DAVID ALLISON (PLAINTIFF)............APPELLANT;

AND

N. McDONALD (DEFENDANT).................RESPONDENT.

1894

*May 21, 22.
Oct. 9.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO.

Mortgage—Discharge—Action on promissory note—Security for mortgage debt.

A. and B., partners in business, borrowed money from C. giving him as security their joint and several promissory note and a mortgage on partnership property. The partnership having been dissolved A. assumed all the liabilities of the firm and continued to carry on the business alone. After the dissolution C. gave A. a discharge of the mortgage, but without receiving payment of his debt and afterwards brought an action against B. on the promissory note.

Held, affirming the decision of the Court of Appeal, that the note having been given for the mortgage debt C. could not recover without being prepared, upon payment, to convey to B. the mortgaged lands which he had incapacitated himself from doing.

Held, also, that by the terms of the dissolution of partnership the relations between A. and B. were changed to those of principal and surety, and it having been found at the trial that C. had notice of such change his release of the principal, A., discharged B., the surety, from liability for the debt.

APPEAL from a decision of the Court of Appeal for Ontario (1) reversing the judgment of the Divisional Court (2) in favour of the plaintiff.

The facts upon which the decision in this case was based may be briefly stated as follows :

The defendant, McDonald, carried on business in partnership with Adam Allison the plaintiff's brother, and the firm borrowed $1,000 from the plaintiff giving

*PRESENT :—Sir Henry Strong C.J., and Fournier, Taschereau, Sedgewick and King JJ.

(1) 20 Ont. App. R. 695. (2) 23 O. R. 288

1894
ALLISON
v.
McDONALD.

him a mortgage on partnership property and a joint and several promissory note as security. The partnership having been dissolved Adam Allison carried on the business alone, and agreed to pay the liabilities of the firm. The plaintiff after the dissolution gave Adam Allison a discharge of the mortgage given to secure his loan but was not paid, and Adam Allison mortgaged the lands again to raise funds. Eventually Adam Allison became insolvent and absconded and plaintiff endeavoured to recover the amount of his loan from defendant by action on the promissory note.

At the trial plaintiff's action was dismissed but an appeal to the Divisional Court resulted in the judgment at the trial being reversed and judgment entered for plaintiff for the recovery of the amount of the note with interest from its maturity. On further appeal the Court of Appeal reversed the decision of the Divisional Court and restored the judgment of the trial judge. The plaintiff then appealed to this court.

Aylesworth Q.C. for the appellant. Unless the terms of dissolution of the partnership changed the relationship between the partners into that of a principal and surety the discharge of the mortgage would not affect plaintiff's remedy on the note. *Swire* v. *Redman* (1); *Birkett* v. *McGuire* (2).

If there was such change of relationship unless plaintiff had knowledge of it he was under no duty to preserve securities or look after the interest of defendant specially. *Oakeley* v. *Pasheller* (3).

Robinson for the respondent referred to *Duncan, Fox & Co.* v. *North and South Wales Bank* (4).

The judgment of the court was delivered by

THE CHIEF JUSTICE.—The respondent Norman McDonald, and one Adam Allison, a brother of the

(1) 1 Q. B. D. 536.
(2) 7 Ont. App. R. 53.
(3) 4 Cl. & F. 207.
(4) 6 App. Cas. 1.

appellant David Allison, were in 1888 in partnership as bankers, and in the course of their business borrowed $1,000 from the appellant who was also a banker. As security for this loan Allison & McDonald gave the appellant their joint and several promissory note dated the 2nd March, 1888, payable two years after date, for $1,000 with interest at ten per cent. They also as further security for the loan gave the appellant a mortgage on certain lands in South Dorchester. The defeasance contained in this mortgage was in the following words:

Provided this mortgage to be void on payment of the said sum of one thousand dollars according to the tenor of a promissory note made and bearing even date herewith made by the said mortgagors to the mortgagee for one thousand dollars and interest thereon as provided by the said note.

