COOPER AND SMITH AND JOHN C. SMITH (DEFENDANTS)..... } APPELLANTS;

AND

THE MOLSONS BANK (PLAINTIFFS)..RESPONDENTS.

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*May 21, 22.

*Dec. 9.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO.

Debtor and creditor—Security for debt—Security realized by creditor—Appropriation of proceeds—Res judicata.

If a merchant obtains from a bank a line of credit on terms of depositing his customers' notes as collateral security the bank is not obliged, so long as the paper so deposited remains uncollected, to give any credit in respect of it, but when any portion of the collaterals is paid it operates at once as payment of the merchant's debt and must be credited to him.

Under the Judicature Act, estoppel by *res judicata* cannot be relied on as a defence to an action unless specially pleaded.

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

The defendants, Cooper & Smith, carried on business in Toronto as manufacturers of boots and shoes up to August 24th, 1893, when they suspended payment. By an agreement made in 1891 with the plaintiff, the Molsons Bank, the firm became entitled to a line of credit in the bank to $150,000 on terms of depositing customers' notes as collateral security, representing as nearly as possible the amount discounted for the firm. At the date of the suspension the bank held notes discounted for the firm aggregating in amount $145,000, some of which matured at different dates in September and the balance in December, 1893. The action in which this appeal was taken was on the last mentioned

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

(1) 23 Ont. App. R. 146. (2) 26 O. R. 575.

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notes four in number, amounting in all to $50,000. There was a judgment against the defendants for over $80,000 and a suit pending for about $7,000, when this action was brought.

In 1893, before the maturity of the notes sued on in this case, a dividend was about to be declared in the estate of the defendants and the bank claimed to rank for the full amount of their judgment without crediting the moneys received on the collaterals of which over $80,000 had been collected. An issue was directed to try out this question resulting in the contention of the bank being upheld. On the trial of the present action the defendants urged that, the whole debt due the bank having then matured, the appropriation must be made and the moneys collected applied either on the previous judgments or on the notes in suit. The trial judge held that he was bound by the finding on the trial of the issue, and gave judgment for the plaintiffs for the full amount sued for. On appeal to the Divisional Court that judgment was set aside and the action dismissed, the court holding that the time had arrived when the bank was bound to elect as to the appropriation and not having elected to apply it to the judgment formerly obtained, it must go in payment of the notes in suit which it more than satisfied. On further appeal the Court of Appeal, Maclennan J. dissenting, reversed the judgment of the Divisional Court and restored that given on the trial, on the ground, first, that the matter was *res judicata* by the finding on the issue, and secondly, that independently of that finding, the bank were entitled to hold the moneys received from collaterals until all other sources of payment of their debt were exhausted. The defendants then appealed to this court.

For a fuller statement of the facts see the judgment of the court.

Foy Q.C. for the appellants. The question for decision on this appeal simply amounts to this: Can a creditor who has in hand a large sum of money collected from his debtor's assets, which were mortgaged to the creditor and deposited for the express purpose of securing payment, obtain judgment for the full amount of his original debt or only for the balance after deducting the cash on hand?

A mortgagee in possession must account for all moneys he has received or, with due diligence, should have received. *Benning* v. *Thibaudeau* (1); *Ontario Bank* v. *Chaplin* (2); *In re Rochette* (3); *In re Oxford & Canterbury Hall Co.* (4); and see *Eastman* v. *Bank of Montreal* (5).

We are not estopped by the findings on the issue tried before Mr. Justice Rose in 1894. That was decided on a different state of facts from those now before the court. See *Heath* v. *Overseers of Weaverham* (6); *Concha* v. *Concha* (7).

At all events, the estoppel should have been pleaded. *Hughes* v. *Rees* (8); *Outram* v. *Morewood* (9); *Edevain* v. *Cohen* (10).

