South Carolina Law Review

Volume 17 | Issue 2 Article 3

1964

Obligor's Right of Set-Off against Assigned Causes of Action

J. Kendall Few

NOTES

OBLIGOR'S RIGHT OF SET-OFF AGAINST ASSIGNED CAUSES OF ACTION

In the early Common Law, choses in action, with certain exceptions,[1] were not assignable.[2] The reason generally given for this rule was that if assignments were permitted it would promote maintenance:[3] that "causes of action might be assigned to great and influential men, and justice might therefor fail."[4] It was feared that the chose might be assigned to one with whom the obligor was unable to contend, and subsequently the "right might be trodden down and the weak oppressed."[5] It is said elsewhere, however, that the true reason for the non-assignability of choses in action in the early English law lay in the relationship between the obligor and his original creditor: it was regarded as such a vital part of the obligation that it could no more be changed than any other term.[6]

But whatever reason is ascribed for the rule, it is quite evident that the device by which a chose in action was assigned to a stranger to the original contract was first received with something less than great enthusiasm. According to Lord Coke, the "great wisdom and policy of the sages and founders of our law" had provided for the non-assignability of choses in action, for otherwise it would have occasioned a multiplicity of "contentions and suits, of great oppression to the people, and the subversion of the due administration of justice."[7]

At an early day, however, equity began to recognize assignments of choses in action, provided they were fairly made, were supported by sufficient consideration, and did not contravene any recognized rule of public policy.[8] If a chose was not assignable at law, the court of equity would entertain a bill in the name

1. 3 WILLISTON, CONTRACTS § 406 (3d ed. 1960).

2. 3 WILLISTON CONTRACTS § 405 (3d ed. 1960).

3. See Parker v. Kennedy, 1 Bay 398, 405 (S.C. 1795) ("a case of great expectation and consequence to the community"); Noland v. Law, 170 S.C. 345, 353, 170 S.E. 439, 442 (1933).

4. 3 PAGE, CONTRACTS § 1256 (1934).

5. COKE, LITTLETON § 214(a).

6. 3 WILLISTON, CONTRACTS § 405 (3d ed. 1960).

7. Lampet's Case, 10 Co. 46, 48 (1612), quoted in Burkett v. Moses, 11 Rich. 432, 438 (S.C. 1858).

8. Hopkins v. Hopkins, 4 Strob. Eq. 207 (S.C. 1850). See Noland v. Law, 170 S.C. 345, 353, 170 S.E. 439, 443 (1933); Childs v. Alexander, 22 S.C. 169, 181-82 (1884).

of the assignee for the use of the assignor provided that no inequitable result ensued.[9]

Another rather ingenious device that was used to circumvent the strict non-assignability rule was the power of attorney.[10] Though the assignee acquired no ownership of the claim, he might be given a power enabling him to sue in the name of the assignor, and it could further be agreed that what the assignee collected as attorney, he might keep for himself. This right was further assured by a covenant on the part of the assignor not to revoke the assignment.

However, the use of powers of attorney had its drawbacks.[11] And with the advent of the Revolutionary War and the necessities of the citizens which sprang out of it, a great number of notes and securities were thrown into circulation.

> In this situation of things, many honest men were desirous of paying off their debts, but could raise no money for that purpose, although they had good bonds in their possession, bearing interest.[12]

Necessity, therefore, gave rise to the circulation of notes and bonds in payment of debts, "and it is certain that they relieved the distresses of the citizens exceedingly. . . ."[13]

Previously, the Statute of Anne had been passed by the South Carolina Provincial Assembly in 1704 permitting the assignment of promissory notes.[14] In 1798, the Legislature took notice of the plight of the assignees of non-negotiable notes and bills, observing that they experienced "many inconveniences" by being compelled to bring suits in the name of their assignor.[15] Being solicitous of the welfare of holders of non-negotiable paper, and disregarding the counsel of Lord Coke and other "sages and founders of our law," the General Assembly passed a statute empowering an assignee of a note or bill to bring suit in his own name.[16] And in 1816 the Assembly felt that it was "expedient

9. *Ibid.*

10. See Marvin v. M'Rae, Rice 171 (S.C. 1839); Brown v. Thompson, 2 McCord 476 (S.C. 1823); Wm. Brown & Co. v. Rees, 3 Brev. 191 (S.C. 1815); Newman v. Crocker, 1 Bay 246 (S.C. 1792); 3 WILLISTON, CONTRACTS § 408 (3d ed. 1960).

