1914

*May 28.
*June 1.

JOHN BROWN, LIQUIDATOR.....APPELLANT;

AND

J. J. COUGHLIN AND W. J. IRWIN..RESPONDENTS.

IN THE MATTER OF THE STRATFORD FUEL, ICE, CARTAGE AND CONSTRUCTION CO.

ON APPEAL FROM THE APPELLATE DIVISION OF THE SUPREME COURT OF ONTARIO.

Principal and surety — Insolvency of debtor — Action by liquidator against principal creditor—Compromise—Agreement not to rank —Payment by sureties—Right of sureties to rank.

By a contract of suretyship C. and others guaranteed payment to a bank of advances to a company by discount of negotiable securities and otherwise, the contract providing that it was to be a continuing guarantee to cover any number of transactions, the bank being authorized to deal or compound with any parties to said negotiable securities and the doctrines of law and equity in favour of a surety not to apply to its dealings. The company became insolvent and its liquidator brought action against the bank to set aside some of its securities which action was compromised, the bank receiving a certain amount, reserving its rights against the sureties and agreeing not to rank on the insolvent estate. The sureties were obliged to pay the bank and sought to rank for the amount.

Held, affirming the judgment of the Appellate Division (28 Ont. L.R. 481), that they were not debarred by the compromise of said action from so ranking.

APPEAL from a decision of the Appellate Division of the Supreme Court of Ontario(1), setting aside the order of Mr. Justice Middleton and restoring that of the local judge.

*PRESENT:—Sir Charles Fitzpatrick C.J. and Idington, Duff, Anglin and Brodeur JJ.

(1) 28 Ont. L.R. 481.

The respondents, Coughlin and Irwin, sought to rank on the insolvent estate of the Stratford Fuel, etc., Co. as creditors for money paid to the Traders Bank for whom they were sureties for advances to the company. The bank, in settling an action brought by the liquidator of the company, had agreed not to rank on the assets and the claim of respondents was resisted on the ground that such agreement by the principal creditor was binding on the sureties. The matter came before Judge Barron, a local judge of the High Court, who decided that the respondents were entitled to rank and gave the following reasons:—

"The claim of Coughlin and Irwin is to rank on the estate of the Stratford Fuel, Ice, Cartage and Construction Company, Limited, in the hands of the liquidator, John Brown, for the sum of $5,624.80, of which the sum of $400 is admitted.

"The claim is made, and it is opposed under the following circumstances: The company while in business became heavily indebted to the Traders Bank of Canada in the sum of $40,000 or thereabouts. They continued in business for some time, but on the 7th January, 1908, an order was made to wind up the said company under the R.S.C. 1906, ch. 144, and amending Acts.

"Coughlin and Irwin, with others, had become and were at the time of the liquidation proceedings, guarantors to the bank of the company for their full indebtedness. Exhibit 'A' contains this guarantee. The bank also held a mortgage dated the 27th August, 1907, from the company securing the full amount of its indebtedness. The liquidator, John Brown, brought an action against the bank, on the 13th February, 1908, to set aside the mortgage (and a second mort-

1914

BROWN v. COUGHLIN.

IN RE STRATFORD FUEL, ICE, ECT., CO.

gage) as void against the creditors, which action was settled on the eve of trial, and the settlement itself appears in the memorandum attached to the record. There still remains due to the bank, after this settlement, the sum of $....., or thereabouts, and the bank demanding payment from the guarantors on the guarantee bond, exhibit 'A,' the present claimants, Irwin and Coughlin, in pursuance of the demand, paid the sum of $6,624.80, of which they claim the sum above mentioned in regard to which there is no dispute.

"Mr. Harding, in opposing the claim of Coughlin and Irwin contends, first: That the settlement made of the action of Brown against the Traders Bank had the effect in law of releasing the guarantors on their bond to the bank, and, therefore, that the payment by Coughlin and Irwin was a purely voluntary one on their parts, one which the bank could not legally insist upon, and *sequitur,* that Coughlin and Irwin cannot now legally rank on the estate in liquidation for a payment illegally made by them as against the liquidator. Secondly:—Mr. Harding maintains that Coughlin and Irwin were privy to the settlement of the suit of Brown v. The Traders Bank, and, therefore, that they are bound by this settlement, and being so bound cannot now rank on the estate in the liquidator's hands. As to the latter contention the first question to be decided is one of fact, namely, were Coughlin and Irwin privy to the settlement in question. I do not find that they were. Hence it is neither necessary nor prudent to pursue the law applicable to a fact which is not found to exist.