Shepley Q.C. for the respondent. The finding on the issue is *res judicata* as to appropriation of proceeds of collaterals and it cannot be litigated again. *In re South American & Mexican Co.* (11); *Flitters* v. *Allfrey* (12); *Rhodes* v. *Moxhay* (13).

Even if not *res judicata* the decision of Mr. Justice Rose was right. The creditor can claim his full debt from the debtor and exhaust other sources of payment

(1) 20 Can. S. C. R. 110.
(2) 20 Can. S. C. R. 152.
(3) 3 Q. L. R. 97.
(4) 5 Ch. App. 433.
(5) 10 O. R. 79.
(6) [1894] 2 Q. B. 108.
(7) 11 App. Cas. 541.
(8) 10 Ont. P. R. 301.
(9) 3 East 346.
(10) 43 Ch. D. 187.
(11) [1895] 1 Ch. 37.
(12) L. R. 10 C. P. 29.
(13) 10 W. R. 103.

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before resorting to the securities. *Commercial Bank of Australia* v. *Wilson* (1); *Athill* v. *Athill* (2); *Young* v. *Spiers* (3); *Eastman* v. *Bank of Montreal* (4); *Beaty* v. *Samuel* (5); *Lewis* v. *United States* (6).

THE CHIEF JUSTICE.—The facts which have given rise to this appeal, and as to which there is no dispute, may be stated as follows: The appellants, Cooper & Smith, in June, 1891, carried on business in partnership at Toronto. The respondents are a bank having a branch or agency office at the same place. The appellants having applied to the respondents for a line of credit, the respondents' manager, Mr. Pipon, on the 13th June, 1891, wrote and addressed to the appellants a letter in the terms following:

> I am pleased to inform you that our board have granted you a line of credit to $150,000 to be secured by collections deposited, rate 6 per cent, one quarter commission on all checks and collections outside of this city, as agreed upon with your Mr. Mason.
>
> Yours truly,
> C. A. PIPON,
> Manager.
>
> The meaning of the above is not that the advance shall be fully covered by collections, but as near as you can.

In the interval between the date of this letter and the 24th of August, 1893, when the appellants stopped payment, the respondents made large cash advances to the appellants. These advances were made in the way of discount by the respondents of the appellants' promissory notes. The appellants, in conformity with the terms of the letter of the respondents' manager of the 13th of June, 1891, handed to the respondents from time to time large numbers of their customers' notes, as collateral security for the advances so made. A list of

(1) [1893] A. C. 181.
(2) 16 Ch. D. 211.
(3) 16 O. R. 672.
(4) 10 O. R. 79.
(5) 29 Gr. 105.
(6) 92 U. S. R. 618.

these collateral notes was kept in a book to which the appellants' book-keeper affixed the following memorandum: "The notes enumerated in this book are deposited with the Molsons Bank as collateral security for advances made by the bank in discounts and overdrafts."

The collateral notes so deposited, as they matured, were from time to time withdrawn by the appellants for collection, other similar notes, all being paper received by the appellants from their customers, being substituted for those so withdrawn.

In August, 1893, the appellants stopped payment. At the time of their failure the respondents held ten promissory notes of the appellants, maturing at various dates between the 4th of September and the 14th December, 1893, for the aggregate amount of $145,000. All of these notes had been discounted by the respondents, and the appellants had received the proceeds. The appellants were also indebted to the respondents in the sum of $1,907, being the balance of their overdrawn account.

The respondents, at the date of the appellants' failure, held as collateral securities, under the agreement of June, 1891, customers' notes which the appellants had deposited with them to the amount of about $105,000. Of course no withdrawal of these collateral notes was permitted by the respondents after the suspension. From that date these notes were collected by the respondents directly, and the question involved in this appeal is, what application the respondents were bound to make of the moneys so received. As the principal notes fell due the bank sued the appellants upon them and recovered judgments, and before the end of September, 1893, they had recovered five several judgments upon five of the appellants' notes, for sums aggregating $83,000. In the first of these actions, in

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which judgment was recovered on the 14th of September, 1893, the respondents sued upon a note for $30,000, due on the 4th of that month, and in that action gave the appellants credit for $6,921.32, the amount which had up to that time been collected on the collateral notes. In the subsequent actions, however, the bank did not credit the moneys which they had in the meantime collected on the collaterals, and they issued executions for the full amount of all their judgments. The proceeds of the collaterals the bank retained as a reserve fund, carrying it to the credit of the appellants in what they called a "suspense account."

