1888

*Mar. 22, 23.

*Dec. 14.

THE MERCHANTS' BANK OF CANADA (PLAINTIFFS)..... } APPELLANTS;

AND

WILLIAM McKAY AND OTHERS (DEFENDANTS)..... } RESPONDENTS.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO.

Surety—Mortgage to bank—Continuing security—Present indebtedness of principal—Commercial paper—Mode of dealing by bank.

McK. gave a mortgage to the M. Bank as security for the present indebtedness of, and future advances to, a customer of the bank. By the terms of the mortgage McK. was to be liable, amongst other things, for the promissory notes, &c., of the customer outstanding at the date of the mortgage, and all renewals, alterations, and substitutions thereof.

Held, per Ritchie C.J., Fournier and Taschereau JJ. That the bank having given up the said promissory notes, etc., and accepted, as renewals thereof, forged and worthless paper, McK. was, to the extent of such worthless paper, relieved from liability as such surety.

Held, per Strong J.—That the bank having accepted the renewals in the ordinary course of banking business, and it not being shown that they were guilty of negligence, the surety was not relieved.

Held, per Gwynne J.—That as there was a reference ordered to take an account of the notes alleged to be forged, the consideration of the surety's liability should be postponed until the account was taken.

APPEAL from a decision of the Court of Appeal for Ontario, affirming the judgment of the Chancery Division (1) in favor of the defendants.

The action in this case was brought for foreclosure of a mortgage given by the defendants as security to the plaintiffs for the indebtedness of the firm of Wm. Kyle & Co., and to enable said firm to increase their

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PRESENT.—Sir W. J. Ritchie C.J. and Strong, Fournier, Taschereau and Gwynne JJ.

(Mr. Justice Henry heard the argument in this case, but died before judgment was delivered).

(1) 12 O. R. 498.

1888

MERCHANTS BANK OF CANADA v. MCKAY.

credit with the plaintiffs' bank. The obligation of the defendants under the mortgage is thus provided for:—

"Provided, this mortgage to be void on payment of twenty-six thousand five hundred and thirteen $\frac{04}{100}$ dollars of lawful money of Canada, as follows: in two years from the date hereof, and all bills of exchange, promissory notes and other paper upon which the said firm of William Kyle & Co. were liable to the said mortgagees on the 24th day of November, A.D. 1883, together with all renewals, substitutions and alterations thereof, and all indebtedness of the said firm to the said mortgagees in respect to the said sum. This indenture being intended to be a continuing security to the said mortgagees for the above amount, notwithstanding any change in the membership of the said firm, either by death, retirement therefrom or addition thereto, and also to secure and cover any sum due or to become due in respect of the interest, commission upon the said notes or renewals, or other commercial paper, and taxes and performance of statute labor."

At the time this mortgage was given the greater part of the business of Kyle & Co. with the bank consisted of the discount of their customers' bills, a small portion being the discount of their own bills with the customers' paper given as collateral. When the suit was brought the greater part of the indebtedness consisted of discounts of the latter character.

The defendants raise two objections to the proceedings against them on the mortgage, namely, that the bank had given up the good paper, which they formerly held, of the customers of Kyle & Co., and had taken in renewal or substitution thereof forged and worthless paper, and that by increasing the discounts with collaterals they had facilitated the giving of such forged paper, inasmuch as the customers would not be notified, as they would in the case of straight discounts.

1888

MERCHANTS' BANK OF CANADA v. McKAY.

The action was tried before Mr. Justice Ferguson, and referred, by consent of counsel, to the Divisional Court. The judgment of the Divisional Court exonerated the defendants from liability on the mortgage, in so far as the bank had parted with the valid securities aforesaid and accepted forged and worthless securities therefor, and an account was ordered. This decision was affirmed by the Court of Appeal. The plaintiffs then appealed to this court.

Robinson Q.C. for the appellants cited *Loomis* v. *Fay* (1).

McIntyre for the respondents, referred to *Sutton* v. *Wilders* (2); *Re Speight* (3).

Sir W. J. RITCHIE C.J.—The mortgage recites that the firm of Kyle & Co. were indebted to the Merchants' Bank, in the course of banking, for debts contracted by the said firm to the bank and for which the bank then held the commercial paper of the customers of the firm upon which the said advances were made, and that the said firm had applied to the bank for additional advances for a limited period, to which the bank had agreed upon receiving security for the present indebtedness, and that the mortgage was intended to carry out that agreement.

The consideration of the mortgage was stated to be $26,513.04, the amount due the bank from the said firm on November 24, 1883, and then unpaid; and the mortgagors conveyed their respective interests in the lands mortgaged to the bank as additional security for such indebtedness.

There was a proviso that the mortgage should be void on payment, in two years from the date of the mortgage, of the above amount and all bills of exchange, promissory notes and other paper upon which the said

(1) 24 Ver. 241. (2) L. R. 12 Eq. 377.
(3) 22 Ch. D. 727.

firm were liable to the bank on November 24, 1883, and all renewals, substitutions and alterations thereof, and all indebtedness of the said firm to the bank in respect of the said sum; and also a proviso that the bills, notes and other commercial paper should not be deemed to be merged in the mortgage.

