The Financing Assignee and the Contract for Sale in the United States and Canada

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THE FINANCING ASSIGNEE
AND THE CONTRACT FOR SALE
IN THE UNITED STATES AND CANADA

BENJAMIN GEVA

Modern commercial law views the right to money due under a contract as a property right. Accordingly, a financing assignee, or an assignee of money due under a contract, is a purchaser of property. This view is consistent with general commercial concepts and provides a comprehensive framework governing the assignee’s position towards the assignor and third parties. Property analysis alone, however, does not fully explain the effect of the assignment on the obligor. A central thesis of this article is that insofar as the obligor is concerned, the financing assignee is a mere agent for collection of the money due under the contract. Therefore, the assignment of money due under a contract does not affect the personal relationship between its original parties. The dual characterization of the assignee as both a purchaser and an agent, stems from the nature of the assigned contract. As any other chose in action, the contract is “property” in the hands of its owner. At the same time it is an “obligatory” or personal relationship between the parties to it. “Purchase” of the right to the money due under the assigned contract cannot affect the obligor’s rights and duties under the contract.

It has been stated “that if a man does take an assignment of a chose in action he must take his chance as to the exact position in which the party giving it stands.” This article is concerned with the validity of this statement, or more specifically with the “exact position” of a financing assignee in relation to the financed contract for sale. To some extent the financer steps into the seller’s shoes; the question is how far. The answer involves the consideration of such issues as what rights and remedies of the seller are available to the financer, and to which of the buyer’s claims and defenses he is subject. This article examines these questions in the context of receivables financing. The goal of the article is to explain the relationship between the financing assignee and the obligor under common law and modern legislation in the United States and Canada. The “agent for collection” theory that will be suggested is neither a

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† See text and notes at notes 40-45 infra.


3 For a definition of “financing assignee”, see text at note 20 infra. For “financing” and “sale” see text and notes at notes 6-9 infra.
challenge nor an alternative to the modern "property" theory governing the assignment of money due under a contract. It is rather an exposition of the inherent limitations of the property theory and an attempt to provide a complement to its operation.

The article begins by outlining the commercial setting. Financing assignment practices are described in the context of sale financing devices in general. The second section contains an explanation of the financing assignee's position in relation to the buyer-obligor under the common law and the survival of this position under modern commercial law legislation in the United States and Canada. Specifically, the extent to which the assignee is subject to the contractual defenses of the obligor will be examined in the context of both the traditional property analysis and the suggested agent for collection analysis. Next, the more difficult questions of what remedies of the original contract the assignee can avail himself of, as well as what modifications to the contract he is subject to, will be examined. The viability of the obligor's restitutionary claim against the assignee for payments made under a mistake of fact will also be considered. It will be submitted that the conceptual framework which best explains the assignee-obligor relationship is that of the assignee as an agent of the assignor for collection of money due under the contract.

The third section examines the use of the negotiable instrument and the waiver of defense, or cut off clause in both countries as devices circumventing a major aspect of the common law position with respect to the financing assignee-obligor relationship. In addition, this section analyzes the major aspects of judicial and legislative responses to these devices and the effect of the legislative responses on the common law scheme which governs the assignee-obligor's relationship.

I. SALE FINANCING AND THE FINANCING ASSIGNEE

As a legal concept, "sale financing" has not acquired a well-defined meaning. An examination of existing sale financing practices reveals that the concept denotes the making of advances to a seller of goods by a third party to a

4 Under the Uniform Commercial Code (U.C.C.), 1962 as well as 1972 Official Texts. Unless otherwise specified, all subsequent references to the U.C.C. are to the 1972 version.


6 The following leading law dictionaries do not contain a definition of either "financing" or "sale financing:" BALLENTINE'S LAW DICTIONARY (3d ed. 1969); BLACK'S LAW DICTIONARY (rev. 4th ed. 1968); BOUVIER'S LAW DICTIONARY (3d rev. 1914 & Baldwin Century ed. 1946). The definition of "financing" in 16A WORDS AND PHRASES (1959 & Supp. 1981) is not helpful. "Financing" under WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED (1976), is "the act, process or an instance of raising or providing funds." Id. at 851.

7 See text and notes at notes 10-14 infra.
sales transaction,\(^8\) known as a "financer" or "financing agency."\(^9\) The advances may be made either in \textit{performance} or in \textit{acceleration} of the buyer's obligation to pay the price under the contract for sale.

Advances are made in \textit{performance} of the buyer's obligation when they are payable to the seller under an obligation of the financer procured by the buyer in pursuance to his duty under the contract for sale. The financer's obligation is embodied in either a negotiable instrument or a letter of credit. The former is a writing signed by the financer that "contain[s] an unconditional promise or order to pay a sum certain in money" to the order of the seller.\(^10\) Such a negotiable instrument usually takes the form of a bill of exchange or a draft\(^11\) drawn either on a bank\(^12\) or on the drawer himself, and is used primarily in the financing of retail purchases. A letter of credit in the context of sales financing is an engagement by its issuer to pay the price of goods sold or to accept a draft drawn by the seller to that amount, provided that the shipping documents representing the goods are tendered to the issuer. Letters of credit are used primarily in commerce between distant parties.\(^13\)

Advances made in acceleration of the buyer's obligation are procured by the seller of the goods. The advances made by the financer to the seller reflect the present market value of the right to obtain the sales price of the goods. Such is the case in receivables financing, where the obligations of customers towards retailers are converted to cash, thereby giving a seller who sells his inventory on credit terms the equivalent of a sale on cash terms.\(^14\) This is also the case in

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\(^8\) The essence of a sales transaction is the passage of title to goods from a seller to a buyer for a price. U.C.C. § 2-106(1); Ontario Sale of Goods Act, ONT. Rev. Stat. 1980 c.462; BALLENTINE'S LAW DICTIONARY, supra note 5, at 1133.

\(^9\) Cf. definition of "financing agency" in U.C.C. § 2-104(2):

- a bank, finance company or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale . . .

- due or claimed under the contract for sale . . .

\textit{Id.} "Financing agency" is broadly defined . . . to cover every normal instance in which a party aids or intervenes in the financing of a sales transaction." U.C.C. § 2-506 comment (1). Note, however, that in its first part the definition fails to mention that the financing agency must be a third party to the sales transaction and that in its last part the definition seems to cover also debt collection unaccompanied by previous advances. The definition is thus overbroad.

\(^10\) U.C.C. § 3-104(1). \textit{See also} Bills of Exchange Act, CAN. Rev. Stat. 1970, c.B-5 (as amended) ss. 17(1) (bill of exchange defined) and 176(1) (definition of a promissory note). The instrument could originally be payable to the buyer and then endorsed to the seller.

\(^11\) "A writing which complies with the requirements of this section is . . . a 'draft' ('bill of exchange') if it is an order..." U.C.C. § 3-104(2). \textit{See also} definition of "bill of exchange" in s. 17(1) of the Canadian Bills of Exchange Act, CAN. Rev. Stat. 1970 c.B-5 (as amended).

\(^12\) "Bank" means any person engaged in the business of banking." U.C.C. § 1-201(4). It is narrower than "financing agency" under § 2-104(2). See note 9 supra. Under § 2 of the Canadian Bills of Exchange Act, CAN. Rev. Stat. 1970 c.B-5 (as amended), "bank" is "an incorporated bank or savings bank carrying on business in Canada." This is narrower than the Code definition.

\(^13\) Letters of credit are covered by Article 5 of the Uniform Commercial Code. For their use in sales financing, see Wiley, \textit{How to Use Letters of Credit in Financing the Sale of Goods}, 20 BUS. LAW. 495 (1965).

\(^14\) "Receivables" are the obligations of customers towards retailers. See, Kripke, Con-
documentary sales financing, where a distant buyer is to pay the price of goods shipped to him upon the arrival of the seller’s documentary draft at the present- ing bank. The seller, rather than sending the draft for collection and then waiting for the arrival of its proceeds at the depositary bank, may at the outset discount the draft with the depositary bank thereby accelerating payment.\(^{15}\)

Where the advances are made in performance of the buyer’s obligation, the financer enforces a separate and independent obligation against the buyer. The financer, therefore, is neither entitled to any of the seller’s rights and remedies nor is he subject to any of the defenses available against him.\(^{16}\) Where the advances are made by the financer in acceleration of the buyer’s obligation to pay the price of goods sold, however, the financer enforces the buyer’s original promise under the contract of sale. In such instances, the extent to which the financer stands in the shoes of the seller can be critical to the resolution of disputes between the obligor and the financer. This article focuses on advances in acceleration of the buyer’s obligation, such as accounts receivable financing.

Receivables or book debts are “debts due to the trader in the course of his trade, . . . which in the ordinary course of his business would be entered in his book.”\(^{17}\) Receivables which are buyers’ unsecured obligations are known as “accounts.”\(^{18}\) When secured, the receivables are “chattel paper.”\(^{19}\) A transac-

ceptual Obsolescence in Law and Accounting—Finance Relations between Retailer and Assignee of Retail Receivables, 1 B.C. IND. & COM. L. REV. 55 (1959) [hereinafter cited as Kripke, Conceptual Obsolescence]. For receivables financing, see Kripke, Financial Assistance Through Commercial and Sales Finance Companies, Leasing Companies, Factors and Field Warehousing, 14 BUS. LAW. 902, 905-07 (1959) [hereinafter cited as Kripke, Financial Assistance].

15 “Draft” is a negotiable instrument which is an order. U.C.C. § 3-104(2)(a). “Documentary draft” is any negotiable or non-negotiable draft accompanying documents, securities or other papers to be delivered against honor of the draft. U.C.C. § 4-104(1)(f). Cf. U.C.C. § 5-103(1)(b). Collection of documentary drafts is dealt with in Part 5 of Article 4 of the Code. For documentary sales and their financing, see Farnsworth, Documentary Drafts Under the Uniform Commercial Code, 22 BUS. LAW. 479 (1967). No specific statutory provisions govern the collection or financing of documentary drafts in Canada.

16 Whether the buyer can use a defense under the sale contract as a basis for enjoining the financer from making the advances to the seller who delivered the goods to him in reliance on the financer’s obligation is discussed in Geva, Contractual Defenses as Claims to the Instrument: The Right to Block Payment on a Banker’s Instrument, 58 OR. L. REV. 283 (1979).


18 The term is adopted by U.C.C. § 9-106. In its 1962 version, the section distinguished between “contract right” (right to payment under “a contract not yet earned by performance . . .”) and “account” (“right to payment for goods sold . . .”). The distinction was abandoned in 1972: “An ‘Account’ means any right to payment for goods sold . . . whether or not it has been earned by performance.” All definitions exclude chattel paper (defined in text and note at note 19 supra). “Accounts” do not constitute a specific type of collateral under the classification of the Ontario P.P.S.A., rather they form a part of the “intangibles” class. See s. 1(m): ‘intangible’ means all personal property including those choses in action, that is not goods, chattel paper, documents of title, instruments or securities.” ONT. REV. STAT. 1980, c.375 (as amended), s. 1(m).

19 “Chattel paper” is defined in U.C.C. § 9-105(1)(b) and P.P.S.A. s. 1(c). This category covers one or more writings embodying a security agreement and a monetary obliga-
tion between a seller and a third party in which receivables are transferred is called an assignment.\textsuperscript{20} The assignment by the seller of receivables against funds advanced by a financier is a financing assignment. In this transaction the financier is a financing assignee.

A financing assignment of receivables can arise as security for a loan or as an outright sale.\textsuperscript{21} An outright sale can be with or without recourse.\textsuperscript{22} If the sale is without recourse, the financier cannot recover from the assignor in the event the buyer, known as the "obligor," or "account debtor,"\textsuperscript{23} defaults. A sale can also be with or without notification to the buyer of goods. If the buyer is notified, a direct collection or notification arrangement results; an indirect collection or non-notification arrangement results if the obligor is not informed of the assignment.\textsuperscript{24} Due to the "resulting opportunities for fraud or for credit reasons," non-notification arrangements are typically with recourse.\textsuperscript{25} Functionally, they resemble a transfer for security,\textsuperscript{26} where the obligor is usually not notified of the assignment, and the risk of non-payment is borne by the seller of goods (the assignor of the receivables).\textsuperscript{27}

The sale of accounts under a notification arrangement without recourse is known as "factoring."\textsuperscript{28} It originated "in the field of textiles, but ... has recently been extended to allied lines of clothing and fabrics, and even into entirely different lines such as furniture."\textsuperscript{29} The practice of factoring is more prevalent in the United States than in Canada where the usual assignment of accounts occurs as security for a loan.\textsuperscript{30} Assignment of chattel paper resulting in notification as well as non-notification arrangements are common occurrences. Notification arrangements are typically found in the automobile field while the non-notification ones are widespread in the furniture field.\textsuperscript{31}
The financing assignment of receivables is governed in the various United States jurisdictions by Article 9 of the Uniform Commercial Code (U.C.C.). The modern statute governing the subject in the common law provinces of Canada is the Personal Property Security Act (P.P.S.A.). Both statutes provide for the assignee's right when "so agreed" with the assignor, and "in any event" on the latter's default, to notify the obligor "to make payment to him [the assignee] whether or not the assignor was theretofore making collections." Until notified, the obligor is to pay the assignor. Thus, notification establishes the direct relationship between the financing assignee and the obligor. Regardless of the type of financing assignment involved, notification gives rise to the question of the financer's "exact position" in relation to the financed contract for sale.

