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Equities As To Liability on Bills and Notes: Rights of a Holder Not in Due Course

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EQUITIES AS TO LIABILITY ON BILLS AND NOTES: RIGHTS OF A HOLDER NOT IN DUE COURSE

Benjamin Geva*

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Introduction

On the dishonour of a negotiable instrument,¹ whether a bill of exchange ("bill")² or a promissory note ("note"),³ given by an obligor⁴ in payment under a basic transaction,⁵ the holder⁶ may

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² "A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay, on demand or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer": Can., s. 17(1); U.K., s. 3(1).

³ "A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person, or to bearer": Can., s. 176(1); U.K., s. 83(1).

⁴ The obligor under the basic transaction may be the drawer of a bill (i.e., the person who
maintain his action for payment on the instrument itself. The power of the obligor to assert defences arising from breach of the underlying contract depends then first on whether the plaintiff is a holder not in due course. It may further depend on the type of defences involved. This article examines the proposition that under Anglo-Canadian law an obligor sued on the instrument by a holder not in due course, can assert all defences available in an action on the underlying contract. He does not have to pursue

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6 "Holder, is "the payee or endorsee of a bill or note who is in possession of it, or the bearer thereof": Can., s. 2; U.K., s. 2.

7 Alternatively, the holder may sue on the underlying contract (see authorities cited in footnote 5, supra), in which case the availability of the obligor's defences is well established.

8 This article is concerned only with the action on the instrument against the party primarily liable under the basic transaction (cf. footnote 4, supra). The availability of his defences in an action on the instrument against another party liable thereon (an endorser) is outside the ambit of this article. For the right of the holder and ius tertii, see A. Barak, "The Uniform Commercial Code - Commercial Paper: An Outsider's View", Part I, 3 Is. L. Rev. 7 (1968), at p. 21.

9 "Underlying contract", and "basic transaction" (text at footnote 5, supra) are interchangeable.

10 "A holder not in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely:

(a) that he became the holder of it before it was overdue and without notice that it had been previously dishonoured, if such was the fact;

(b) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it": Can., s. 56(1); U.K., s. 29(1).

In this article, "holder not in due course" denotes every holder (footnote 6, supra) who is not a holder in due course. This can be the payee (an "immediate party", footnote 24, infra) as well as a subsequent transferee who does not take the instrument in the conditions prescribed in Can., s. 56(1); U.K., s. 29(1) (a "remote party", footnote 26, infra).

11 Falconbridge, supra, footnote 5, at p. 665.

12 Such a rule, missing from the Act, is explicitly provided for in the American Uniform Commercial Code ("UCC") (1962 as well as 1972 Official Text). See UCC 3-306 and 3-408 set out in Appendix 2; cf. Part IV, infra.
his remedies in a separate action against the party in breach. The focus of the article is on the general theory underlying negotiable instruments and the liability thereon. Part I outlines the statutory scheme governing the rights of a holder not in due course in light of applicable policy considerations. Part II presents the concept of "defect of title" as central to the delineation of defences available against a holder not in due course. The discussion sets forth the division of "defect of title" into "equities as to ownership" and "equities as to liability" and closely examines the scope of the latter. It concludes that all contractual defences, as distinguished from counterclaims and set-offs arising from separate transactions, are "equities as to liability". Part III establishes the applicability of this analysis to the unilateral contract under a negotiable instrument. Part IV challenges the traditional summary as to the scope of the defence of failure of consideration and supports the proposition that failure of consideration (the defence of breach of contract) is an equity as to liability on a bill or note available against a holder not in due course. The concluding part of this article is the plea for a statutory clarifying amendment designed to restate the basic proposition that a holder not in due course holds the instrument subject to all defences available in an action on the underlying contract.

The following example will facilitate the understanding of the problem explored in this article. A negotiable instrument is issued by a buyer to the order of a seller in return for two machines sold to him. The seller breaks the contract. His breach could take different forms. He can fail altogether to deliver the machines (total failure of consideration), he can fail to deliver one of the two machines (partial failure of consideration in an ascertained or liquidated amount), or while having provided both machines, he can be in breach of a warranty with respect to them (partial failure of consideration in a sum uncertain). The instrument either remains in the hands of the seller (the immediate party) or is negotiated by him to a finance company (a remote party) which, for one reason or another, fails to be a holder in due course. In either case the buyer is sued on the instrument by a holder not in due course. Having failed or chosen not to rescind or terminate the contract, or being not entitled to

13 Discussion of the defence of absence of consideration would also be appropriate. Due to space limitations I chose not to deal with it in the framework of the present article.
exercise this remedy in the first place, can the buyer assert his
defences arising from the seller's breach in an action on the
instrument? Stated otherwise, the issue is the buyer's ability to
avoid circuity of actions as well as the risk of ultimately incurring
loss, namely his power to litigate his liability in the action on the
instrument instead of in a separate action brought by him after
having been forced to pay the full amount of the instrument. The
answer ultimately given in this article is that every defence arising
from the seller's breach can be raised against every holder not in
due course. Depending on the size of the damage caused by the
breach, the effect of such defence is either to extinguish or to
diminish the recovery on the instrument.

I. The Statutory Scheme Under the Bills of Exchange Act

The Bills of Exchange Act, in the United Kingdom as well as in
Canada and other Commonwealth jurisdictions ("the Act"),
explicitly provides that a holder in due course of a negotiable
instrument holds it free from "any defect of title of prior parties,
as well as from mere personal defences available to prior parties
among themselves". In contrast, as regards defences available
against a holder not in due course, the Act contains no compre-
hensive rule, but rather provides only for two specific situations.
Thus, an overdue instrument "can be negotiated only subject to
any defect of title affecting it at its maturity". Likewise, any
person who takes a dishonoured instrument "that is not overdue"

13a The principal provisions of the Act are reproduced in Appendix 1. Note also the UCC
provisions reproduced in Appendix 2 for comparison and a possible direction for legis-
lation reform.
14 Both cited in footnote 1, supra. The Canadian Act is "the adoption . . . with some
modification" of the U.K. Act, Falconbridge, supra, footnote 5, p. 425. The differences
between the two statutes which are applicable to the subject-matter of this article are
analyzed in footnotes 30-52 and text, infra.
15 For a complete list of jurisdictions which have adopted a statute modelled on the Act,
see Falconbridge, supra, footnote 5, pp. 431-2.
16 The provisions dealing with rights of the holder or the holder in due course referred only
to bills of exchange. None the less, "the provisions of [the] Act relating to bills of
exchange apply, with the necessary modifications, to promissory notes": Can., s.
186(1); U.K., s. 89(1).
17 Can., s. 74(b); U.K., s. 38(2) (emphasis added). The implication from this provision is
that "real defences", i.e., those "based upon the nullity of the res" are available also
against a holder in due course: Falconbridge, supra, footnote 5, p. 688. Examples of real
defences are absolute incapacity, forgery, or non est factum: Falconbridge, pp. 668 and
672.
18 Can., s. 70(1); U.K., s. 36(2) (emphasis added).
with notice of the dishonour takes it "subject to any defect of title
attaching thereto at the time of dishonour". 19

Besides its silence on the rights of a holder not in due course in
other situations, the Act does not specify the entire scope of
"defect of title". 20 Its provisions are further neutral as to the
delineation of "mere personal defences available to prior parties
among themselves". This neutrality also extends to the effect of
"mere personal defences" on the rights of a holder of an overdue
instrument as well as of one who takes a dishonoured instrument
"that is not overdue" with notice of the dishonour. 21 Indeed, the
Act's treatment of the subject is not at all clear or comprehensive.

Policy considerations support the obligor's power to assert all
his contractual defences against every holder not in due course. 22
This power results in avoiding circuity of actions: rather than first
paying in the action on the instrument and then pursuing his
remedies in a separate action, the obligor is able to litigate his
liability immediately in the action on the instrument. 23 Also, the
absence of power to assert his defences in the action on the
instrument is bound to leave the obligor with remedies only
against his immediate party (the party in breach). It may thus
confer on a remote party 24 an absolute right to payment even
when he is not a holder in due course. 25

In so far as standard form contracts are concerned, the
obligor's power to assert his defences is further consistent with
optimality principles. 26 Thus, a creditor under a standard form

19 Can., s. 72; U.K., s. 36(5) (emphasis added).
20 Some examples are enumerated in Can., s. 56(2); U.K., s. 29(2), see Appendix 1, infra.
21 Cf. footnotes 17-19 and text, supra.
Gering, eds. (Cape Town, Juta, 1966), p. 271: "a holder who fails to qualify as a holder
in due course should in principle be in the position of an ordinary [assignee] of a
contractual claim". (The word "cessionary" is used in the text in lieu of "assignee". The
former, in South African law, corresponds to the latter in English law; Cowen, ibid., at
p. 6 and note 24.) The position of an assignee is set forth in footnotes 72-81 and text,
footnotes 91-102 and text, footnote 111 and text, infra. Whether policy considerations
support the obligor's power to assert his defences also against a holder in due course is
not within the scope of the present article.
23 Cf. footnotes 197-8 and text, infra.
24 Parties are "immediate" or "remote" in relation to their own dealings underlying the
instrument. On a promissory note issued by a buyer to the order of a seller of goods and
subsequently discounted with a finance company, the maker-buyer and the payee-seller
are immediate parties, the maker-buyer and the endorsee-finance company are remote
parties, and the payee-seller and the endorsee-finance company are immediate parties.
25 Cf. footnotes 186-90 and text which follows, infra.
26 Cf. A. Schwartz, "Optimality and the Cut-off of Defenses Against Financiers of
contract (typically the seller of goods or his financing assignee) is likely to estimate the risk stemming from the withholding of payments by the aggregate of obligors on bills or notes more accurately than an obligor is likely to evaluate the risk of incurring loss by being obliged to pay notwithstanding his defences. The price structure of sellers using mass contracts is therefore likely to reflect better all costs when the obligor has the power to assert his defences, than when he lacks this power. As the optimal allocation of resources is conditioned on the reflection of all costs of an item in its price, optimality is encouraged by the availability of all defences arising from the underlying contract. Finally, creditor's reliance on absolute payment does not outweigh debtor's reliance on absolute performance. The former should not take precedence unless fully negotiated and agreed between two parties of equal bargaining power.