In February, 1889, Adam Allison and the respondent dissolved partnership. By the terms of the agreement for dissolution Adam Allison (who was to continue the business) undertook to pay all the liabilities of the partnership and the respondent relinquished all the assets to Adam Allison. On the 1st of July, 1889, the respondent conveyed his interest in the equity of redemption of the mortgaged property to Adam Allison. On the 19th May, 1891, the appellant gave up the security of the mortgage in favour of his brother and executed a statutory discharge which had the effect of vesting the equity of redemption in Adam Allison. Adam Allison subsequently mortgaged the property for a new loan to another lender. On the 16th July, 1891, Adam Allison, having become insolvent, made an assignment for the benefit of creditors. On the 20th August, 1891, the appellant brought the present action to recover the amount of the promissory note from the respondent. The respondent set up in his defence that by releasing the mortgage the appellant had dis-

1894
ALLISON
v.
McDONALD.
The Chief Justice.

charged him. The cause was originally heard before the Chancellor who dismissed the action. The learned Chancellor's judgment proceeded upon two distinct grounds: First, he held that the mortgage and promissory note having been given for the same debt, the appellant could not recover upon the note after having released the mortgage inasmuch as, apart altogether from any relation of principal and surety existing between Adam Allison and the respondent, the latter, on payment of the note, would have been entitled to a transfer of the mortgage which the appellant had, by discharging that security, put it out of his power to give him; secondly, the Chancellor's decision was put upon the independent ground that the dissolution agreement had changed the relationship of Adam Allison and the respondent *inter se*, and that from thenceforward it had become that of principal and surety in consequence of Adam Allison's undertaking to pay off the liabilities of the firm; that the appellant had notice of this alteration in the relationship of his debtors when he released the mortgage; and that consequently he, the respondent, was discharged.

The Queen's Bench Division on appeal dealt only with the latter point, and on the security of *Swire* v. *Redman* (1) held that both the respondent and Adam Allison having contracted with the appellant as principal debtors, and there having been no relation of suretyship actually existing between them at the time the promissory note and mortgage were given, the subsequent change in their relation to each other could not affect the appellant even though he had notice of it; and on this ground they reversed the Chancellor's judgment. The learned judges of the Queen's Bench Division do not seem to have had their attention

(1) 1 Q. B. D. 536.

directed to the first point; at all events they do not deal with it in the judgment of the court. The Court of Appeal have, by a majority of three to one, reversed the judgment of the Queen's Bench and restored the Chancellor's judgment, the dissenting judge being Mr. Justice Maclennan. The judgment of the Court of Appeal proceeds upon the point taken up in the first branch of the Chancellor's judgment, namely, that the appellant could not call upon the respondent to pay the mortgage debt without being prepared upon payment to re-convey to him the lands mortgaged to secure the debt, which he had incapacitated himself from doing. Upon this point I entirely agree with the judgments of Mr. Justice Burton and Mr. Justice Osler delivered in the Court of Appeal.

So completely is the principle upon which they have decided the case supported by authority that it would, under the old system of procedure when law and equity were administered separately, have been of course to enjoin an action to recover on a promissory note brought under such circumstances as are disclosed by the evidence in this record. The rule is elementary and so well established that it is almost superfluous to quote authorities in support of it. The principle is the plain and just one that he who gives a pledge in security for a debt is, upon payment, entitled to a return of that which he has given in security, from whence it follows that if the creditor is unable to return the pledge he will not be allowed to exact the debt. *Palmer* v. *Hendrie* (1); *Lockhart* v. *Hardy* (2); *Walker* v. *Jones* (3). It has even been carried so far that in the case of *Schoole* v. *Sall* (4) Lord Redesdale restrained a mortgagee from suing at law upon his personal securities, not because he could not re-convey

(1) 27 Beav. 349; 28 Beav. 341.
(2) 9 Beav. 349.
(3) L. R. 1 P. C. 50.
(4) 1 Sh. & Lef. 176.

1894

ALLISON v. McDONALD.

The Chief Justice.

the mortgaged estate, but because he could not re-deliver up all the title deeds which had been handed over to him, having lost them. Amongst the cases cited above those of *Walker* v. *Jones* (1) and *Palmer* v. *Hendrie* (2) are indistinguishable in principle from the present which they also closely resemble in their circumstances. Even if the mortgagee had obtained an absolute foreclosure by which he had made the mortgaged estate his own, and had then sold it for its fair value but for less than the mortgage debt, he could not sue the mortgagor on his bond, covenant, note or other collateral personal security for the unsatisfied residue, and that for the same reason, that he could not give him back the estate. In Coote on mortgages (3) the law is stated very clearly and concisely as follows:

> Ordinarily speaking a mortgagee can avail himself of all his collateral securities, but he cannot transfer the mortgage and retain the collateral securities or sever them from the mortgage: and where he assigned the latter and retained the former he was restrained from proceeding on the collateral security pending a suit for redemption. So he cannot proceed on his collateral securities if he has sold the estate, though fairly, for less than was due; and if he join with the purchaser of the equity of redemption in a sale and permit him to receive the purchase money the mortgagee, not being able to re-convey the estate, will not be allowed to sue the mortgagor for the amount so permitted to be received. He is also restrained from proceeding on his collateral securities if, having put the title deeds out of his power, he is unable to convey the estate effectually.