II. THE FINANCING ASSIGNEE AND THE OBLIGOR: THE GENERAL LAW

A. An Assignee Takes the Contract Subject to the Obligor's Defenses

Assignment of choses in action was first recognized by courts of equity. "At common law, a debt was looked upon as a strictly personal obligation, and an assignment of it was regarded as a mere assignment of a right to bring an action at law against the debtor." Courts of law, therefore, prohibited assignment of

32 Besides applying "to any transaction ... which is intended to create a security interest in ... chattel paper or accounts," Article 9 explicitly applies "to any sale of accounts or chattel paper." U.C.C. § 9-102(1). Exclusions in § 9-104 relate to "certain transfers ... which, by their nature, have nothing to do with commercial financing transactions." U.C.C. § 9-104 comment 6. (Citations to § 9-102 are from the 1972 version; the 1962 version includes a reference also to "contract rights;" cf. note 18 supra.)
33 The P.P.S.A. applies to "every transaction ... that in substance creates a security interest," as well as to "to every assignment of book debts not intended as security ..." Ont. Rev. Stat. 1980, ch. 375 (as amended), s. 2. Statutes which govern financing assignments of receivables in non-P.P.S.A. jurisdictions (e.g., Assignment of Book Debts Acts) are concerned only with the effect of non-registration of the assignment on third parties. All other aspects have remained "as if the Act had never been passed," Snyder's Ltd. v. Furniture Fin. Corp. Ltd., 66 Ont.L.R. 79, 86 (1930).
34 U.C.C. § 9-502(1) (This provision is titled "Collection Rights of Secured Party," but "secured party" includes the person to whom accounts or chattel paper has been sold. U.C.C. § 9-105(m.); P.P.S.A. s. 57(1)(a).
35 U.C.C. § 9-318(3); P.P.S.A. s. 40(2).
37 See text and note at note 2 supra.
38 "Chose in action is a known legal expression used to describe all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession," Torkington v. Magee [1902] 2 K.B. 427, 430 (per Channell, J.). "In its primary sense, the term ... includes all rights which are enforceable by action — rights to debts of all kinds, and rights of action on a contract ..." Holdsworth, The History of the Treatment of Choses in Action by the Common Law, 33 Harv. L. Rev. 997 (1920).
40 Fitzroy v. Cave [1903] 2 K.B. 364, 372 (per Cozens-Hardy, L.J.) (emphasis added).
chooses in action. The courts of equity viewed this resistance to assignability as "too absurd . . . to adopt." The latter courts "admitted the title of an assignee of a debt, regarding it as a piece of property, an asset capable of being dealt with like any other asset . . . ." This position gained a limited statutory recognition and finally made its way into modern commercial law legislation.

The assignment of a chose in action has never been held to prejudice the position of the obligor. "The assignee . . . can acquire no greater rights under the assignment than those enforceable by the assignor, and he, therefore, takes subject to all defenses existing in respect of the right assigned which would be available against the assignor seeking to enforce the right assigned." A leading authority for this proposition is Newfoundland v. Newfoundland Railway Company. In that case, a railway company undertook to complete the construction of a railway. Payments were attached to the progress of the work; each payment was to be made by the obligor upon the completion of a designated section of the railroad. The railway company completed a portion of the line and broke the contract. An assignee of a division of the railway sued the obligor for the payment attached to the construction of that division. Though this part of the railway had been completed, the assignee did not prevail. His entitlement to payment could not be separated from the obligor's claim for the damage caused by the railway company's breach.

The Judicial Committee of the Privy Council, a court of last appeal for colonies and dominions in the British Empire, understood the assignee to argue

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41 The objections to assignability of choses in action at common law are summarized by W.R. Warren, The Law Relating To Choses In Action 31-32 (1899). They include maintenance, the duty of a debtor to seek out his creditor and the completion of the transfer of ownership by physical delivery.
44 Originally in s. 25(6) of the English Judicature Act, 1873, 36 & 37 Vict., 66. The provision covers "[a]ny absolute assignment by writing . . . (not purporting to be by way of charge only) of any debt or other legal chose in action of which express notice in writing shall have been given to the debtor. . . ." Id. "The statute has not altered the law in substance. It is merely machinery," G. Cheshire & C. Fifoot, supra note 39, at 500. Most notably the statute gave the assignee a right at law and thus enabled him to sue in his own name.
45 See text and notes at notes 32-37.
46 1 F. T. White & O.D. Tudor, A Selection Of Leading Cases In Equity 142 (Whittake, 8th ed. 1910). See also Restatement of Contracts § 167(1) (1932): "An assignee's right against the obligor is subject to all limitations of the obligee's right, to all absolute and temporary defenses thereto, and to all set-offs and counterclaims of the obligor which would have been available against the obligee had there been no assignment . . . ." Id. The phraseology of the Restatement (in particular, the use of "limitations," and the "absolute"—"temporary" dichotomy) is criticized by 2 G. Gilmore, supra note 2, at 1089.
48 Id. at 202.
49 Paragraph 14 of the contract, id. at 204, as construed by the court, id. at 208-09.
50 Id. at 206.
51 Id. at 202.
52 Id.
53 Id. at 212-13.
in that case that "when a debt or claim under a contract has been assigned . . . the debt or claim is so severed from the rest of the contract that the assignee may hold it free from any counterclaim in respect of other terms of the same contract."

It rejected the argument unequivocally:

It would be a lamentable thing if it were found to be the law 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 counterclaim by the other party in respect of the rest of the contract, which may be burdensome.

Under Newfoundland Railway, then, an assignee cannot claim from an obligor that which the assignor himself was not rightly entitled to under the terms of the assigned contract.

It has been often stated that for the obligor's defenses to be available against the assignee, they must arise from facts which "occurred before notice of the assignment was given to [him]." This phrase, however, applies only in conjunction with defenses arising outside the contractual nexus between the obligor and the assignor such as from a separate contract between them. As to defenses arising from the assigned contract, notice of assignment is entirely irrelevant.

As provided by both the U.C.C. and the P.P.S.A., an assignee is subject to "all the terms of the contract . . . and any defense or claim arising therefrom." No reference is made in this context to the notice of the assignment. Notice, however, is relevant in cutting off "any other [unaccrued] defense or claim" arising outside the assigned contract.

While the obligor may make use of some of the claims and defenses available against the assignor, such rights can be asserted only defensively against a financing assignee. "The assignee who comes in to finance the transaction, does not thereby become responsible for the assignor's warranties or prospective performance." Some deviation from this proposition occurred at

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54 Id. at 210.
55 Id. at 212 (per Lord Hobhouse).
56 F.D. WHITE & O.D. TUDOR, supra note 46, at 142. This is also the position of the American Restatement of Contracts. RESTATEMENT OF CONTRACTS § 167(1) (1932).
57 See generally G. GILMORE, supra note 2, at 1090-91. Professor Gilmore has noted: The Code improves on the Restatement by the device of distinguishing between what might be called the contract-related and the unrelated defenses and claims. Defenses and claims "arising" from the contract can be asserted against the assignee whether they "arise" before or after notification. As we shall see, that is presumably what the restaters meant: the contingencies of future performance of the contract were to be regarded as "facts existing at the time of the assignment." Under the Code, "any other defense or claim" is available against the assignee only if it "accrues before . . . notification."

58 U.C.C. § 9-318(1)(a); P.P.S.A. s. 40(1)(a).
59 U.C.C. § 9-318(1)(b); P.P.S.A. s. 40(1)(b).
the turn of the century in the context of the indorsement and delivery of a bill of lading by a financing bank. Nonetheless, this deviation was soon "repudiated by the court of its inception and buried beneath an avalanche of adverse criticism." The absence of affirmative liability on the part of the financing assignee is consistent with the fact that an assignee of a chose in action does not undertake the performance of the assigned contract. Rather, the assignee takes the benefit of the contract, as may be reduced by its burdens. The obligor "has no claim to recover anything against the [assignee]; he only meets the [assignee's] claim by counterclaim of damages arising out of the same contract." The obligor "meets the assignee's claim by counterclaim" by offsetting or recouping the amount of the counterclaim against the claim of the assignee. This neither involves the filing of a counterclaim by the obligor nor does it entail the assignee's affirmative liability. Rather it means the assertion of the assignor's breach, and the amount of any claim arising therefrom, in the obligor's defense against the assignee's action.

The assignee's position towards the obligor's defenses could be explained fully by regarding the chose in action in his hands as his "piece of property." The assignee's subjection to the obligor's defenses is thus one aspect of the

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61 Landa v. Lattin, 19 Tex. Civ. App. 246, 46 S.W. 48 (1898). In this case a seller of wheat in a documentary sales transaction discounted the draft (drawn on the buyer) with the depositary bank. Id. at 247, 46 S.W. at 49. (For this practice see text and note at note 15 supra). It was held that by taking the bill of lading relating to the wheat as security for the advance, the depositary bank had become the owner of the wheat responsible to the buyer for its quality. 19 Tex. Civ. App. at 252-53, 46 S.W. at 52.


63 For case law supporting this proposition, see Loegler v. C.V. Hill & Co., 238 Ala. 606, 608-09, 193 So. 120, 121 (1940).

64 Young v. Kitchin, (1888) 3 Ex. D. 127, 131 (per Cleasby, B.).

65 The term "set off" is used here in the sense of "equitable set off." Cf. note 299 infra.

66 For the use of "set off" in the present context, see Newfoundland v. Newfoundland R. Co. (1888) 13 App. Cas. 199, 213 (P.C.).

67 This term is used in American law. Recoupment . . . although frequently confused with set-off, is recognized as a distinct principle, namely, the right to present in opposition to the defendant for loss or damage sustained by him in the same transaction through [the other party's] breach of contract or duty . . . Loyd, The Development of Set-Off, 64 U. PA. L. REV. 541, 563 (1916).

68 But see D.P.C. Corp. v. Jobson, 15 A.D.2d 861, 224 N.Y.S.2d 772 (1962), where a buyer was allowed to interpose a counterclaim against a financing assignee up to the amount of the assignee's demand. It is submitted that the court erred on this point.


60 See text and note at note 42 supra.
maxim, *nemo dat quod non habet*. The assignor could not convey more than what he had — a right to payment subject to his performance. Likewise, the rule that the assignee is not liable for the assignor’s breach of the assigned contract could stem from the absence of any contractual relationship between the obligor and the assignee, i.e., from the fact that the assignee *owns* the right to payment under the contract but is not a party owing a duty to perform it. Also in the framework of “property” analysis, the assignee’s subjection to external offsets arising prior to notifying the obligor of the assignment could be explained either by the equitable origin of the assignee’s title or by the assignee’s partial title up to notification.

While property analysis aids an understanding of the assignee’s position vis-a-vis the obligor’s defenses, it does not convey the entire effect of the assignment on the assignor-obligor’s ongoing contractual relationship. Indeed, the extent to which the assignee “steps into the assignor’s shoes” in exercising remedies under the contract, as well as in being entitled to receive notices thereunder, remains unanswered. “Property” analysis further fails to explain satisfactorily the position of the assignee with respect to subsequent modification of the contract by the original parties thereto. The “property” analysis is also responsible for the confusion regarding the obligor’s alleged restitutionary claim against the assignee for sums paid to the latter under a mistaken belief as to the propriety of the assignor’s performance. In order to reach an understanding of these aspects of the financing assignee’s position, it is necessary to supplement the property analysis with the explanation that the assignee is an agent for collection.

B. An Assignee is a “Mere Agent for Collection”

As noted above, property analysis fails to describe adequately the effect of an assignment of money due under a contract. It is submitted that questions concerning the commercial triangle of the assignor, assignee, and obligor, can

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73 The point is well demonstrated in 2 G. Gilmore, supra note 2, ch. 41.

74 An example of an entitlement to receive notices is the case of rightful rejection of goods. Ontario Sale of Goods Act (S.G.A.), ONT. REV. STAT. 1980 c.462 s. 35; U.C.C. § 2-602(1).

75 Obviously, modification of a contract for sale is relevant in the context of an assignment of a contract which is executory at least in part (e.g., a contract for the sale of goods to be delivered by stated installments).

76 See text and notes at notes 127-84 infra.
be answered by the proposition that the assignment of money due under a contract does not affect the underlying contractual relationship between the assignor and obligor. From the obligor's viewpoint, only the notice of assignment is critical. The effect of that notice, however, merely is to let the obligor know to whom payment should be made. Questions concerning the assignee's right to exercise remedies under the assigned contract, his obligation to abide by modifications thereto, and his liability in restitution for payments made under a mistake of fact, can all be answered by this mode of analysis.

This view gives new life to the original common law position as to the effect of an assignment of a chose in action, i.e., that the transaction is a mere assignment of a right to bring an action at law against the debtor. In this modern manifestation, however, the view does not purport to provide a comprehensive theory covering all aspects of the assignment of choses in action. Instead, the view is limited to describing the effect of an assignment on the obligor's contractual position. Thus, insofar as the obligor is concerned, the assignee is a "mere agent for collection," or "an attorney with a power to collect or dispose of the claim for his own use." While in equity and under modern statutes a chose in action is "a piece of property" whose transfer is effective as against third parties, the assigned contract creates a "strictly personal" relationship between the obligor and the assignor which is unaffected by the assignment.