The treatment given under the Canadian Act to holders of two classes of instruments purports to respond to these policy considerations. First, a bill or note "the consideration of which consists, in whole or in part, of the purchase money of a patent right [must bear] prominently and legibly . . . the words Given for a patent right". Its "endorsee or other transferee" takes it under s. 15 "subject to any defence or set-off in respect of the whole or any part thereof that would have existed between the original parties".

The scope of s. 15 depends on the meaning of its key terms. As

27 This risk being, the unjustified withholding of payments.
28 The latter is at least the loss of the "earning differential", i.e., the difference between what the obligor could earn with the payments so made less the legal interest on those amounts when recovered in a separate action: Schwartz, supra, footnote 26, at pp. 504-5.
29 But cf. footnotes 225-30 and text, infra.
30 These two exceptions are not provided for under the U.K. Act (but cf. footnote 47, infra).
31 Can., s. 14(1). The marking has to be made "before [the instrument] is issued", ibid. The section applies also to an instrument "the consideration of which consists, in whole or in part . . . of a partial interest, limited geographically or otherwise, in a patent right".
32 The provision thus applies only to a remote party (cf. footnotes 164-78 and text, infra).
33 Can., ss. 14-16 originate from an 1884 statute, "An Act for the better prevention of Fraud in connection with the Sale of Patent Rights", S.C. 1884, c. 38, and see Falconbridge, supra, footnote 5, p. 459, where it is none the less suggested these sections should be repealed as "it is not clear why instruments given for a patent right should be treated in an exceptional manner".
'defence' includes counterclaim" some confusion may arise. Thus, according to Falconbridge, "claim and counterclaims are merely independent cross-claims made by the plaintiff and the defendant respectively in the same action". A counterclaim may arise under, but is not confined to, matters arising from the plaintiff's action. It "is the assertion by the defendant of a demand which does not answer or destroy the plaintiff's claim". It is unlikely, however, that "defence" in the context of s. 15 encompasses counterclaims arising outside the underlying transaction. At the same time, the right of "set-off" to which the holder is explicitly made subject under s. 15 relates to a separate transaction. Its assertion reduces the amount recovered under the plaintiff's claim in whole or in part. The over-all effect of s. 15 under this construction is to put a remote party holder of an instrument governed thereby in the same position as an assignee of the underlying contract.

The second class of instruments whose holder appears to be exempted from the incomprehensive coverage of the statutory scheme is governed by Part V of the Canadian Act. A bill or note issued by a buyer of consumer goods or services ("consumer purchase") is defined in s. 188 as:

(a) by an individual other than for resale or for use in the course of his business, profession or calling, and

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34 Under Can., s. 2. There is no corresponding clause in the U.K. Act. The meaning of this definition should be understood in light of footnotes 73-81 and text, infra, cf. footnotes 186-92 and text, infra.
35 Falconbridge, supra, footnote 5, p. 437.
35a Ibid.
36 Cf. footnotes 73-89 and text, infra.
37 For this meaning of "set-off", see Falconbridge, supra, footnote 5, p. 671. Had "set-off" in s. 15 related either to a failure of consideration expressed in an ascertained and liquidated amount under the basic transaction itself, or to "equitable set-off" (cf. footnote 202 and text, infra), the reference would have been superfluous.
38 Falconbridge, supra, footnote 5, p. 437. The exact language of Falconbridge is that "a set-off is by its nature a defence ... [It] may have the effect of extinguishing the plaintiff's claim in whole or in part". Yet, the characterization of set-off as a "defence" as well as its "extinguishing" effect will substantially be modified in footnotes 84-126 and text, infra. In particular see footnotes 104-8 and text, and footnote 124, infra.
39 See footnote 24, supra.
40 Rights of an immediate party are not governed by s. 15; see footnote 32 and text, supra.
41 See Part II, "Defect of Title" ..., infra.
43 "Consumer purchase" is defined in s. 188 as:

... a purchase, other than a cash purchase, of goods or services or an agreement to purchase goods or services
sumer bill" or "consumer note" ) is required thereunder to "be prominently and legibly marked on its face with the words 'Consumer Purchase'". Under s. 191, the right of its holder "to have the whole or any part thereof paid by the purchaser . . . is subject to any defence or right of set-off, other than counter-claim, that the purchaser would have had in an action by the seller on the consumer bill or consumer note".

The exclusion of "counterclaim" side by side with the inclusion of "set-off" in s. 191 is probably designed to make clear that apart from the right of "set-off", a cross-claim arising out of a separate matter with the seller cannot be asserted by way of defence against an action of a remote party on the instrument. This results in avoiding the confusion mentioned above with respect to s. 15. None the less, unlike s. 15, s. 191 does not turn out to be

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(b) from a person who is engaged in the business of selling or providing those goods or services.

A critical examination of some case law dealing with this definition can be found in my comment in 3 C.B.L.J. 90 (1978-79), at p. 94.

44 Can., s. 189, provides in part:

189(1) A consumer bill is a bill of exchange
(a) issued in respect of a consumer purchase, and
(b) on which the purchaser . . . is liable as a party.

It does not include, however, a cheque apart from a cheque post-dated more than 30 days at the time of issue.

45 Under Can., s. 189(2),
(2) A consumer note is a promissory note
(a) issued in respect of a consumer purchase, and
(b) on which the purchaser . . . is liable as a party.

46 Can., s. 190(1). The marking has to be made "before or at the time when the instrument is signed by the purchaser".

47 Substantially the same result will be accomplished in the U.K. under the Consumer Credit Act, 1974 (U.K.), c. 39 where ss. 123-5 (no commencement date at time of publication) prohibit the taking of negotiable instruments in consumer transactions and deny a holder in due course status to one who takes an instrument in contravention of the prohibition.

48 The nature of set-off as a cross-claim is set forth in footnote 108 and text, supra.

49 Other interpretations appear unacceptable. Thus, the exclusion of "counterclaim" in s. 191 could have read as exempting a remote party from affirmative liability towards the buyer for the seller's breach. This would state the obvious and as such would be superfluous. Cf. footnote 81 and text, infra. Alternatively, the exclusion of "counterclaim" could have referred to defences giving rise to a counterclaim for unliquidated damages, as for instance under breach of warranty. This would limit the exposure of the holder to a failure of consideration expressed in an ascertained and liquidated amount (cf. text that follows footnote 164, infra). This construction stands on a tenuous footing. Identifying "counterclaim" in s. 191 with a counterclaim for unliquidated damages puts a great strain on the language of the section.

50 See footnotes 34-6 and text, supra. In enacting Part V, Parliament followed the Can., s.
an exception to the incomprehensiveness of the Act. The availability of defences against the holder of a consumer bill or note is not dependent under s. 191 only on the scope of "any defence or right of set-off, other than counter-claim". The holder's exposure is further limited thereunder to defences that "the purchaser would have had in an action by the seller on the consumer bill or consumer note".\(^{51}\) As our inquiry is directed at finding what defences are available against an action of a holder not in due course suing on a bill or note, this is rather unhelpful language. Apart from putting a remote party on the same footing as an immediate one,\(^ {52}\) it falls short of delineating the defences applicable to an action or a consumer bill or consumer note.

It appears then that the model proposition as to the subjection of the right of a holder not in due course to all defences available on the underlying contract, while supported by sound policies, is reflected only in s. 15 of the Canadian Act which governs the rights of a remote party not a holder in due course of an instrument properly marked as given for a patent right. The proposition was also intended to have been adopted in Part V of the Canadian Act with respect to bills and notes issued by buyers of consumer goods or services. Apart from this, the delineation of defences available against a holder not in due course is not explicitly provided for in the Act and requires further analysis.

II. "Defect of Title" and Contractual Defences

Prima facie, the obligor's contractual defences fall within either "defect of title" or "mere personal defences". This stems from the scheme governing the position of a holder in due course towards the obligor's defences. Thus, it is well established, beyond the need to cite any supporting authority, that the obligor's contractual defences are not available against a holder in due course. The range of defences which are not available against a holder in due course is delineated in the Act by the


\(^{51}\) See footnote 47 and text, supra, emphasis added. The phrase "on the consumer bill or consumer note" should either be replaced with "on the consumer purchase" or omitted altogether.

\(^{52}\) Cf. footnotes 164-78 and text, infra. Note, however, that the effect of Part V of the Canadian Act is not to make a remote party liable on the instrument: cf. footnotes 186-92 and text, infra.
categories of "defect of title" and "mere personal defences". The obligor's defences must therefore fall within the territory covered by these expressions.

Further examination reveals that in dealing with the availability of the obligor's defences against a holder not in due course, the critical expression is "defect of title". As already mentioned, in providing for two specific situations of a holder not in due course, the Act omits any reference to "mere personal defences" and is explicit with respect to the holder's subjection only to "any defect of title". The consensus among the majority of textbook writers is accordingly that "whereas neither 'defect of title' nor 'mere personal defences' may be raised against a holder in due course, defects of title may be raised against a remote party who is not a holder in due course, but 'mere personal... defences' are not available against such a holder". "A mere personal defence" is good only "as between the two parties between whom it arises, that is, between immediate parties". Implicit in this summary is the subjection of an immediate party to his own defect of title. Thus, it is only "defect of title" which is central to the delineation of defences available against all holders not in due course. Whether the obligor's contractual defences do fall within its ambit will now be examined.

The term "defect of title" was introduced into the Act as the statutory equivalent of the common law expression "equity

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53 Can., s. 74(b); U.K., s. 38(2); see footnotes 17 and text, supra.
53a As Can., s. 74; U.K., s. 38, is far from being an adequate statement (for example, it fails to state the validity of real defences against a holder in due course: Falconbridge, supra, footnote 5, p. 666), there is also the possibility that contractual defences are neither "defect of title" nor "mere personal defences" and that their invalidity against a holder in due course is established by a principle external to the explicit provisions of the Act. As the present discussion concludes that contractual defences are "defects of title", this possibility is not pursued.
54 See footnotes 18-19 and text, supra. The two specific situations are the holder of an overdue instrument and the holder of a dishonoured instrument with notice of the dishonour.
55 But cf. Byles on Bills of Exchange, 23rd ed., M. Megrah and F. R. Ryder, eds. (London, Sweet & Maxwell, 1972), p. 190, "It would seem to be implied [by Can., s. 74; U.K., s. 38] that the rights of any holder other than in due course must be less than absolute and it would follow that he would be subject to defects of title in or mere personal defences of prior parties" (emphasis added). This proposition is qualified later: if the transferee is not a holder in due course "any defect of title may be set up against him, but not a mere personal defence, unless it is a defence which the defendant could set up against the transferor to the ultimate transferee" (ibid., p. 195, emphasis added).
56 Cowen, supra, footnote 22, p. 274. See also Falconbridge, supra, footnote 5, p. 666.
57 Falconbridge, supra, p. 667.
attaching to the bill”. Possible grounds for a defect of title set forth in the Act are obtaining the instrument or its acceptance by fraud, by duress or force and fear, by other unlawful means, or by illegal consideration, as well as its negotiation in breach of faith or fraud. As the list is preceded by “in particular”, it is overwhelmingly accepted that “the examples . . . do not exhaust the category”.

