaches to the unit upon sale to the consumer.

6. Wholesale operations and wholesale financing have become increasingly involved in recent years due to the tremendous increase in this type of financing procedure. A small error in execution of the lien document, in registration or satisfaction of the lien, or in the handling of the wholesale goods can result in many unforeseen consequences and costly litigation.

7. At the present time, new wholesale financing is handled through the medium of a conditional sale contract pursuant to the provisions of the Ontario Conditional Sales Act R.S.O., 1950, c. 61, s. 2. This statute requires individual registration and satisfaction of each wholesale transaction.

8. This individual registration of each instrument evidencing a wholesale transaction for a merchant, who undoubtedly has contracted with the sales finance company for a series of wholesale transactions extending over a long period of time, necessitates extraordinary caution on the part of the sales finance company, as the security to that company is subject to attack through errors which may occur in registration, satisfaction, and other mechanical procedures now in practice. Unnecessary restriction of credit is a natural consequence, and in addition, the fluidity of wholesale financing is hampered by this individual registration as it gives public notice to all competitors of a merchant of his private financial transactions.

9. For many years, the same situation existed in the United States. A number of individual states refused to recognize the security interest created by a wholesale lien document and other states required the same exactitude [as] in the registration of a retail lien document. Realizing the necessity for a fluid operation in the financing transactions between entrepreneurs, unhampered by rigid requirements geared for the protection of the consumer public, a great many states solved this problem by attacking it through legislation. One such solution is in the form of what is known as the Uniform Trust Receipts Act. Other states have adopted similar legislation that is less complicated.

10. Both types of statutes have the same common principles which preserves and enhances the flexibility of wholesale financing, namely, the central registration of a statement of intention to do wholesale financing. After reviewing both types of statutes, the companies believe that the simpler law is better suited to the mercantile customs and statutes of the Province of Ontario, rather than the complicated and involved Trust Receipts Act.

11. When a sales finance company and a merchant contract to floor plan or finance the merchant's purchases from the manufacturer, the protection of the wholesale lien on all transactions between the merchant

and the manufacturer is guaranteed under both statutes by the initial simple expedient of registration of a Statement with the central state authority, which is a Statement of Wholesale Financing.

12. This Statement, executed by the merchant and the sales finance company is actually a statement of intention of the parties to enter into a series of wholesale financing transactions which are, or will be, evidenced by wholesale lien documents. In the United States the Statement is usually centrally registered within the state with the office of the Secretary of State.

13. The registration of this Statement constitutes notice to all creditors of the merchant and affords complete protection against claims of third parties except *bona fide* retail purchasers from the merchant. The registration is valid for a varying number of years, ranging from one year to three years, and must be renewed at the expiration of that time if the sales finance company and the merchant wish to continue the financing arrangement. In practical and general terms this results in adequate protection to both the merchant and sales finance company, without restricting in any manner the power of sale of the merchant to the general public. Yet, at the same time, it eliminates the unwieldly burden of local registration and satisfaction of each lien document with the attendant wide margin for error and consequent loss of lien through incorrect registration or other mechanical failure of documentation.

14. The registration of a Statement of Wholesale Financing eliminates the present practice of making public record of perhaps confidential purchases and arrangements, while securing to the interested parties the same, or perhaps better, protection against third party claimants as are secured to them under the present system of registration of each lien document. Such central registration protects the merchant from any alleged oral agreement which would limit his rights; protects his credit from the effects of the registration of a conditional sale contract appearing on the public records against him and, at the same time, reveals nothing to his competitors of the price paid by him for the merchandise covered by the financing; it preserves for him the protection against forfeiture of his equity of redemption except in the single instance where such equity is certain to be consumed by depreciation; it has no effect upon his power of sale to the public; the retail purchaser acquires valid title free of the wholesale lien; he is not subject to any lien which might attach to the proceeds received by the merchant. The simplification of procedure, combined with the assurance of greater certainty of security to the sales finance company lowers the cost of wholesale financing which in turn reflects in lower cost and greater benefit to the consuming public.

15. This type of registration does not disturb the rights of warehousemen, carriers and processors as to specific liens granted to such parties by law, rather, it enables them to rely upon the merchant's possession of the goods with a greater certainty of the validity of specific liens. It frees the retail buyer in the ordinary course of trade from constructive notice of any wholesale lien by virtue of individual registration of the lien document. At the same time, it provides accessible, adequate, central notice of the lienor's rights and eliminates unnecessary and perplexing formalities by giving a clear definition of such rights.

16. The companies have undertaken to draft an amendment to the existing Ontario Conditional Sales Act relating solely to wholesale lien

documents and as a separate article to that. This draft is submitted herewith for the Select Committee's consideration in conjunction with the recommendations by the companies contained herein.