If an assignee is a "mere agent for collection" whose status does not affect the obligor's contractual rights and duties, what is the basis for his independent right to payment from the obligor? It is proposed that as an assignment is created by a contract between the assignor and the assignee, its effect on the obligor does not differ from the effect of any contractual relationship on third parties. While the assignment does not affect the obligor-assignor contract, it does charge the obligor with a duty not to interfere with the assignor-assignee contract. Breach of this duty is actionable by the assignee in tort. Once notified of the assignment, the obligor is under a duty to honor it. In paying the assignor, notwithstanding a notification of the assignment, the obligor thus incurs tort liability towards the assignee. To describe the wrongful payment

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77 See text and notes at notes 38-45 supra.
79 See text and note at note 43 supra.
80 See text and note at note 40 supra. Third parties refers to competing assignees and the assignor's creditors.
82 He cannot settle with the assignor without the assignee's consent so as to defeat the latter's right. See, e.g., Progressive Design Inc. v. Olson Bros. Mfg. Co., 190 Neb. 208, 206 N.W.2d 832 (1973).
83 See note 81 supra. The tortious nature of the liability is, however, not acknowledged by modern case law. See, e.g., Manes Constr. Co. v. Wallboard Coating Co., 497 S.W.2d 334 (Tex. 1973), where on payment to the assignor notwithstanding notice of the assignment the court speaks generally of the obligor's "double liability," without specifying its nature. Id. at 337.
by the obligor to the assignor as a failure to discharge the obligor's debt, rather than as the rise of liability in tort, may describe the end result of such a wrongful payment. It is an inaccurate description of the process leading to the result, however, since it ignores the personal relationship created by the assignor-obligor contract, which remains unaltered by the assignment.

The assignee's status as a "mere agent for collection" certainly could be the basis for subjecting the claim in his hands to the obligor's defenses against the assignor, as well as to external offsets arising prior to the assignment. The assignee's freedom from external offsets arising after notification is consistent with the obligor's duty not to interfere with the assignor-assignee contractual relationship. Having been notified of the assignment, the obligor may not defeat the assignee's right emerging from the assignee's contract with the assignor, by dealing with the assignor in connection with matters which are unrelated to the assigned contract. Likewise, the absence of any affirmative liability on the assignee's part for the assignor's breach of the assigned contract follows from the fact that the assignee is a "mere agent for collection" rather than a party to that contract owing a duty to perform it. The scope of the assignee's agency relates to collection alone and not to the performance of the assignor's contract.

In sum, the assignee's position towards the obligor's defenses is fully explained not only by "property" analysis, but also under the alternative "mere agency for collection" analysis. The advantage of the latter analysis, however, lies in its superior ability to explain the assignee's position towards the obligor in the framework of an overall theory underlying the effect of the assignment on the assignor-obligor's ongoing contractual relationship.

1. The Extent of the Assignee's Rights under the Assigned Contract

As an "agent for collection," the assignee is entitled to exercise all the assignor's rights and remedies for the enforcement of the obligation under the assigned contract. Assignment of a contract right entails the assignment of all securities given by law or by contract to secure its performance. It also en-

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64 Such a thought is reflected in the language of the statutory provision which governs the assignee's right. See text and notes at notes 35-36 supra.

65 On the nature of "external offsets," see note 70 supra.


67 But cf. U.C.C. §§ 2-506(1) and 2-707(2) (referring to the seller's rights in the goods, particularly to the right to stop delivery). The former provision is inapplicable to an ordinary financing assignee. The application of the latter is controversial. Benfield, Rights of a Seller's Assignee to Reclaim Goods Under the UCC, 53 Tex. L. Rev. 1, 11 et seq. (1975) [hereinafter cited as Benfield].

tails the power to exercise rights and remedies under a security agreement which secures the obligor’s payment. The assignment confers on the assignee the power to sue the obligor for damages for breach of his undertaking and not merely the power to collect the debt itself.

Nevertheless, the assignee does not step fully into the existing contractual relationship with the obligor. He can neither rescind the contract on the ground of the obligor’s misrepresentation nor otherwise terminate the contract in lieu of the assignor. As a “mere agent for collection,” he is neither entitled to the obligor’s notices under the assigned contract, for example in the case of a rightful rejection of goods sold under the contract, nor authorized to act in response to them. He lacks the power to accept the obligor’s anticipatory breach, as well as to instruct the obligor-buyer what to do with rightfully rejected goods. All matters relating to the performance or dissolution of the assigned contract are beyond the scope of his authority, which relates to collection alone.

Policy arguments support the assignee’s exclusion from the assignor-obligor contractual relationship. Thus, according to Professor Gilmore, “[a]s a matter of policy . . . despite notification of assignment, the buyer should . . . be privileged to go on dealing with the seller alone. The assignee’s involvement is with the financing aspect, not the goods aspect of the transaction.”


91 This was correctly noted in Jones v. Bailey, 1 Mass. App. Ct. 41, 45-46, 294 N.E.2d 599, 602 (1973). The difference between an action to collect a debt and an action for damages for breach of contract is extensively discussed by Levontin, Debt and Contract in the Common Law, 1 ISR. L. REV. 60 (1966).

92 See provisions cited in note 74 supra.

93 Regarding anticipatory breach and the innocent party’s right to accept it, see W. ANSON, ANSON’S LAW OF CONTRACT 510 (A. Guest 24th ed. 1974).

94 The latter right is given to a seller in case of a merchant buyer under U.C.C. § 2-603.


96 G. GILMORE, supra note 2, at 1098.
there is only scant authority directly supporting this proposition, its accuracy is supported by the "agency for collection" analysis.

A notable exception to this absence of direct authority is the assignee's inability to rescind the assigned contract on the basis of the obligor's misrepresentation which induced the assignor to enter into the assigned contract. Viewed as a personal right stemming from the misrepresentation in favor of the misrepresentee, the bare right to rescind is not assignable. Nor does the right pass to the financing assignee as an incident of the assignment of rights under the contract for sale. As a post-Code case stated, "the seller's right of reclamation based on misrepresentation is personal to the seller and cannot be exercised by anyone else." In refusing to view the assignability of the right to rescind as an incident of the assignment of the contract, the holding of the case is consistent with the "mere agent for collection" status of the assignee.


The rule provided under U.C.C. section 9-318(2), and followed by the provinces of Manitoba and Saskatchewan, states that prior to the completion

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97 Id. at § 41.6.
100 Under U.C.C. § 2-702(2):
Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after receipt, but if misrepresentation of solvency has been made to the particular seller in writing, within three months before delivery the ten-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

Id. There is no corresponding seller's right in the Anglo-Canadian law.

101 As an authority to the misrepresentation basis of the seller's right of reclamation, the court cited Note, Selected Priority Problems in Secured Financing Under the Uniform Commercial Code, 68 YALE L.J. 751, 761 (1959). 458 F.2d at 941 n.4.
102 In re Hardin 458 F.2d 938, 940-41 (7th Cir. 1972). The holding of the case with regard to the non-assignability of the seller's right to reclaim was criticized. Benfield, supra note 87, at 11-23. The critic, however, did not distinguish between the assignability of the right to damages arising from fraud or misrepresentation, and the non-assignability of the right to rescind a contract entered into on the basis of fraud or misrepresentation. Cf. text and notes at notes 79-80 supra (assignability of the former as an incident of the assignment of the debt). In this respect, his criticism is unconvincing. Other arguments made by the critic concerned the direct effect of the misrepresentation on the assignee and the "quasi security" nature of the seller's right of reclamation. These points are outside the present inquiry. Cf. text at note 31 infra.

103 P.P.S.A. s. 40(3). There is no corresponding provision in the Ontario P.P.S.A. But see the recommendation to adopt it in ONTARIO LAW REFORM COMMISSION, 1 REPORT ON SALE OF GOODS 125 (1979) [hereinafter cited as Ontario L.R.C.].
of the assignor's performance and "notwithstanding notification of the assign- ment, any modification of or substitution for the [assigned] contract made [by the assignor and obligor] in good faith and in accordance with reasonable commercial standards is effective against the assignee." The assignee's status as an agent of collection, combined with the tort obligations of the obligor towards the assignee provide the only viable theory for such a rule. The original parties' right to modify or substitute the contract as between themselves can be explained only if their ongoing contractual relationship survives the assignment, which is the case if the assignee is a mere agent for collection. The obligor's right to interfere with the assignor-assignee contract is explained in these circumstances by his privilege to protect his own contract. As a privilege to liability for interference with contractual relations, it must be exercised in good faith.

The rule under U.C.C. section 9-318(2) has never been fully acknowledged at common law. While English common law actually rejected it altogether, American common law fell short of conclusively endorsing it. Both the English rejection and the American hesitation are founded on the erroneous application of "property" analysis to the assignee-obligor relationship.

The authority for the English position holding modification after assignment ineffective against the assignee is found in *Brice v. Bannister*. Following notification, payment was to be made by the obligor directly to the assignee. The shipbuilder fell into difficulties and requested that the obligor pay him directly. Money so advanced to the assignor enabled him to complete the contract. A majority of the Court of Appeal held that an amount equal to sums so paid could be recovered from the obligor by the assignee. The majority acknowledged that the assignor's failure to perform would have excused the obligor from paying these sums to the assignee. While acknowledging that the obligor's direct payment to the assignor had avoided the latter's failure, the majority reasoned that the obligor could not "defeat or prejudice the [assignee's] right." A vigorous dissent was delivered by Brett, L.J., who could not agree that the theory underlying the assignee's rights "should be ex-

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104 The section further provides that "the assignee acquires corresponding rights under the modified or substituted contract." See generally G. Gilmore, supra note 2, at 1121-24.

105 Obviously, the assignor's own power to participate in the modification of the assigned contract could be in breach of his contract with the assignee. Cf. U.C.C. § 9-318(2).

106 See generally J. Fleming, supra note 81, at 684; W. Prosser, supra note 81, at 944-45. (1878) 3 Q.B. 569. "Apart from this decision, there appears to be no Anglo-Canadian authority that deals squarely with the question." Ontario L.R.C., supra note 103, at 124.

107 3 Q.B. 569, 570.

108 Id. at 571.

109 Id. at 570-71.

110 Id. at 571.

111 Id. at 578.

112 Id. at 581.

113 Id. at 577.

114 Id. at 578 (per Cotton, L.J.).
tended so as to prevent the parties to an unfulfilled contract from either cancel-
ing or modifying, or dealing with regard to it in the ordinary course of
business' and in good faith."116 "If they cannot modify it, it seems . . . to
denote a state of slavery in business that ought not to be suffered."117

American case law has not shared the dogmatism of the majority of the
court in Brice v. Bannister.118 Indeed, direct authority supports the power of par-
ties of an assigned executory contract "to rescind or discharge [it] entirely or to
modify [it] by agreement."119 The "right of the original parties to rescind or
modify the contract . . . in good faith" has been recognized.120

Yet, courts are generally content with a more modest proposition,
originally pronounced in Peden Iron & Steel Co. v. McKnight: "When the ex-
istence of the assigned fund is dependent upon performance by the assignor of
an executory contract, the anticipatory debtor may . . . do whatever reasonably
appears to be necessary to enable the assignor to perform the contract."121 The
implication of such a formulation is that the obligor's ability to modify a con-
tract is not defined by general freedom of contract principles but rather by no-
tions of what is necessary to enable the assignor to perform the contract. A
modern trend is to view this issue as a question of "priority" between the
assignee and the assignor as to sums paid to the latter in order to "rescue"
altogether the right to obtain payment from the obligor.122 The reluctance to
accept the theoretical underpinnings of section 9-318(2) can be explained as an
adherence to the notion that an assignment transfers a static property right.123
Instead, regarding the assignee as a "mere agent for collection" could offer a
superior viewpoint which would put the rule under U.C.C. section 9-318(2) in
line with an overall theory explaining the assignee's position towards the
obligor. As an agent for collection, the assignee cannot object to modifications
made by the original parties to the contract, as envisioned by section 9-318(2).

3. The Scope of the "Agency for Collection" Theory

It is tempting to challenge this "agency for collection" analysis by noting
its ancient origin and arguing that it is inconsistent with the modern approach

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116 Id. at 579 (Brett, L.J. dissenting).
117 Id.
118 See generally G. GILMORE, supra note 2, at §§ 41.8-9.
120 See G. GILMORE, supra note 2, at 1106-07. The original contribution of "[t]he
anonymous author of the article on assignment in Corpus Juris" in spelling out this principle is
acknowledged by Gilmore. Id., discussing material presently found at 6A C.J.S. Assignments § 85
(1975) (originally 5 C.J. 959-60).
Bannister, discussed in text at note 107 supra, would have fit this rule.
122 See, e.g., Walker v. Nitzberg, 13 Cal. App. 3d 359, 91 Cal. Rptr. 526 (1970); Hoover
123 An example of this notion is the view that the original parties' power of modification
is a limitation on the rule conferring on the assignee the property and the full control over the
assignee right after assignment and notice. See text and note at note 120 supra.
to the assignment of choses in action as a transfer of pieces of property, ""asset[s] capable of being dealt with like any other asset."" However, such a challenge is based on a misconception as to the present scope of the "agency for collection" thesis, as well as on an erroneous view as to the scope of equity principles developed to govern the assignment of choses in action. Thus, dealing with the assignment of monies due under contracts, equity courts were concerned with contract rights as choses in action, i.e., as pieces of property. They were not interested in the effect of the assignment on the underlying contractual relationship. By happenstance, the main aspect of the latter question, namely, the assignee's subjection to the obligor's defenses, could be explained in the framework of the general property theory developed by courts of equity.