Indeed, “why a breach of positive contract, should not form as strong a defence, as a breach of faith, is hard to perceive”. Yet, pre-Act cases involved “equities of the bill”, “equities that attach to the bill itself”, “equities affecting it”, or equities “with which the bill is incumbered” of a narrower range than the entire scope of the underlying contract. Thus in Holmes v. Kidd where “[u]pon the concoction of [the] bill it was agreed that it was not to be paid if the canvas was sold”, it was held that “[t]hat agreement directly affects the bill and was part of the consideration for it”. As “the incumbrance on the bill was part of the transaction out of which the bill arose” the agreement became an equity attaching thereto. Other examples enumerated in pre-Act case law were “the payment or satisfaction of the bill itself to such holder, or where the title of such holder was only to secure the balance of an account due”. While the subjection of an immediate party not a holder in due course to the defence of total failure of consider-

59 Can., s. 56(2); U.K., s. 29(2); the provision is set forth in Appendix I, infra.
62 A summary of cases as well as of the interchangeable terms used can be found in Re Overend, Gurney, & Co. (1868), L.R. 6 Eq. 344 at pp. 359-60; Note, “Equities Attaching to Overdue Bills of Exchange”, 49 L.T. 122 (1870).
64 Holmes v. Kidd, supra, at p. 893 H. & N., p. 730 E.R., per Williams, J.
ation was explicitly recognized, this recognition was generally not made in conjunction with the broad principle of the holder’s subjection to the equities of the instrument.

None the less, it is erroneous to put “defect of title” into the narrow perspective of specific direct cases decided prior to 1882. What constitutes “defect of title” is a function of the nature of the title to bills and notes. Thus, according to Professor Chafee, a bill or note is both a chattel and a chose in action. Its ownership “involves not only the right to possess a thing but the right to sue”. Corresponding “to the duplex nature of the negotiable instrument”, equities affecting it “must [thus] be classified accordingly as they relate to the ownership of the chattel or to liability on [the] obligation”. Under this classification, “equities” affecting the right to sue, side by side with those affecting the right to possess the piece of paper, constitute defects of title.

Indeed, the subjection of an assignee of a chose in action “to all defences existing in respect of the right assigned which would be available against the assignor seeking to enforce the right assigned”, has long been “expressed by the statement that the assignee takes subject to all equities”. In this framework Young v. Kitchin held in the late 19th century that an obligor under an

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66 With the possible exception of Puget De Bras v. Forbes (1792), 1 Esp. 117 at p. 118, 170 E.R. 298 at p. 299, per Lord Loughborough.
67 See e.g., Jefferies v. Austin (1738), 1 Str. 674, 93 E.R. 774; Solly v. Hinde (1834), 2 Cr. & M. 516, 149 E.R. 865.
69 Cf. Falconbridge, supra, footnote 5 at p. 667 “A defect of title ... relates to the instrument and affects title to it”.
70 Z. Chafee, “Rights in Overdue Paper”, 31 Har. L. Rev. 1104 (1917-18), at p. 1109. The “right to sue” in this context is the power to enforce the obligation rather than the standing to bring the action.
71 Ibid., at p. 1110.
cese for Value Without Notice”, in Lectures on Legal History (Cambridge, Harvard University Press, 1913), 253 at pp. 258-60. An assignment of “any debt or other legal chose in action” is subject to “all equities which would have been entitled to priority over the right of the assignee if this Act had not passed”. This was originally provided for in the U.K. in s. 25(6) of the Supreme Court of Judicature Act, 1873 (U.K.), c. 66, (“the original provision”). Semble s. 54(1) of The Conveyancing and Law of Property Act, R.S.O. 1970, c. 85. See also s. 136 of the Law of Property Act, 1925 (U.K.), c. 20, under which assignment is “subject to equities having priority over the right of the assignee” (emphasis added). The declaratory nature of the original provision (which has been retained in Ontario) emerges unequivocally from its language.
73 (1878), 3 Ex. D. 127 at p. 131, per Cleasby, B. The decision was made in conjunction
assigned contract that had been broken by the obligee-assignor "has no claim to recover anything against the [assignee]; he only meets the [assignee's] claim by a counter-claim of damages arising out of the same contract". Shortly thereafter, in Government of Newfoundland v. Newfoundland Railway Co. the Privy Council adhered to this principle and explained how the obligor could meet the assignee's claim with a counterclaim. The position that "a party to a contract may assign a portion of it, perhaps a beneficial portion, so that the assignee shall take the benefit, wholly discharged of any counter-claim by the other party in respect of the rest of the contract which may be burdensome" was considered by the court "a lamentable thing" and accordingly was rejected. It was thus held that "unliquidated damages [entitling the obligor to a counterclaim] may ... be set off against an assignee if flowing out of and inseparably connected with the dealings and transactions which also give rise to the subject of the assignment".

The obligor's equities have thus been perceived quite broadly to include "the terms and conditions of the contract under which the indebtedness arose". The proposition which emerges from both leading cases is indeed that an obligor can recoup his

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with the original provision set forth in footnote 72, supra. Note that the "assignee" in the text above is an assignee who has not undertaken the assignor's performance of the underlying contract.

74 (1888), 13 App. Cas. 199 at pp. 212-13. The court did not use the term "equities" but directly relied on Young v. Kitchin.

75 The use of the term "set-off" in this context is unfortunate: cf. footnotes 37-8 and text, supra; footnotes 198-203 and text, infra. American jurisprudence prefers the term "recoupment" see footnote 80, infra.

76 Supra, footnote 74, at p. 213, per Lord Hobhouse.

77 Equities in favour of the obligor should be distinguished from "latent" equities, i.e., equities in favour of any person other than the obligor"; Ames, supra, footnote 72 at p. 258. Yet the expression "the obligor's equities" is unfortunate as it also covers the "equities of the parties", see footnote 82 and text, infra. The expression "equities as to liability" (see footnotes 70-1 and text, supra) appears to be more accurate.

78 See e.g., National Surety Corp. v. Algernon Blair Inc., 150 S.E. 2d 256 (Ga. C.A. 1966), cf. Snyder's Ltd. v. Furniture Finance Corp. Ltd., [1931] 1 D.L.R. 398 at p. 406, 66 O.L.R. 79 at p. 88 (S.C. App. Div.), per Orde, J.A., where "an express provision [in a conditional sale contract] that the contract may be assigned to the defendant company" was held to be "an equity to which [a competing assignee] was subject".

79 See footnotes 73-76 and text, supra.

80 "Recoupment ... although frequently confused with set-off, is recognized [in American law] as a distinct principle, namely, the right to present in opposition to the plaintiff's claim, for its reduction or extinguishment, a right of action in the defendant for loss or damage sustained by him in the same transaction through [the other party's] breach of
damage arising from breach of any term of the assigned contract by meeting the assignee's claim thereon with a defence whose subject-matter gives ground to a counterclaim arising from the breach. Depending on the size of the damages the effect of such defence is either to extinguish or to diminish the size of the assignee's right but not to charge him with liability.\textsuperscript{81}

Equities attaching to the instrument were contrasted in pre-Act case law with "equities of the parties", that is with "collateral matters [such] as the statutory right of set-off" or with "a right of set-off ... which is merely a personal right not affecting the bill".\textsuperscript{82} This formula appears to be adopted by the Act when speaking of the holder in due course holding free from "any defect of title ... as well as from mere personal defences".\textsuperscript{83} The scope and the basis of the latter category will now be contrasted with those of the former. In turn, this examination will support the earlier thesis that "defect of title" includes contractual defences.

Strictly speaking, a "mere personal defence" is not "defence".\textsuperscript{84} Rather, it is a claim arising outside the underlying contract\textsuperscript{85} whose availability in the principal claim depends on a specific statute. A "mere personal defence" is either the right to set off a separate liquidated claim, or the right to set up an independent counterclaim for unliquidated damages. The right of set-off is available to a defendant since a 1729 statute\textsuperscript{86} and is

\textsuperscript{81} Note the statutory deviation from this principle under s. 42a of The Consumer Protection Act, R.S.O. 1970, c. 82, as amended by S.O. 1971, Vol. 2, c. 24, s. 1(1) (which is the standard provision of provincial consumer protection legislation): The assignee "is subject to the same obligations, liabilities and duties of the assignor". None the less, his exposure to consumer defences shall not be in "an amount greater than the balance owing on the contract at the time of the assignment."

\textsuperscript{82} Re Overend, Gurney, & Co. (1868), L.R. 6 Eq. 344 at pp. 360-1.

\textsuperscript{83} See footnote 17 and text, supra.

\textsuperscript{84} In its broadest sense, "defence" includes recoupment (footnote 80, supra), set-off and counterclaim; Corbin on Contracts (St. Paul, West Publishing Co. 1951), vol. 4, §896.

\textsuperscript{85} "Mere personal defences" should not be confused with "personal defences", the latter expression being interchangeable with "defects of title"; cf. Riley, supra, footnote 60, p. 106.

\textsuperscript{86} "An Act for the Relief of Debtors with respect to the Imprisonment of their Persons", 1729, 2 Geo. II, c. 22, s. 13, repealed by the Civil Procedure Acts Repeal Act, 1879 (U.K.), c. 59, and the Statute Law Revision and Civil Procedure Act, 1883 (U.K.), c. 49. Both repealing statutes provided, however (the former in s. 4(1)(b), the latter in s. 5(b)) that:

4(1) The repeal effected by this Act shall not affect
given to him as of right. The right to assert a counterclaim was originally introduced by the 1873 Judicature Act. Permission to present it may be refused under Rules of Practice if in the opinion of the court it cannot be conveniently disposed of in the pending action.

