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Creditors Rights: Canadian Admiral Corporation Limited v. L. F. Dommerick and Company Incorporated, (1964) S.C.R. 238

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CREDITORS RIGHTS

Canadian Admiral Corporation Limited v. L. F. Dommerich and Company Incorporated, [1964] S.C.R. 238.

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CREDITORS' RIGHTS — BANKRUPTCY — RESPECTIVE RIGHTS OF ASSIGNEE OF ACCOUNTS RECEIVABLE AND CREDITOR CLAIMING SET-OFF.

The problem facing the Supreme Court of Canada was whether an assignee of accounts receivable, under a "factoring arrangement" with its assignor, would be subject to a set-off arising from a subsequent purchase by the assignor from the firm that was indebted to the assignor and whose account had been previously assigned to the assignee.

The Supreme Court of Canada reversed both the trial decision and that of the Ontario Court of Appeal[1] and unanimously held that a set-off could be exercised.

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9 *Ibid.*

10 *Cf. Massella v. Langlais,* [1955] S.C.R. 263 at 281, where Judson J. expressed this view as to the purpose of the Act.

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1 [1962] O.R. 902.

The facts were that Canadian Admiral Corporation Limited were purchasers of materials from Rotor Electric Company Limited. Up to September, 1954, Admiral had made payments direct to Rotor for such purchases. However, from that time on, Rotor entered into a "factoring arrangement" with L. F. Dommerich and Company Incorporated, the plaintiff in the trial court and respondent in the two appeal courts, whereby Rotor would assign its accounts receivable to Dommerich and the latter would notify Admiral that these debts had been assigned and then collect them for a stated charge to Rotor. From September, 1954, to February, 1960, the procedure was that Rotor would prepare the invoices pertaining to its sales to Admiral and send them to both Dommerich and Admiral. On the invoice sent to Dommerich there was an enclosed document stating that such account had been assigned to Dommerich for valuable consideration. Dommerich in turn would then invoice Admiral for this same amount. On the invoice sent by Rotor to Admiral were stamped two notices: one stated that any objections to the bill were to be reported to Dommerich and the other, that the account had been transferred and assigned to Dommerich for valuable consideration. Within this period, any payment Admiral had made had been to Dommerich.

In October, 1959, Admiral, which had been purchasing materials from Rotor, reversed its role to that of a vendor and sold a quantity of stereo tuners to Rotor. At the time of the first delivery of these tuners, the amount owing by Admiral to Dommerich pursuant to the purchases Admiral had made from Rotor was an amount greater than the sale price of the tuners. The President of Admiral, who knew that the President of Rotor had earlier been involved in a business failure, wished to protect Admiral's financial position and hence in order to insure that Admiral would always be more indebted to Rotor than Rotor to Admiral, instructed the accounts payable supervisor to hold a substantial sum in reserve in order to offset what was on the accounts receivable ledger for Rotor. When Rotor went into bankruptcy, it owed Admiral an amount slightly less than the price of the tuners. It was only when Dommerich claimed from Admiral the total amount of the prior assignments, that Dommerich learned of the sale from Admiral to Rotor. Neither Rotor nor Dommerich up to that time had any notice or knowledge of the intention of Admiral to hold back an amount equal to the sale price of the tuners.

Thus the action arose when Dommerich claimed that amount from Admiral which Admiral had sought to set-off in complete extinction of Rotor's debt.

Both the trial court and the Court of Appeal of Ontario held that no set-off would be allowed. In the Supreme Court of Canada, these decisions were unanimously reversed and Admiral was permitted to exercise a set-off. Thus, in order to understand the Supreme Court's decision and in particular to indicate why it decided to allow the set-off, it will be necessary to examine the decision of both the Court of Appeal and the Supreme Court.