CONDITIONAL SALE CONTRACTS ON PERSONAL PROPERTY FOR SALE OR TO BE PROCESSED.

Sec. 1 Conditional sale contracts upon personal property held for sale or upon personal property to be processed or fabricated into, or to become a component part of articles or products processed or manufactured shall be valid and enforceable, as herein provided, upon compliance with the provisions of this Article.

Sec. 2 Any person contemplating receiving, by purchase or otherwise, a conditional sale contract or conditional sale contracts upon personal property of the type and character described in Section 1 of this Article may cause a Statement of Wholesale Financing to be registered in the manner herein set forth.

Sec. 3 Such Statement of Wholesale Financing shall be executed by the vendee (hereinafter called Dealer) and by the holder of such conditional sale contracts (hereinafter called Entruster) and shall contain substantially the following:

(a) The name and address of the Dealer and Entruster, and of the chief place of business of each within this Province, if any; and if the Entruster has no place of business within this Province, a designation of this [sic] chief place of business outside the Province.

(b) A statement that the Entruster expects to receive from the Dealer a conditional sale contract or conditional sale contracts covering personal property of the type and character described in Section 1 of this Article.

(c) The general nature and type of personal property to be the subject of the conditional sale contract or conditional sale contracts to be taken.

(d) The following form of Statement of Wholesale Financing or any other form containing substantially the same information shall suffice for the purpose of this Article.

STATEMENT OF WHOLESALE FINANCING.

The undersigned Dealer and Entruster, in accordance with the statutes in such case made and provided hereby state:

(a) The name of the Dealer is:

....

(Print or Type Name of Dealer)

The address of the Dealer is:

....

(Print or Type Address of Dealer)

The name of the Entruster is:

....

(Print or Type Name of Sales Finance Co.)

The address of the Entruster is:

....

(Print or Type Address of Sales Finance Co.)

(b) That the Entruster contemplates receiving from the Dealer a conditional sale contract or conditional sale contracts upon personal property held for sale or upon personal property to be processed or fabricated into, or to become a component part of articles or products processed or manufactured.

(c) The general nature and type of personal property to be the subject of the conditional sale contract or conditional sale contracts to be taken are:

....

....
(Dealer)

By....................................
(Its Authorized Agent)

....
(Entruster)

By....................................
(Its Authorized Agent)

Sec. 4 Such statement of Wholesale Financing or executed copies thereof shall be registered with the Provincial Secretary.

Sec. 5 (a) Any conditional sale contract executed and delivered by such Dealer to the Entruster named in such Statement of Wholesale Financing upon personal property of the type and character described in such Statement of Wholesale Financing within one year from the date of registration of such Statement of Wholesale Financing with the Provincial Secretary shall be valid and enforceable without the necessity of registering such conditional sale contract or conditional sale contracts as provided in the Conditional Sales Act, R.S.O., 1950, c. 61, s. 2, against all persons who thereafter acquire rights or interests in such personal property except as otherwise in this Article provided.

(b) At any time before expiration of the registration period specified in subsection (a), a like statement, or an affidavit by the holder alone, setting out the information required by section 3(d) may be registered in like manner as the original registration. The registration of such further statements or affidavit shall be valid in like manner and for a like period as an original registration and shall also continue the rank of the holder's existing title interest as against all interests.

Sec. 6 *A retail purchaser* in the ordinary course of business purchasing from the dealer personal property of the type and character described in Section 1 of this Article shall acquire such property free and clear of any conditional sale contract as in this Article permitted, notwithstanding compliance with the provisions of this Article; unless the holder of any such conditional sale contract shall have taken possession of the personal property before any such purchase.

Sec. 7 The registering of a Release of Statement of Wholesale Financing, duly executed by the holder in the office of the (Provincial Secretary), shall from the date of such registration render said Statement of Wholesale Financing of no further effect as to any conditional sale contract executed and delivered thereafter, provided, however, that the registering of such Release shall not in any manner affect the validity or enforceability of *any conditional* sale *contract taken* by *the* holder *prior* thereto except as in this Article provided.

Sec. 8 The registration fees for registering instruments required hereunder and indexing thereof shall be as follows:

(a) For registering Statements of Wholesale Financing and Release of Statements of Wholesale Financing with the Provincial Secretary shall be the sum of . . . each.

(b) The Provincial Secretary shall set up and maintain indices of such registering [sic] in such manner as may readily furnish information to those persons requesting the same.

(c) The Provincial Secretary shall be required upon written request to make a search of his records covering instruments registered, pursuant to this Article, and certify thereto. The fee for such search and certification shall be the sum of for each . . . search not exceeding a period of three years.

NOTE: The finance companies prepared a similar draft of a proposed amendment to the Ontario Bills of Sale and Chattel Mortgages Act, which has not been reproduced here.