The right to assert a "mere personal defence" is a mode of adjusting mutual claims or avoiding circuity of action. Being a separate cause of action against the immediate party rather than an answer to the claim on the underlying contract, a "mere personal defence" is confined to the relations between those immediate parties between whom it arose. It cannot be asserted against a remote party. A controversial application of this proposition, in the context of the assignment of a chose in action, is Stoddart v. Union Trust, Ltd. In this case a claim for damages in respect of the assignor's fraud which had induced the debtor to enter into the assigned contract was treated by the court as "strictly a personal claim against the assignor". Being "not connected with the chose in action assigned" the fraud could not be asserted by way of defence against the assignee's claim unless

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(b) Any ... principle or rule of law or equity established ... under any enactment, so repealed.

The practice of raising a set-off is presently governed in the U.K. by s. 39(1)(a) of the Supreme Court of Judicature (Consolidation) Act, 1925 (U.K.), c. 49, and R.S.C. (Revision), 1962, O. 18, r. 17 applicable to every claim by the defendant "whether of an ascertained amount or not". The right to set off a liquidated amount is provided for in Ontario by The Judicature Act, R.S.O. 1970, c. 228, ss. 131-3. The provisions are modelled on those repealed in the U.K. They go, however, further than English law in allowing a defendant to recover his excess in the action itself: Gates v. Seagram (1909), 19 O.L.R. 216 (C.A.); Grills v. Farah (1910), 21 O.L.R. 457 (H.C.J.).

See in general: Loyd, supra, footnote 80 at pp. 566-7.

Cf. footnotes 199-203 and text, infra.

See footnote 57 and text, supra.


Ibid., at pp. 193-4, per Kennedy, L.J.

Ibid., at p. 188, per Vaughan Williams, L.J.

Though the good faith of the assignee was explicitly noted (see e.g., Stoddart, ibid., at p. 187, per Vaughan Williams, L.J.), this aspect of the decision should not be overstated. As the case did not involve a bill or note, the assignee could not be a holder in due course.
the contract had been set aside and treated void by the debtor. As "the fraud induced the very transaction creating the assigned right" the validity of this decision has been doubted and criticized. The actual result in the case should, however, be understood in light of the distinction between "mere representation" inducing the contract and the "terms" of the agreement incorporated therein. While the broadening of the category of "mere personal defences" through collateral contracts or liability for negligent statements has led to the breakdown of some effects of the representation-term dichotomy in so far as immediate parties are concerned, Stoddart v. Union Trust, Ltd. strongly demonstrates the effect of this classification with respect to the relations between remote parties. The decision correctly points out the distinction in law between matters "flowing out of and inseparably connected with the dealings and transactions [under] the subject of the assignment" on one hand and matters which are "not connected with the chose in action assigned" on the other. Only the former are "equities which would have been entitled to priority over the right of the assignee". The latter give rise to a mere "claim for damages [which] is a personal claim against the wrong-doer [falling] dehors the contract" and thus do not affect the right to sue thereupon.

The availability of the right to set off a liquidated sum due under an independent transaction (the right of set-off) against a remote party has introduced some complexity. Indeed, set-off is the "personal equity" par excellence under the pre-Act case law. This corresponds to the nature of the right as "not a modification of [the assigned] obligation, but an incident of its enforcement", a matter of procedure, or "a convenient mode

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96 Corbin on Contracts, supra, footnote 84, para. 893, text that follows note 7.
98 Stoddart has not been adopted by the American UCC. Defining contract in s. 1-201(11) as "the total legal obligation which results from the parties' agreement" (i.e., from their bargain in fact; s. 1-201(3)), the U.C.C. rejects altogether the representation-term classification.
99 Supra, footnote 92, at p. 193, per Kennedy, L.J., quoting Lord Hobhouse in Government of Newfoundland, supra, footnote 74, and distinguishing between Stoddart and Young, supra, footnote 73.
100 Supra, at p. 188, per Vaughan Williams, L.J.
101 Supra. The phrase is taken from s. 25(6) of the Supreme Court of Judicature Act, 1873 (U.K.), c. 66. See footnote 72, supra.
102 Supra, footnote 92 at p. 194, per Kennedy, L.J.
103 See footnote 62 and text at footnote 82, supra.
104 Falconbridge, supra, footnote 5, p. 852.
of settling mutual accounts or preventing multiplicity of actions between the [original] parties".\textsuperscript{105} In contrast to the civil law "compensation" which operates automatically by the sole operation of law to extinguish mutual obligations,\textsuperscript{106} set-off at common law is "a personal privilege, and not an incident or accompaniment of the debt".\textsuperscript{107} It "is not a defence, but a cross action [which] concedes the validity of the plaintiff's claim, and is found upon an independent cause of action in favour of the defendant, who may at his election assert it by way of set-off, or enforce it by separate suit".\textsuperscript{108} From this perspective, it appears, Falconbridge correctly distinguishes between "an equity relating to the assigned debt" which must be "inseparably connected with or inherent in [it] in such a way as to affect [its] validity or the amount" on one hand, and the "debtor's right of set-off . . . arising from matters wholly unrelated to the assigned debt" on the other hand.\textsuperscript{109}

It follows that the right to set-off should not be available against a remote party holder not in due course of a bill or note, as well as against an assignee of a chose in action. It is overwhelmingly accepted, indeed, that a holder takes an instrument free from a prior party's right of set-off.\textsuperscript{110} None the less, it is equally well established that an assignee takes a chose in action subject to the debtor's right to set off a liquidated amount owing from the assignor under a separate transaction which accrues before the debtor receives notice of the assignment.\textsuperscript{111} Following this model, the Canadian Act provides for the subjection to the right of set-off of a remote party holder of an

\textsuperscript{105} Ibid., at p. 671.


\textsuperscript{107} Lincoln v. Grant, 47 D.C. App. 475 (1918), at p. 483.

\textsuperscript{108} Ibid. For characterizing both set-off and counterclaims as independent claims, see also Stooke v. Taylor (1880), 5 Q.B.D. 569 at p. 575 per Cockburn, C.J. Under Rules of Practice a set-off may be either pleaded as a defence or set up by way of counterclaim: A-G. Ont. v. Russell (1921), 64 D.L.R. 59, 49 O.L.R. 103 (S.C.). Yet, notwithstanding Falconbridge (see text at footnote 35, supra), it is misleading to characterize set-off as a defence (subject to footnote 84, supra). In its nature, set-off is an action: Campbell v. Imperial Bank, [1924] 4 D.L.R. 289, 55 O.L.R. 318 (S.C. App. Div.).

\textsuperscript{109} Falconbridge, supra, footnote 5, pp. 162-3.

\textsuperscript{110} Citations in footnote 62, supra; Falconbridge, supra, footnote 5, p. 667.

\textsuperscript{111} See e.g., Cavendish v. Geaves (1857), 24 Beav. 163, 53 E.R. 319; Roxburghe v. Cox (1878), 17 Ch.D. 520 (C.A.), at p. 526, per James, L.J. The rule is presently embodied in s. 40(1)(b) of The Personal Property Security Act, R.S.O. 1970, c. 344.
instrument properly marked as given for a patent right\textsuperscript{112} as well as of every holder of a properly marked consumer bill or note.\textsuperscript{113}

The subjection of the assignee is sometimes explained by the existence of specific statutory provisions.\textsuperscript{114} The inability to raise a prior party's set-off against a holder of a negotiable instrument is often viewed as produced by a specific rule under the old law merchant.\textsuperscript{115} Both suggestions are erroneous. The model set-off provision in England and other Commonwealth jurisdictions\textsuperscript{116} is "a simple statute of set-offs" which "simply provides that ... the defendant may have set off against the demand of the plaintiff any ... debt due which he has against the plaintiff'.\textsuperscript{117} The statute thus falls short of establishing the obligor's power to set off as against the assignee a debt due from the creditor (the plaintiff's assignor).\textsuperscript{118} As for the unavailability of a prior party's set-off against a holder not in due course, it has in fact been based in pre-Act cases on the nature of the right at common law rather than on any rule particular to the law merchant.\textsuperscript{119}

One explanation of the assignee's subjection to the debtor's right of set-off is the equitable origin of the assignee's title.\textsuperscript{120} Another explanation is based on the suggestion that the assignee is "only partly owner" until he gives the debtor notice of the assignment.\textsuperscript{121} As the holder of a negotiable instrument, whether

\textsuperscript{112} Can., s. 15, see footnotes 31-41 and text, supra.
\textsuperscript{113} Can., s. 191, see footnotes 42-52 and text, supra. Set-off is available between two immediate parties, footnote 57 and text, supra. Therefore, the effect of s. 191 is to subject also a remote party to it, cf. footnote 52 and text, supra.
\textsuperscript{114} Falconbridge, supra, footnote 5, p. 671 and pp. 162-3.
\textsuperscript{116} See citations in footnote 86, supra.
\textsuperscript{117} Supra, footnote 115 at p. 447. "A simple statute of set-offs" should be distinguished from statutes allowing prior party set-offs, under which an assignee is explicitly held subject to set-offs, supra, at pp. 447-8.
\textsuperscript{118} Statutes providing that an assignment of contractual rights is without prejudice to any set-off or defence existing before notice of the assignment have been adopted in most U.S. jurisdictions: Restatement of the Law: Contracts, 2nd Tentative Drafts Nos. 1-7 (St. Paul, American Law Institute, 1973), p. 321. This is also the position of the Ontario Personal Property Security Act, supra, footnote 111, as well as UCC 9-318(1)(b).
\textsuperscript{119} Citations in footnote 62, supra.
\textsuperscript{121} W. W. Cook, "The Alienability of Choses in Action: A Reply to Professor Williston", 30 Har. L. Rev. 449 (1916-17), at pp. 473-4; see also p. 475, ibid., and text at footnote 123, infra.
in due course or not, has always been seen as having the legal title from the moment of the negotiation, both explanations are also consistent with his taking the instrument free from a prior party’s right of set-off. There is, however, in this framework no discernible ground for the obligor’s inability to set off against a subsequent holder the original creditor’s indebtedness accruing before negotiation, for it is clear that until then the legal title to the instrument remains undivided in the hands of the original creditor. Likewise, “principles of fairness, of public policy, etc.” which allegedly support the assignee’s subjection do not appear to explain their inapplicability to the holder of an instrument.