The Court of Appeal speaking through Laidlaw, J.A. disallowed a set-off on the grounds that the arrangement between Rotor and Dommerich constituted an equitable assignment of future choses in action and consequently there could be no set-off by Admiral after it had received notice of the assignment. The basis for this holding was determined by several factors. First, the court recognized the notation that appeared on each of the accounts payable ledger sheets pertaining to the Rotor account. This notation read that all cheques were to be made payable to Dommerich commencing from September 13, 1954. Secondly, the actual business procedure that had been practised between Admiral, Rotor and Dommerich was reviewed by the court and found to support its conclusion that the agreement constituted an equitable assignment of future choses in action. This procedure consisted of Rotor preparing the invoices for sales to Admiral, addressing them to Admiral and stamping on each invoice two notices: one, that objections to the bill were to be reported to Dommerich and the other, that the account had been transferred and assigned to Dommerich for valuable consideration. These invoices were then sent to Dommerich which in turn forwarded them to Admiral. Laidlaw, JA. concluded that:

> . . . no set-off or counterclaim could be allowed in respect of a debt arising between Admiral and Rotor subsequent to the notice to Admiral of the assignment from Rotor to Dommerich.[2]

For authority he relied on a statement by Vaines:

> . . . after notice of an assignment of a chose in action the debtor cannot by payment or otherwise do anything to take away or diminish the rights of the assignee as they stood at the time of the notice. And so no set-off or counter-claim will be allowed in respect of a debt arising between the original parties subsequently to the notice of the assignments, unless such debt flows out of, and is inseparably connected with the dealings and transactions which also give rise to the subject of the assignment.[3]

Obiter, the Court of Appeal concluded that even if there was no equitable assignment and the rights of Dommerich depended upon separate assignments from Rotor to Dommerich, nevertheless each invoice contained express notice to Admiral of the assignments. Furthermore, at the time Admiral sold the tuners to Rotor, Admiral owed Dommerich per the assignments $62,470.67 which was greater than the sale price of the tuners ($43,942.52). In this regard, Laidlaw, JA. held:

> Thus, it was not permissible in law for Admiral to set-off against that debt or any part thereof owing by Admiral to Dommerich and of which Admiral had notices of assignment, a debt which arose subsequent to the time when it received such notices.[4]

Thus, the basis of the Court of Appeal's decision was that once the assignments had commenced, Admiral which had actual notice of such assignments, could not defeat the interests of Dom-

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2 [1962] O.R. 902, 909.
3 Vaines, J. C., Personal Property, (2nd) p. 211; [1962] O.R. 910.
4 [1962] O.R. 902, 910.

merich by asserting a set-off. In other words Dommerich, it is submitted, was in the position of a secured creditor by way of assignment vis-à-vis Admiral, regardless of what has subsequently ensued between Admiral and Rotor after Admiral received actual notice of the assignments.

Whether the arrangement was classified as an equitable assignment of future choses in action or merely as a combination of successive assignments, the effect of the receipt of notice by Admiral seemed to be the key factor according to the Court of Appeal in the securing of Dommerich's interest against a potential set-off. Laidlaw, JA. states:

> I find expressly that after the receipt by Admiral of the letter from Rotor dated September 13, 1954, Admiral had notice of the assignment by Rotor to Dommerich of future debts owing by Admiral to Rotor and that Admiral could not thereafter do anything to take away or diminish the rights of Dommerich as they stood at the time of receipt of that notice.[5]

At the time of "that notice" on September 13, 1954, the debt owed by Admiral to Rotor was $1,045.30 and hence, it is submitted on this reasoning, that if the sale of the tuners from Admiral to Rotor occurred thereafter and prior to any further assignments, then the right of Admiral for the sale price of the tuners would be subjected to the prior amount of $1,045.30. If, on the other hand, the facts had been that the sale of the tuners had occurred prior to any assignments other than the original assignment of $1,045.30 but that there were subsequent assignments after the tuner sale, it would seem to follow that the subsequent assignments would be subject to the rights of Admiral which in turn would be subject to the first assignment of $1,045.30. In other words, it would be a situation analogous to that of a priority situation with each priority depending upon the receipt of notice. This line of reasoning, it is submitted, is supported by the above statement of Laidlaw, J.A. that the rights between the parties were determined "as they stood at the time of receipt of that notice".[6]