Under the respondents' executions, and the executions of other creditors of the appellants, the sheriff seized a large quantity of goods and chattels the property of the appellants, and having sold the same held the proceeds for distribution under the Creditors' Relief Act, the amount realized not being sufficient to pay off all the execution creditors in full.

On the 4th of October, 1893, the appellants made, not a general but a specific assignment for the benefit of their creditors of certain book debts and other credits and property not comprising such as had been seized by the sheriff.

On the 27th November, 1893, the respondents commenced an action against the appellants upon another promissory note (the sixth) which had fallen due on the 22nd of September, 1893, for $5,000, and also for $1,907 the amount of the overdrawn account.

In the beginning of November, 1893, the appellants raised the contention that they were entitled to have credit, upon the executions in the sheriff's hands, for money up to that time collected by the bank on the collateral notes, amounting, as it was alleged, to about $17,000, and an application was made, to compel the

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respondents to give such credit, to the master in chambers who refused the application, which refusal having been upheld on appeal to Mr. Justice MacMahon, in chambers, the appellants further appealed to the Divisional Court of Queen's Bench. Upon this last mentioned appeal the Divisional Court, on the 29th December, 1893, made an order discharging the order of the master and that of Mr. Justice MacMahon confirming it, and directing an issue to be tried upon the question:

Whether, before or since the recovery of the judgments above mentioned, the said bank have received any payments which ought to be applied in satisfaction, in whole or in part, of such judgments or any of them, and if so when such payments (if any) ought to be so applied, and to what extent.

This issue, together with one which had been previously directed by an order of Judge McDougall, the County Court Judge, to the same effect, was tried before Mr. Justice Rose, on the 13th April, 1894, who, having reserved the case for consideration, subsequently, and on the 20th April, found that the respondents had not received any payment which they were bound to apply as contended, and subsequently an order was made, dated the 23rd of May, 1894, declaring that the respondents, up to the 20th April, 1894, had not received any payments which, either at the time of the receipt thereof ought to have been, or at the date of the said order ought to be, applied in satisfaction in whole or in part of the judgments or any of them.

The present action was commenced on the 2nd of June, 1894. It was brought to recover the last four of the ten notes aggregating $50,000, which all fell due in December, 1893, and the defence set up was payment or satisfaction in whole or in part by the money received by the respondents on the collateral notes. The appellants also, by way of counter claim, prayed for an account of what the bank had collected on the col-

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lateral notes and for a declaration that the appellants were entitled to credit on the notes discounted for all sums received by the respondents on the collateral notes, and were entitled to thereafter receive credit on the appellants' notes sued upon, for all moneys the respondents might thereafter collect on the collateral notes or any of them.

The respondents joined issue on the statement of defence and did not reply specially either to the defence or counter claim. At the trial of the action on the 18th of April, 1895, it was admitted that the bank had up to that date received upon the collaterals over and above the sum of $6,921.32 which was credited in the action on the first note, the sum of $82,135, none of which had as yet been applied in any way to reduce the debt due by the appellants. Mr. Justice Rose, who tried the action (without a jury), gave judgment for the respondents for the full amount of the notes sued upon, holding that the respondents were not obliged to credit the money in their hands against the notes in question, but were entitled to retain the fund so realized as a reserved fund, carrying the amount to the credit of a "suspense account," thus following his previous decision on the trial of the issue, which the learned judge considered *res judicata* of the question involved. The appellants appealed from that judgment to the Divisional Court, which court set aside the judgment and dismissed the action, for the reasons stated in a judgment delivered by Mr. Justice Street, in which it was held that the respondents were bound to apply the money in reduction of the appellants' debt to the respondents, and that no such application having been previously made it ought to be applied *pro tanto* in payment of the notes sued upon.