In fact, the assignee’s subjection to the obligor’s right of set-off is one aspect of the original common law position with respect to the assignee’s rights. Thereunder, “the so-called assignee is not ... successor, but [merely] an attorney with a power to collect or dispose of the claim for his own use”. It is none the less, incongruous to think today of the assignee’s position towards the claim on the assigned debt as different from the holder’s position towards the claim upon the instrument negotiated to him.

It is suggested here that as the right of set-off is not an “equity relating to the assigned debt” but rather a “personal equity”, it should be governed in principle by the same rule applicable to other counterclaims or cross demands. The right should thus not be made available against the assignee of a chose in action as well as against a remote party holder not in due course. Apart from a specific statutory provision, the assignee’s subjection to the right of set-off can only be based on the assignor-debtor agreement. Indeed, a contractual term incorporating the right of set-off into the assigned contract can exist whether or not the debt has been embodied in a negotiable instrument, in which case it is obvious that the right of set-off turns into an “equity” whether “relating to the assigned debt” or “attaching to the instrument” embodying it. What appears then to be inexplicable is why

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123 Cook, supra footnote 121 at p. 475.
123a Ames, supra, footnote 72, at p. 258.
124 See footnote 108 and text, supra. Suggestions as to the difference between counter- claims and set-offs (see footnote 34-8 and text, supra) go to Rules of Practice and not to their inherent nature. See e.g., Gates v. Seagram (1909), 19 O.L.R. 216 (C.A.).
125 See footnote 118, supra.
original parties are not presumed to intend the incorporation of the right of set-off into the underlying contract once a negotiable instrument has been used. Neither the classification of set-off as a "mere personal defence" nor the inability to raise it against a remote party not a holder in due course is affected by this query.

It may be concluded that in drawing a contrast between "defect of title" and "mere personal defences" the Act follows the pre-Act differentiation between an "equity attaching to the bill" and the "equities of the parties". In turn the latter differentiation is modelled on the contrast between an "equity relating to the assigned debt" and "a personal claim" which is "not connected with the chose in action assigned". The comprehensiveness of the equities "relating to the assigned debt" with respect to all "the terms and conditions of the contract under which the indebtedness arose" entails that all defences arising from the underlying contract are defects of title. This formula specifically excludes counterclaims arising from separate matters, whether in liquidated or unliquidated amounts.

III. "Equities as to Liability" and the Obligation Under a Negotiable Instrument

Regarding the terms of an assigned executory contract as "equities attaching thereto" has been based on the premise that "[t]he thing . . . which was assigned . . . was not any absolute property of [the assignor], but that which was coming to him under the [executory] contract, and was therefore, subject to [its] conditions". Yet a negotiable instrument is an unconditional order or promise to pay. It is a unilateral contract not governed by "an equitable adjustment of performances".

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127 See footnote 17 and text, supra.
128 See footnote 82 and text, supra.
129 See footnote 109 and text, supra.
130 See footnotes 93-4 and text, supra.
131 See footnote 78 and text, supra.
133 See footnote 2, supra.
134 See footnote 3, supra.
135 "A unilateral contract consists of a promise . . . made by one of the contracting parties only"; *Corbin on Contracts* (St Paul, West Publishing Co., 1963), vol. 1, §21, p. 52. Examples of unilateral contracts explicitly include a promissory note and a bill of exchange, *ibid.*, pp. 55-6.
cable under "the well known doctrine of implied conditions in the field of bilateral contracts". The subjection of its holder to the obligor's contractual defences therefore requires further explanation.

To begin with, equity jurisdiction over adjustment of remedies relating to one transaction preceded any theory of implied dependency of performances. Thus, under medieval common law, a seller's undertaking to provide a sound horse was treated as separate from, and collateral to, his primary undertaking to provide a horse, "as if the giving of a warranty formed a separate transaction". In this framework, the buyer's obligation to pay for the horse was an independent covenant. It was absolute and its enforcement was not dependent on the fulfilment of the seller's warranty. None the less, there is early authority upholding the right of a buyer "sued at law for the price" and wishing "to set-off his loss from the breach of [the seller's] warranty" to "come . . . to the chancellor and pray . . . for a certiorari, to have the whole case heard in equity". The unconditional nature of the buyer's obligation in relation to the seller's warranty under the common law was not conceived as a bar to viewing the two obligations as one case in equity. The same reasoning can easily be applied to the relationship created by the buyer's unconditional obligation under a negotiable instrument towards the seller's performance of the underlying contract.

Moreover, an analogy can be drawn between the availability of the obligor's defences in an action on a negotiable instrument and their availability in an action on a document under seal ("specialty contract"). A negotiable instrument, "quite like . . . a specialty . . . stands apart, complete in itself". Its effect on the transaction under which it is given, is akin to the effect of an

137 Up to the turn of the 19th century. See footnotes 195-8 and text, infra.
139 Cf. Loyd, supra, footnote 80 at pp. 545-6.
141 Arguably, here lie the foundations of the doctrine of "equitable set-off": cf. footnotes 202-3 and text, infra. Its application to sale of goods was none the less abandoned: cf. footnotes 193-203 and text, infra.
142 Aigler, supra, footnote 136 at p. 480 and note 35.
143 See footnote 5, supra.
undertaking contained in a specialty contract ("obligation") on the contract evidenced by it. As early as 1422 it was indeed determined that "if I am your debtor... by a simple contract and I make an obligation to you for the same [amount] on the same contract... I am discharged of the contract by obligation".144

It was settled under medieval common law that "in Debt on a contract the plaintiff shows in his count for what cause the defendant has become his debtor. Otherwise in Debt on an obligation [specialty] for the obligation is a contract in itself".145 Being of "high nature" the undertaking under a specialty contract was divorced from the consideration thereto and could not be varied or contradicted by any extrinsic evidence. "The defendant was bound by the deed, the whole deed and nothing but the deed."146 Accordingly, failure of consideration under the basic transaction did not constitute at common law a valid defence to an action on the deed.147

None the less, defences founded on the conduct of the obligee on a specialty could successfully be raised in equity. Thus, "whenever it was plainly unjust for [the obligee] to insist upon his strict legal right" the Chancellor would "furnish the obligor with a defense by enjoining the action".148 Equitable jurisdiction explicitly encompassed the defence of failure of consideration under the underlying contract.149

Though in itself not a specialty,150 a negotiable instrument has been characterized as "the modern mercantile specialty".151 Professor Chafee accordingly suggested that equities affecting the right to sue upon the instrument ("equities as to liability") are

145 Anon (1385), Bellewe 111, 72 E.R. 47 (the English translation, according to Fifoot, supra).
146 Fifoot, supra, footnote 144, p. 231.
148 Ibid., at p. 106.
149 Ibid., at pp. 108-9. Other defences were frauds, illegality, payment, accord and satisfaction, discharge of surety, accommodation, duress, agreement not to sue and acquiescence.
151 Ames, supra, footnote 147, p. 115.
parallel to grounds upon which an obligor on a specialty "would before modern statutes have had to go into chancery to maintain his defense". While the availability of failure of consideration against an action on a specialty contract is supported by case law dealing with total failure of consideration alone, once the veil separating the deed and the basic transaction has been pierced no logical line can be drawn between different types of defences available on the underlying contract.

It has been said that a bill of exchange "is itself a contract separate from the [underlying] contract for sale", operating "as a contract in its own right". This, however, should not result in the insulation of a holder of the bill from the defences arising from the underlying sale. Adjustment of remedies arising from the same transaction leads to the definition of the liability on the unilateral contract undertaken thereunder. This tends to obliterate the distinction between bilateral and unilateral contracts. It hardly makes any difference indeed, whether an obligation to pay is excused on the basis of the other party's failure to perform his part of a bilateral contract, or whether it is excused on the basis of a defence arising from the same failure to perform in a case of a unilateral contract. On final account, "the laws distinguishing negotiable instruments from non-negotiable instruments are not based upon any inherent distinctions between the obligations assumed in the one class or the other of such contracts". The unconditionality of the engagement on a bill or note goes to form only and is not a matter of substance.

152 The Common Law Procedure Act, 1854 (U.K.), c. 125, s. 83.
153 Chaffee, supra, footnote 70 at p. 1111.
154 Tourville v. Naish (1734), 3 P.Wms. 307, 24 E.R. 1077, and a "case of the time of Henry VI" whose facts are outlined by Ames, supra, footnote 147, p. 108.
155 Nova (Jersey) Knit Ltd. v. Kammgarn Spinnerei GmbH, [1977] 2 All E.R. 463 (H.L.), at pp. 479-80 per Lord Russell of Killowen. See also Anglo-Italian Bank v. Wells (1878), 38 L.T. 197 (C.A.), at p. 199. The "separate contract" theory led in these cases to a contrary result to the result argued in the text above.
156 For this distinction in general, see Corbin On Contracts, supra, footnote 135, §21.
157 Cf. footnotes 135-6 and text, supra.
159 The other side of the coin is a contract for sale containing a cut-off clause (i.e., a term whereby the buyer waives his right to assert his defences against an assignee): Killoran v. Monticello State Bank (1921), 57 D.L.R. 359, 61 S.C.R. 528, [1921] 1 W.W.R. 988. It is not a "negotiable instrument" notwithstanding the resulting unconditional obligation of the buyer. Cf. Geiger Finance Co. v. Graham, 182 S.E. 2d 521 (Ga. C.A., 1971).
The availability of the maker's or drawer's defences against an action on the instrument has thus not been barred by the unconditional language of the promise or order. "The content of a promise [or order] is one thing, the development and recognition of a defense quite another."\textsuperscript{160}

IV. The Defence of Failure of Consideration

In the law of bills and notes, "there is a failure of consideration where the performance is either absent, incomplete, or defective".\textsuperscript{161} "Failure of consideration" is thus interchangeable with the breach of the underlying contract. The total breach thereof is known as a total failure of consideration as, for example, where a seller does not provide the goods he promised to sell. At the same time, "where some benefit has been received", the failure of consideration is partial.\textsuperscript{162} Where a seller's breach constitutes the provision of only some of the goods under the contract (e.g., two out of three cars) the partial failure of consideration is in an ascertained or liquidated amount. Otherwise, as for example in the case of breach of warranty with respect to goods sold and delivered which gives rise to a claim for unliquidated damages, the partial failure is in a sum uncertain.\textsuperscript{163}

The traditional summary of the rules which under Anglo-Canadian law determine the availability of the defence of failure of consideration to an action on a bill or note by a holder not in due course is inconsistent with the analysis made so far in this article. Under this summary,\textsuperscript{164} total failure of consideration is a defence against an immediate party and possibly against a remote holder for value with notice. \textit{Quaere}, whether it is a defence against a remote party without notice who is none the less not a holder in due course. Partial failure of consideration is a defence \textit{pro tanto}

\textsuperscript{160}Aigler, \textit{supra}, footnote 136 at p. 480.