This view caused the illusion that the entire effect of the assignment on the contractual relationship could be explained by these principles of equity. When the less frequently asked questions are approached, however, the theory developed by courts of equity is inadequate. The common law "agency for collection" theory provides answers to these questions in a framework explaining the entire effect of the assignment on the contractual relationship. As such, the common law theory appears superior in this context to the orthodox "property" approach of courts of equity.

Nevertheless, it should be stressed that there is no conflict between the common law "agency for collection" analysis and the equity "property" analysis. It is not suggested here to substitute the former for the latter for all intents and purposes. Each theory provides an explanation for a separate aspect of the assignment of money due under a contract. Thus, it is possible for both to exist simultaneously. On the one hand, equity is interested in identifying the person who, as against the world, is entitled to the money due under a contract. On the other hand, the "agency for collection" thesis is concerned with the effect of the assignment on the contractual nexus. Inasmuch as a contract right is a chose in action, its assignment is a transfer of property, governed by principles of equity which were developed to deal with the effect of such a transfer on the right to the money due. At the same time, inasmuch as the contract right represents an obligatory relationship, the assignment should not affect this relationship. While the assignment is a transfer of property against the world, it merely serves as a notice to the obligor informing him to whom he should pay. In this respect alone the assignee is a "mere agent for collection" towards the obligor.

4. Is Money Paid to an Assignee Recoverable in Restitution?

Just as the agent for collection analysis explains the assignee's right to exercise remedies under the primary contract, as well as his obligation to abide by

125 See text and notes at notes 69-72 supra.
126 Such questions are summarized in text and notes at notes 73-76 supra.
modifications thereto, so too does the analysis provide a theoretical justification for treatment of an obligor's claim for restitution of payments made to the assignee under a mistake of fact. As will be demonstrated, application of less adequate explanations of the nature of the assignor-obligor relationship has caused confusion in this area of law.

The question of restitution of payments made to the assignee arises when the obligor has made payments in ignorance of the defenses which could be asserted against the assigned claim, i.e., has paid money under a mistake of fact. The first hurdle to be overcome is the existence of a subsisting contract; "if the contract is not brought to an end, the payer is restricted to his remedies under the contract which continues to govern the situation." As already explained, no remedy is available against the assignee under the assigned contract. This hurdle is overcome when the contract is terminated. In this situation, could the obligor recover from a bona fide assignee? Until this century, it was thought that only a mistake as to the existence of liability could establish a right to recover money paid under a mistake of fact. The following statement of Bramwell, B., in Aiken v. Short appears to underlie this view:

In order to entitle a person to recover back money paid under a mistake of fact, the mistake must be as to a fact which, if true, would make the person paying liable to pay the money, not where, if true, it would merely make it desirable that he should pay the money.

The mistake, then, must be as to a fact which leads the payer to believe he is liable for the debt.

In Aiken, the plaintiff sought to recover from the defendant a sum of money which he had paid to her in discharge of a debt owed to the defendant by a third party. The third party's debt was secured by an equitable mortgage on an asset which, subject to the mortgage, had been transferred by him to the plaintiff-payer. Payment was made by the plaintiff to discharge the

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127 Payments made to the assignor definitely cannot be recovered from the assignee. But cf. General Motors Acceptance Corp. v. Kyle, 54 Cal. 2d 101, 351 P.2d 768, 4 Cal. Rptr. 504 (1960) (in order to enforce the contract the assignee had to cure the illegality with which it was tainted, by restoring to the buyer "that with which the buyer parted . . . including payments which he made to the seller-assignor prior to the assignment." Id. at 114, 351 P.2d at 776, 4 Cal. Rptr. at 504.

128 There is neither an English nor a Canadian direct authority on this question. For American authorities, see notes 139, 142, 170, and 178 infra.


130 See text at notes 6-37 supra.

131 Cf. R. Goff & J. Jones, supra note 129, at 299 (restitutionary claim for a total failure of consideration under a contract).

132 Payee's knowledge of payor's mistake is a ground for recovery. Ward & Co. v. Wallis [1900] 1 Q.B. 675, 678-79 (per Kennedy, J.).

133 R. Goff & J. Jones, supra note 129 at 69.


135 Id. at 210-11.

136 Id.
mortgage. The payer later discovered that the third party lacked title to the asset and, consequently, could not convey it to the plaintiff. Payment had thus not conferred on the plaintiff the desired benefit. The court held that the plaintiff-payer could not recover the payment from the defendant-payee because the "money which the defendant got from her debtor [through the plaintiff] was actually due to her." Because the plaintiff made the payment under the mistaken impression that it was desirable to do so, not under the mistaken belief that he was liable for the debt, the *Aiken* court refused to grant restitution.

It remained for an 1881 Massachusetts case to apply the doctrine of *Aiken v. Short* to a transaction involving the assignment of money due under a contract. In *Merchants’ Insurance Co. v. Abbott*, an insurer brought an action against the assignee of an approved claim under a policy. The assignment was made by the assured as security for the payment of a debt owed by him to the assignee. Having paid the assignee, the insurer discovered that the assured had deceived him as to his entitlement. Consequently, the insurer-obligor sought to recover the assured’s creditor, namely from the assignee, an amount equal to sums paid to him under the policy. The *Merchants* court, however, held the obligor was not entitled to restitution.

The basis of the *Merchants* court’s decision to deny the obligor restitution of his payments to the assignee does not appear to lie in the *Aiken* decision, however. The cases are quite dissimilar in certain respects. While *Aiken* presented no mistake as to the validity of the underlying debt discharged, the *Merchants* case did involve a mistake as to the ability to avoid liability. In an obligor-assignee situation, the obligor’s defenses under the assigned debt affect his liability thereunder. Referring to the distinction drawn by the *Aiken* court, *Merchants* did not involve a mistake as to a fact which, "if true, would merely make it desirable to pay." Instead, the mistake in *Merchants* was "as to a fact which, if true, would make the person paying liable to pay the money.”

While one could draw a distinction between a mistake as to facts which nullify a

137 *Id.*
138 *Id.* at 215 *(per Platt, B.)*.
140 *Id.* at 397.
141 *Id.* at 397-98.
143 See *Merchants*, 131 Mass. at 403.
145 *Id.*
subsisting liability, as in *Merchants*, and a mistake as to the existence of the debt itself,\textsuperscript{146} the *Aiken* paradigm, the differences between the two situations are more of form than substance. Defenders of the result in *Merchants*, therefore, must look elsewhere than *Aiken* for support.

*Aiken* no longer represents the only source of law to which advocates of the *Merchants* result may look; however, present authorities appear to repudiate the view of *Aiken* that recovery of money paid under a mistake of fact will only be allowed if the mistake is one as to liability. Under the modern view, it is sufficient that the mistake would be “in some respect or another fundamental to the transaction.”\textsuperscript{147} As this is a broad all-inclusive test, the question becomes whether the obligor-assignee situation falls within a recognized exception to the rule.\textsuperscript{148} Accordingly, the *Merchants* decision must be re-examined to determine if there exists a sound theoretical basis for the opinion in the modern law of restitution.

A close reading of *Merchants* reveals that while relying on *Aiken*, the case was not decided according to whether the obligor’s mistake concerned the existence of liability.\textsuperscript{149} Instead, the grounds for the denial of restitution were: (a) that the obligor’s mistake was not “as between” himself and the assignee, but rather “as between” himself and the assignor; (b) that the obligor’s payment to the assignee was made at the assignor’s request and on his behalf so as to be “in legal effect a payment by the [obligor] to [the assignor];” and (c) that payment by the obligor to the assignee at the assignor’s request was “a satisfaction of [the assignor’s] debt to [the assignee].”\textsuperscript{150}

Statements requiring an operative mistake of fact to be “as between” plaintiff and defendant have recently been characterized as “dogmatic denials of the plaintiff’s right to recover in restitution” which cannot be upheld.\textsuperscript{151} “In principle recovery should be allowed because it is the payer’s mistake which alone should be relevant.”\textsuperscript{152} The modern law of restitution, then, seems to repudiate the first ground of the *Merchants* decision.

The second ground for the *Merchants* opinion was the theory that the obligor’s payment to the assignee was in legal effect a payment to the obligor to the assignor. Accordingly, no action of restitution could be pursued against the assignee, which as a matter of law, was not the recipient of the payment. This rationale could have merit in the situation where a creditor instructs his debtor to pay a third party without conferring on that third party any rights of his own

\textsuperscript{146} Recovery under the latter kind of mistake was allowed in Norwich Union Fire Ins. Soc’y Ltd. v. Wm. H. Price, Ltd., [1934] A.C. 455.

\textsuperscript{147} Morgan v. Ashcroft, [1938] 1 K.B. 49, 77 (per Scott L.J.) (emphasis added); R. GOFF & J. JONES, supra note 129, at 69-71.


\textsuperscript{149} *Aiken v. Short* itself is frequently explained on a broader ground, R. GOFF & J. JONES, supra note 129, at 85-88. Cf. text and notes at notes 159-63 infra (the defense of bona fide purchase).

\textsuperscript{150} *Merchants*, 131 Mass. at 401.

\textsuperscript{151} R. GOFF & J. JONES, supra note 129, at 74.

\textsuperscript{152} Id.
to pursue against the debtor. Yet, inasmuch as the right to enforce payment belongs to the assignee, payment in its satisfaction could not be regarded as payment to the assignor. In other words, the second ground fails to meet the objection raised by the assignee’s “property” in the right to obtain payment from the debtor.

The third ground relied upon by the Merchants court to deny restitution to the obligor was that the obligor’s payment was in satisfaction of the assignor’s debt to the assignee. Under this view, the payment is in satisfaction of a valid debt and therefore not recoverable in restitution. One flaw inherent in this rationale is that it excludes situations where there is no outstanding indebtedness between the assignor and his assignee, as is the case in an outright sale of receivables without recourse. Apart from that consideration, the conceptual framework of the rationale is also unsound. Payment by the obligor to the assignee is in satisfaction of the obligor’s own debt. An additional effect of the payment could well be the discharge of the assignor’s debt to the assignee. However, it is erroneous to conclude that the obligor’s payment is made in satisfaction of the assignor’s indebtedness. In fact, here lies the fundamental difference between Aiken and Merchants. Payment in the former was indeed in satisfaction of the third party’s debt to the defendant-payee. The plaintiff-payer’s mistake did not concern the discharged indebtedness and thus could not be “in some respect or another fundamental to the transaction [underlying it].” In Merchants, however, the payer’s payment was in satisfaction of his own debt and his mistake concerned the transaction giving rise to the debt. The mistake, therefore, does appear to be fundamental to the transaction.

Just as the Aiken decision failed to constitute compelling precedent for the holding that the obligor may not collect restitution of payments made to the assignee, so too does the “fundamental to the transaction” test fail to support the three grounds of the Merchants decision. The search for a theoretical justification for the decision thus continues. A few eminent jurists from both sides of the Atlantic regard the obligor’s inability to raise his restitutionary claim against the assignee as an aspect of the defense of bona fide purchase. This view is shared by the editors of the American Restatement of Restitution.

153 Indeed the case of a buyer who instructs a seller to deliver the goods to a subbuyer, Merchants, 131 Mass. at 402, falls within this category.
154 Cf. text at notes 77-126 supra.
156 See text and notes at notes 134-38 supra. Payment could thus be regarded as payment by the third party through an agent.
157 See text and note at note 147 supra.
158 See text and note at note 141 supra.
159 R. Goff & J. Jones, supra note 129, at 85; 13 WILLISTON ON CONTRACTS § 1574 (3rd ed. 1970). See also Ames, supra note 142, at 272, speaking of the “far-reaching principle of natural justice [under which] as between two persons having equal equities, one of whom must suffer, the legal title shall prevail.” According to Ames, this principle explains, inter alia, the assignee’s right to “keep what he has got, although the obligor paid in ignorance of the fact that he had a valid defense to the enforcement of the claim.” Id. at 277-78.
160 See RESTATEMENT OF RESTITUTION § 14(2) (1937). “An assignee of a non-negotiable chose in action who, having paid value therefor, has received payment from the
However, the doctrine of good faith purchase does not apply to an assignee of a chose in action.\textsuperscript{161} This view, therefore, must be taken as a theoretical framework both for ground (c) in \textit{Merchants}\textsuperscript{162} and for \textit{Aiken}.\textsuperscript{163} Alternatively, it is a species of the “as between” limitation on restitutionary recovery.\textsuperscript{164} Either way, with the failure of ground (c) and the “as between” limitation, the bona fide purchase view is not convincing.