I have taken the foregoing statement of the facts, which are in no way disputed, from the judgments of Mr. Justice Maclennan and Mr. Justice Street.

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The respondents then appealed to the Court of Appeal, and that court allowed the appeal and restored the judgment of Rose J. The present appeal is from this order.

From this judgment of the Court of Appeal Mr. Justice Maclennan dissented.

The learned Chief Justice and Mr. Justice Burton held that the bank were not bound to apply the money received from the collateral notes, but were entitled to hold that money as a reserve fund carried to the credit of a suspense account.

Mr. Justice Osler proceeded entirely upon the ground of estoppel, holding that the judgment on the trial of the issues operated as *res judicata* of the question involved in the present action.

Mr. Justice Maclennan was of opinion that the respondents had a right to hold the money which they had received from the collateral notes in suspense until all the notes became due, but that as soon as the notes which were sued on in this action (which were the last in point of date to become due) had matured the bank ought to have applied the funds in their hands to the reduction of the aggregate debt.

The object of the bank in not applying the money received by them was in order that they might prove for their whole debt unreduced by any payments, and so obtain a larger dividend of the money levied under the execution, and remaining in the sheriff's hands to be applied on the executions *pro ratâ* under the Creditors' Relief Act.

Although the bank credited the amount they had collected from the collaterals to an account in its books, called a suspense account, it does not appear that they set apart the fund or separated it in any way from their other moneys with which they carried on their business as bankers. The presumption there-

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fore is that they have been and are making profit of this money belonging to the appellants, for which they render no account to the appellants and give them no credit by way of interest or otherwise, whilst at the same time they are seeking to charge the appellants with interest on the judgments which they have recovered.

As regards the point of estoppel, I am of opinion that it constitutes no answer to the counter claim of the appellants. Under the system of pleading introduced by the Judicature Act, it has been decided that *res judicata* as a defence, or as a reply to a counter claim, must be specially pleaded. This was decided by the English Court of Appeal in the case of *Edevain* v. *Cohen* (1).

This consideration alone is sufficient to dispose of the question of estoppel, and upon it I am of opinion that we ought to decide this point against the respondents, for, having regard to the way in which the appellants were forced into the trial of the issues, which involved no question of fact but a mere question of law, no amendment ought to be permitted. Further, I agree with the view of Mr. Justice Maclennan that the question litigated in this action, brought to recover on notes which were not even due when the issue was directed, cannot be considered as the same identical question as that involved in the issues, although it may depend on the same principle of law, and might therefore, according to the established rules of judicial comity, be binding upon inferior tribunals and courts of co-ordinate jurisdiction, though not *res judicata* binding on appellate jurisdictions. I consider, therefore, that the whole question as to the rights of the appellants and the obligations of the respondents as to the application of this money in the hands of the latter, derived from the collaterals, is at large.

(1) 43 Ch. D. 187.

I entirely agree with the proposition that a creditor holding a collateral security (by which term I understand a security co-ordinate with the obligation for the principal debt, and co-ordinate with any other security held for that debt, and not as implying a secondary or subordinate security only to be resorted to after prior securities have been exhausted) (1), cannot be compelled by his debtor to release his security by turning it into money to be applied in reduction of the debt, but is at liberty to sue for and recover the full amount of his debt whilst continuing to hold his security unrealized. This was always the law in the case of mortgagees, and was acted on in the administration of assets until altered by statute.

The creditor had the right to reserve any security which had not been liquidated or realized, in order that he might exercise his own judgment as to the most advantageous time and manner of realizing it.

The remedy of the debtor, if he objected to such reservation, was to pay the debt in full and thus redeem the security. The principle upon which courts of equity acted was that the mortgagee or secured creditor was entitled to make the most of his securities.