"I may add, however, that in law information to a surety of time being given to the principal debtor by the creditor, when there is a reservation of rights

against the surety, is no bar whatever either to the creditor proceeding against the surety or the surety proceeding against the debtor. (*Webb* v. *Hewitt*(1).)

"Then as to the first objection. The facts in this case must not be confused with a case of an absolute and unqualified release of a debtor without condition or proviso. In such a case the debt is gone and it is impossible to preserve a right against a surety when the debt is satisfied. It is said by Mr. Harding that though the entire debt is not entirely gone, yet a substantial security, namely, the mortgage referred to, is gone, and that the guarantors have lost the right to be subrogated to the bank in regard to this security. If there is anything in this, it is a matter for the guarantors, and they do not complain. If they have been deprived of the benefit of subrogation it is their loss and no one else need complain if they don't, and they don't. But of what benefit is it to be subrogated to a creditor in regard to a security which is paid off by the debtor to that creditor, and for which payment full credit is given by that creditor to the debtor? The security in question can only be paid once by the debtor. The company having paid it by the carrying out of the settlement they cannot be asked to pay it over again to the guarantors. The guarantors are already benefited by the payment. They gain, they do not lose. By the lessening of their liability on the amount of their indebtedness or their liability on the guarantee bond they happily have had so much less to pay on account of the debtor to the creditor.

"The law of subrogation, as I understand it, has no application here. Broadly speaking, subrogation

(1) 3 K. & J. 438.

1914

BROWN v. COUGHLIN.

IN RE STRATFORD FUEL, ICE, ETC., CO.

is this:—A surety on paying the debt of his principal is entitled to be subrogated to all the securities, funds, liens and equities which the creditor holds against the principal debtor, or has a means of enforcing payment from him. The case in question is not a case of an obligation being extinguished by payment by a surety under such circumstances as entitled him to claim the obligation as still subsisting for his benefit. It is the simple case of payment by a debtor to his creditor of one of the securities that the creditor holds. I can quite appreciate that a creditor must not play pitch and toss with his security and negligently impair the position of the surety and increase the amount that the surety has ultimately to pay, but in this case it is not contended that the settlement made by the bank of the security in question, was other than a reasonable one under all the circumstances, and which, while it satisfied the bank *pro tanto,* likewise benefited the guarantors, the claimants, and lessened the amount of their claim as guarantors against the estate in liquidation.

"Then as to the settlement, while it extinguished the debt *pro tanto* there still remains a large portion of the debt due to the bank. It is said that as to this balance the bank lost its right by the settlement in question, that they can not in law pursue the guarantors, and that, therefore, the guarantors have no right to rank on the estate in regard to a payment by them for which they were not liable in law. But first, what is the contract of suretyship, and next, what does the settlement say ?

"The contract of suretyship is to be seen in exhibit 'A' and the settlement by the indorsement on the record. It is thus seen that the rights of the bank

are specially preserved by both documents against the guarantors by the reservation of remedies against them. Now, what is the result in law of a reserve of remedies when the surety does not consent to the discharge of the debtor? Such a reservation prevents the discharge of the surety upon the principle that it rebuts the implication that the surety was meant to be discharged, and it prevents the rights of the surety against the debtor being impaired. (See *Bateson* v. *Gosling*(1).) The debtor may even be discharged and the surety held provided the contract between the surety and creditor so provides, and in this case the contract of surety does so provide. (See *Cowper* v. *Smith*(2).)

"There is not in this case the element of novation as there was in *Commercial Bank of Tasmania* v. *Jones*(3), and in *Perry* v. *National Provincial Bank of England*(4). In the cases cited there was substitution of one debtor for another as to portion of the debt, as to which portion there was held to be accord and satisfaction, and, therefore, to that extent the creditor could make no claim against the surety. In the case *sub judice* the bank by their settlement did not procure their claim in full. Part of their original debt still remained unpaid. It is obvious, of course, that if the bank had been paid in full there would be an end of the matter. There was a balance still unsatisfied. This balance has been now partly satisfied by the payment of $6,624.80, of which $400 is admitted, and from which $1,000 has to be deducted, and

(1) L.R. 7 C.P. 9.
(2) 4 M. & W. 519, 520, 521.
(3) [1893] A.C. 313, at p. 316.
(4) [1910] 1 Ch. 464.