In my opinion the bank was not justified in parting with any of the securities held by them at the time of the making of the mortgage unless the same were paid or renewed with valid paper of the same character; that if the bank gave up the paper so held by them, and took in lieu of it forged paper, they must be answerable for the loss sustained thereby; that the securities held by the bank at the date of the mortgage were held as well for their own benefit as for the benefit of the sureties, the mortgagors; and that if they gave up such paper, and did not obtain renewals or other commercial paper therefor, but gave up said notes and accepted in lieu thereof forged and invalid instruments, they discharged the defendants from the payment of the said mortgage to the extent of the paper so given up, without any evidence of negligence *pro* or *con.*; I think the bank was bound to see before giving up the notes they held at the date of the mortgage that the notes they took in renewal or substitution therefor were genuine, valid notes. I think the distinction is most manifest between the *bonâ fide* taking a valid note, though the party might not be solvent and the note consequently, for the time being, apparently worthless, and the bank taking a forged note. In the first case the surety, on payment, would be entitled to the note and to hold it for what it might be, or at any time afterwards become, worth; in the latter the forged note, by no possibility, could ever be of any value. To my mind the clear intention of all parties, to be gathered from the deed,

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Ritchie C.J.

is that the renewals, substitutions and alterations were to be by valid, binding commercial paper of the customers of the firm, and not by taking, in lieu of such paper, not commercial paper of such customers but utterly worthless and forged paper. I think that in accepting this security from these sureties the bank, by clear implication of law, undertook that they would do nothing in reference to the paper held by them in derogation of the rights of the sureties; that they would take in renewal or substitution thereof paper of the same character as that then held by them, namely, commercial paper of the customers of the firm; and I think, in favor of the sureties, the giving up of valid commercial paper, which, when paid, the sureties had a right to have the benefit of, and taking forged and invalid paper in lieu thereof, was necessarily, as against the sureties, a negligent and improper act. I think the bank was bound to be in a position to hand over, on payment, to the sureties good and valid commercial paper of the customers of Kyle & Co., such as they held at the date of the mortgage, and if they had given up such paper, and not taken, in lieu thereof, good, valid, commercial paper, and cannot give them securities of such a character but have only forged and invalid paper to offer them, the sureties, in my opinion, are thereby relieved to the extent of such invalid paper.

It must be borne in mind that between the surety and the principal debtor there is no privity of contract. The surety contracts with the creditor; therefore, it is what the creditor does that alone has to affect the surety. The creditor has no right to deal with the principal debtor in derogation of the rights of the surety, behind the backs of the sureties and without their consent, whether such dealings were induced by negligence, carelessness, or over-confidence in the

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Ritchie C.J.

debtor. The right of subrogation attaches as soon as the liability of the surety attaches. If this is so, and the surety is entitled to be subrogated to the position of the creditor in respect to any valid securities of the principal debtor held by him, how can it be in the mouth of the creditor to allege that he, without the assent of the sureties, gave up such valid securities, and, in lieu thereof, took valueless, invalid and forged securities, which the surety must accept as and for the valid securities he gave up?

There can be no doubt, in this case, that the dealings of the bank with the principal debtor were, in the highest degree, prejudicial to the surety. There was, in my opinion, a clear duty on the bank to ascertain, before they gave up any of the securities they held alike for their own benefit as for the benefit of the sureties, that they were justified in doing so; and if they gave them up without receiving the money therefor, or valid commercial paper of the customers of Kyle & Co. in renewal or substitution therefor, they did so at their own risk and peril, whether the same was caused by negligence, carelessness, over-confidence in Kyle & Co., or any other cause, so long as the sureties were no parties, directly or indirectly, to the action of the bank. To hold that they could do so, and force the loss on the sureties, would be, in my opinion, at variance with the well-established rights of sureties.

If the bank held collateral security to the benefit of which the sureties were entitled, upon what principle, by any act of the bank, could the sureties be deprived of such, their unquestionable right?

Why, then, should the sureties and not the bank bear any loss arising from the loss of these collaterals? As between the bank and the sureties the loss was, no doubt, occasioned by the misconduct of a third party

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Ritchie C.J.

and by the action or misapprehension of the bank in reference thereto, but in no way by or through the action, interference or consent of the sureties. Upon whom, then, should the loss fall but upon the bank through whose instrumentality the collaterals were lost? To adjudge otherwise, and make the loss fall on the innocent sureties, would be a strange way indeed of treating them as "favored debtors."

I cannot discover a particle of evidence to justify the suggestion of the learned Chief Justice of the Court of Appeal "that from all that appears on the evidence a portion of this paper might have been forged at the time of the execution of the mortgage." I am at a loss, in the absence of any evidence to that effect, to understand how such a contention can now be urged or such a conclusion implied. On the contrary, the mortgage distinctly recognizes that the collaterals then held were valid securities, and I fail to see a suspicion cast on them, or even a contention that such might have been the case.

The cases, both in England and the United States, leave no doubt on my mind as to the law governing this case. I will refer to the following. In *Pearl* v. *Deacon* (1) the Master of the Rolls says:—

In the judgment of Vice-Chancellor Wood in *Newton* v. *Chorlton* (2) there is a statement, in every word of which I concur. He says, as regards the creditor, "He is bound to give to the surety the benefit of every security which he holds at the time of the contract—every security which he then holds; and he is not allowed in any way to vary the position of the surety with reference to those securities. That has been decided most distinctly in *Mayhew* v. *Crickett* (3) by Lord Eldon, where there was a warrant of attorney in the hands of a creditor put into operation by the creditor, and a judgment obtained, from which he afterwards discharged the principal debtor. Lord Eldon held it utterly immaterial whether the warrant of attorney was known to the surety at the time he entered into the contract or not. The surety had a complete right to the benefit of it, and if the benefits were lost to him he was at once discharged."

(1) 24 Beav. 191. (2) 10 Hare 651.
(3) 2 Swanst. 185.

In *Wheatly* v. *Bastow* (1), per the Lord Justice Turner:

The creditor is, no doubt, under the obligation of preserving the securities which he takes from the principal debtor, for (as observed by the Vice-Chancellor) the surety may entitle himself to the benefit of the securities, and if any of them be lost by the act or default of the creditor the surety may be wholly or partially discharged (2), but the creditor enters into no contract with the surety not to assign the debt or the securities.