11. See 3 WILLISTON, CONTRACTS § 409 (3d ed. 1960).

12. Parker v. Kennedy, 1 Bay 398, 429 (S.C. 1795).

13. *Ibid.*

14. 2 S.C. Stat. 544 (Cooper 1839), now embodied in S.C. CODE ANN. §§ 8-1102 and 8-1103 (1962).

15. 5 S.C. Stat. 330 (Cooper 1839) (preamble).

16. *Ibid.*

and just" that this privilege be extended to the assignees of judgements and decrees and passed an act permitting their assignment.[17]

The culmination of this Legislative process came in 1870 with the passage of the Real Party in Interest Statute.[18] It was then provided that "every action *must* be prosecuted in the name of the real party in interest. . . ." [Emphasis added]. This statute, however, did little more than to give expression to a principal which had long been established by previous law.[19]

It is the purpose of this undertaking to examine the interplay between the assignment of choses in action and the obligor's right of set-off. The South Carolina Statutes provide also that an assignment of a chose in action "shall be without prejudice to any set-off or other defense existing at the time of, or before notice of, the assignment."[20] Let us suppose, for example, that *A* owes *B* $1000 and *B* owes *A* $500. *B* later assigns his right to *C*. Can *A* (the obligor), when sued by *C* (the assignee), set off the $500 owing to him by *B* (the assignor)? The "contentions and suits" which follow are an attempt to answer this and other questions concerning set-offs against assigned causes of action.

OBLIGOR'S RIGHT OF SET-OFF AGAINST AN ASSIGNEE OF A NON-NEGOTIABLE CHOSE IN ACTION

An obligor, until he has been notified of an assignment, is protected in making payments to, or otherwise dealing with, the assignor, his original creditor. The assignee, standing in the shoes of his assignor,[21] takes the assignment subject to all defenses and set-offs which the obligor has against the assignor

17. 6 S.C. Stat. 1816 (Cooper 1839).

18. Every action must be brought in the name of the real party in interest... S.C. CODE ANN. § 10-207 (1962).

19. See Cathcart v. Sugenheimer, 18 S.C. 123, 131 (1882). The Uniform Commercial Code § 9-318(4) completes the cycle from the non-assignability rule in the early Common Law to the rule that the parties may not effectively prohibit the assignment of a contract right.

20. "But this Section shall not apply to a negotiable promissory note or bill of exchange transferred in good faith and upon good consideration before due." S.C. CODE ANN. § 10-706 (1962).

21. Woodrow v. Frederick, 133 S.C. 431, 131 S.E. 598 (1926); Pittman Bros. v. Raysor, 49 S.C. 138, 17 S.E. 463 (1892); Waring v. Cheesborough & Campbell, 1 Hill 187 (S.C. 1833).

> [T]he intermediate holders have acquired no higher rights, nor should they occupy any better position, than the original payee.

Hodges v. Connor, 1 Speer 120, 123 (S.C. 1842).

before he receives notice of an assignment.[22] But, from the moment the obligor receives notice of an assignment, his situation is drastically changed. With exceptions hereafter noted, *no* defenses in favor of the obligor against his original obligee, the assignor, acquired after notice to him of an assignment, will avail against the assignee.[23] This is the rule recognized in *Newman v. Crocker*,[24] stating that the equity in favor of the obligor can never be carried down further than assignment and notice.[25] Therefore, if payment were made to the assignor after notice of the assignment, it would be at the risk of the obligor; and he would be obliged to pay it over again to the assignee.[26]

> the cases . . . shew that a release by the assignor, or payment to him, after notice to the debtor of the assignment, will not be allowed to defeat the action.[27]

However, where the obligor acquires his right of set-off against the assignor before notice of an assignment, it is immaterial that the assignee had no knowledge of the obligor's claim. The assignee takes the claim subject to defenses in the obligor, though he buys it for value, and in good faith.[28]

Maturity of the Obligor's Claim

In no jurisdiction is a set-off effective against the assignee if it was *acquired* by the obligor after notice of the assignment,[29] for then it would lack the mutuality which is essential to the right of set-off.[30] But the question of when the right of set-off

22. S.C. CODE ANN. § 10-706 (1962); RESTATEMENT, CONTRACTS § 167; 3 WILLISTON, CONTRACTS § 432 (3d ed. 1960). See notes 65-72 *infra.* and accompanying text.