It has been stated recently that a restitutionary claim may fail if “payment is made for good consideration, in particular if the money is paid to discharge, and does discharge, a debt owed to the payee … by the payer.”\textsuperscript{165} This broad language appears to apply to a payer who forgoes his defenses and obtains through his payment a discharge for an otherwise valid liability.\textsuperscript{166} Yet, it is submitted that in its true sense, the phrase should be limited to payment made either “with a full knowledge of the facts”\textsuperscript{167} or “without reference to the truth or falsehood of the fact.”\textsuperscript{168} Indeed, a discharge of an obligation which has been extinguished by virtue of valid defenses could hardly be regarded as “good consideration” unless a compromise is involved. By its nature, a compromise contemplates “waiving further investigation and \textit{taking the risk of mistake}.”\textsuperscript{169} Absent this assumption of risk, payment of a liability to which there exists a valid defense cannot be regarded as having been made for valid consideration.

There is great difficulty, then, in posting a theoretical justification for denying the obligor’s restitutionary claim against the assignee. The holding in \textit{Merchants} is not compelled by \textit{Aiken}, nor by the “fundamental to the transaction” test of the modern law of restitution. Similarly, notions of the assignee as a good faith purchaser, and the concept of the obligor’s payments being made for valid consideration, both fail to justify denial of the obligor’s claim.

The theoretical weakness underlying the objection to the obligor’s restitutionary claim against the assignee undoubtedly has contributed to the recent erosion of support for this objection by American courts. The Supreme Court of Ohio signaled this turning point in \textit{Firestone Tire and Rubber Co. v. General Na-}

\textsuperscript{161}See, \textit{e.g.}, Gilmore, \textit{The Commercial Doctrine of Good Faith Purchase}, 63 \textit{Yale L.J.} 1057, 1067–68 (1954) [hereinafter cited as Gilmore, \textit{Commercial Doctrine}]. Notwithstanding \textit{Williston ON CONTRACTS}, supra note 159, the good faith purchase of the money is not to the point.

\textsuperscript{162}See text at note 150 supra.

\textsuperscript{163}See text and notes at notes 151, 156–58 supra.


\textsuperscript{165}See, \textit{e.g.}, W.A. \textit{Seavey} & A.W. \textit{Scott}, supra note 160, at 9.

\textsuperscript{166}See text and notes at notes 151, 156–58 supra.


\textsuperscript{169}R. \textit{Goff} & J. \textit{Jones}, supra note 129, at 30 (emphasis added). See text and notes at notes 95–97 supra.
ional Bank of Cleveland. Firestone involved a buyer’s action against his seller’s assignee to recover sums paid to the assignee under the mistaken belief that the sums were due on accounts assigned by the seller as security for a loan. In fact, the sums were not due as the goods had not been sent by the seller. The court held that sums paid by the buyer and credited against the loan were recoverable. The court failed to give any consideration to the fact that the payee was the seller’s financing assignee. Moreover, under the facts of the case, the court charged the defendant-assignee with “an implied representation that [the seller] had delivered goods in transit to [the buyer].” This representation “induced [the buyer] to make the payment.” Considering the representation aspects of the case, the decision appears to fall short of establishing a broad basis for a restitutionary claim against the assignee in the hands of an obligor.

Unfortunately, these limitations of the Firestone decision were overlooked by Professor Gilmore who concluded on the basis of the case that “where the assignor fails to perform the contract, the assignee cannot retain mistaken or even negligent payments made to it by the obligor unless there has been a subsequent change of position by the assignee.” Backed with Gilmore’s support, this interpretation of Firestone gained a foothold in subsequent case law. Adherence to Gilmore’s interpretation has been strict. Courts following Gilmore’s interpretation even disregard his failure to question whether the seller-assignor’s subsequent insolvency, leaving the assignee without a meaningful recourse against him, constitutes “a subsequent change of position by the assignee” so as to deny recovery within Gilmore’s own contemplation.

No convincing theory supporting the obligor’s restitutionary claim against the assignee appears to emerge from recent case law. It is submitted that such support does not exist, and that the restitutionary claim’s emergence can be attributed to the confusion underlying Merchants. A misunderstanding as to the assignee-obligor relationship is the essence of this confusion. As in the areas of the assignee’s rights under the assigned contract, and his obligation to abide by modifications thereto, the concept of the assignee as an agent for collection provides a helpful mode of analysis.

Under the agent for collection analysis, the assignment of the benefit of a contract neither charges the obligor with disabilities nor confers upon him additional rights. From the obligor’s point of view, the assignee is a “mere agent

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170 159 Ohio St. 423, 112 N.E.2d 636 (1953).
171 Id. at 424-28, 112 N.E.2d at 638-39.
172 Id. at 428, 441, 112 N.E.2d at 640, 645. Query whether this finding is compatible with the court’s view that the lender was a holder in due course with respect to a check given directly to the seller and then negotiated to him.
173 Id. at 441, 112 N.E.2d at 645.
174 See Id. at 439-42, 112 N.E.2d at 644-46.
175 Id. at 440, 112 N.E.2d at 645.
176 Id.
177 2 G. GILMORE, supra note 2, at 1096-97 n.4.
179 See text and notes at note 177 supra.
for collection' to the account of the assignor. The assignee's independent right
is relevant only in his relations with third parties, such as creditors of or pur-
chasers from the seller-assignor, but not against the obligor.180 This is in fact an
explanation of the second ground given by the court in Merchants: a payment to
the assignee is "in legal effect a payment by the [obligor] to [the assignor]."181
Yet, as the court failed to pronounce this ground in a framework of a com-
prehensive theory of agency which explains the assignee-obligor relationship,
the ground sounded unpersuasive.182

On final account, what underlies the denial of the obligor's restitutionary
claim against the assignee, is the analogy between the assignee's position and
that of an agent for collection applying payment towards his principal's in-
debtedness to him. Indeed, the general rule is that an agent who has received
payment on his principal's behalf is subject to the payer's restitutionary claim
for money paid under mistake.183 Nonetheless, an exception exists where the
agent has applied the payment towards his principal's indebtedness to him. 184
Except in an outright sale of receivables without recourse, the assignee, as an
agent for collection, falls directly within this exception. It is submitted that the
position of an assignee in a non-recourse outright sale is sufficiently analogous
to the position of assignees in other situations so as to be governed by the same
rule. While in a non-recourse outright sale there is no assignor's outstanding
indebtedness to the assignee, the assignee does apply the obligor's payment
towards the expenses he had incurred in purchasing the receivables. This
perspective should put him on the same footing as an assignee applying pay-
ment towards the assignor's indebtedness.

The agent for collection analysis, then, provides a rationale for the denial
of the obligor's restitutionary claim against the assignee. While the conceptual
failings of other proferred rationales resulted in the erosion of the rule in Mer-
chants, the agency analysis places the decision on firm footing. In turn, this
serves to implement sound policies. Thus, by denying the obligor’s restitu-
tionary claim against the assignee, the agent for collection analysis leads to a
result which prevents the circumvention of the rule under which the financing
assignee is not liable for the assignor’s breach of the assigned contract.185 As
indicated elsewhere by this author, a rule which provides for the lack of an affir-
mative liability on the part of the financing assignee, is consistent with optimi-
mality considerations.186 Supporting such a rule, the agency for collection
theory serves a useful purpose.

180 C.f. text and notes at notes 78-84 supra.
181 131 Mass. at 401. See text and note at note 150, supra.
182 See text and notes at notes 153-54, supra.
supra note 129, at 557-58.
185 For this rule see text at notes 60-68, supra.
186 Geva, Optimality and Preservation of Consumer Defenses—A Model for Reform, 31 CASE W.
III. THE FINANCING ASSIGNEE AND THE OBLIGOR’S DEFENSES: 
CUT-OFF DEVICES AND THE EFFECT OF CONSUMER PROTECTION LEGISLATION

A. The Effectiveness of Cut-off Devices

It is in a financer’s self-interest to take the receivables of an assignor free from the obligor’s defenses. His best course would be to abandon receivables financing altogether and lend money directly to retail buyers to enable them to buy on cash. As a borrower, the obligor would be absolutely liable to repay the loan whether or not he was satisfied with the goods purchased with the borrowed funds. However, receivables financing gives the assignee the assurance of a regular flow of business from sellers of goods, as well as an easy means of securing a seller’s liability as an indorser of the retail paper. In addition, receivables financing in the United States historically was not subject to state usury laws. It also gave the financer an advantageous position on the debtor’s default, as well as an exemption from filing statutes. The existence of these advantages prompted the financer to develop a means of protecting his self-interest without undermining the use of receivables financing.

To achieve this goal, financers adopted devices such as the promissory note and the waiver of defense, or cut-off clause in the conditional sale contract. The promissory note is “an unconditional promise . . . to pay . . . a sum certain in money . . .”. It is a “negotiable instrument” used to insulate the financer from the obligor’s defenses on the basis of the old law merchant as incorporated into modern statutes. The cut-off clause is an agreement by the buyer, contained in the sale contract, not to assert against an assignee any defenses which he may have against the seller. The effectiveness of such a clause stems from the power of parties, by their own agreement, to make their

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187 Obviously this is not always true any more. Provisions governing the preservation of consumer defenses against some lenders are included in the regulation and the statute respectively cited in notes 286 and 290, infra.
188 Cf. Hogan, Integrating the UCCC and the UCC—Limitations on Creditors’ Agreements and Practices, 33 LAW & CONTEMP. PROBS. 686, 690 (1968). As to the seller’s liability as an indorser, cf. discussion on recourse and without recourse arrangement in text and notes at notes 21-31 supra.
189 See generally Gilmore, Commercial Doctrine, supra note 161.
190 Id.
192 See definitions in s. 176(1) of the Canadian Bills of Exchange Act, CAN. REV. STAT. 1970, C. B-5 (as amended) [hereinafter cited as the Canadian B.E.A.]; § 1 of the American Uniform Negotiable Instruments Law (N.I.L.); and § 3-104 of the American Uniform Commercial Code (U.C.C.) Article 3 of the U.C.C. replaced the N.I.L. in all American jurisdictions.
194 See sources cited in note 192 supra.
To take a promissory note free from the obligor's defenses, the financer must be a bona fide purchaser for value, or in the technical language of statutes, a "holder in due course." Likewise, regardless of their language, waiver of defense clauses are deemed to incorporate a "good faith" requirement. Thus, both devices, the promissory note and the waiver of defense clause, can benefit only an assignee who has acquired his rights in good faith. "Good faith" means honesty and is determined subjectively. In relation to the financing assignee, "good faith" is the absence of both actual knowledge of the obligor's defenses and the means of attaining such knowledge to which the assignee willfully shuts his eyes. Neither mere suspicion of the existence of defenses, nor mere knowledge of the terms of the contract which are capable of giving rise to defenses, defeats the assignee's good faith. Indeed, "notice of a condition to liability on an instrument, as distinguished from notice of an executory consideration, prevents one from [becoming] a holder in due course." However, the "condition" whose knowledge prevents one from enjoying a holder in due course status is one which triggers liability on an instrument. For example, one who knows that an instrument was given as collateral to secure a principal obligation knows in effect that liability on the instrument arises only on the breach of the principal obligation. He thus has notice of a condition—breach of the principal obligation—which triggers liability on the instrument and therefore he may not enjoy a holder in due course status. He may not enforce the instrument against the obligor unless the condition (breach of the

195 *In re The Agra & Masterman's Bank Ltd., ex parte The Asiatic Banking Corp. Ltd.* (1867) L.R. 2 Ch. App. 391, 397, 36 L.J. Ch. 222, 226 (per Cairns, L.J.). It would not matter whether in enforcing a waiver of defense clause an assignee acts as a direct promisee from the obligor (who gave consideration thereto by taking the assignment on the basis of the clause) or as an assignee of the right arising from the clause (originally running to the assignor though in the assignee's favor). In either case, the enforcing assignee is neither a mere third party beneficiary of the promise in the clause, nor a "mere agent for collection" of the assignor's debt (cf. text and notes at notes 38-184, *supra*). But cf. Hamilton v. Railton [1925] 3 D.L.R. 1090 (Sask. CA) (unless he is a direct promisee, an assignee is subject to the obligor's power to rescind the assigned contract, notwithstanding the waiver of defense clause).

196 See ss. 56(1) and 74(b) of the Canadian B.E.A.; §§ 52 and 57 of the N.I.L., and §§ 3-302(1) and 3-305 of the U.C.C.


Statutes treat the element of "without notice" as separate from the element of "good faith"; see sections cited in note 196, *supra*. Yet, substantively, the former is part of the latter.

198 Cooke v. Real Estate Trust Co., 180 Md. 133, 143, 22 A.2d 554, 560 (1941) (emphasis added). See also First & Lumbermen's Nat'l Bank v. Bucholz 220 Minn. 97, 18 N.W.2d 771 (1945). "It is well settled that knowledge of an executory consideration, as distinguished from knowledge of a condition to liability on a negotiable instrument . . . does not prevent one from taking it as a holder in due course." *Id.* at 101, 18 N.W.2d at 774.

principal obligation) has been fulfilled. On the other hand, knowledge of a "condition" which under the terms of an executory contract excuses liability on the instrument given in payment under that contract does not prevent one from becoming a holder in due course. For example, the seller's failure to deliver the goods to the buyer is typically a condition which under the sale agreement excuses the buyer from his duty to pay for the goods. Knowledge of the actual occurrence of such a failure is knowledge of the buyer's defenses. Yet knowledge of this "condition" merely as a term of the contract is not knowledge of a "condition to liability," but rather of an "executory consideration." As such, it should not defeat the assignee's good faith.