In *Wolff* v. *Day* (3), per Hannen J:

We are not bound by the exact terms of it; but I take it to be established that the defendant became surety upon the faith of there being some real and substantial security pledged, as well as his own credit, to the plaintiffs; and he was entitled, therefore, to the benefit of that real and substantial security in the event of his being called on to fulfil his duty as a surety, and to pay the debt for which he had so become surety. He will, however, be discharged from his liability as surety if the creditors have put it out of their power to hand over the surety the means of recouping himself by the security given by the principal. That doctrine is very clearly expressed in the notes in *Rees* v. *Barrington* (4). As a surety on payment of the debt is entitled to all the securities of the creditor, whether he is aware of their existence or not, even though they were given after the contract of suretyship, if the creditor, who has had or ought to have had, them in his full possession or power, loses them, or permits them to get into the possession of the debtor, or does not make them effectual by giving proper notice, the surety to the extent of such security will be discharged. A surety, moreover, will be released if the creditor, by reason of what he has done, cannot, on

(1) 7 DeG. M. & G. 280.

(2) See Chitty Contr., 10th Am. ed. 583; *Law* v. *East India Co.*, 4 Ves. 824; *Capel* v. *Butler*, 2 S. & S. 457. A creditor who has his debt secured by a surety, and has also property pledged to him by the principal debtor as security, is bound to keep the property for the benefit of the surety as well as of himself, and if he surrender the property without the knowledge and consent of the surety he loses his claim against the surety to the extent of the property given up. *Baker* v. *Briggs*, 8 Pick. 122; *Bank of Manchester* v. *Bartlett*, 13 Vt. 315; *Lichtenthaler* v. *Thompson*, 13 Serg. & R. 157; *N. Hamp. Savings Bank* v. *Colcord*, 15 N.H. 119; *Watriss* v. *Pierce*, 32 N. H. 560, 573; *La Farge* v. *Hester*, 11 Barb. (N. Y.) 159; *Taylor* v. *Morrison*, 26 Ala. 728; *Neimcewiez* v. *Ghan*, 3 Paige 614; *Smith* v. *Tunno*, 1 McCord, Ch. 443. The fact that other security, as good or better than that surrendered, was substituted for it, will not preclude the surety from availing himself of the discharge. *N. Hamp. Savings Bank* v. *Colcord*, 15 N. H. 116.

(3) L. R. 7 Q.B. 763.

(4) 2 White & Tudor's L. C. 4th ed., p. 1002.

1888

MERCHANTS' BANK OF CANADA v. McKAY.

Ritchie C.J.

payment by the surety, give him the securities in exactly the same condition as they formerly stood in his hands." And numerous cases are cited in support of those statements.

In De Colyar's Law of Guarantees (1), the law is thus laid down :—

Between the surety and the principal debtor there is no privity of contract for the surety contracts with the creditor.

183.—* * In all these cases there is a privity between the parties which constitutes an identity of person ; but there is no privity between the surety and principal,for the surety contracts with the creditor. They do not constitute one person in law, and are not jointly liable to the plaintiff.

290.—Another right is, that he is entitled to the benefit of all the securities, whether known to him (the surety) or not, which the creditor has against the principal. And it is the duty of the creditor, as soon as the surety has paid the debt, to make over to him all the securities which he, the creditor, holds, in order that the surety may recoup himself. In the case of a person who becomes surety for a limited amount of a debt he has, on payment of the amount for which he is liable, all the rights of a creditor in respect of that amount and is entitled to a share in the security held by the creditor for the whole debt.

391.— We have already seen that a surety is entitled to the benefit of all securities which the creditor has against the principal. It follows, therefore, that if the surety be deprived of this benefit by the act of the creditor he will be discharged to the full extent of the security to which he was entitled ; and, consequently, a creditor is bound to use diligence and care with regard to securities held by him. Thus, for instance, a creditor holding a mortgage for a guarantee debt is bound to hold it for the benefit of the surety so as to enable him, on paying the debt, to take the security in its original condition, unimpaired. The right of the surety is to have the same security in exactly the same plight and condition in which it stood in the creditor's hands.

In *Watts* v. *Shuttleworth* (2) Pollock C.B. says :—

The rule upon the subject seems to be that if the person guaranteed does any act injurious to the surety, or inconsistent with his rights, or if he omits to do any act which his duty enjoins him to do, and the omission proves injurious to the surety, the latter will be discharged. Story's Equity Jurisprudence (3). The same principle is enunciated and exemplified by the Master of the Rolls in *Pearl* v. *Deacon* (4), where he cited with approbation the opinion of

(1) P. 181.
(2) 5 H. & N. 247.
(3) Sec. 325.
(4) 24 Beav. 186, 191.

Lord Eldon in *Craythorne* v. *Swinburne* (1), that the rights of a surety depend rather on principles of equity than upon the actual contract; that there may be a *quasi* contract; but that the right of the surety arises out of the equitable relation of the parties. The Master of the Rolls also referred to the judgment of Vice-Chancellor Wood in *Newton* v. *Chorlton* (2), where he laid down that a creditor is bound to give the surety the benefit of every security he holds at the time of the contract; that the surety has a complete right to the benefit of it, and if the benefit be lost he would be discharged.

In *Newton* v. *Chorlton* (3) the marginal note thus states the law:—

The contract of suretyship entitles the surety to require that his position shall not be altered by any arrangement between the creditor and the principal debtor, from that in which he stood at the time of the contract; and it, therefore, entitles him absolutely to the benefit of all the securities for the debt which the creditor held at the time of the contract.