Thus a mortgagee out of possession was entitled to proceed (to the great oppression of the debtor, it is true) concurrently with an action on the covenant, an action of ejectment and a bill of foreclosure, and in practice these concurrent proceedings were generally resorted to. As Sir W. Page Wood L.J., says in *Kellock's Case* (2):

> Courts of equity allow the mortgagee to proceed at one and the same time with a bill to foreclose, an action on the covenant and an action of ejectment. They do so upon this principle, that the mortgagee has a right to say "the bargain by my debtor is that he will pay me, and I am entitled to insist upon that. I have also the pledge

(1) *Athill* v. *Athill*, 16 Ch. D. 211. (2) 3 Ch. App. 776.

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in my hands which no one can take from me without paying me in full, and it is for me to say when I will choose to realize that pledge." The pledge may be of very great value at one time and not of much value at another time, and the bankruptcy rule prevents the creditor from taking any benefit by his personal demand against the debtor except on the terms of selling at a time when the property pledged may perhaps not sell for half as much as it would fetch if the creditor could choose his time for realizing it.

In the case of *Mason* v. *Bogg* (1), the question arose before Lord Cottenham what were the rights of a creditor who held a security in the case of the administration of assets under a decree where the estate was insolvent. It was contended against the creditor that in such a case he was bound first to realize his security, or, as in bankruptcy, to value it, and then restrict his proof in the administration suit to the balance. This contention was however repelled by the Lord Chancellor, who thus lays down the rule :

> A mortgagee has a double security, he has a right to proceed against both and to make the best he can of both. Why he should be deprived of this right because the debtor dies and dies insolvent, it is not very easy to see.

This rule has since, both in England and in the province of Ontario, been altered by statute as regards administration suits, and the rule which always prevailed in bankruptcy procedure, requiring the creditor to value or realize his security, and give credit for the valuation or amount realized, has been substituted for it.

In *Kellock's Case* (1) the question arose in a winding-up proceeding and it was there held by the Lords Justices that the creditor was not bound to follow the bankruptcy rule but was entitled to the benefit of that which prevailed in the Court of Chancery in administration suits. This rule, which entitles a secured creditor to choose his own time for turning his security into money, has, however, no application to the case of

(1) 2 Mylne & C. 447. (2) 3 Ch. App. 776.

a creditor who has actually realized his security. In such case the money coming into the creditor's hands must be treated as payment in full, or *pro tanto* as the case may be, for the reason of the rule that the creditor is not bound to realize his security but may retain the same in order that he may sell to the best advantage then ceases to exist.

Another rule, which at first sight would seem to furnish an argument for the respondents here, was that the creditor is not bound to accept a partial payment; it is his right to say to the debtor, I will not be paid in driblets; pay me in full and redeem my security or leave me to do the best I can with it.

To apply these principles to the present case, I quite agree that so long and so far as the collateral notes remained unpaid in the respondents' hands there was no obligation to give any credit in respect of them, and the bank was entitled to sue for and recover judgments for the full amount of the direct notes constituting the principal debt due to them by the appellants. So soon, however, as money came into their hands by the payment of the collaterals, which they were bound to use due diligence in enforcing payment of, they were in the position of a creditor who had agreed to receive and who had received a partial payment, and were bound to appropriate those moneys in the payment, in the first place of interest and then to the reduction *pro tanto* of so much of the principal debt as had fallen due.

In the first instance the bank did this by giving credit in the first action which it brought for the sum then in hand received from collaterals. The device of carrying moneys so received to the credit of a suspense account seems to have been an after-thought resorted to for the purpose of obtaining a larger dividend out of the fund in the hands of the sheriff.