The use of the waiver of defense clause in the United States was prompted at the turn of this century by doubts as to the negotiability of a promissory note used with a conditional sale contract. Insofar as these doubts stemmed from interpreting the "unconditional promise" on the note as being qualified by the obligation on the conditional sale contract and, thus, dependent on the seller's satisfactory performance thereunder, they were unconvincing. The "unconditional promise" on a promissory note is a formal requirement which has nothing to do with the actual agreement of the promissor. A separate promissory note, given in conjunction with an obligation on a conditional sale contract, retains its individual identity and, therefore, is negotiable. Nonetheless, insofar as the doubts as to negotiability stemmed from the practice of printing a promissory note and a conditional sale contract on the same sheet of paper, they were quite substantial. While by itself the promise to pay satisfied the formal requirements of a promissory note, typically it was followed by a recital of the other terms of agreement. This fact invited the argument that the promise to pay was not "unconditional" and hence the document containing it was not a "promissory note" capable of being transferred free from the obligor's defenses. The argument succeeded in a few jurisdictions.

At the same time, financiers were reluctant to abandon this "single sheet" or "integrated chattel paper" concept. Its use gave them the assurance that a mistaken or fraudulent seller would not assign the conditional sale contract to

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200 This would be so notwithstanding First & Lumbermen's Nat'l Bank v. Bucholz, 220 Minn. 97, 18 N.W.2d 771 (1945) (see also Annot., 44 A.L.R.2d 8, 130 (1955)) where the court viewed knowledge by the assignee bank of the seller's executory obligation to deliver the goods as "notice of a condition to liability" which prevented it from becoming a holder in due course.

201 The various meanings of "negotiable" and "negotiability" are set forth in Gilmore, Commercial Doctrine, supra note 161, at 1063-67. The definition includes the quality of transferability free from the obligor's defenses.

202 See generally id. at 1094. The controversy persisted for quite a long period; see cases collected in Annot., 44 A.L.R.2d 8 (1955).


204 See Comment, Is the Negotiability of a Promissory Note Impaired by a Retention of Title Clause?, 7 Tul. L. Rev. 607 (1933).

205 See Gilmore, Commercial Doctrine, supra note 161, at 1094.

206 For these terms, see Ziegel, Range v. Corporation de Finance Belvedere, 48 Can. B. Rev. 309, 310 (1970).
anyone but the holder of the promissory note. Perhaps financers also hoped that the use of an integrated document could prompt courts to extend the "im-parting negotiability" doctrine to a conditional sales contract travelling with a negotiable note. Under this doctrine, "universally accepted in the mortgage cases,"

a negotiable note 'imparts' its negotiability to the mortgage which secures it, so that both note and mortgage pass free of equities and defenses; the holder in due course of the note can foreclose his mortgage without being subject to the mortgagor's defenses in the same way that he can collect his money claim by suing on the note.

For unexplained reasons the doctrine had not been applied to the conditional sale contract. Perhaps financers hoped that an integrated document would alter the courts' position. To be on the safe side, by inserting the waiver of defense clause into the integrated document, financers sought to avoid the risk of subjecting themselves to the buyer's defenses if the note were to be held non-negotiable. Use of an effective waiver of defense clause thus enabled financers to protect their interests and devise "a scheme of operations that could be carried out nationally with as few local variations as possible."

Nonetheless, the waiver of defense clause did not receive a uniformly warm reception by courts in the United States. In American National Bank v. Sommerville, the California Supreme Court invalidated the clause on the theory that such an effort to deprive an obligor of his contract defenses attempted to create a negotiable instrument outside the framework of the Negotiable Instruments Law (N.I.L.). While the N.I.L. appeared to disfavor the achievement of negotiability by contract, Professor Gilmore accurately criticized this aspect of the Sommerville decision. Although precluding the obligor from asserting his defenses against the assignee, the contract containing a waiver of defense clause remained otherwise non-negotiable and, thus, did not interfere with the policy of "no negotiability by contract." Indeed, "if without notice of assignment the buyer paid the assignor, he would be

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207 In case of the note ending up with persons different from those party to the conditional sale agreement, it is the holder in due course of the note who prevails over the assignee of the conditional sale contract. Until dishonor of the note the obligation on the sale has been suspended. Kessler, Levi & Ferguson, Some Aspects of Payment by Negotiable Instrument: A Comparative Study, 45 YALE L. J. 1373 (1936). See also U.C.C. § 3-802(1)(b).

208 Gilmore, Commercial Doctrine, supra note 161, at 1094.

209 Id. at 1083. For the scope of the doctrine and for its impact on the holder in due course's position vis-a-vis the mortgagee or the mortgagor's transferees and creditors, see, e.g., Bautista & Kennedy, The Imputed Negotiability of Security Interests Under the Code, 38 IND. L.J. 574 (1963); Britton, Assignment of Mortgages Securing Negotiable Notes, 10 ILL. L. REV. 337 (1916).

210 See Gilmore, Commercial Doctrine, supra note 161 at 1094.

211 Id. at 1095.

212 191 Cal. 364, 216 P. 376 (1923).

213 See N.I.L. § 1: "An instrument to be negotiable must conform to the following requirement ... ." (emphasis added). Arguably this language (with no counterpart either in the Canadian B.E.A. or the U.C.C.) bars the creation of "negotiable instruments" which do not comply with the requirement of the N.I.L.

214 Gilmore, Commercial Doctrine, supra note 161, at 1095.
discharged; if the seller assigned the same contract successively to A and to B, their priorities would be determined by the common law of assignment and not by the law of negotiable instruments.\footnote{Id.}

In Anglo-California Trust Co. v. Hall,\footnote{Id. at 229, 211 P. at 993-94.} the Utah Supreme Court upheld the waiver of defense clause where the buyer’s defense was breach of warranty and no fraud was involved.\footnote{Id. at 211 P. at 994.} The court cited “public policy,” however, as a basis for limiting the clause’s effectiveness to such a situation.\footnote{Id. 211 P. at 994.} This public policy-oriented limitation was not universally accepted. For example, it was argued that the waiver of defense clause “does not exempt the wrongdoer himself from an action by the defrauded [buyer].”\footnote{Beutel, Negotiability by Contract: A Problem in Statutory Interpretation, 28 Ill. L. Rev. 205, 214 (1933).} Rather, it is . . . a device for the protection of an innocent person in the form of a direct promise to him.”\footnote{Id.} Notwithstanding this argument, by 1940 the majority view in the United States adhered to this “breach of warranty in the absence of fraud” rule.\footnote{Gilmore, Commercial Doctrine, supra note 161, at 1096 n.118. The minority view adhered to Sommerville. Id.} Within its framework an assignee could rely successfully on a waiver of defense clause.

The Uniform Commercial Code removed all doctrinal doubts as to the effectiveness of cut-off devices in the United States. Under section 9-206(1), “an agreement by a buyer . . . that he will not assert against an assignee any claim or defense which he may have against the seller . . . is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense.”\footnote{U.C.C. § 9-206(1). The provision adds that this assignee is nonetheless subject to defenses “which may be asserted against a holder in due course of a negotiable instrument.” Id. This fact has never been in doubt (cf. American Plan Corp. v. Woods, 16 Ohio App. 2d 1, 240 N.E.2d 886 (1968)). The “buyer of consumer goods” exception of § 9-206(1) is mentioned in the text and notes at notes 233-34 infra.} The section also provides that “a buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.”\footnote{U.C.C. § 9-206(1).} In addition, Article 3 provides that “[a] separate agreement does not affect the negotiability of an instrument.”\footnote{U.C.C. § 3-119(2).} In the language of the official comment, “[t]he negotiability of an instrument is always to be determined by what appears on the face of the instrument alone.”\footnote{U.C.C. § 3-119 comment 5.}

The practice of printing the promissory note and the conditional sale contract on the same piece of paper spread to Canada. As in the United States,\footnote{See text and note at note 204 supra.} this inevitably gave rise to the issue of the negotiability of the “promissory note.” Draftsmen countered this difficulty in two ways. First, they separated
the "promissory note" from the rest of the conditional sale contract, although retaining them on the same sheet of paper.\textsuperscript{227} Second, they also inserted a waiver of defense clause in the terms of the conditional sale contract itself.\textsuperscript{228} The Supreme Court of Canada upheld the effectiveness of this scheme in \textit{Killoran v. Monticello State Bank}.\textsuperscript{229} Three justices based their decision on the independence of the promissory note in relation to the contract: "the collateral agreement is no part of the instrument . . .[;] it is not to qualify the absolute obligation of the promissor."\textsuperscript{230} Though printed on the same piece of paper as the contract, the promissory note was found to be "severable from this agreement."\textsuperscript{231} The two other justices relied on the waiver of defense clause.\textsuperscript{232} The case thus resulted in an unqualified victory for the cut-off devices. No one device, however, received unanimous approval from the court.

\textbf{B. The Courts' Challenge to the Cut-off Devices}

Nonetheless, the doctrinal victory of the cut-off devices came too late and gave financers too little. When used in connection with the sale of consumer goods, the enforceability of these devices had been questioned in the United States on public policy grounds since the early forties. Concerns over the use of the devices in consumer transactions were based on two considerations: the inferior bargaining position of individual consumers vis-a-vis the commercial community, and the existence of a regular course of business between financers and sellers of consumer goods.\textsuperscript{233} Recognition of these factors led to an increasing awareness that "the buyer—Mr. and Mrs. General Public—should have some protection somewhere along the line."\textsuperscript{234}

The draftsmen of the Uniform Commercial Code purported to stay neutral. Thus, the rule as to the effectiveness of the cut-off devices was explicit-
ly stated to be "[s]ubject to any statute or decision which establishes a different rule for buyers . . . of consumer goods." The official comment clarified this by stating that Article 9 of the Code "takes no position on the controversial question whether a buyer of consumer goods may effectively waive defenses by contractual clause or by execution of a negotiable note." In the absence of a direct statute, however, the language of this "buyer of consumer goods" exception proved to be ambiguous. In particular, questions arose as to whether section 9-206(1) applied to consumer transactions in the absence of "any statute or decision," and whether it warranted the establishment of a different rule by way of a new judicial precedent. In any event, the interpretation of section 9-206(1) did not play a substantial role in the development of rules designed to protect consumers from the cut-off devices.

The strongest challenge to the effectiveness of cut-off devices in consumer transactions concerned the financer's status as a good faith purchaser of the retail paper. Since cut-off devices worked only in favor of a good faith purchaser, this challenge could avoid altogether the doctrinal recognition of cut-off devices by the Code. Thus, under what came to be known as the "close connectedness" doctrine, a financer in consumer goods transactions could be denied a holder in due course status in certain situations, such as:

... when it appears from the totality of the arrangement between dealer and financer that the financer has had a substantial voice in setting standards for the underlying transaction, or has approved the standards established by the dealer, and has agreed to take all or a predetermined or substantial quantity of the negotiable paper which is backed by such standards . . .

In some cases, close business association provided the financer with access to

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235 U.C.C. § 9-206(1). The general rule of § 9-206(1) is set forth in the text and note 222 supra. "Consumer goods" in Article 9 of the Code are goods "used or sought for use primarily for personal, family or household purposes." See U.C.C. § 9-109(1).

236 U.C.C. § 9-206(1) comment 2.


238 See text and note at note 222 supra.

knowledge of the seller’s business practices. In denying holder in due course status to the financer who willfully had shut his eyes to such knowledge, courts applied well-established standards of good faith. In other instances, notwithstanding the injection of some objective elements to the “good faith” standard under the Code, the close connectedness doctrine frequently was seen as modifying the test of “good faith.” This author has argued elsewhere that the doctrine is not concerned with the “good faith” of the financer, but rather with his status as a “good faith purchaser” and that as such it “is an application of the spirit of the old distinction between a remote and immediate party . . .” In cases involving close connectedness, “rather than being a purchaser of the instrument after its execution, [the financer is] to all intents and purposes a party to the agreement and the instrument from the beginning.”

The doctrine applies whenever “the seller contemplated that credit would in fact be advanced by, and the note in fact held by the particular financing institution involved.” Thus, having been involved in the arrangement from its inception, the financer is not a “remote party” who could be a holder in due course.

The Ontario Court of Appeal in Federal Discount Corp. Ltd. v. St. Pierre introduced the “close connectedness” doctrine to Canada. It has since become known as the “Federal Discount Doctrine.” Relying on American cases, the court in Federal Discount noted both the financer’s exercise of “a measure of control over the seller’s sales by the requirements laid down with regard to the negotiable paper” and the intimate relationship between seller and financer.