How then did the Supreme Court of Canada circumvent the above holding of the Court of Appeal that a set-off could not be exercised? The crux of the Supreme Court's decision was stated by Judson J. who held that:

> . . . the result was that on receipt of the invoice stamped with the assignment, Admiral was not entitled after this date to set-off against that invoice an indebtedness of Rotor which arose subsequent to the date of the notice of the assignment of that account but the converse also holds true. Admiral was entitled to assert with respect to any particular assignment that on the date when notice of that assignment was given, and proper accounting between Admiral and Rotor, there was nothing owing to Rotor.[7]

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5 *Id.*, at 909.
6 *Ibid.*
7 [1964] S.C.R. 238, 246.

The phrase in the above statement which distinguishes it from the Court of Appeal's decision is the phrase—"but the converse also holds true". Subject to this onerous proviso, it would appear that when Admiral received each notice of assignment as stamped upon each respective invoice, Admiral could not exercise a set-off against that particular invoice. How then was the proviso interpreted? The subsequent line of the reasoning explains how the converse would seem to hold true. It would appear that subsequent to any particular assignment Admiral was "entitled", although not legally bound, to state its position by having a "proper accounting" undertaken between Admiral and Rotor. If this was the situation, what interpretation can be placed on the phrase—"there was nothing owing to Rotor"? To revert back to the fact situation, Rotor owed Admiral, at the time of the bankruptcy, $43,942.52 for the tuners and Admiral owed Dommerich $49,871.57 for the assignments. Admiral at this time paid the difference to Dommerich in order not to prejudice Admiral's position. Was this balancing of accounts by Admiral an example of a "proper accounting"? Was this an accounting between Admiral and Rotor or between Admiral and Dommerich? In light of the Supreme Court's decision, this would appear to be a "proper accounting" and could have been exercised by Admiral at any time despite its receipt of the notices of assignment.

It would appear that Admiral could remain silent, although aware of its potential set-off, and at any time have the accounts examined so as to determine what each party owed the other. In other words, the receipt of notice and the effect of such notice would be of no consequence to Admiral, for it could at any time demand a balance of accounts. Consequently, rather than Dommerich being in the position of a secured assignee, Admiral, the original debtor, now finds itself in the fortunate position of being a secured creditor. Admiral became a secured creditor regardless of its receipt of notices of assignments and regardless of the fact that when Rotor bought the tuners Admiral owed Dommerich via the assignment arrangement an amount greater than the sale price of the tuners.

Counsel for Dommerich contended that the onus was on Admiral to warn or advise of a possible set-off that might arise. To support their submission, three Canadian cases[8] were relied upon. Although no reference was made to these cases in the Supreme Court, it is submitted that a distinction should have been made on the ground that these particular cases were within the realm of Banking Law and the peculiarities of the banker-customer relationship. The duties of the customer (although the *Ewing* case was a banking situation yet not a literal banker-customer relationship) to a bank are not analogous to those duties and legal obligations within either an assignment or "factoring" assignment.

[8] *Ewing v. Dominion Bank* (1901), 35 S.C.R. 133, 153; *Lazard Bros. and Co. v. Union Bank*, 47 O.L.R. 76, 82; *W. H. Fraser v. Imperial Bank*, 47 S.C.R. 313, 379.