In *Springer* v. *Toothaker* (4) per Hathaway J.:—

In equity, a creditor who has the personal contract of his debtor with a surety, and has also or takes afterwards, property from the principal as security for his debt, is to hold the property fairly and impartially for the benefit of the surety as well as for himself, and if he parts with it without the knowledge or against the will of the surety he shall lose his claim against the surety, to the amount of the property so surrendered.

The People v. *Janson* (5), *Rees* v. *Berrington* (6), *Law* v. *E. I. Co.* (7), *Baker* v. *Briggs*; 2 ed. of 1 Story's Eq. (8).

In *Green* v. *Millbank* (9), N. Y. Sup. Court, per Van Vorst J.:—

In *Hinckley* v. *Kreitz* (10) Church C.J. adopts the comprehensive statement of Story, that if a creditor does any act injurious to the surety, or inconsistent with his rights, or if he omits to do any act, when required by the surety, which his duty enjoins him to do and the omission proves injurious to the surety, in all such cases the latter will be discharged. 1 Story's Eq. Juris. (11).

In *N. H. Savings Bank* v. *Colcord* (12) Parker C.J. speaking of the principles of equity which regulate the relation of principal and surety, says:—

(1) 14 Vesey 164, 169.
(2) 10 Hare 651.
(3) 10 Hare 647.
(4) 43 Maine Rep. 384.
(5) 7 Johns 337.
(6) 2 Vesey Jr. 542.
(7) 4 Vesey 849.
(8) 8 Pick. 132.
(9) 3 Abbott's New Cases 152.
(10) 58 N. Y. 583-592.
(11) Par. 325.
(12) 15 N. H. Rep. 122.

1888

MERCHANTS' BANK OF CANADA v. McKAY.

Ritchie C.J.

Among these, as we have had occasion to notice in other cases, is one which requires a creditor, who has an obligation, executed by principal and surety, and who has also collateral security from the principal, to appropriate the avails of the security to the payment of the debt, or to hold it for the benefit of the surety, who, if he pay the debt, will be subrogated to the rights of the creditor * * * If he surrenders such collateral security without the knowledge of the surety the latter will be discharged entirely, or *pro tanto*, according to the value of the security thus surrendered. *Law* v. *East India Co.* (1); *Baker* v. *Briggs* (2); 1 Story's Eq. Jur. (3); *McCollum* v. *Hinckley* (4); *Bank of Manchester* v. *Bartlett* (5); *Commonwealth* v. *Vanderslice* (6); *Lichtenthaler* v. *Thompson* (7). But if the surety assent to the surrender it will not affect his liability.

I think the judgment of the Divisional Court should be restored and the matter referred to the master, to take the accounts directed in that judgment.

STRONG J.—The mortgage for the foreclosure of which this action was brought was executed by the respondents as sureties to secure a large debt due to the appellants by Kyle & Co., a firm of wine and spirit merchants carrying on business in Toronto. The appellants also held as collateral security for the same debt negotiable paper, consisting of bills of exchange and promissory notes, made and accepted by the customers of Kyle & Co. and endorsed by the latter. The proviso for the defeasance of the mortgage was as follows:—

Provided, this mortgage to be void on payment of twenty-six thousand five hundred and thirteen $\frac{84}{100}$ dollars of lawful money of Canada, as follows: in two years from the date hereof; and all bills of exchange, promissory notes and other paper upon which the said firm of Wm. Kyle & Co. were liable to the said mortgagees on the 24th day of November, A.D., 1883, together with all renewals, substitutions and alterations thereof, and all indebtedness of the said firm to the said mortgagees in respect of the said sum. This indenture being intended to be a continuing security to the said mort-

(1) 4 Vesey 824.
(2) 8 Pick. R. 122.
(3) Par. 326.
(4) 9 Verm. R. 147.
(5) 13 Verm. R. 35.
(6) 8 Serg. & Rawle 457.
(7) 13 Serg. & Rawle 157.

gagees for the above amount, notwithstanding any change in the membership of the said firm, either by death, retirement therefrom or addition thereto, and also to secure and cover any sum due or to become due in respect of the interest, commission upon the said notes or renewals or other commercial paper, and taxes and performance of statute labor.

The respondents in their defence insist that the security has been discharged by reason of the appellants having renewed the original notes, bills and negotiable paper held by them as collateral securities at the date of the mortgage, and taken in substitution therefor renewals which turned out to be forged, as regards the names of the parties to such paper other than that of Kyle & Co., by whose fraud the appellants were induced to take these forged renewals, and the respondents further insist that the acceptance of such forged paper in lieu of the original genuine paper was such negligence on the part of the appellants that they are thereby exonerated from liability, either wholly or *pro tanto* to the extent of the value of the notes and bills which were exchanged for forged renewals.

The action came on for trial before Mr. Justice Ferguson who, at the conclusion of the evidence and with the consent of the parties, adjourned the cause for its further disposal into the Divisional Court, where it came on for argument before the Chancellor and Mr. Justice Proudfoot who gave judgment for the defendants (the present respondents). The appellants then appealed to the Court ot Appeal, with the result that the judges being equally divided the appeal was dismissed.