In Fisher on Mortgages (4) the law is summarized in the same way.

It is out of the question to say that the conveyance of the equity of redemption by the respondent to Adam Allison made any difference or entitled the appellant to release the mortgage in the way he did thus disregarding the equitable right of the respondent to have a re-conveyance of the mort-

(1) L. R. 1 P. C. 50.
(2) 27 Beav. 349; 28 Beav. 341.
(3) Ed. 1884, p. 794.
(4) 4 ed. p. 13.

gaged estate if compelled to pay the debt. Notice of the conveyance by the respondent to Adam Allison ought, as Mr. Justice Osler points out, if it had had any effect, to have made the appellant more cautious in his dealings with the estate, for, if any inference was to be drawn from it, that inference ought to have been that Adam Allison having obtained that conveyance had in law, apart from the actual agreement, on the dissolution become bound to indemnify the respondent against the mortgage debt, inasmuch as the purchaser of an equity of redemption *primâ facie* comes under that obligation to the mortgagor. If the agreement on the dissolution had been, not only that Adam Allison was to have the equity of redemption, but further that the respondent was to pay the mortgage debt, and the appellant had had notice of such an arrangement between the partners, then, but not otherwise, he would have been justified in releasing the mortgage so as to vest the legal estate in his brother. It was not essential that the respondent should prove that the appellant had notice of the dissolution agreement; he had no right to put the security out of his hands without being sure that the respondent had no further claim to it and would not be prejudiced by a release. Not having done this he must take the consequences of his negligence and cannot now sue the co-debtor, whose clear right of redemption he has destroyed, for the personal debt.

I prefer putting my judgment on the same ground as the Court of Appeal, not that I can have now any doubt about the Chancellor being perfectly right in the second ground on which he placed his judgment so far as regards the law. The case of *Swire* v. *Redman* (1) cannot now be regarded as a binding authority if it

(1) 1 Q. B. D. 536.

1894

ALLISON
v.
McDONALD.

The Chief Justice.

ever was one. *Rouse* v. *Bradford Banking Co.* (1) even if it has not demonstrated that *Oakeley* v. *Pasheller* (2) was originally an authority against the doctrine of *Swire* v. *Redman* (3), has at least shown that the construction put upon that case by Lord Cairns and Lord Hatherly in *Overend Gurney & Co.* v. *Oriental Financial Corporation* (4) and by the Irish Exchequer Chamber in *Maingay* v. *Lewis* (5) was such that the law must now be considered as settled in accordance with those decisions. I should have thought that when *Pooley* v. *Harradine* (6) and the class of cases to which that decision belongs had once decided that it was a good equitable defence to an action on a promissory note to show that a party appearing upon the paper to be primarily liable was in truth *ab initio* a mere surety for another party appearing to be secondarily liable, and that a creditor for value having no notice of such relationship when he took the paper was nevertheless upon having such notice bound to deal with the parties according to their real relationship and could not release the real principal without discharging the surety, that the whole question was conceded. I confess I think these decisions were very great innovations upon the rights of creditors, but I have never been able to see what difference it can make to the creditor, if he is to be bound by notice given to him after the debt is contracted, whether the parties were principal and surety *ab initio* or only became so by some subsequent arrangement between themselves of which he has notice. I entirely agree with the law as laid down by the Chancellor, whose view is now confirmed by *Rouse* v. *Bradford Banking Co.* (1), and I should have probably considered myself

(1) 7 Repts. 33; S. C. [1894] 2 Ch. 32.
(2) 4 Cl. & Fin. 207.
(3) 1 Q. B. D. 536.
(4) L. R. 7 H. L. 348.
(5) Ir. Rp. 5 C. L. 229.
(6) 7 E. & B. 431.

bound by his finding on the question of notice, but I must say that I think the evidence on that point was very weak, and that too on a question the affirmative of which ought to be proved beyond all doubt, for if the rights of a creditor are to be affected by an agreement between his joint and several debtors that one shall thereafter be a principal and the other a mere surety I am of opinion that the clearest proof of notice should be given.

The appeal must be dismissed with costs.

Appeal dismissed with costs.

Solicitors for appellant: *Hanna & Cowan.*

Solicitor for respondent: *John A. Robinson.*