23. *E.g.*, Patten v. Mutual Benefit Life Ins. Co., 192 S.C. 189, 6 S.E.2d 26 (1939); Bacot v. South Carolina Loan & Trust Co., 132 S.C. 340, 127 S.E. 562 (1925); Newman v. Crocker, 1 Bay 246 (1792). And see Olympic Radio and Television v. Baker, 230 S.C. 383, 95 S.E.2d 636 (1956), holding that, in pleading payment to the assignor, the obligor must aver that such payment was made before notice of the assignment. And in Bank of Commerce v. Waters, 215 S.C. 543, 56 S.E.2d 350 (1949), it was held that the obligor's right of set-off is defensive only and that it could not result in an affirmative judgment against the assignee for the excess.

24. This discount cannot be allowed, because the transactions are all subsequent to the time of assignment and notice.
1 Bay 246 (S.C. 1792).

25. *Id.* at 247.

26. *Ibid.*

27. Mixon v. Jones, 1 Rich. 395, 396 (S.C. 1845) (for then no harm is done to the debtor).

28. 3 WILLISTON, CONTRACTS § 432 (3d ed. 1960).

29. See CORBIN, CONTRACTS § 897 (1951).

30. Thorn v. Myers, 5 Strob. 210, 212 (S.C. 1850).

must mature yet remains. Must a debt which the assignor owes to the obligor to be set off against the assignee have matured before the assignment, before the obligor receives notice of the assignment, or merely before the commencement of the suit? Here the authorities are at variance.[31]

Suppose that *A* is indebted to *B* on a demand note in the amount of $1000 and *B* owes *A* $500 payable on January 1. *B* assigns his claim to *C* on December 31, and *C* notifies *A* of the assignment on January 2. Can *A*, when sued by *C*, set off the $500 owed him by the assignor, *B*, though it had not matured at the time of the assignment but had matured before notice?

Williston appears to favor the view that the right of set-off in the obligor need not have matured even at the time of the notice of the assignment, because the denial of such a right would not be consistent with the general principle allowing set-off against the assignee of claims due from the assignor.

> And there is good authority to support the rule that the only questions should be: (1) did the claim against the assignor exist, whether matured or not, before notice of the assignment, and (2) were both claims matured when the set-off was asserted.[32]

Until notice of the assignment, the obligor should be allowed to assume that he is still under contract with the assignor, and, whether his claim against the assignor has matured or not, it should not be decisive of the case.[33]

This divergence of opinion was evident in the early South Carolina law and is nowhere better illustrated than in the case of *McAlpin v. Wingard & Muller*.[34] The majority of the court were of the opinion that the obligor's claim must have been due and payable *before the assignment*, or otherwise it could not be set off against the assignee. Justice Richardson, however, dissented. He conceded that after the assignment the obligor could not *acquire* new demands against the assignor in order to set them off against the assignee. But he urged that an unmatured

31. CORBIN, CONTRACTS § 897 (1951).

32. 3 WILLISTON, CONTRACTS § 432, p. 189 (3d ed. 1960).

33. Maryland Co-op. Milk Producers v. Bell, 206 Md. 168, 110 A.2d 661 (1955).

34. 2 Rich. 547 (S.C. 1846). Though this case dealt not with a non-negotiable chose in action but with a negotiable note taken with notice of its infirmities, the same principles generally apply. See notes 114-146 *infra*. and accompanying text.

debt must be interpreted as money *due now* but only *payable* in the future—that the debt was a present obligation and the fact that it had not matured concerned remedy alone.

However, this case cannot be taken as authority for the proposition that a set-off which matures after the assignment but before notice of the assignment to the obligor may not be interposed against the assignee. Though the court intimates that the debt must have been due before assignment, the question of notice was not raised and the restriction appears to stem from an unfortunate choice of language.

This conclusion is borne out in *Jervey v. Strauss*.[35] Though the court held that the burden of proof rested on the assignee to prove the time of the assignment, they left open the question of whether the obligor's set-off must have matured before the assignment or only before notice of the assignment.

> We choose, however, to reserve all questions concerning notice, and concerning the distinction, if any, between discount and payment.[36]

Though the question of notice was left open in *Jervey v. Strauss*, it is readily apparent that South Carolina would cast its lot with those jurisdictions requiring only that the obligor's demand have matured before notice of the assignment.[37] And it now appears questionable whether the obligor's demand must even have matured before he receives notice.