Upon the general question of law involved there can be little doubt. The duty of a creditor as regards collateral securities in his hands to which a surety on payment of the debt would be entitled to be subrogated has long been well settled by courts of equity. The creditor is bound to conserve the securities for the

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Strong J.

benefit of the surety, and if he parts with them in such a way as to put them beyond the reach of the surety on payment, or does anything which a prudent owner of such securities, acting in his own interest and in the regular course of business, would not do, or if he omits to do anything which such a prudent owner would do for the preservation of the securities, and they are thereby lost or deteriorated in value, or the surety is prejudiced, the latter is wholly or *pro tanto* (as the case may be) discharged from liability. That this is the rule to be applied in the present case does not indeed seem to have been questioned by any of the learned judges whose opinions have been adverse to the appellants. The Chancellor, in delivering the judgment of the Divisional Court, places the decision upon the ground of default on the part of the appellants, and in the Court of Appeal both the learned judges who agreed with the Chancery Division most distinctly place their judgments on the ground that the bank, in giving up the original genuine paper in exchange for forged renewals, was guilty of neglect and breach of duty as regards the respondents. The defendants themselves have, indeed, placed their defence on this same ground, for in the eighth paragraph of their statement of claim, where they put forward the principle of law on which they rely, they propound their defence as follows:

8. The defendants further says that at the time of the execution of the said mortgage the plaintiffs held commercial paper of the said Kyle & Co. to an amount exceeding in value the amount secured by the said mortgage, and it was the duty of the plaintiffs to keep the same, or if they give up the same, or any part thereof, to obtain renewals thereof, or other commercial paper of the customers of said Kyle & Co., in substitution thereof, and to have said commercial paper ready to transfer and hand over to the defendants upon payment by them of the amount secured by the said commercial paper or procure other such paper in its stead, but negligently and improperly gave up the valid commercial paper held by them, and took instead thereof forged and invalid instruments, and they have not now commercial paper of the customers of the said Kyle & Co.,

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Strong J.

to which the defendants would be entitled upon payment of the amount secured by the said mortgage, and the defendants say that they are discharged and released from the payment of the said mortgage, or any part thereof.

Both the Chief Justice and Mr. Justice Osler, who gave judgment in the Court of Appeal in favor of the appellants, adopt the same view of the case, conceding that if the bank was "guilty of negligence" the consequence would have been that the respondents, as sureties, would have been discharged, and they base their judgments on the inference of fact that there was no such negligence. There is, therefore, so far as both the courts below are concerned, a general consent of judicial opinion as to the abstract rule of law, by the application of which to the facts the case must be decided; and the difference of opinion which has arisen must be referred entirely to the different views taken by the several judges of what constitutes negligence in the circumstances of this particular case. In other words, the difficulty which has led to the conflict of opinion has arisen, not in laying down the legal principle applicable, but in applying it to the facts in evidence.

In order to ascertain whether the appellants have failed in their duty so as to render themselves liable to the imputation of negligence we must in the present, as in all cases where negligence is charged, and whether the question is to be determined by a jury under the direction of a judge, or by a court having in its own hands the decision of both law and fact, first of all enquire and endeavor to define, with as much exactitude as the nature of the case admits of, what is the standard of duty to which the appellants were bound to conform. In doing this the respondents will certainly have no right to complain if it is held that the creditor, in a case like the present, is bound to the same degree of diligence as a trustee in dealing with securities belonging to the trust, and to no greater, for it might easily

1888

MERCHANTS' BANK OF CANADA v. McKAY.

Strong J.

be shown, as Mr. Justice Osler has said, that the analogy is not perfect and that the creditor in his dealings with collateral securities is not so strictly dealt with as is an express trustee in his management of the trust fund. But in doing this I am certainly not prepared to consider the instance of strictness in adjudicating on the liability of a trustee afforded by Lord Romilly's decision in *Bostock* v. *Floyer* (1) as conclusive, but I prefer to adopt the rule propounded by the higher authority of the House of Lords in the well-known case of *Speight* v. *Gaunt* (2), and apply it to the facts of the case before us.

Then, in *Speight* v. *Gaunt* (2) the House of Lords plainly and authoritatively state the law to be that a trustee ought to conduct the business of the trust in the manner an ordinarily prudent man of business would conduct his own affairs and that beyond that there is no obligation binding him. Applying that rule here, and always bearing in mind the facts that the creditors holding the collateral notes here were a banking corporation, that the notes had come into their hands, and the debt of the principal debtors had been contracted, and the whole transaction had occurred, in the ordinary course of the business of banking, and in the usual way of managing the bank account of a mercantile customer, our actual enquiry here is still further narrowed to this: Did the appellants, in accepting the fabricated renewals, do any act or fail to take any precaution which a prudent bank manager would not have done or would have taken under the circumstances?

In order to ascertain what is to be considered the duty of a banker in taking renewals of a large line of commercial paper, such as the appellants were the holders of in the present instance, we must, of course, have regard to the evidence so far as it is that of persons who may

(1) 35 Beav. 603. (2) 9 App. Cas. 1.

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Strong J.

be regarded as experts, as to the course of business as carried on by bankers in such cases. But the court is not to confine itself to the evidence. It is also bound to bring its own common experience to bear and to take into consideration the practicability or impracticability of adopting the precautions which it is suggested ought to have been taken, and which might have prevented the loss. Then, considering the facts and the evidence in this way it certainly appears to me that it would be utterly impracticable to carry on the business of banking if every transaction, like the renewal of a note, was required to be attended with a degree of suspicious vigilance against forgery which no ordinarily prudent bank manager would ever think of exhibiting or could exhibit, without insult and injury to his customers, unless his suspicions had previously been aroused by circumstances warranting an exception to the usual course of dealing. Here there were no such circumstances; Kyle & Co. were traders in fair credit, and doing a large business in the same place as the bank itself, and immediately under the eyes of the bank officers, and no taint of suspicion had ever been attached to them. Under such circumstances an enquiry directly by the bank of each one of the customers of the firm, whose names appeared on notes presented for discount or as renewals, would not only have been out of the regular course, in the absence of cause for suspicion, but would have been an unwarranted injury to their commercial credit, and if they had turned out to be honest dealers, as the bank had every right to suppose them to be, would have been considered as an insult to be resented by the withdrawal of their account.