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241 See text and note at note 197 supra.
245 Commercial Credit Co. v. Childs, 199 Ark. 1073, 1077, 137 S.W.2d 260, 262 (1940) (emphasis added). The phrase “participant in the arrangement” should have substituted the expression “party to the agreement” in the citation. For a critical view of the closely connected financer’s pretention to qualify as a remote party holder in due course, see McEwen, Economic Issues in State Regulation of Consumer Credit, 8 B.C. Ind. & Com. L. Rev. 387, 401 (1967); Comment, Translating Sympathy for Deceived Consumers into Effective Programs for Protection, 114 U. Pa. L. Rev. 395, 414 (1966).
249 32 D.L.R.2d 86, 100.
250 Id. at 98, 99.
Consequently, the court refused to see the financer as a holder in due course.\textsuperscript{251} "To pretend that [the financer and seller] were so separate that the transfer of each note constituted an \textit{independent commercial} transaction not affected by the pre-existing arrangements between them would . . . be to permit the form to prevail over the substance."\textsuperscript{252}

American cases applying the close connectedness doctrine all involved a consumer who had been "reamed, steamed and dry cleaned" by his seller.\textsuperscript{253} \textit{Unico v. Owen}, a leading case, however, "reserve[d] specifically the question whether, when the buyer's claim is breach of warranty as distinguished from failure of consideration, the seller's default as to the former may be raised as a defense against the financer."\textsuperscript{254} This appears to be in line with pre-Code case law which held that in the absence of fraud, an assignee claiming the benefit of a waiver of defense clause was not subject to defenses arising from breach of warranty by the seller.\textsuperscript{255} Yet, this revival of the "breach of warranty in the absence of fraud" rule is erroneous. While the rule could be revived for consumer transactions under U.C.C. section 9-206(1)'s\textsuperscript{256} provision permitting "a different rule for buyers . . . of consumer goods," its revival in the general context of denying a financer "good faith purchaser" status is unwarranted. The U.C.C. is quite explicit in providing that one not a holder in due course, as well as an assignee who cannot enforce a waiver of defense clause, is subject to all the contractual defenses of the obligor.\textsuperscript{257} Obviously, breach of warranty falls into this category. As such it is a defense available to the obligor against every assignee who is neither a holder in due course nor one who can enforce a waiver of defense clause, whether or not the breach of warranty is based on fraud.

The question of financers' exposure to the breach of warranty defense is quite complex in Canada. Under Anglo-Canadian law the traditional view is that the failure of consideration in a sum uncertain, i.e., the breach of warranty, is not available as a defense against a remote party holder not in due course of a promissory note.\textsuperscript{258} At the same time, under Canadian law, an assignee of a conditional sale contract who cannot enforce a waiver of defense clause is subject to all contractual defenses including the breach of warranty.\textsuperscript{259} The

\begin{itemize}
\item \textsuperscript{251} \textit{Id.} at 100.
\item \textsuperscript{252} \textit{Id.} at 99-100 (emphasis added).
\item \textsuperscript{253} J. \textsc{White} \& \textsc{R. Summers}, \textit{supra} note 239, at 483.
\item \textsuperscript{254} \textit{Unico v. Owen}, 50 N. J. 101, 123, 232 A.2d 405, 417 (1967).
\item \textsuperscript{255} See text and note at note 221 \textit{supra}.
\item \textsuperscript{256} See text and notes at notes 235-37 \textit{supra}.
\item \textsuperscript{257} U.C.C. §§ 3-306(b), 3-408 and 9-318(1). None of these provisions have changed pre-Code law.
\item \textsuperscript{259} The position of an assignee (who is not the beneficiary of a waiver of defense clause) with respect to obligor's defenses is discussed in the text and notes at notes 46-47, 53 \textit{supra}.
\end{itemize}
availability of the defense of breach of warranty against an assignee may therefore depend on whether the latter does not sue on the obligor’s promissory note.

A few courts in the United States have revived the doctrine of “no negotiability by contract” to supplement the doctrine of close-connectedness in consumer transactions. This doctrine was particularly helpful to consumers in situations falling outside the close-connectedness doctrine. Equally helpful to such consumers was the Supreme Court of Canada’s decision in *Range v. Belvedere Finance Corp.*, where the court found a promissory note separated by a perforated line from a conditional sale contract not to be a negotiable instrument. The Court distinguished its earlier decision in *Killoran v. Monticello State Bank*, upholding the use of a similar instrument, on the ground that the sale contract in *Belvedere Finance* did not contain a waiver of defense clause.

This line of cases, both in the United States and in Canada, is entirely unsatisfactory. American courts have failed to respond to the criticism of the “no negotiability by contract” theory. The realization that there is nothing in Article 3 of the U.C.C. which inhibits the development of negotiable instruments outside of the Code’s framework seems to have escaped American courts. Similarly, the decision of the Supreme Court of Canada in *Belvedere Finance* failed to realize that the majority in *Killoran* had based its decision upholding the use of a cut-off device on the independence of the promissory note in relation to the contract irrespective of the presence of a waiver of defense clause. The most serious shortcoming of these American and Canadian attacks on the effectiveness of the cut-off devices, however, is the ease with which they can be circumvented by proper draftsmanship. Thus, the use of a separate promissory note could protect financiers in the United States, while the inclusion of the waiver of defense clause in the accompanying conditional sale contract could protect financiers in Canada. Rather than challenge the underlying premise of cut-off devices, this line of cases in the United States and Canada presented a victory for the scheme upheld in *Killoran*: a separate promissory note and a waiver of defense clause in the conditional sale contract.

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262 See text and notes at notes 229-32 *supra*.

263 See text and note at note 213-15 *supra*.

264 In setting the elements of negotiability, unlike the N.I.L. s. 1 (see note 213 *supra*), U.C.C. § 3-104(1) provides: “Any writing to be a negotiable instrument within this Article must . . .” (emphasis added). This language does not preclude the possibility of “negotiable instruments” outside Article 3.

265 *Range* is persuasively criticized by Ziegel, *supra* note 206.

266 See text and notes at notes 229-32 *supra*. 
could insulate the financer from consumer defenses so long as he could qualify as a good faith purchaser of the retail paper.

One judicial doctrine did develop which attacked the very principle on which the cut-off devices are based. The power of the judiciary to refuse to enforce contractual terms which are contrary to public policy or unconscionable\textsuperscript{267} suggested a framework for the evolution of a comprehensive theory of consumer protection against cut-off devices.\textsuperscript{268} As one American court stated in another context, "[u]nconscionability 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."\textsuperscript{269} According to Professor Kripke, a contract containing a cut-off device "is a contract adhesion—a form contract proposed by the seller on a take-it-or-leave-it basis . . . [which has] appropriately been called private legislation."\textsuperscript{270} Also, in executing either a promissory note or a conditional sale contract containing a waiver of defense clause, the typical consumer "is unaware of the consequence of signing."\textsuperscript{271} Unconscionability, or public policy, thus appeared to provide a basis for invalidating the use of cut-off devices.\textsuperscript{272}

A few courts did apply the doctrine and ruled against the effectiveness of cut-off devices in consumer transactions irrespective of the existence or the absence of a financer-seller close business relationship.\textsuperscript{273} Strong policy counterarguments were made in support of the cut-off devices, however, and therefore, against the application of unconscionability. In particular, the devices were defended on the grounds that a financer "is only a source of credit," and that the elimination of the cut-off devices would raise the price of credit and thus, deny it to poor consumers.\textsuperscript{274} In this framework, disclosure of

\textsuperscript{267} See U.C.C. § 2-302. For a summary of unconscionability from a Canadian perspective, see ONTARIO LAW REFORM COMMISSION, 1 REPORT ON SALE OF GOODS 153 (1979).
\textsuperscript{268} Such a rule could indeed easily be "a different rule for buyers . . . of consumer goods" under U.C.C. § 9-208(1).
\textsuperscript{271} Kripke, Consumer Credit, supra note 270, at 472.
\textsuperscript{274} For a summary of the pro and con policy arguments, see Felsenfeld, Some Ruminations About Remedies in Consumer-Credit Transactions, 8 B.C. IND. & COM. L. REV. 535, 550-51 (1967).
the effect of cut-off devices was suggested as the proper remedy to consumers' ignorance.\textsuperscript{275}

Overall, abstract doctrines and principles of law, side by side with simplistic policy arguments, failed to resolve the issue of financers' exposure to consumer defenses. Cases considering the application of unconscionability as well as the close connectedness doctrine became increasingly inconsistent.\textsuperscript{276}

There was a growing awareness that the issue of preservation of consumer defenses is a question of risk allocation\textsuperscript{277} which should be resolved by legislation. Thus, the way was paved for legislative intervention, in both the United States and Canada.

C. The Effect of Consumer Protection Legislation

While differing in details, state statutes in the United States uniformly invalidate or restrict the effect of cut-off devices. They are also virtually uniform in limiting the financer's exposure to consumer defenses to the amount outstanding at the time he receives notification of the defenses.\textsuperscript{278} Even an Illinois state statute addressing an assignee's exposure to "any defense or right of action,"\textsuperscript{279} was not read by the court as providing for an assignee's affirmative liability. The court observed that:

\textsuperscript{275}This was the original position of the American F.T.C. In re All-State Indus. of N.C., Inc., TRADE REG. REP. (CCH) ¶ 18,740, reproduced in H. KRIPE, CONSUMER CREDIT: TEXT-CASES-MATERIALS 248 (1970). Later the F.T.C. ruled against the effectiveness of the cut-off devices. See text and notes at notes 286-87 infra.


\textsuperscript{277}For a detailed policy analysis, see Geva, Optimality and Preservation of Consumer Defenses—A Model for Reform, 31 CASE W. RES. L. REV. 51 (1980).


\textsuperscript{279}Illinois Consumer Fraud Act, (ILL. REV. STAT. ch. 121\(\frac{1}{2}\) §262D (1971).
The statute is designed only to operate in the context of an assignment . . . As such, it is really the debt assigned which is subject to the buyer's defenses and rights of action, although it is against the assignee who holds the instrument acknowledging the debt that the buyer must assert his claims. In no case, therefore, should the assignee's liability exceed the amount owed to him.280

Thus, the assignee could not be liable in excess of the outstanding debt.

State statutes did not purport to affect common law principles governing the assignee-obligor relationship.281 They were designed merely to invalidate the cut-off devices. Emphasizing the assignee's lack of affirmative liability, some statutes added that "[t]he rights of the buyer . . . can only be asserted as a matter of defense to a claim by the assignee."282 This approach, however, turned out to be unfortunate in connection with a consumer's action to rescind the contract. While not charging the assignee with affirmative liability, such an action is brought by the obligor against the assignee as defendant. The action cannot be said to be asserted "as a matter of defense" to the assignee's claim. In this context one court observed that "[i]t would be ironic indeed if a provision in an act intended to benefit consumers could be invoked to their detriment to such an extent that they would stand in a less advantageous position than others in the commercial arena."283 Nonetheless, the court went no further than to repudiate the effect of the provision against an assignee with notice of the defenses, as well as against an assignee closely associated with the seller.284 In this framework, an assignee who is a "bona fide purchaser" appears to hold the retail paper free from the buyer's action of rescission. However, the question can be raised whether the assignee is not in any event bound by the buyer's effective rescission as against the seller. One state statute explicitly permits the consumer to assert his defenses against the assignee as a "sword" to rescind the contract.285

State provisions in the United States recently have been preempted by a regulation issued by the Federal Trade Commission.286 The regulation nullifies the effect of the holder in due course doctrine as well as the waiver of defense

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281 For these principles see text and notes at notes 38-184 supra.
284 Id. at 824, 484 P.2d at 980.
clause in the consumer context. It does so by requiring a seller to include in a "consumer credit contract" a provision stating that "any holder of this consumer credit contract is subject to all claims and defenses" of the buyer, and that "[r]ecovery hereunder . . . shall not exceed amounts paid by the debtor hereunder." This F.T.C. rule thus goes beyond state statutes, as well as the common law, in providing for the consumer’s right to recover past payments from the assignee.

In Canada, legislation invalidating cut-off devices developed along the lines set up by the overall distribution of legislative power. Section 91(1)(18) of the British North American Act of 1867 assigned to the Parliament of Canada the exclusive legislative power in relation to bills of exchange and promissory notes. Under section 92(13) of this act, "matters coming within . . . property and civil rights in the province" were assigned to the exclusive power of each provincial legislature. Accordingly, the Federal Parliament invalidated the effect of the holder in due course doctrine in connection with bills and notes, and provincial legislatures invalidated the effect of the waiver of defense clause.

Federal and provincial legislation in Canada provide different rules with regard to the financer’s exposure to consumer defenses. Under federal law, a holder of a consumer bill or note is subject only to the consumer’s right to withhold payment. Most provinces, however, provide that the seller’s

287 16 C.F.R. § 433.2(a). "Consumer credit contract" is broadly defined in C.F.R. § 433.1(1) to include "[a]ny instrument which evidences or embodies a debt arising from . . . a 'financed sale'." This definition includes the contract for sale as well as a promissory note given thereunder.

288 See text and notes at notes 278-81, supra. The rule is, however, roughly consistent with the recommendation of the National Commission on Consumer Finance, 17 Consumer Credit in the United States, 35, 36 (1972) (financer’s exposure to consumer defenses up to original amount financed).