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That the receipt by a creditor of the proceeds of a collateral security is to be treated as a payment is shown by the case of *Peacock* v. *Pursell* (1). There the creditor had been asked to accept a current bill of exchange, of which the debtor was the holder, in part payment, the balance of the debt being paid in cash. The creditor refused to accede to this, but agreed to retain the bill as collateral security. When the bill became due it was not paid, and the creditor, by neglecting to give notice of dishonour, lost recourse upon the drawer. The court held that by this neglect the creditor was in the same position as if the amount of the bill had been paid to him. The court there, treating the case as one in which the bill had been paid, held that a payment would have operated *ipso facto* in satisfaction of the debt without requiring any act of appropriation by the creditor.

Erle C. J. says:

> The legal effect of taking a bill as collateral security is, that if when the bill arrives at maturity the holder is guilty of laches and omits duly to present it and give notice of its dishonour, if not paid, the bill becomes money in his hands as between him and the person from whom he received it. That being so the plaintiffs' debt is satisfied.

Willes J. delivered judgment to the same effect, saying:

> But if the creditor, when the bill falls due, is guilty of laches, whereby the security becomes deteriorated or valueless, it becomes equivalent to actual payment * * By their laches the plaintiffs have converted this into a money payment.

This case shows clearly that if a creditor accepts from his debtor a negotiable security, the amount of which is afterwards paid to the creditor by a party to the bill, that operates at once as a payment of the principal debt.

It may be said, however, that whilst that may be so where the amount realized from the collateral

(1) 14 C. B. N. S. 728.

security is sufficient to satisfy the whole debt, yet where it is not equivalent in amount to the principal debt the creditor is not bound to treat it as a partial payment since he is not obliged to accept payment in driblets. Had I not been successful in finding an authority directly in point I should however, nevertheless, have considered that a creditor who takes a collateral for less than the amount of his debt impliedly agrees that the money realized from such security shall be treated as a partial payment.

This indeed was the decision of the court in *Benning* v. *Thibaudeau* (1), a case decided upon an appeal from the courts of the province of Quebec, but depending upon principles of law identical with those we have to apply in the present case. Moreover, the result of a contrary decision would, as will be made apparent hereafter, have been so unjust and unreasonable to the debtor and his other creditors that for that reason it was considered inadmissible. Whilst I say this of *Benning* v. *Thibaudeau* (1), I am far from saying that, decided as it was upon the law of Quebec, it was a decision directly binding upon the Court of Appeal.

The case of *Thompson* v. *Hudson* (2) is, however, a case directly in point in the appellants' favour.

The defendant in that case, in order to secure two several debts to the North-Eastern Railway Company, had made two separate mortgages to trustees for the railway company. By the rule prevailing in courts of equity which has obtained the denomination of the consolidation of securities, the mortgagees, having their two mortgages in hand, were entitled to treat the two debts as consolidated into one single liability, and for that consolidated debt to hold both the mortgaged estates as security for the aggregate debt, as was contended by the defendants' counsel and conceded by

(1) 20 Can. S. C. R. 110.
(2) L. R. 10 Eq. 497.

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counsel for the plaintiff in the case of *Thompson* v. *Hudson* (1).

The mortgagees there having sold, under their power of sale, one estate for a price less than the whole amount of the debt, sought to do precisely what the respondents seek to do here, viz.: to hold the money so produced by the sale of part of the security as a reserve or suspense fund, and to go on charging interest on the whole debt, treating the money accruing from the sale as money which they were not bound to deduct from their debt.

The chief clerk took the account on this footing, but on appeal to the Master of the Rolls the contrary was determined, and that for reasons entirely applicable to the present case. Sir Roundell Palmer and Sir R. Baggally, arguing for the mortgagees, insisted that "the principle is that a mortgagee is not bound to receive payment of his debt by driblets." The observations of the Master of the Rolls have a direct bearing upon the contention of the bank in the case before us, viz.: that it is entitled to hold the money it has derived from the collaterals as a reserve fund put in a suspense account, whilst the money itself, as we are entitled to presume, is mixed with the general funds of the bank and used in carrying on its banking business, a presumption which the device of book-keeping resorted to does not remove.