It seems to me, therefore, that it is most unjust and unreasonable now, because it has turned out that Kyle & Co. were a dishonest and bankrupt firm, engaged in

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Strong J.

practising a series of frauds upon the bank, to say that the appellants ought, at their peril, and by going out of the usual course of their business and of the business of all bankers, to have discovered that the notes which were put off upon them as genuine were, in truth, forgeries. Such a proposition is, I think, well answered by reference to the judgment of Bramwell, L.J., in *Baxendale* v. *Bennett* (1) when the learned judge says, in the passage which has been quoted by Mr. Justice Osler, "Every one has a right to suppose that a crime will not be committed, and to act on that belief." If the appellants had omitted any usual precaution, or had blindly persisted in dealing with the firm after circumstances had occurred calculated to rouse the suspicions of not merely a prudent man but of a prudent banker, who, I concede, ought to be more on his guard against such frauds than one not engaged in banking business, then the case would have admitted of very different considerations; but nothing of the kind is established by the evidence.

As to the omission to give notice of notes about to fall due it has, in my opinion, no bearing on the case, the practice not having been universal or even general and having for its object not the detection of frauds or forgeries but the insuring of punctuality by the parties primarily liable on the paper, a precaution sometimes adopted but not in the interest of the parties to the paper but purely for the convenience of the bank itself, and therefore one which it was not bound to take and was at liberty to omit or discontinue as suited its own convenience without being subjected to any imputation of negligence for so doing. On the whole I am unable to see that any act or default can be imputed to the appellants, which amounted to

(1) 3 Q. B. D. p. 530.

misfeasance or negligence in taking the forged renewals in substitution for the genuine notes originally held by the bank.

1888

MERCHANTS' BANK OF CANADA v. McKAY.

Strong J.

Had the mortgage not contained a clear recognition by the sureties of the creditors' right to renew the case would have been susceptible of very different considerations. In that case the appellants would have parted with the genuine notes at their peril; and besides, as Mr. Justice Burton says in his judgment, there would then have been another independent ground of discharge, arising from the giving of time implied in taking the renewals.

There is, however, an express assent, as I construe the mortgage deed, to the course of renewal and substitution adopted, and, indeed, having regard to the way in which a bank account of this kind with a wholesale firm, having a large number of small customers, retail sellers and hotel keepers, scattered over the Province, is carried on it is scarcely to be conceived as possible that the bank would have taken a security which so restricted and fettered them as to have disabled them from renewing the notes which might be in their hands. There need, however, be no difficulty about this for it is not possible, upon any ordinary principles of construction, to do otherwise than hold that the sureties have, in the language used in the proviso in the mortgage deed (before extracted), stated their acquiescence in the mode of dealing which was subsequently adopted. The sole question is that already considered, whether the appellants, in renewing the notes as they were entitled to do by the terms of the mortgage, were guilty of negligence in allowing forged paper to be imposed upon them, and this to the best of my ability and to my own satisfaction I have already answered in the negative.

Therefore, I have come to the same conclusions as

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Strong J.

were arrived at by the Chief Justice in appeal and by Mr. Justice Osler, and in the main for the same reasons. The judgments of both the courts below should be reversed and discharged, and the usual foreclosure decree should be entered in the Chancery Division, with costs to the appellants in the Court of Appeal and in this court.

FOURNIER J.—I concur in the judgment delivered by His Lordship the Chief Justice.

TASCHEREAU J.—I would dismiss this appeal with costs for the reasons given by Patterson J. in the court below.

GWYNNE J.—The sole question appears to be as to the proper form of the decree to be made in this suit, which was instituted by the plaintiffs, as mortgagees of certain real estate against the defendants, the mortgagors thereof, who, by the mortgage, became sureties only for the payment of a debt therein mentioned as being then due by a firm named Kyle & Co. to the plaintiffs. The suit was brought for the purpose of realising out of the mortgaged premises the amount remaining due in respect of the debt so guaranteed.

The question arises out of the ordinary course before the taking of the accounts of the debt secured by the mortgage, under the following circumstances. A firm carrying on in the city of Toronto a large wholesale business, as dealers in liquors and tea, under the name of Kyle & Co., were, upon the 24th November, 1883, indebted to the plaintiffs in the sum of $26,513 for monies advanced to them upon the discount of commercial paper of the said firm, and the plaintiffs refused to give the firm any further accommodation unless they should furnish them with additional security for the said debt; the defendants having agreed to become

such security by giving a mortgage upon real estate, the plaintiffs procured the mortgage which is sued upon to be prepared by their solicitor for execution by the defendants, and it was executed by them accordingly.

(After reading the recitals and covenant for payment in the mortgage His Lordship proceeded):

Now, it being by the Banking Act illegal for the plaintiffs to take security by mortgage upon real estate for future advances to be made thereon to any one, this mortgage, to be valid, must be construed, as indeed is also provided by the express terms of the instrument, as a security only for the debt of Kyle & Co. as it existed on the 24th day of November, 1883, and as represented by the commercial paper recited in the mortgage as having been before then discounted by the plaintiffs for Kyle & Co. The plain intent of the mortgage appears to me to be that the defendants should become, and they did thereby become, sureties for the due payment of such commercial paper, or of such other commercial paper as the plaintiffs in the ordinary and proper course of their business should take, by way of renewals thereof or in substitution therefor, during the period of two years. Any payments made to the plaintiffs by any of the parties primarily liable, or by Kyle & Co. themselves, upon any of the commercial paper then in existence, or upon any renewals thereof, would be a satisfaction *pro tanto* of the defendant's liability. Provision is made in the mortgage for the plaintiffs taking renewals of the then existing paper, and so on of such renewals during the two years, and the plain intent of this provision appears to me to be, that the defendants should exercise equally as sound a discretion as to the commercial paper which should be taken by them by way of renewals of, or in substitution for, the paper represent-

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Gwynne J.