In *Bank of Commerce v. Waters*,[38] the obligor attempted to set off against the assignee a credit memorandum given to him by the assignor *after notice of the assignment*. The credit was for an alleged overcharge in the original sale, and, as such, it is arguable that the credit was "due" back to the obligor from the inception of the original contract. However, the following statement by the court leaves the question very much in doubt.

35. 11 Rich. 376 (S.C. 1858).

36. *Id.* at 383.

37. [T]he action by the assignee shall be without prejudice to any set-off or other defense *existing* at the time of, or *before notice* of, the assignment. [Emphasis added].

S.C. CODE ANN. § 10-706 (1962).

> [The assignee must] show not only that the assignment, but that notice thereof to the maker or obligor, was prior to the *accrual* of the alleged set-off against the assignor. [Emphasis added].

Bank of Columbia v. Gadsden, 56 S.C. 313, 316, 33 S.E. 575, 576 (1899).

38. 215 S.C. 543, 56 S.E.2d 350 (1949).

> While the memorandum was dated about a year after the sale (and assignment) it related to it and *the subject of it* existed before the assignment.[39] [Emphasis added].

Although the obligor may not set off against the assignee a claim against the assignor that he *acquired* after notice of the assignment, the onus is on the assignee to prove that notice was given prior to the accrual of the alleged set-off against the assignor.[40]

Maturity of the Assigned Claim

Although the authorities are somewhat at variance, some cases have held that the rule requiring mutual and reciprocal debts subsisting between the parties at the same time applies not only to the obligor's claim but to the assigned claim as well.[41] Thus, where the *assigned* claim was not due at the time of assignment, the obligor could not set off, when later sued upon it, a claim against the assignor though it had matured at the time of the assignment.[42]

Therefore, depending on the exact wording of the applicable statute, some cases have denied the obligor's right of set-off where the assigned contract was completely executory. In New York, for example, the statutory right of set-off against an assignee is allowed only if it might have been allowed against the assignor while the contract belonged to him.[43] Accordingly, in an action against a lessee by the lessor's assignee, for rent accruing *subsequent to the assignment*, the lessee was not allowed to set off a matured claim that he held against the lessor.[44]

---

39. *Id.* at 550, 56 S.E.2d at 352.

40. [The defendant] makes a *prima facie* defense when he establishes a set-off against the assignee accrued at *the commencement of the action,* which plaintiff may rebut by showing that the set-off accrued after the notice of the assignment.

Bank of Columbia v. Gadsden, 56 S.C. 313, 316, 33 S.E. 575, 576 (1899).

41. 3 WILLISTON, CONTRACTS § 432 (3d ed. 1960).

42. Likewise it has been held that if the assigned claim was not due at the time of the assignment, the debtor cannot set off, when later sued upon it, a claim against the assignor which was due at the time of the assignment, at least if the assignor is not insolvent.

The denial of a right of set-off because either the assigned claim or the cross claim was not due at the time of the assignment is, however, not consistent with the general principle allowing set-off against the assignee of claims due from the assignor . . . .

3 WILLISTON, CONTRACTS § 432, pp. 188-89 (3d ed. 1960).

43. N.Y. CIVIL PRACTICE LAW AND RULES § 3019(c) (1963).

44. Stafford Sec. Co. v. Kremer, 258 N.Y. 1, 179 N.E. 32, 78 A.L.R. 822 (1932).

Otherwise the lessee, who has maintained a "prudent silence" while the consideration is being supplied by the assignee, is allowed to set off against him a claim against his assignor and, in effect, occupy the building rent free.[45]

However, though there are no cases on the point, the rule may be otherwise in South Carolina. Our statute contains no such restrictive language as that of New York.[46]

> the action by the assignee shall be without prejudice to *any* set-off or other defense existing at the time of, or before notice of, the assignment.[47] [Emphasis added].

The North Carolina Supreme Court, construing a statute similar to our own,[48] has held that, even in an action for rent accruing after the assignment, the lessee may set off a claim which he held against the assignor.[49] The proposition discussed here, however, appears not to have been raised, the case turning on the broad proposition that an assignor cannot confer upon his assignee a greater right than he himself has.