To buttress their holding that the onus was not upon Admiral to warn of a set-off, the Supreme Court relied heavily on the case of *Mangles v. Dixon*[9] which held that:

> . . . the principle is perfectly clear, that where there is no fraud, nothing to lead to the conclusion in the mind of the party who receives the notice, that the party who gives it has been deceived and is likely to sustain a loss . . . it is clear that the former is not bound to volunteer information.[10]

This statement of general principle supported the view as held by Judson J. that:

> . . . it was for Dommerich to look after its own business and for Admiral to mind its own business. Admiral did not mislead Dommerich and was under no obligation to disclose its own dealings and to volunteer information. The onus was on Dommerich, as assignee, to satisfy itself as to the equities which might exist when it took these assignments month by month.[11]

The *Mangles* case, relied upon as authority for the non-volunteering of information, seems by this decision to completely counteract the receipt and effect of notice as a means to cut-off future set-offs.

Obiter, the Supreme Court adopted the submission of counsel for Admiral that even if the agreement was an equitable assignment of future choses in action, it was void as against the creditors of Rotor for non-compliance with the Assignment of Book Debts Act.[12] Section 3 of that Act reads:

> 3(1). Except as provided in this Act, every assignment of book debts made by a person engaged in a trade or business in Ontario is absolutely void as against the creditors of the assignor and as against the subsequent purchasers unless the assignment is . . .
>
> (c) registered, as hereinafter provided, together with the affidavits within thirty days of the execution of the assignment.

Admiral was a creditor entitled to the protection of this Act. The document was not registered nor did it comply with any of the statutory requirements. In the Court of Appeal, Laidlaw, JA. spoke of the Act as not being applicable and that:

> . . . it was not raised at the trial or in the notice of appeal or in the memorandum of points of fact and law filed on behalf of the appellant. It appears to me to have been a last moment endeavour to support the appeal but there is no merit in it.[13]

As mentioned above, the Supreme Court did not adopt this approach but referred to the Act by way of *dicta.*

The decision of the Supreme Court of Canada is the preferred decision particularly in view of the seemingly unsettled nature of, and ambiguities related to, the law of assignments.

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9 (1852) 3 H.L.C. 702.
10 *Id.,* at 734 and found at [1964] S.C.R. 241.
11 [1964] S.C.R. 238, 247.
12 R.S.O. 1960, c. 24.
13 [1962] O.R. 902, 911.

An influential legal decision is one that possesses persuasive qualities and attributes as illustrated by its consideration of all relevant courses of action applicable to the fact situation facing the court of law. This decision of the Supreme Court of Canada, it is submitted, lacks this necessary persuasive element particularly in view of its rather abrupt dismissal and consequent reversal of the holding of the Ontario Court of Appeal. That the Supreme Court was hesitant or failed to conduct a thorough analysis of the problem tends only to reinforce this submission.

Certain policy considerations appear to have influenced the decision of the Supreme Court. Towards the end of his judgment, Judson J. contends that:

> . . . the arrangement was entirely for the financial advantage and convenience of Rotor and Dommerich. Dommerich earned a fee and Rotor avoided the trouble of running a collection department. I can see no reason why such an arrangement should impose additional duties on Admiral as a purchaser of Rotor's products or restrict the rights which it would otherwise have in dealing back and forth with this supplier and customer.[14]

That the arrangement was for the benefit of Dommerich and Rotor only cannot be denied. Certainly Admiral had nothing to gain from such an arrangement. Hence, why should Admiral be thrust into a detrimental position because of this private and mutually beneficial dealing between Rotor and Dommerich? It can be validly argued that Admiral could have sold the tuners to Rotor by means of a secured sales transaction. But why should an independant contractual arrangement between Rotor and Dommerich be permitted to affect the rights of Admiral? Thus it would appear that these policy considerations were influential in the Supreme Court's decision yet were not examined in the Court of Appeal.