Lord Romilly M. R. says:

> The railway company had then in hand upwards of £20,000, after all interest and costs had been paid, which was the property of Hudson. What were they to do with it? They might pay it over to him; they were not bound to do so; but I think it impossible that they can contend that they are entitled to keep this money, to make interest upon it for ten years, and still to charge interest on the whole amount due to them on the larger sum * * It is a case of this description: A mortgagee in possession with a power of sale sells a large portion of the estate, say over half, and receives purchase money sufficient to

(1) L. R. 10 Eq. 497.

pay all interest and costs and half the principal due. Can the mortgagee say, I will charge interest in future on the whole debt and only allow the mortgagor the rents received for the unsold moiety and nothing in respect of interest on the money received and employed by the mortgagee? I think not. I am of opinion therefore that the third exception must be allowed and that the proper mode of adjusting the account in such a case is to wipe off so much of the principal as the surplus of the purchase money, after payment of interest and costs, will discharge, and then go on with the account as against a mortgagee in possession with an altered and diminished debt. See what injustice a different rule would inflict. * * It is true, as said by counsel for the railway company, that a mortgagee is not obliged to accept payment of part of the debt, and that the whole must be paid if any, but then why do they retain £20,000 belonging to Mr. Hudson? If they merely kept down the interest and paid the balance over to Mr. Hudson I should assent, but not when they actually keep in their hands and make interest on the sums received at a rate if employed in the conduct of the railway, as I assume it to have been, at least as great as they are able to charge Mr. Hudson on this account.

The order made by the Master of the Rolls was that the purchase money received by the mortgagees should be deducted from the capital secured by the mortgage.

This case in all essential principles appears to me to be an authority for the appellants in the present case, and to shew conclusively that if the bank purposes (as of course it does) to retain the moneys coming into their hands as the proceeds of the collateral notes, they were bound to apply those moneys in reduction of their debt, as well to such parts of it as are in judgment as to such not recovered, by first crediting these receipts on the interest and deducting the balance from the principal of the debt due to them by the appellants. The proposal to retain the money in a reserve fund until it is to the advantage of the bank to apply it—(that is for an indefinite time for none of the learned judges in the Court of Appeal suggest any determinate time at which the appropriation ought to be made) is totally inadmissible consistently with what is laid down as law in *Thompson* v. *Hudson* (1).

(1) L. R. 10 Eq. 497.

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As to the case decided by the Privy Council of the *Commercial Bank of Australia* v. *Official Assignee of Wilson* (1), it has in my opinion no application whatever to the present appeal; the bank in that case were not bound to apply the funds which the guarantors had placed in their hands under an express agreement that it should not be applied in payment of the debt of the principal debtor.

The appeal must be allowed, the order of the Court of Appeal and also that of the Divisional Court discharged, and a judgment based upon the counter claim entered, declaring that the appellants are entitled to have all moneys received by them as the proceeds of promissory notes lodged by them with the respondents as collateral security under the agreement of the 13th of June, 1891, in the pleadings mentioned, duly applied and credited to them in account, the said moneys so received being first applied in payment of interest and the balance in reduction of principal. The judgment must further direct that an account be taken upon the principle above indicated, and that the judgments recovered and executions issued by the respondents do stand as security only for the balance found to be due to the respondents on taking the account directed.

The respondents must pay the costs of this action in this court and in all the courts below, up to the present time, such costs to be deducted from the amount found due to the respondents.

Further directions and subsequent costs must be reserved.

TASCHEREAU J.—I am of opinion that the appeal should be allowed with costs. I adopt the reasoning of Street and Maclennan JJ. in the courts below.

(1) [1893] A. C. 181.

SEDGEWICK, KING and GIROUARD JJ. concurred in the opinion of the Chief Justice.

Appeal allowed with costs.

Solicitors for the appellants: *Foy & Kelly.*

Solicitors for the respondents: *Maclaren, Macdonald, Merritt & Shepley.*