Surety's Right of Set-Off

As stated above, the right of set-off at law is generally limited to a subsisting obligation between the parties to the suit. The assignee insulates himself from any subsequently acquired defenses of the obligor by giving him notice of the assignment. He therefore takes the assignment subject *only* to those equities which the debtor had against the assignor at the time notice

45. *Id.* at 2, 179 N.E. at 32. It is argueable that this case does not stand for the broad proposition that the assigned claim must be due and payable at the time of the assignment for a right of set-off to exist. If the contract is assigned before *anything* is due thereon, consideration may be regarded as supplied entirely by the assignee. Thus, at the time of the assignment there was not merely immaturity but nonexistence of the claim against which the alleged right of set-off is asserted. See Annot., 78 A.L.R. 824 (1932).

46. In an action on a contract assigned to the plaintiff, a claim existing against the assignor at the time of the assignment and belonging to the defendant in good faith before notice of the assignment shall be allowed as a conterclaim to the extent of the plaintiff's claim, *if it might have been so allowed against the assignor while the contract belonged to him.* [Emphasis added].

N.Y. CIVIL PRACTICE LAW AND RULES § 3019(c) (1963). Compare this language with that of S.C. Code Ann. § 10-706 (1962) quoted in note 97 *infra.*

47. S.C. CODE ANN. § 10-706 (1962).

48. In case of an assignment of a thing in action the action by the assignee is without prejudice to any set-off or other defense, existing at the time of, or before notice of, the assignment. . . .

N.C. GEN. STAT. § 1-57 (1953).

49. Standard Amusement Co. v. Tarkington, 247 N.C. 444, 101 S.E.2d 398 (1958). See Annot., 78 A.L.R. 824 (1932).

is given. Hence, where the defendant is a surety or is otherwise contingently liable for a matured obligation of the assignor, and where he is not compelled to pay the assignor's obligation until *after* the assignment (omitting for the present the question of notice), he has no legal right of set-off against the assignee.[50] The rights of the parties become fixed upon assignment, and the surety's liability, being then only contingent, is not such as he may use in offset to an action by the assignee of a claim payable by him to his principal.[51]

This principle appears to have been nailed down in South Carolina in *Nettles v. Huggins*.[52] There, money paid by the defendant surety after the assignment in discharge of a debt of his assignor was not allowed as a set-off in an action by the assignee. The lower court's decree conceded that the result was different from that which must strike the mind as just and that it would have been glad to find the rule less stringent than was supposed.[53] Nevertheless, the court of appeals affirmed.

> it is certainly well settled by our decisions that nothing can be allowed against the assignee, which did not have a perfect legal right of enforcement before the assignment.[54]

The same rule was applied in *Ragsdale v. Winnsboro Bank*,[55] where the court held that the rights of the parties depend upon the state of facts existing at the time of the making of the assignment.[56] Thus, payment of the assignor's obligation by the sureties after assignment was not a proper set-off against the as-

50. See Annots., 65 A.L.R. 1439, 1441 (1930); 46 L.R.A. (N.S.) 62 (1913). For a surety's right of set-off against an assignee for the benefit of creditors, see United States Fid. & Guar. Co. v. Woolridge, 268 U.S. 234, 40 A.L.R. 1094 (1925).

51. 47 AM. JUR. *Set-off and Counterclaim* § 61 (1943). See Annot., 23 L.R.A. 305, 306 (1894).

52. 8 Rich. 273 (S.C. 1855). *Accord,* Ragsdale v. Winnsboro Bank, 45 S.C. 575, 23 S.E. 947 (1896).

53. Nettles v. Huggins, 8 Rich. 273, 273-74 (S.C. 1855).

54. *Id.* at 275. However, in Neal v. Sullivan, 10 Rich. Eq. 276 (S.C. 1858), the lower court allowed the surety to set off against the assignee of the principle any amounts he might be compelled to pay *after the assignment* in consequence of his subsisting liability as guarantor. The plaintiff excepted on the ground that the defendant was bound to prove that he was "damnified" before he could avail himself of the defense. However, the Chancellor affirmed the decree. No cases are cited in support of the holding and the only justification would appear to be that the estate of the principle appeared to be insolvent. For a discussion of the obligor's right to an equitable set-off where the requisites of mutuality and maturity are absent, see notes 155-168 *supra,* and accompanying text. *But see* note 57 *infra.*

55. 45 S.C. 575, 23 S.E. 947 (1895).