\textsuperscript{162}Note — Failure, \textit{ibid.}, at p. 86.

\textsuperscript{163}The observation that "damages for breach of contract is not a failure of consideration": \textit{Edcal Industrial Agents Ltd. v. Redl and Zimmer} (1966), 60 D.L.R. (2d) 289 at p. 297, 58 W.W.R. 527 (Alta. S.C. App. Div.), is, with respect, incorrect.

\textsuperscript{164}See, in general, Chalmers, \textit{supra}, footnote 5, pp. 103-4; Falconbridge, \textit{supra}, footnote 5, p. 620.
against an immediate party and is available only when the failure is in an ascertained and liquidated amount. It is not a defence against a remote party holder for value. "Holder for value" is a holder who either himself took the instrument for value, or who derives his title from one who had given value for it.\textsuperscript{165} He does not have to be a holder in due course.

The availability of the defence of failure of consideration against a holder not in due course depends under this summary first on whether the claimant holder for value is an immediate or a remote party.\textsuperscript{166} Secondly, it depends on whether the failure involved has been total or partial.\textsuperscript{167} The validity of these classifications will now be examined.

It appears that the immediate-remote party dichotomy can easily be dismissed as groundless. None of the leading cases cited by Chalmers\textsuperscript{168} and Falconbridge\textsuperscript{169} either turned on the identity of the plaintiff as a remote party not a holder in due course or otherwise purported to establish a distinction between different claimants who are not holders in due course. Thus, a leading case as to the availability of partial failure of consideration in an ascertained or liquidated amount involved a remote rather than an immediate party.\textsuperscript{170} Furthermore, support for the proposition that partial failure of consideration "is not a defence against a remote party who is a holder for value"\textsuperscript{171} is drawn by Chalmers and Falconbridge from a case which in fact turned on the type of defence involved rather than on the immediate-remote party dichotomy.\textsuperscript{172} Other cases holding that failure of consideration, whether partial\textsuperscript{173} or total,\textsuperscript{174} is no defence against a remote party

\textsuperscript{165} Cf. Barclays Bank Ltd. v. Astley Industrial Trust Ltd., [1970] 2 Q.B.D. 527 at pp. 538-9, per Milmo, J.: Can., s. 54(1); U.K., s. 27.

\textsuperscript{166} There is no further subdivision between a holder for value and a holder who is not. Once "valuable consideration" (or "value" see Can., ss. 2, 53(1); U.K., ss. 2, 27(1)) is given by a holder, he and all subsequent holders are holders for value. "Failure of consideration" can thus arise only in the context of a holder for value.

\textsuperscript{167} There is further subdivision between partial failure which is in an ascertained and liquidated amount, and partial failure which is in sum uncertain. See text following footnote 164, supra.

\textsuperscript{168} Chalmers, supra, footnote 5, p. 103 and note 26, p. 104 and notes 34-5.

\textsuperscript{169} Falconbridge, supra, footnote 5, p. 620 and notes (l), (m), (p) and (q).

\textsuperscript{170} Agra and Masterman's Bank Ltd. v. Leighton (1866), 2 Ex. D. 56. See also McGregor v. Bishop (1887), 14 O.R. 7 (H.C.J.).

\textsuperscript{171} Chalmers, supra, footnote 5, p. 620 and note 35, Falconbridge, supra, footnote 5, p. 620 and note (q).

\textsuperscript{172} Archer v. Bamford (1822), 3 Stark 175, 171 E.R. 812. Cf. footnote 181 and text, infra.


\textsuperscript{174} Robinson v. Reynolds (1841), 2 Q.B. 196 at p. 211, 114 E.R. 76 at p. 82 (Ex. Ch.);
turned on the holder in due course status of the remote party. Unfortunately, however, they often used the terms "indorsee for value", "holder for value", or "remote party" as interchangeable with "holder in due course". This inaccurate use of the terms has indeed been a source of confusion resulting in creating the erroneous impression that, in so far as failure of consideration is concerned, a remote party, even when not a holder in due course, is in a better position than an immediate party. It is my thesis, however, that all parties who are not holders in due course, whether immediate or remote, are in the same position with respect to the defence of failure of consideration.

This analysis results in the availability of total failure of consideration as a defence against every holder not in due course. It likewise results in the availability of partial failure of consideration expressed in an ascertained and liquidated amount as a defence pro tanto against such a holder. The remaining issue is the position of a holder not in due course towards partial failure which is not in an ascertained or liquidated amount.

The fact that partial failure of consideration not in an ascertained and liquidated amount cannot be raised as a defence against a holder not in due course is overwhelmingly accepted. Indeed, the defence of an effective repudiation of the underlying contract is available against a holder not in due course even when its ground is a partial failure in a sum uncertain. What is meant by the holder’s power to overcome the defence is rather, the

176 Robinson v. Reynolds, supra, footnote 174.
178 Ashley Colter, Ltd. v. Scott, supra, footnote 173.
179 Cf. footnote 165 and text, supra.

defendant’s inability to reduce or extinguish his liability by meeting an action on a bill or note with a defence based on fact giving rise to a claim for unliquidated damages stemming from the breach of the underlying contract itself. Thus, under “a deep rooted concept of English commercial law”, “the nature and function of ... a bill” is,

... not merely to serve as a negotiable instrument, it is also to avoid postponement of the purchaser’s liability to the vendor himself, a postponement grounded on some allegation of failure in some respect by the vendor under the underlying contract, unless it be total or quantified partial failure of consideration.

Accordingly, where the defendant has “derived some benefit ... the question how much, being one of unliquidated damages, could be decided in a cross action.” Though he may pursue this cross claim, the defendant “ought first to pay his cheque”, and to pursue his remedy in a separate proceeding against the party liable for the breach.

Chalmers and Falconbridge undermine the effect of the obligor’s inability to raise partial failure in a sum uncertain as a defence against a holder not in due course. Their opinion is that following the Judicature Acts, it is possible to include such a failure of consideration in a counterclaim “which may have all the practical consequences of a defence to the claim.” This view is none the less erroneous. The raising of a counterclaim contemplates the personal liability of the defendant thereunder (the plaintiff in the principal action). Yet an obligor “has no claim to recover anything against [a remote party]”. The latter’s subjection to a counterclaim arising from the breach of the underlying contract can mean no more than subjection to the obligor’s power to meet the claim by a defence based on facts giving rise to the counterclaim. Thus, the immunity of a remote party from

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182 See e.g., Solomon v. Turner (1815), 1 Stark 51 at p. 52, 171 E.R. 398 at p. 379, where Lord Ellenborough “will not admit the evidence for the purpose of reducing the damages by shewing that the pictures were of an inferior value”.


185 Jackson v. Murphy (1888), 4 T.L.R. 92 (Q.B.).

186 Chalmers, supra, footnote 5, pp. 104-5.

187 Falconbridge, supra, footnote 5, p. 621 and note (s).

188 Cf. footnotes 34-5 and text, footnotes 73-81 and text, supra.

189 See footnote 73 and text, supra.

190 But note the confusion that needlessly arose in Edcal Industrial Agents Ltd. v. Redl and
the defence of partial failure of consideration in a sum uncertain confers on him in relation to this defence an absolute right on the instrument as if he were a holder in due course. Chalmers' and Falconbridge's views may be relevant only in the context of an immediate party who is personally liable on the counterclaim. Yet, even with respect to such a party, courts stress the fact that a counterclaim "is not an absolute right to set off damages against a debt" but "merely a right depending on the discretion of the judge". As against an action on a bill or note the prevailing tendency is to disallow a counterclaim for unliquidated damages based on the underlying contract. Underlying this tendency is indeed, the belief in the existence of a substantive rule of law which gives the holder (whether an immediate or remote party) an absolute right to recover on the instrument. Thus, notwithstanding Chalmers' and Falconbridge's obervations, the alleged holder's immunity cannot be circumvented by rules of procedure.

In the past, the obligor's inability to assert the defence of a sum uncertain against a holder of an instrument coincided with the common law rule under which a breach of warranty with respect to goods sold could not be introduced to decrease the amount of recovery in the action on the contract for their sale. The latter rule was originally explained by treating the sale of a chattel and the giving of a warranty with respect to it as two separate and independent transactions. By the turn of the 19th century this rationale had disappeared and the common law rule was

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1 Zimmer (1966), 60 D.L.R. (2d) 289, 58 W.W.R. 527 (Alta. S.C. App. Div.). While deciding that breach of contract which gives rise to a claim for unliquidated damage does constitute "defect of title", the court erroneously required the obligor to file a counterclaim against the immediate party (and not merely to plead the subject-matter in defence) as a condition to the availability of the breach as a defence to the action of the remote party, ibid., at pp. 297-8 D.L.R.


191a "This discretion is rarely exercised in the case of a claim on a bill of exchange save in exceptional cases": Nova (Jersey) Knit Ltd. v. Kammgarn Spinnerei GmbH, [1977] 2 All E.R. 463 (H.L.), at p. 474, per Lord Salmon. See also: Newman v. Lever (1888), 4 T.L.R. 91 (Q.B.), at p. 92 per Stephen, J., "without ... strong grounds a counterclaim ought not to be allowed in an action on a bill ... which is not disputed".

192 See e.g., James Lamont & Co., Ltd. v. Hyland, Ltd. (No. 2), [1950] 1 All E.R. 929 (C.A.), and Krauss v. Luciuk, [1928] 1 D.L.R. 1132 at p. 1134, [1928] 1 W.W.R. 184, 22 S.L.R. 374 (C.A.), per Martin, J.A., "the defendant has not set up a counterclaim, and even if he had, I do not see how any relief could be given".

