

Case Law Update: i Trade Finance Inc v Bank of Montreal

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2011 SCC 26 (Released May 20, 2011)

Secured Transaction *Personal Property Security Act* Equity Fraud

The appellant i Trade Finance had advanced money to a company, Webworx Inc., operated by a fraudster. The fraudster used the advances to the company to buy shares in a BMO Nesbitt Burns account which, in turn, were pledged to BMO to obtain additional credit. Both of the parties to this appeal were unaware of the fraud.

The appellant brought a civil proceeding against the fraudster after the fraud was discovered. This resulted in an order that imposed a constructive trust or equitable lien on all the property purchased by the fraudster through funds advanced to Webworx. The appellant was also granted a tracing order that allowed the appellant to trace assets of the fraudster. The order excluded assets in the hands of *bona fide* purchasers for value without notice. The appellant sought funds in the hands of BMO. At trial the appellant successfully claimed the funds at issue, but the trial judge's decision was overturned at the Court of Appeal. The Supreme Court dismissed the appeal. Its analysis provides insight into the interaction between the PPSA, equity, and the legal effect of fraud on a secured transaction.

The Supreme Court held that the key issue was whether BMO could be described as a *bona fide* purchaser for value, which requires a consideration of the nature of each party's interest in the funds. The court emphasized that the appellant's rights were based in the tracing order and as such, recovery is based on whether the funds can be imposed with a constructive trust or equitable lien. This is an equitable interest and is not governed by the PPSA.

BMO's interest, however, was based in a pledge by the fraudster, a transaction meant to create a security interest as defined by the PPSA. The court noted the key element is whether the fraudster had rights in the collateral. Fraud makes a transaction voidable, not void. The court found that Webworx had the consent of the appellant to use the funds at the time and, as such, the appellant bore the risk of loss. As a result, the fraudster had rights in the collateral. The court, therefore, concluded that BMO had a valid PPSA security interest. Moreover, BMO was a *bona fide* purchaser for value as its acquisition of the shares by way of the pledge falls within both the PPSA and the equitable definition of "purchaser". As a *bona fide* purchaser for value, BMO's funds fell outside the ambit of the tracing order and, as a result, BMO could retain the funds.



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