1914

BROWN v. COUGHLIN.

IN RE STRATFORD FUEL, ICE, ECT., CO.

for which balance I think the sureties should rank on the estate in liquidation.

"It is said that the bank also claims the right to rank for dividend on the claim of $39,600, but while their claim of $39,600 was originally filed prior to the settlement of the suit, that settlement positively provides that they, the bank, shall not rank on the estate in the hands of the liquidator. In other words, they agree to abandon and forego one of their remedies. They carefully preserved their rights and remedies against the guarantors, whose right in turn to rank for dividend is not lost to them any more than they, the sureties, would lose their rights had the bank undertaken not to sue the company, which they could have done without impairing the remedies of the surety in regard to any sum that they have paid or may be called upon to pay.

"For these reasons, then given in brief, I think that the claimants, Coughlin and Irwin, have the right to rank on the estate in question for the sum first mentioned, and a report by me as master will follow accordingly."

An appeal was taken to Mr. Justice Middleton, who reversed the local master's order, but it was restored on further appeal to the Appellate Division of the Supreme Court.

Sir George Gibbons K.C. and *R. T. Harding* for the appellant.

Hellmuth K.C. and R. S. Robertson for the respondents.

THE CHIEF JUSTICE.—I would dismiss this appeal with costs. (See what Barron J. says, *supra.*)

The appellant was the debtor of the Traders Bank at the time the agreement was made. The bank renounced its right to rank on the estate in consideration of the payment of $25,000, but reserved its recourse against the sureties among whom were the respondents. The latter being obliged to pay the debt now claim to rank against the estate of the principal debtor whose debt they paid. It appears to me obvious that they are entitled to rank on an estate of which they are creditors by reason of the payment made to the bank. The claim is not filed in subrogation of the bank's claim under section 69 of the Act, but as that of a creditor under section 76.

The appeal should be dismissed with costs.

IDINGTON J.—The appellant, who is a liquidator of said company, which is in process of being wound up under the "Winding-up Act," brought an action against the Traders Bank to set aside some securities obtained by it from said company and comprised the action by a brief memo. indorsed on the record entered for trial of which clauses 1 and 5 are all that are material for consideration of the question raised herein.

Said clauses are as follows:—

1. The defendants to be entitled to the proceeds of the real estate and ice franchise, twenty-five thousand dollars referred to in the pleadings, but agree not to rank upon the estate in the hands of the plaintiff as liquidator.

5. The bank to retain and hereby reserves all its rights against all securities in its hands and against the guarantors of its debt.

The respondents were sureties to the bank for the general balance due by the company to it.

The instrument by which they became such sureties has been lost, but is shewn to have, in the main at

1914

BROWN v. COUGHLIN.

IN RE STRATFORD FUEL, ICE, ECT., CO.

Idington J.

least, consisted of a general printed form in common use by banks to be signed by guarantors for securing payment of such general balance as may be found due by a customer of the bank.

One term thereof was as follows:—

> This is a continuing guarantee intended to cover any number of transactions, and we agree that the said bank may deal or compound with any of the parties to the said negotiable securities, and take from and give up to them again security of any kind in their discretion, and that the doctrines of law or equity in favour of a surety shall not apply hereto.

The questions raised herein must be solved by the correct appreciation of this power of compromise and the relation thereto of the said stipulations one and five above quoted from the memo. of settlement between the parties thereto.

Can it be maintained that the said memo. of settlement was a compromise within the meaning of the guarantee whereby the claims of the bank as against the debtor were compounded and the principal debtor so absolved thereby that the sureties could have no resource against it?

I do not think so. I assume the guarantee is possibly capable of some such operation, though I doubt such construction.

I put it thus to test the only ground on which it seems to me the matter could be resolved in favour of appellant's contention.