ing the debt, as it stood on the 24th of November, A.D. 1883, as they would and should have taken in case they had renewed such paper from time to time without having had the additional security of the mortgage. They were not, by getting the additional security from sureties, to be less careful in the conduct of that part of their business with Kyle & Co., in which the sureties were concerned, than they would have been if they had given time to Kyle & Co. for the payment of their then existing debt without having the additional security given by the sureties. They were not to be at liberty to be indifferent to the interest of the sureties. Their plain duty, as it appears to me, was to keep the account of the debt of Kyle & Co., for which the defendants were sureties, and of the plaintiffs' dealings with the commercial paper in existence, recited in the mortgage, as representing such debt when the mortgage was executed, and of their dealings, also, with all the commercial paper which they should take from time to time by way of renewal of such paper, or by way of renewal of such renewals, during the whole period of the two years mentioned in the mortgage, wholly separate and distinct from the account the plaintiffs should keep with Kyle & Co. of all subsequent advances the plaintiffs should make to them upon other paper with which the defendants had nothing to do.

What the plaintiffs now appear to have in fact done was to mix the two accounts together and to keep them as one account, just as if the defendants were sureties for the future advances as well as for the existing debt, thus mixing the account of the transactions with which the defendants as such sureties were concerned, with transactions with which they had no concern whatever; and the plaintiffs continued this mode of keeping their accounts until the month of September, 1885, when Kyle & Co. became insolvent and all further dealing with them ceased. At the time of their

becoming insolvent Kyle & Co. are said to have been indebted to the plaintiffs on the footing of the single account so kept by them in a sum exceeding $57,000, for which the plaintiffs held paper of the customers of Kyle & Co., endorsed by them to, and discounted by, the plaintiffs to the amount only of about 25 per cent. of the whole amount, and for the balance or 75 per cent. all they held was Kyle & Co.'s own promissory notes to the plaintiffs, together with which certain paper purporting to be the paper of customers of theirs, and payable to them, was deposited with the plaintiffs as collateral on collection for Kyle & Co., but this paper was not indorsed to, or discounted by, the plaintiffs, and nearly all of this latter paper the plaintiffs allege that they now believe to have been forged by Kyle & Co. At the time the defendants became sureties by the mortgage which they executed, it now appears that the debt for which they became sureties, that is to say, the $26,513 due on Nov. 24th, 1883, was, when the defendants executed the mortgage, represented by what are called straight discounts, that is to say, the paper of customers of Kyle & Co. payable to and endorsed by them to the plaintiffs and discounted by the latter for Kyle & Co., to the amount of $21,745 and the balance of $4,768 by Kyle & Co.'s own notes to the plaintiffs, accompanied with collaterals deposited on collection. The plaintiffs' manager, in his evidence, admits that by reason of the difference in the manner in which the plaintiffs were accustomed to deal with what he calls the straight discounts, and the paper deposited by way of collateral to Kyle & Co.'s own notes on collection, the result of the change made by the plaintiffs to take such a large amount of Kyle & Co.'s own notes with collaterals, instead of the customers' paper on discount, was that thereby Kyle & Co. were the better enabled to commit the forgeries which it is alleged

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Gwynne J.

they have committed, and that if the plaintiffs had only discounted customers' paper, indorsed by Kyle & Co. to the plaintiffs, the forgeries could hardly have been successfully committed at all. The plaintiffs are now claiming, under these circumstances, the right to recover from the defendants, under their mortgage, the whole $26,513, with interest, as still due and payable by them. The Chancery Division of the High Court of Justice for Ontario made a decree, whereby it was declared:

1. That the defendants are exonerated from liability upon the mortgage in question in this action, in so far as they have been prejudiced by the conduct of the plaintiffs in surrendering the securities held by them on the 20th December, 1883, on the indebtedness of Kyle & Co., secured by the said mortgage, or any securities, received by the plaintiffs in renewal or substitution of such securities or in renewal or substitution of any such renewals or substitutions, and receiving in renewal or substitution therefor forged instruments from the firm of Kyle & Co., and doth order and adjudge the same accordingly.

And the court did further declare:

2. That *primâ facie* the plaintiffs are bound for the face value of all securities held by them on the 20th December, 1883, or at any subsequent time, on the indebtedness of Kyle & Co., secured by the said mortgage which they the said plaintiffs may at any time have surrendered on receiving forged securities in lieu thereof, but the plaintiffs are to be at liberty to adduce evidence to reduce such liability to the amount which the said defendants have been actually damnified by the plaintiffs' acceptance of such forged securities, and subject to these declarations the court referred it to the master to take the account for redemption of sale of the mortgaged premises.

Upon an appeal taken from this decree to the Court of Appeal for Ontario that court was divided in opinion, and thereupon the case has been appealed to this court.

In my judgment, the case is not yet ripe for a decision upon the question whether the defendants are relieved from liability in respect of such forged paper, if any, as the plaintiffs may have taken from Kyle & Co., which can be held to be referable to the particular tran-

saction for which the defendants are guarantees. Nor can the question properly arise until the court shall be furnished with evidence (to be produced on the taking of the account, which the defendants are entitled to have taken) showing the circumstances under which such forged paper was received by the plaintiff, and what was the particular paper given up by the plaintiffs upon every occasion upon which such forged paper came into their hands.