This case, it is submitted, is indicative of the court's reluctance to aid a professional business concern that has failed to avail itself of all the information that could quite easily be obtained by it. Since the President of Rotor had been involved in a previous business failure, one would conjecture that the dealings between Rotor and Dommerich would have been more closely scrutinized. For example, the suspicions of Dommerich should have been aroused when the amount of the assigned accounts receivable increased from $1,045.30 in 1954 to $62,470.67 in 1959. That Dommerich's letter to Admiral remained unanswered seems to suggest that Dommerich was not acting as would a prudent business concern. Furthermore, if Dommerich were unaware of the credit rating of Rotor, then it was only Dommerich that was to blame. Certainly any court of law would not have been in sympathy with such a careless firm.

The question arises as to whether this decision would have been materially altered if the current draft bill in Ontario that is appropriately referred to as "An Act to reform and make uniform the Law

14 [1964] S.C.R. 238, 247.

regarding Security Interests in Personal Property and Fixtures" had been enacted. There are several sections in this draft bill that appear to have some relevance to the issue in this case.

Section 14 states:

> An agreement by a buyer not to assert against an assignee any claim or defence that he may have against the seller is enforceable by the assignee who takes the assignment for value, in good faith and without notice, except as to such defences as may be asserted against a holder in due course of a negotiable instrument under the Bills of Exchange Act (Canada).

This section seems to be only a statutory expression of a contract law principle providing that the "agreement" was a valid and enforceable agreement as supported by valuable consideration. To persuade a buyer or account debtor to enter into such an enforceable agreement would certainly solidify the position of the assignee but, it is submitted, that many buyers would undoubtedly be hostile to such an agreement. That many buyers or account debtors would subject themselves to such an agreement would depend, of course, on their bargaining power, their legal *naiveté,* and the terms and conditions of the total commercial transaction.

A more relevant section is section 37(1) (a) and (b). This states:

> Section 37(1)
>
> Unless an account debtor has made an enforceable agreement not to assert defences or claims arising out of a sale as provided by section 14, the rights of an assignee are subject to,
>
> (a) the contract between the account debtor and the assignor; and
>
> (b) any other defence or claim of the account debtor against the assignor that accrued before the account debtor received notice of the assignment.

It should be noted that s. 37 refers to s. 14 as an "enforceable agreement", whereas s. 14 in its actual wording contemplates merely an "agreement". However, as submitted above, s. 14 must contemplate an "enforceable agreement", for otherwise the latter section would have little legal effect. An oddity of s. 37(1) (a) is that it refers to only one contract and thus the applicability of this particular section to the rights and liabilities of Rotor, Dommerich and Admiral would be afflicted with some inherent problems. Does "the contract" refer to the contractual situation regarding the original sales transactions flowing from Rotor to Admiral or to the quite distinct and separate contractual situation with reference to the sales of the stereos by Admiral as vendor to Rotor, the purchaser? There is nothing in the Act to indicate that this section should necessarily refer to the first contract, *viz.,* that contract having as its subject matter the sales by Rotor to Admiral. Hence, it is submitted on this reasoning that this section of the draft bill would not have altered the decision of the Supreme Court.

Section 37(1) (b) like Section 37(1) (a) speaks in the singular as it seems to contemplate only one assignment in that the section

specifically refers to "the assignment". What then would be the legal solution to a situation involving several assignments together with an equal number of notices that had been received by the account debtor? The section specifies that the rights of the assignee are subject to those defences that accrued "before" the account debtor received notice of the assignment. The situation contemplated by Section 37(1)(b) would consequently stand in complete hostility to the decision of the Supreme Court of Canada. However, section 37 does not qualify or limit itself by any reference that subsections (a) and (b) are necessarily the only rights to which an assignee is subjected.

A brief conclusion may be drawn at this point. If the rights of an assignee are subject to additional claims of defenses other than those enumerated in section 37 of the draft bill, an additional claim or defense certainly must include the one as promulgated in this decision of the Supreme Court of Canada. Said defense or set-off arose on the ground that the account debtor was "entitled", yet not legally bound in the absence of fraud, either to inform or to volunteer information to the assignee of the potential right of set-off that could and did, in fact, result, from an independant sales transaction by the account debtor to the assignor.