So long as the debt exists and the surety is called upon to pay it, he must in law be entitled to pursue his usual remedies of a surety against the debtor when once he has paid his debt; unless he has contracted himself out of such right in some such way as I have suggested.

This ground not being open to appellant by virtue

of what has transpired, what answer can he have to the statutory right of the surety to rank as a contingent creditor and in virtue thereof to rank for what he has been called upon to pay by the concurrence of appellant permitting the sureties to be pursued ?

If the liquidator intended to avert such consequences it was open to him to have refused his assent to such recourse against the surety or to have insisted upon the sureties assenting to the settlement.

I cannot see how the surety can, short of some such methods, be deprived of his right to rank in respect of what at the date of the winding-up order was a contingent claim which in light of what has transpired has become an actual claim against the debtor whose assets are in the appellant's hands.

I think the appeal must be dismissed with costs.

DUFF J.—Unless precluded by agreement express or implied or by some equity or estoppel arising from some conduct of the parties the surety (by reason of the relation created by the contract of suretyship) is entitled to require the principal debtor to discharge his obligation to the creditor in so far as that may be necessary to relieve the surety. The debtor in other words comes under an obligation to the surety to save the surety harmless from any prejudice which might arise from the non-performance of the principal obligation. It is not disputed that the correlative right of the surety may be enforced in a winding-up where the principal obligation is to pay a sum of money and the principal debtor is the company in process of winding-up. I do not think it is really disputed either, at all events, it is obviously so, that the surety cannot by

1914

BROWN v. COUGHLIN.

IN RE STRATFORD FUEL, ICE, ETC., CO.

Duff J.

any act of the creditor alone be deprived of his right to compel the debtor to protect him by discharging the debt, or to indemnify him against the consequences of his failure to do so. The substance of the argument in this case is, that by the terms of the suretyship contract, the creditor, the bank, was made the agent of the sureties and as such agent empowered to enter into arrangements on their behalf with the principal debtor binding on the sureties as if made by them in person, and that by the agreement of June 15th, 1909, an arrangement was entered into pursuant to this authority between the creditor and the debtor whereby the creditor agreed on behalf of the sureties as well as on behalf of itself that no claim should be made in the winding-up in respect of the debt in question. There are two answers to that: The documents are as follows:—

To the Traders Bank of Canada.

In consideration of the Traders Bank of Canada making advances to the Stratford Fuel, Ice, Cartage and Construction Company, Limited, either by the discount of negotiable securities consisting of bills of exchange or promissory notes, or by overdrafts, or otherwise, from time to time as the said bank may think fit; we jointly and severally hereby guarantee payment in full of such negotiable securities or overdrafts or other indebtedness provided, however, that the amount to be paid by us under this guarantee shall not exceed $38,000. This is a continuing guarantee intended to cover any number of transactions, and we agree that the said bank may deal or compound with any of the parties to the said negotiable securities, and take from and give up to them again security of any kind in their discretion, and that the doctrines of law or equity in favour of a surety shall not apply hereto. It is also agreed that the guarantors shall be liable for the ultimate balance remaining after all moneys obtainable from other sources shall have been applied in reduction of the amount which shall be owing from the Stratford Fuel, Ice, Cartage and Construction Company, Limited, to the said bank; provided, however, that they shall not be liable for a greater amount than the said sum of $38,000, but the said bank shall not be bound to exhaust all such resources against all parties previous to making

demand upon us for payment, the intention being that the Traders Bank of Canada shall have the right to demand and enforce this guarantee in whole or in part from the guarantor whenever the principal debtor or any party or parties concerned fail to discharge any obligation they have entered into.

This guarantee shall subsist notwithstanding any change in the constitution of the company.

As witness our hands at Stratford this 24th day of October, 1907.

Witness:

J. J. COUGHLIN.

J. J. COUGHLIN. (Seal.)
W. G. IRWIN "
W. J. MOONEY. "
F. B. DEACON. "
G. R. DEACON. "
JAS. A. GRAY. "

BROWN v. TRADERS BANK.

1. The defendants to be entitled to the proceeds of the real estate and ice franchise, twenty-five thousand dollars referred to in the pleadings, but agree not to rank upon the estate in the hands of the plaintiff as liquidator.