193 See Note — Failure, supra, footnote 161 at p. 86.

194 See footnotes 137-9 and text, supra.
explained by the unfairness of surprising a plaintiff-seller who "may only come prepared to prove the agreement for the specific sum". This explanation marked the fall of the common law rule. Following some cases ignoring the rule, Lord Tenterden, C.J., stated in Street v. Blay "on the principle . . . of avoiding circuity of action . . . the plaintiff [seller] ought to be prepared to prove compliance with his warranty, which is part of the consideration for the specific price agreed with the defendant [buyer] to be paid". The common law rule was finally reversed in Mondel v. Steel, which held in an action for the price of goods sold that "it is competent for the defendant [buyer] not to set-off, by a proceeding in the nature of a cross action, the amount of damages which he has sustained by breach of the contract, but simply to defend himself by shewing how much less the subject-matter of the action was worth, by reason of the breach of contract".

It is often said that this change in the common law rule "was made, not upon any principle of law, but upon grounds of convenience, in order to prevent circuity of action." Such view obliterates the distinction between the availability of a counter-claim arising from the subject-matter of the claim, and of a counterclaim arising from a separate matter. It appears from the preceding discussion, that while avoidance of circuity of action was the moving force behind recognizing the availability of

197 (1831), 2 B. & Ad. 456 at pp. 462-3, 109 E.R. 1212 at p. 1214 (obiter). Cf. note (a) to Germaine v. Burton, supra, footnote 196, where the buyer's right "to prove the inferiority of the article in diminution of damages, in an action [for] the stipulated price" was said to follow from the right of a purchaser of a warranted article who returns it "still to maintain an action for breach of warranty".
200 See footnotes 90-1 and text, supra.
the former, this recognition ultimately expressed itself in a principle of substantive law. "That it was no mere procedural rule designed to avoid circuity of action but a substantive defence at common law was the very point decided in Mondel v. Steel."\textsuperscript{201} While historically this change relating to "contracts for sale of goods and for work and labour" was "independent of the doctrine of 'equitable set-off' developed by the Court of Chancery to afford similar relief in ... other types of contract",\textsuperscript{202} its effect was to make one principle of law applicable to the availability of defences arising from all types of contract.\textsuperscript{203}

Over some trend to conform to this change in the general contract law,\textsuperscript{204} the weight of authority declined to reverse the inability to raise a partial failure in a sum uncertain against a holder not in due course of bills and notes.\textsuperscript{205} Rather, over the years doctrinal rationales to this inability have been sought and developed. Thus, it was stated, "the mere question of damages never gives a court of equity jurisdiction ... The account which a court of equity adjusts must be one of debtor and creditor, and not an account of debts one way and of damages the other way".\textsuperscript{206} None the less, this argument is valid only in the context of an adjustment of claims arising from separate matters.\textsuperscript{207} It has anyway become obsolete since the 1873 Judicature Act\textsuperscript{208} which "distinctly put[s] an unliquidated claim on the same footing as a

\textsuperscript{201} Gilbert-Ash (Northern) Ltd. v. Modern Engineering (Bristol) Ltd., [1973] 3 All E.R. 195 (H.L.), at p. 215, per Lord Diplock.

\textsuperscript{202} Ibid. But see footnotes 140-1 and text, supra. The evolution of this doctrine of "equitable set-off" is traced in Morgan & Son, Ltd. v. S. Martin Johnson & Co. Ltd., [1949] 1 K.B. 107 (C.A.), at pp. 112-3, per Tucker, L.J.

\textsuperscript{203} As the doctrine of "equitable set-off" lies within the discretion of the court (see e.g., Rawson v. Samuel (1841), Cr. & Ph. 161, 41 E.R. 451), some distinction remained between "contracts for sale ... and for work and labour" on one hand and "other types of contracts" on the other hand: Gilbert Ash (Northern) Ltd., supra, footnote 201 at p. 215, relying on Hanak v. Green, [1958] 2 All E.R. 141 (C.A.), at pp. 149-50, per Morris, L.J. The account given in Kaps Transport Ltd. v. McGregor Telephone and Power Construction Co. Ltd. (1970), 13 D.L.R. (3d) 732 at pp. 734-5, 73 W.W.R. 549 (Alta. S.C. App. Div.), is over-simplistic in dealing with both developments as one.

\textsuperscript{204} De Sewhanberg v. Buchanan (1832), 5 Car. & P. 343, 172 E.R. 1004.

\textsuperscript{205} See Note — Failure, supra, footnote 161 at p. 86.


\textsuperscript{207} "The mere existence of cross-demands is not sufficient" to invoke the doctrine of "equitable set-off" (See footnote 202 and text, supra); Rawson v. Samuel (1841), Cr. & Ph. 161 at p. 178, 41 E.R. 451 at p. 458.

\textsuperscript{208} Supreme Court of Judicature Act, 1873 (U.K.), c. 66.
liquidated claim for the purpose of set-off". From this viewpoint it was indeed correctly stated that the holder’s immunity from a partial failure in a sum uncertain is produced by a historical anomaly and “there is probably no longer a reason for continuing it”.

There is, however, another rationale to the limited scope of the defence of failure of consideration. The holder’s power over partial failure in a sum uncertain was thus explained in *James Lamont & Co., Ltd. v. Hylands, Ltd. (No. 2)* “treating the execution of a bill of exchange either as analogous to a *payment in cash*, or as amounting to an *independent contract* within the wider contract in pursuance of which it was executed, and not dependent as regards its enforcement on due performance of the latter”. Both grounds, respectively called the “payment in cash” and “independent contract” theory, will now carefully be considered.

It has already been argued in Part III that the unconditional language of the contract on a bill or note does not lead to the separation between the liability thereon and the defences arising from the underlying contract. Indeed, rather than focusing on the language of the undertaking, the “independent contract” theory rests on a specific agreement. Thereunder, a “distinction [exists] between an action for the price of the goods, and an action on the *security* given for them. In the former, the value only can be recovered; in the latter . . . the party holding bills given for the price of goods supplied can recover them, unless there has been a total failure of consideration”. As for the

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212 This is the explanation of the decision of Jessel, M.R., in *Anglo-Italian Bank v. Wells* (1878), 38 L.T. 197 (C.A.), at p. 199. His reference there to “some other contract” was unfortunate: but cf. *James Lamont & Co., Ltd.*, supra, footnote 211 at p. 932; and footnote 155 and text, supra.

213 *Obbard v. Betham* (1830), M. & M. 483 at p. 485, 173 E.R. 1232. See also the expla-
"payment in cash" theory, under it "the payment by a bill of exchange is to be taken as the payment of so much cash; the defendant ought to satisfy the bill and proceed upon the remedy for the breach of warranty".214

Both grounds thus appear separate from general principles of law as to the relationship between an action for the price of goods and either the defence of breach of warranty or the defence of an unliquidated claim.215 There is indeed some old authority explicitly suggesting the independence of the rule governing the scope of the defence of failure of consideration in the law of bills and notes from any principle governing the cause of action on the contract for sale.216 None the less, this view may be oversimplified. First, in Lewis v. Cosgrave,217 a plaintiff who attempted to extend the "independent contract" theory into a case of total failure of consideration was met by an argument drawn from an analogy to the rule under which a plaintiff in an action on the sale is non-suited where total failure of consideration is involved. Secondly, it appears that historically objection to the holder's power to recover over partial failure in a sum uncertain coincided with the opposition to the common law rule separating the action for the price of goods and the breach of warranty with respect to them. Thus, Lord Kenyon who as early as 1791218 and 1794219 upheld the availability of partial failure of consideration in a sum uncertain as a defence pro tanto to an action on an instrument, was quoted in 1788 to be "of opinion that [in an action for goods sold and delivered] the non-compliance with the warranty might have been given in evidence . . . in reduction of the damages".220

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215 Cf. footnotes 193-203 and text, supra.


217 Supra, footnote 213.


220 Cormack v. Gillis (Middlesex Sittings after Easter 1788), cited in Basten v. Butter
This of course, strongly undermines the suggestion that the inability to raise partial failure in a sum uncertain against a holder not in due course on one hand, and developments with regard to the availability of the defence of breach of warranty as well as of unliquidated damages on the other hand, are unrelated.

Yet, even if seen as an independent rule, the holder’s power to recover over the defence of partial failure in a sum uncertain appears to stand on a tenuous footing. Both grounds underlying it, the “independent contract” and the “payment in cash” theories, are in fact the two sides of the same coin. While the former provides the cause of the holder’s freedom, the latter is the result thereof. It further appears that historically the “independent contract” theory preceded the “payment in cash” explanation\(^\text{221}\) and thus the latter is in fact an aftermath rationale to a rule which had already been perceived as existing. The holder’s power to overcome the defence of partial failure in a sum uncertain appears then to be founded on the “independent contract”. In this framework, its applicability is governed indeed by the contours of this contract. Thus for example, in \textit{Moggridge v. Jones}, a partial failure in a sum uncertain was overcome by the plaintiff since “the money agreed . . . would have been payable immediately; but for the convenience of the defendant the plaintiff agreed to take his acceptance at a future day”.\(^\text{222}\) Likewise in \textit{Grant v. Welchman}, where a certain sum of money was to be paid immediately but “the defendant’s note . . . was taken as an indulgence to him”, the court let the plaintiff recover the entire amount of the note over the defence of partial failure in a sum uncertain as “the whole consideration was then payable”.\(^\text{223}\)

These cases establish a link between the express agreement of the parties and the “payment in cash” theory. The link fits easily into the framework of the accepted general rule under which an agreement which governs an instrument is an equity affecting it.\(^\text{224}\) Yet if the holder’s power to recover over the partial failure

\(^{221}\) See citations in footnotes 213-14, \textit{supra}. The “independent contract” cases were decided between the turn of the 19th century and 1830. The first “payment in cash” case is from 1840.

\(^{222}\) \textit{(1811)}, 14 East. 486, 104 E.R. 688.

\(^{223}\) \textit{(1812)}, 16 East 207 at p. 208, 104 E.R. 1067 at pp. 1067-68.