As at present advised, it appears to me (assuming any of the paper which the plaintiffs now hold to have been forged by Kyle & Co., and which in the present state of the case can be assumed only) that before any question can be effectually raised between the plaintiffs and the defendants as to any such paper it must be made to appear that such paper, is legitimately referable to and connected with the original debt which was secured by the mortgage—that is to say, that such forged paper is paper which the plaintiffs actually received in renewal of or in actual substitution for paper which they held at the time of the execution of the mortgage, or by way of renewal of or in actual substitution for any renewals of such paper; and for this purpose it is necessary that an account should be taken of the particular dealings of the plaintiffs with the several bills of exchange and promissory notes which, at the time of the execution of the mortgage, represented the debt guaranteed by it, apart from and unaffected by any dealings between the plaintiffs and Kyle & Co. subsequently to the mortgage, and not guaranteed thereby, and of all renewals from time to time of all such original paper so guaranteed by the mortgage, and of all renewals of such renewals, respectively, and of all paper received by the plaintiffs in actual substitution for such original paper, or for any renewals thereof, and of all payments from time to time made to or received by the

1888

MERCHANTS' BANK OF CANADA v. McKAY.

Gwynne J.

plaintiffs on account of or properly referable to such paper or any part thereof. Until such an account shall be taken it cannot be determined whether any paper in particular now held by the plaintiffs does or does not represent any part of the original debt guaranteed by the mortgage. In the case, as it at present stands, no question arises as to appropriations of payments under the rule in *Clayton's case* (1). *The City Discount Co.* v. *McLean* (2) and *Fenton* v. *Blackwood* (3), and cases of that description, have no application to the present case. But the defendants being guarantees for particular distinct transactions which constitute part only of the plaintiffs' dealings with Kyle & Co., and having no connection with large advances made by the plaintiffs to Kyle & Co., subsequently to the transactions guaranteed by the defendants' mortgage, are entitled, whatever may have been the mode in which the plaintiffs kept their accounts with Kyle & Co., to have an account taken of the transactions in respect of which the defendants are guarantees, wholly unprejudiced by and separated from the dealings of the plaintiffs with Kyle & Co., with which the defendants have no concern. They have as much right to call upon the plaintiffs to account for all paper from time to time accepted by them by way of renewal of the original commercial paper mentioned in the mortgage as then existing as they have for an account of all monies paid by any of the parties primarily liable upon any such paper, or by Kyle & Co. themselves, upon the occasion of the plaintiffs giving up, if they did give up, any of such paper to them, and of the circumstances under which the plaintiffs parted with any such original commercial paper or any renewals thereof. This case differs from *Moffatt* v *Merchants Bank* (4) in this, that the guarantee there was by

(1) 1 Mer. 572.
(2) L. R. 9 C. P. 962.
(3) L. R. 5 P. C. 167.
(4) 11 Can. S. C. R. 46.

bond a mode of security which it was competent for the plaintiffs to take by way of security for future advances as well as for a debt already incurred, and which the majority of the court held was in its terms a security for such future advances. While referring to this case, I wish to observe that the head note of the case, as reported in 11 Can. S.C.R. 46, is very inaccurate and misleading. It is there in substance said that the judgment of the majority of the court was that the obligor in the bond was liable upon it according to its tenor and effect, a point as to which there could not well be any difference of opinion; but I am represented as having dissented from this proposition, whereas the only difference of opinion which existed between me and the majority of the court was as to what was the tenor and effect of the bond, they being of opinion that it covered the future advances, I that it was limited to the then existing debt alone.

The decree should, in my opinion, be varied and should be to the effect following: declare that the defendants are sureties only for the debt of $26,513 in the mortgage in the pleadings mentioned as represented by the commercial paper in the said mortgage also mentioned as constituting such debt, and that as such sureties they are entitled to have an account taken of all the plaintiffs' dealings with such commercial paper, and of all payments, if any made in respect thereof, or properly referable to, and which should have been credited by the plaintiffs to any of such paper, and in the taking of such account the defendants are to be kept free from all prejudice, if any there be, arising from the fact of the plaintiffs having in the account kept by them with Kyle & Co. mixed up their, the said plaintiffs', dealings in respect of the paper held by them representing the said $26,513 from subsequent advances made by the plaintiffs to Kyle & Co., with which the defendants had no concern. Refer

1888

MERCHANTS' BANK OF CANADA v. McKAY.

GwynneJ.

it to the master to take an account of all such securities as aforesaid so recited in the said indenture of mortgage, and of all the dealings of the plaintiffs in respect of each and every such securities, and of all payments, if any, made thereon or on account thereof, and also of all securities from time to time taken and received by the said plaintiffs by way of renewal of or in substitution for any such original securities, or by way of renewal of or in substitution for any of such renewals, and of all sums of money paid directly to the plaintiffs by any of the parties to any of such securities other than Kyle & Co., or by the said Kyle & Co., either directly in respect of any of such securities or properly referable thereto ,and which should have been credited by the plaintiffs to any of such securities, or to the original debt of $26,513 represented thereby ; and the said master is to report what amount, if any, appears to remain due upon or in respect of said original securities, or of any other and what securities in particular from time to time received by the plaintiffs in renewal of or in substitution for any of them ; and what are the particular securities, if any there be, now held by the plaintiffs which have at any time or times been received by them in renewal of or in substitution for any of such original securities, or by way of renewal of or in substitution for any of such renewals ; and under what circumstances each of such securities was taken and received by the plaintiffs, and whether any of the paper now held by the plaintiffs representing any part of the said original securities is for any and, if any, what reason valueless. And whether, in the opinion of the said master, any diminution in value from the face amount of such securities, or any of them, if any there be, has arisen from any and, if any, what neglect or disregard by the plaintiffs of any duty due by them to the defendants as such sureties as aforesaid. The master to report such further special cir-

cumstances, if any there be, appearing in evidence before him.

Reserve further consideration and costs.

Appeal dismissed with costs.

Silicitors for appellants: *Smith, Rae & Green.*

Solicitors for respondents: *McKays, McIntyre & Stewart.*

Solicitors for respondent Clarkson: *MacLaren, Mac-Donald, Meredith & Shepley.*

1888

MERCHANTS' BANK OF CANADA v. MCKAY.

Gwynne J.