2. The defendants to pay to the plaintiff the sum of one thousand dollars.

3. Each party to pay own costs of suit.

4. The other securities held by the defendants to be declared valid.

5. The bank to retain and hereby reserves all its rights against all securities in its hands and against the guarantors of its debt.

GEO. C. GIBBONS,
For Plaintiff.
GIDEON GRANT,
For Defendants.

June 15—09.

First, the document of the 24th October, 1907, above quoted, does not in express terms invest the bank with any authority to act as the agent of the sureties in dealing with the principal debtor. Nor does the document in apt terms limit the rights or the remedies of the sureties as against the debtor. The stipulation that "the doctrines of law or equity in favor of a surety" shall not apply to compositions between the bank and the principal debtor, although it

1914

BROWN v. COUGHLIN.

IN RE STRATFORD FUEL, ICE, ETC., CO.

Duff J.

is perhaps capable of being read as applying to the rights of the surety as against the principal debtor does not necessarily relate to such rights, and the context would appear to indicate that such rights are not within the contemplation of the clause. Without analysing the language further I will simply say that I do not think the construction contended for accords with the real intendment of the stipulation. But assuming the appellant to be right in his contention as to the construction of this document, I think the compromise of June 15th, 1909, when rightly read, does not amount to a release of the sureties' rights. I think when the first paragraph is read with the last it becomes apparent that according to its true meaning the instrument only embodies a stipulation by the bank that the bank will not press its own claim to rank upon the assets of the company in the hands of the liquidator.

ANGLIN J.—In order to give its full legal effect to the reservation in the document of compromise of the bank's rights against the sureties, its agreement not to rank on the debtor's estate in liquidation must be deemed similar in its results to a covenant not to sue. It does not operate as a release of the debtor. It is in fact an agreement that the bank will not claim to rank in the liquidation for the balance of its demand as a creditor. It is said that on payment the surety becomes subrogated to the rights of the creditor, and that it is only by virtue of such subrogation that his right to proceed against the primary debtor arises. It follows, the appellant maintains, that in the present case the sureties cannot rank on the estate in liquidation because the creditor had

debarred himself from so ranking. But as the creditor's covenant not to sue the principal debtor does not preclude the surety who pays the creditor from bringing action against the debtor for indemnification, so the agreement not to rank in the present case left that right open to the sureties on their making payment. Moreover, while it would appear to be the purpose of the bond sued upon that dealings between the creditor and the primary debtor, which would ordinarily operate to discharge the sureties, should not have that effect, there is nothing in that instrument which, in the event of the sureties being compelled to meet the primary debtor's obligation, necessarily deprives them of the right, which the law otherwise gives them, to claim indemnification by the primary debtor or out of his estate in liquidation; and I do not think it should receive such a construction.

The appeal, in my opinion, fails and should be dismissed with costs.

BRODEUR J.—I fail to see how the guarantors who have paid the debt of the principal debtor could be prevented from ranking on the assets of the estate of the latter. The liquidator who is contesting the claim of the sureties invokes an agreement which he has made with the principal creditor who undertook not to rank upon the estate. But at the same time it is stipulated in the same agreement that the creditor could demand and enforce his right against the sureties.

By that agreement the principal creditor could not claim personally from the estate. And if he had not succeeded in collecting anything from the sureties he would lose the balance of his claim, but if he col-

1914

BROWN v. COUGHLIN.

IN RE STRATFORD FUEL, ICE, ECT., CO.

Brodeur J.

lects something from the sureties the latter become entitled to make a claim against the estate. The agreement was a personal one as far as the creditor was concerned, but it did not bind the sureties.

The reservation of rights against the sureties leaves the debt alive. *Kearsley* v. *Cole*(1); *Green* v. *Wynn*(2).

The sureties' right to be indemnified by the principal debtor or his estate will not be held to have been abandoned unless a contract on their part to abandon it has been proved.

There is no evidence that such an undertaking exists in this case.

The reservation of the principal creditor's remedies against the guarantors necessarily implies the continuance of their right to be indemnified. Halsbury, Laws of England, vol. 15, p. 519.

This appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: *Harding & Owens.*

Solicitor for the respondents: *R. S. Robertson.*

(1) 16 M. & W. 128.

(2) 4 Ch. App. 204.