\(^{224}\) See footnotes 63-4 and text, \textit{supra}. 
in a sum uncertain is based on contract, it should not extend to
cover situations where an actual agreement is lacking. Indeed,
the possibility of an "independent contract" implied by law
appears unwarranted, particularly in connection with standard
form contracts. In an era where the failure to point out onerous
terms in a contract may result in their unenforceability, and
where a "most telling objection [for the use of negotiable instru-
ments in the sale of consumer goods] is that ordinarily the buyer
is not aware of the legal effect of signing a negotiable note", an
implied waiver of defence clause relating to an action on an
instrument which is unknown to the signer appears unthinkable:

... one [should always start] with the presumption that each party [to a
contract] is to be entitled to all those remedies for its breach ... including
the remedy of setting up a breach of warranty ... To rebut that
presumption one must be able to find in the contract clear unequivocal
words in which the parties have expressed their agreement that this remedy
shall not be available in respect of breaches of that particular contract.

Furthermore, even an explicit clause in a standard form contract,

601, 4 B.L.R. 50 (C.A.), and the comment by R. Hasson, 3 C.B.L.J. 193 (1978-79).
226 E. J. Murphy, "Another 'Assault upon the Citadel': Limiting the Use of Negotiable
Notes and Waiver-of-Defense Clauses in Consumer Sales", 29 Oh. St. L.J. 667 (1968),
at p. 671. The citation in the text relates to the waiver of defences against a holder in
due course.
227 Recall that the waiver of defences is final as against a remote party even when not
holder in due course, footnotes 186-92 and text, supra. As against the immediate party
the waiver of defences relates to the action on the instrument. It does not bar the
obligor from pursuing his remedy in a separate action against the immediate party;
footnotes 182-5 and text, supra.
228 Subject, of course, to the possibility of proving an applicable usage. "But then one
must be careful to see that one is not ascribing to the commercial world a custom or
habit which prevails only in a particular market or particular section of the commercial
world"; Easton v. London Joint Stock Bank (1886), 34 Ch. D. 95 (C.A.), at p. 113, per
Bowen, L.J. Cf. in general, P.H. Clarke, "Incorporating Terms into a Contract by a
a course of dealing is "through the operation of the rules of offer and acceptance"

p. 718, [1973] 3 All E.R. 195 at p. 216 (H.L.), per Lord Diplock, dealing with a
building contract. In this case the House of Lords specifically disapproved of a series of
previous decisions of the Court of Appeal (criticized by I. N. D. Wallace, "Set Back to
Set-Off", 89 L.Q.R. 36 (1973)), upholding the importance of "cash flow" in
the building industry and entitling contractors to recover in full notwithstanding the
obligor's defences. One of the disapproved cases, Frederick Mark Ltd. v. Schield,
[1972] 1 Lloyd's Rep. 9, 11 (C.A.), specifically used "a bill of exchange as a convenient
analogy".
specifically pointed out to the obligor, may be struck out as one-sided and unconscionable so as not to be enforceable.\textsuperscript{230}

It thus appears that failure of consideration, whether total or partial, whether in an ascertained or liquidated amount or not, is an equity as to liability on a bill or note and as such is available as a defence to an action thereon by any holder not in due course, whether immediate or remote party. Where the failure is partial, it is available as a defence \textit{pro tanto} in reduction of the recovery by the holder. Original parties may agree to treat the obligation on the instrument as absolute and not dependent on the performance of the contract. The execution of the bill or note is to be treated then as payment in cash. None the less, such an agreement must be actual and is subject to ordinary controls on contractual terms.

\textbf{Conclusion}

The Bills of Exchange Act, in the United Kingdom as well as in Canada and other Commonwealth jurisdictions, falls short of explicitly stating that a holder not in due course holds the instrument subject to all defences available in an action on the underlying contract. While this proposition is supported by policy considerations it is reflected only in s. 15 of the Canadian Act which governs the rights of a remote party holding an instrument properly marked as given for a patent right. The proposition was intended to have been adopted also in Part V of the Canadian Act with respect to bills and notes issued by buyers of consumer goods or services.\textsuperscript{231}

The delineation of defences available against a holder not in due course in other circumstances turns on the scope of “defect of title”. In contrasting between “defect of title” and “mere personal defences”\textsuperscript{232} the Act follows the pre-Act differentiation between an “equity attaching to the bill” and the “equities of the parties”.\textsuperscript{233} On its part, the latter differentiation is modelled on

\textsuperscript{230} “Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favourable to the other party”: Williams \textit{v.} Walker-Thomas Furniture Co., 350 F. 2d 445 (D.C. Cir. 1965), at p. 449. \textit{Cf.} Arralle \textit{v.} Costain Civil Engineering Ltd., [1976] 1 Lloyd’s Rep. 98 (C.A.), at p. 102, even independent legal advice does not always save the transaction.

\textsuperscript{231} See Part I, “The Statutory Scheme …”, \textit{supra}.

\textsuperscript{232} See footnote 17 and text, \textit{supra}.

\textsuperscript{233} See footnotes 127-8 and text, \textit{supra}.
the contrast between "an equity relating to the assigned debt" and "a personal claim" which is "not connected with the chose in action assigned". Indeed, a negotiable instrument "is both a chattel and a chose in action". Its ownership "involves not only the right to possess a thing but the right to sue [thereunder]". Thus, equities "relating to the assigned debt" as distinguished from "equities of the parties" affect the title to a negotiable instrument.

The comprehensiveness of the equities "relating to the assigned debt" with respect to all "the terms and conditions of the contract under which the indebtedness arose" entails the consequence that all defences arising from the underlying contract are defects of title. This specifically excludes counterclaims arising from separate matters, whether in liquidated or unliquidated amounts. The subjection of an assignee of a chose in action to set-offs of liquidated amounts arising from independent transactions is an anomaly which is carried by the Canadian Act to the case of an instrument issued in return to a patent right as well as to consumer bills and notes. This anomaly neither turns the right of set-off into a defect of title nor necessarily results in the subjection thereto of a holder not in due course.

Pre-Act cases do not pronounce the proposition that defences arising from the underlying contract are equities as to liability on bills and notes. Neither this fact, nor the unilateral nature of the contract on a bill or note poses a serious challenge to the heretofore analysis. "The laws distinguishing negotiable instruments from non-negotiable instruments are not based on any inherent distinctions between the obligations assumed in the one class or the other of such contracts ... The content of a promise [or order] is one thing, the development and recognition of a defense is quite another".

Thus, failure of consideration, whether total or partial, whether in an ascertained or liquidated amount or not, is an equity as to liability on a negotiable instrument. It is available as a

234 See footnotes 129-30 and text, supra.
235 See footnotes 70-1 and text, supra.
236 See footnote 78 and text, supra.
237 See Part II, "Defect of Title ...", supra.
238 See footnotes 62-9 and text, supra.
239 See footnote 160 and text, supra, and, in general, Part III, "Equities as to Liability ...", supra.
defence to an action thereon by any holder not in due course, whether an immediate or a remote party. Where the failure is partial, it is available as a defence *pro tanto* in reduction of the holder's recovery. Cases holding against the availability of the defence of partial failure in a sum uncertain are explained either by their contemporary rules of common law which have since then become obsolete or by the agreement of the original parties. Yet such an agreement must be actual and is subject to ordinary controls on contractual terms.\(^{240}\)

It thus appears that the proposition that a holder not in due course holds the instrument subject to all defences available in an action on the underlying contract is supported by policy considerations as well as by a close analysis as to the nature of a negotiable instrument and the concepts underlying the scope of liability under it. While passing also a critical examination of the case law, the proposition is, none the less, inconsistent with the prevailing view on the scope of the defence of failure of consideration. It might thus be unrealistic to expect courts to pronounce it. Legislative intervention aimed at correcting the anomaly is warranted.

**APPENDIX 1**

Defences Available against a Holder Not in Due Course — The Statutory Scheme Under the Canadian Bills of Exchange Act*  

2. In this Act

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“defence” includes counterclaim;
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15. The endorsee or other transferee of any such instrument having the words *Given for a patent right* so printed or written thereon, takes the instrument subject to any defence or set-off in respect of the whole or any part thereof that would have existed between the original parties.

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\(^{240}\) See Part IV, "The Defence of Failure ...", supra.
*Can., s. 56(2) is U.K., s. 29(2); Can., s. 70(1) is U.K., s. 36(2); Can., s. 72 is U.K., s. 36(5); Can., 74(b) is U.K. s. 38(2). Can., ss. 15, 191 and the specific definition from Can., s. 2 do not have corresponding provisions in the U.K. Act.*
56(2) In particular the title of a person who negotiates a bill is defective within the meaning of this Act when he obtained the bill, or the acceptance thereof, by fraud, duress or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud.

70(1) Where an overdue bill is negotiated, it can be negotiated only subject to any defect of title affecting it at its maturity, and thenceforward no person who takes it can acquire or give a better title than the person from whom he took it had.

72. Where a bill that is not overdue has been dishonoured, any person who takes it with notice of the dishonour takes it subject to any defect of title attaching thereto at the time of dishonour; but nothing in this section affects the rights of a holder in due course.

74. The rights and powers of the holder of a bill are as follows:

(b) where he is a holder in due course, he holds the bill free from any defect of title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill;

191. Notwithstanding any agreement to the contrary, the right of a holder of a consumer bill or consumer note that is marked as required by section 190, to have the whole or any part thereof paid by the purchaser or any party signing to accommodate the purchaser is subject to any defence or right of set-off, other than counter-claim, that the purchaser would have had in an action by the seller on the consumer bill or consumer note.
APPENDIX 2

The UCC Provisions**

§3-306 Rights of One Not Holder in Due Course

Unless he has the rights of a holder in due course any person takes the instrument subject to

(b) all defences of any party which would be available in an action on a simple contract; and

(c) the defenses of want or failure of consideration

§3-408 Consideration

... Failure of consideration is a defense as against any person not having the rights of a holder in due course ... Partial failure of consideration is a defense pro tanto whether or not the failure is in an ascertained or liquidated amount.

**Reproduced for comparison and a possible direction for revising the statutory scheme under the present Act. The overlap in the UCC provisions between "defenses . . . available in an action on a simple contract" and "failure of consideration" is explained in B. Geva, "Contractual Defenses as Claims to the Instrument: The Right to Block Payment on a Banker's Instrument", 58 Ore. L. Rev. 283 (1979), at pp. 296-7 and 301-4.