289 The distribution of legislative powers is governed in Canada by the Constitution Act, 1867 (formerly named the British North America Act, 1867, 30 & 31 Vict., ch. 3 (as amended)).


293 Section 191 of the Bills of Exchange Act speaks of the assignee’s subjection "to any defence . . . that the purchaser would have had in an action by the seller . . . ."
assignee is either responsible,\textsuperscript{294} liable,\textsuperscript{295} or exposed to recovery\textsuperscript{296} up to the balance due at the time of the assignment.

Receivables financers in the United States and assignees of sale agreements (but not holders of negotiable instruments issued in payment thereunder) in most Canadian provinces are thus exposed to some affirmative liability. In the United States, this exposure is limited to the entire value of the "consumer credit contract."\textsuperscript{297} In the Canadian provinces, the limitation is set by the balance owing under the contract at the time of the assignment. For example, under s.31(2) of the Ontario Consumer Protection Act,\textsuperscript{298} the obligor "shall not recover from, or be entitled to, set off against an assignee . . . an amount greater than the balance owing on the contract at the time of the assignment." The assignee’s exposure consists of three elements. First, it reflects the consumer’s right to withhold payment or "to set off."\textsuperscript{299} Second, it represents amounts paid to the assignee after the buyer receives notification of the assignment. Third, it could include amounts paid to the seller after assignment but before notification.\textsuperscript{300} No greater sum is recoverable from the assignee.\textsuperscript{301} In the United States, exposure to amounts paid under the "consumer credit contract" includes a fourth element: amounts paid to the seller prior to the assignment.

Subjecting the assignee to more than the consumer’s right to withhold payment represents a departure from the common law position with respect to the assignee-obligor relationship.\textsuperscript{302} Yet, inasmuch as a financing assignee is not a "bona fide purchaser" of receivables generated in a consumer transaction,\textsuperscript{303} his exposure to a limited affirmative liability is consistent with the view that the assignee’s good faith is the basis for the lack of duty on his part to

\textsuperscript{294} QUE. REV. STAT. 1978 c.9 (as amended), s. 103.
\textsuperscript{295} NFLD. REV. STAT. 1970 c.256 (as amended, s. 22A; N.S REV. STAT. 1967, c53/C-38 (as amended), s. 20B; P.E.I. REV. STAT. 1974, c.C-17 (as amended), s. 23.
\textsuperscript{296} ONT. REV. STAT. 1980 C.87, s. 31; SASK. REV. STAT. 1978 c.C-41 (as amended), s. 17.
\textsuperscript{297} See text and note at note 287 supra.
\textsuperscript{298} ONT. REV. STAT. 1980 C.87, s. 31.
\textsuperscript{299} "Set off" is used here in the sense of the American "recoupment." See text and notes at notes 65-66 supra. In English law such "set off" is more properly called "equitable set off." Morgan and Son Ltd. v. S. Martin Johnson & Co. Ltd., [1949] 1 K.B. 107 (C.A.). It is to be distinguished from the statutory right of set off which relates to a right to a debt in a liquidated sum of money arising outside the assigned contract.
\textsuperscript{300} After assignment, but before notification, the account debtor is to pay the assignor. U.C.C. § 9-318(3), Ont. P.P.S.A. s. 40(2). The assignee’s exposure to amounts so paid to the seller was explicitly omitted in Ontario in relation to the assignee’s liability for the seller’s misleading, deceptive, or unconscionable consumer representation. See s. 4(4) of the Business Practices Act ONT. REV. STAT. 1980 c.55: "the liability of an assignee . . . is limited to the amount paid to the assignee under the agreement."
\textsuperscript{301} Ont. CPA s. 31 should not be construed as entitling the consumer to recover more than he has actually paid since the assignment. What is limited in s. 31 "to the balance owing . . ." is the right to "recover . . . or . . . set off" (emphasis added), not the right to recover in addition to the right of set off.
\textsuperscript{302} See text and notes at notes 63-68 supra.
\textsuperscript{303} See text and notes at notes 238-46 supra.
The implication of this view is that in the absence of "good faith," the assignee could be subject to return payments made to him by the obligor under a mistake of fact as to the seller's performance.

Subjecting an assignee "to the same obligations, liabilities and duties as the assignor," presently the rule in five Canadian provinces, goes further than invalidating the waiver of defense clause or extending the amount of the financier's exposure to liability. Section 103 of the new Quebec Consumer Protection Act goes so far as to provide that the seller's assignee "is jointly and severally responsible with the merchant for the performance of the merchant's obligations. . . ." Such language undermines altogether the common law scheme which governs the assignee-obligor's relationship. The assignee becomes involved in the seller-buyer's contractual relationship. Thus, he could be entitled to certain notices as well as be authorized to act thereunder. Arguably, he could terminate or rescind the contract, and would not be subject to the modification of the contract by the original parties thereto.

In some situations the effect of such a rule would be proper. For example, the right to rescind the contract for buyer's misrepresentation as to his solvency should belong not to the seller but rather to the assignee who had been contemplated as the credit extender and was thus, in fact, the misrepresentee. Nonetheless, the overall rationale of the new order and its indiscriminate application to the entire scope of the financing assignee-obligor's relationship is far from clear. Provincial legislatures in Canada subverted the common law scheme and undermined altogether the "agency for collection" theory without resolving specific issues which are bound to arise, and without engaging in a policy discussion designed to illuminate the emerging new order and its reach. This state of affairs does not reflect a wise use of legislative powers.

**CONCLUSION**

Under the common law as well as under modern commercial legislation in the United States and Canada, the seller's assignee takes the contract for sale subject to the buyer's defenses. Nonetheless, vis-a-vis the buyer, the financing assignee is a "mere agent for collection." He does not step into the seller-

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304 See text and notes at notes 132, 159-60 supra.
306 A provision which merely invalidates the effect of the waiver of defense clause in consumer transactions is s. 16 of the Ontario P.P.S.A. (ONT. REV. STAT. 1980 c.375) as well as of the Manitoba P.P.S.A (MAN. REV. STAT. 1973 c.5/P 35 (as amended)).
307 QUE. STAT. 1978 c.9 (as amended), s. 103.
308 Id.
309 See text and notes at notes 38-184 supra.
310 Cf. text and notes at notes 92-123 supra.
311 Cf. text and notes at notes 98-102 supra; Benfield, supra note 87, at 21.
buyer's contractual relationship. The assignee is in "the exact position" of the seller only with respect to the buyer's right to withhold payments.

To avoid subjection to the buyer's defenses, financing assignees adopted the use of the promissory note and the waiver of defense clause in the conditional sale contract. In connection with consumer transactions, such devices were disfavored by American and Canadian courts. However, abstract doctrines and principles of law failed to effectively preserve consumer defenses. Effective protection could be accomplished only by legislation. Federal regulation in the United States and provincial legislation in Canada now go beyond the preservation of consumer defenses and provide for a limited assignee's affirmative liability. Canadian provincial legislation subjects the assignee to the seller's "obligations, liabilities and duties," and in one instance even makes assignees responsible "for the performance of the merchant's obligations." Such language contemplates the assignee's involvement in the performance of the assigned contract and undermines altogether the common law scheme governing the assignee-obligor's relationship.

312 Cf. text and note at note 2 supra.
313 See text and notes at notes 304-06 supra.
Appendix

1. Commercial law legislation governing the financing assignee’s rights
   (a) U.C.C. (1972 Official Text) § 9-318
      (1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as provided in Section 9-206 the rights of an assignee are subject to
         (a) all the terms of the contract between the account debtor and assignor and any defense or claim arising therefrom; and
         (b) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.
      (2) So far as the right to payment or a part thereof under an assigned contract has not been fully earned by performance, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.
      (3) The account debtor is authorized to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor.
      (4) A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or to become due or requires the account debtor’s consent to such assignment or security interest.
   (b) Ontario Personal Property Security Act, s. 40
      (1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as provided by section 16, the rights of an assignee are subject to,
         (a) all the terms of the contract between the account debtor and the assignor and any defense or claim arising therefrom; and
         (b) any other defense or claim of the account debtor against the assignor that accrued before the account debtor received notice of the assignment.
      (2) The account debtor may pay the assignor until the account debtor receives notice, reasonably identifiable with the relevant rights, that the account has been assigned, and, if requested by the account debt-
or, the assignee shall furnish proof within a reasonable time that the assignment has been made, and, if he does not do so, the account debtor may pay the assignor.

2. Provisions governing rights of a holder in due course
   (a) U.C.C. §§ 3-302(1), 3-305

§ 3-302 (1) A holder in due course is a holder who takes the instrument
   (a) for value; and
   (b) in good faith; and
   (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

§ 3-305 To the extent that a holder is a holder in due course he takes the instrument free from
(1) all claims to it on the part of any person; and
(2) all defenses of any party to the instrument with whom the holder has not dealt except
   (a) infancy, to the extent that it is a defense to a simple contract; and
   (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
   (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
   (d) discharge in insolvency proceedings; and
   (e) any other discharge of which the holder has notice when he takes the instrument.

(b) The Bills of Exchange Act (Canada) ss. 56, 74(a), (b)

56. (1) A holder in due course is a holder who has taken a bill, complete and regular on the fact 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 dishonored, 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.

   (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.

74. The rights and powers of the holder of a bill are as follows:
   (a) he may sue on the bill in his own name;
   (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 defenses available to prior parties among themselves,
and may enforce payment against all parties liable on the bill;

3. Commercial law legislation governing the effect of a waiver of defense clause
   (a) U.C.C. § 9-206(1)
       Subject to any statute or decision which establishes a different
       rule for buyers or lessees of consumer goods, an agreement by a buyer
       or lessee that he will not assert against an assignee any claim or
       defense which he may have against the seller or lessor is enforceable by
       an assignee who takes his assignment for value, in good faith and
       without notice of a claim or defense, except as to defenses of a type
       which may be asserted against a holder in due course of a negotiable
       instrument under the Article on Commercial Paper (Article 3). A
       buyer who as part of one transaction signs both a negotiable instru-
       ment and a security agreement makes such an agreement.
   (b) Ontario Personal Property Security Act, s. 16
       Except as to consumer goods, an agreement by a debtor not to
       assert against an assignee any claim or defence that he has against his
       seller or lessor is enforceable by the assignee who takes the assignment
       for value, in good faith and without notice, except as to such defences
       as may be asserted against the holder in due course of a negotiable in-
       strument under the Bills of Exchange Act (Canada).

4. The financing assignee under consumer protection laws
   (a) FTC Rule: Preservation of Consumer Claims and Defenses, § 433.2
       (United States)
       In connection with any sale or lease of goods or services to con-
       sumers, in or affecting commerce as "commerce" is defined in the
       Federal Trade Commission Act, it is an unfair or deceptive act or
       practice within the meaning of Section 5 of that Act for a seller, direct-
       ly or indirectly, to:
         (a) Take or receive a consumer credit contract which fails to
             contain the following provision in at least ten point, bold face, type:

             NOTICE
             ANY HOLDER OF THIS CONSUMER CREDIT CON-
             TRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES
             WHICH THE DEBTOR COULD ASSERT AGAINST THE
             SELLER OF GOODS OR SERVICES OBTAINED PUR-
             SUANT HERETO OR WITH THE PROCEEDS HEREOF.
             RECOVERY HEREUNDER BY THE DEBTOR SHALL
             NOT EXCEED AMOUNTS PAID BY THE DEBTOR
             HEREUNDER.

   (b) Part V of the Bills of Exchange Act (Canada), ss. 190,191
       190. (1) Every consumer bill or consumer note shall be pro-
minently and legibly marked on its face with the words “Consumer Purchase” before or at the time when the instrument is signed by the purchaser or by any one signing to accommodate the purchaser.

(2) A consumer bill or consumer note that is not marked as required by this section is void, except in the hands of a holder in due course without notice that the bill or note is a consumer bill or consumer note or except as against a drawee without such notice.

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 counterclaim, that the purchaser would have had in an action by the seller on the consumer bill or consumer note.

(c) *Section 31 of the Ontario Consumer Protection Act*

(1) The assignee of any rights of a lender has no greater rights than and is subject to the same obligations, liabilities and duties as the assignor, and the provisions of this Act apply equally to such assignee.

(2) Notwithstanding subsection 1, a borrower shall not recover from, or be entitled to set-off against, an assignee of the lender an amount greater than the balance owing on the contract at the time of the assignment, and, if there have been two or more assignments, the borrower shall not recover from an assignee who no longer holds the benefit of the contract an amount that exceeds the payments made by the borrower to that assignee.

Relevant Definitions (Section 1)

(b) “borrower” means a person who receives credit;

(f) “credit” means credit for which the borrower incurs a cost of borrowing and,

(i) given under an agreement between a seller and a buyer to purchase goods or services by which all or part of the purchase price is payable after the agreement is entered into, or

(ii) given by the advancement of money

(1) “lender” means a person who extends credit;

(d) *Section 103 of the Quebec Consumer Protection Act*

103. The assignee of a debt owed to a merchant under a contract to which the latter is a party cannot have more rights than the merchant and is jointly and severally responsible with the merchant for the performance of the merchant’s obligations up to the amount of such debt at the time it is assigned to him or, if he assigns it in turn, up to the amount of the payment he has received.