56. *Id.* at 583, 23 S.E. at 950.

signee, the sureties not being creditors of the maker at the time of the transfer.[57]

But where the surety is compelled to satisfy the assignor's obligation *before assignment*, his rights against the assignor are no longer contingent and may properly be set off against the assignee.[58] And if any doubt existed after *Nettles v. Huggins* and *Ragsdale v. Winnsboro Bank* whether the protection afforded to a surety who pays before the assignment would be extended to a surety who pays after the assignment *but before notice*, it was settled in *Bank of Columbia v. Gadsden*.[59] The burden of proof was said to rest on the assignee to prove that the surety had *notice* of the assignment before his set-off accrued. As the assignee failed to sustain his burden, the set-off was allowed.[60]

Waiver or Estoppel of the Obligor to Assert His Defenses

There is authority that where the assignee expressly takes his claim subject to the equities between the obligor and the assignor, the obligor may set off against such assignee a claim against the assignor that was not due and payable at the time of assignment.[61] The assignee in such cases is said to be subject to the rule that the equity prior in time is superior in right.[62]

And where the debtor and the assignor, having mutual but unmatured claims against each other, agree that one demand be set off or extinguished by the other, their agreement is binding upon a subsequent assignee.[63] The assignee must take the

57. *Ibid.* This case involves an attempted set-off by the obligor against the assignee for the benefit of creditors of the obligee and, therefore appears to cast further doubt on Neal v. Sullivan, 10 Rich. Eq. 276 (S.C. 1858). See discussion of that case in note 44 *supra*. However, although *Ragsdale* denies the right of set-off despite the insolvency of the principle, there is authority for the proposition that the surety *may* set off his "contingent" liability against the assignee, the contingency of his obligation having been removed in a very real sense by the insolvency of the principle. See Annot., 40 A.L.R. 1096 (1926), notes 155-168 *infra*. and accompanying text.

58. See Annot. 65 A.L.R. 1439, 1441 (1930). This conclusion also appears to be implicit in the two South Carolina cases discussed above.

59. 56 S.C. 313, 33 S.E. 575 (1899).

60. Though this case involves the set-off of a claim against an intermediate assignee and its availability against a sub-assignee, the same principle applies.

61. See Annot., 27 A.L.R. 112, 117 (1923).

62. See Annot., 4 L.R.A. 858, 859 (1889).

63. When there has been an agreement between the parties that one debt be set-off against the other, one of the parties cannot assign the evidence of the indebtedness and thereby defeat the action. Martin v. Richardson, 68 N.C. 240 (1872). *Cf.* Wilson v. Dargan, 4 Rich. 544 (1851). Where *B* is indebted to *A*, and *A* is indebted to a firm of which *B* is a co-partner, and it is agreed between them that one demand be set off against the other, such demand is binding on a subsequent assignee of A's demand against B. For a discussion of set-off of joint obligations see KARESH, *The Uniform Partnership Act, Part 2*, 3 S.C.L.Q. 366, 431-33 (1951).

demand *cum onere* since he cannot occupy a better legal position than the law affords to his assignor.[64]

Just as a debtor and creditor may agree that their mutual claims be set off, a debtor may waive his right to a set-off by making an express promise to render performance to the assignee.[65] This is the principle espoused in *Lane v. Winthrop*.[66] The question was said to be whether the right upon which the action was brought, was an assigned right or an original right.[67] The obligors, in agreeing with the assignor to render performance to the assignee, were estopped from asserting against the assignee a claim which they held against the assignor. The transaction was in the nature of a new contract and the right of the assignee was original.

> The only case which contradicts [this rule] . . ., in my opinion, is neither good law or good sense.[68]

The obligor may also be estopped by conduct short of an express promise from asserting his defenses against the assignee.

> If, however, the obligor, from fraud, negligence or folly, represent himself to be liable on the bond to one about to deal for assignment . . .; or even if the obligor, with full knowledge of his defense, acquiesces in an assignment without disclosure of his defense; such representations or concealment will amount to an estoppel *in pais* upon the obligor from setting up his defenses.[69]

But mere silence or inaction on the part of the obligor will not constitute an estoppel. There must be some *positive* encouragement or participation by him inducing the assignee to take the assignment.[70]

64. Wilson v. Dargan, 4 Rich. 544 (1851). See discussion of that case in note 63 *supra*.

65. See Annot., 51 A.L.R.2d 886 (1957).

66. 1 Bay 116, 1 Am. Dec. 599 (S.C. 1790).

67. Id at 118, 1 Am. Dec. at 601. This principle was applied later in Silas v. Cay, Mortimer & Co., 12 Rich. 558 (S.C. 1860). To the defendant's objection to the action being brought by the assignee rather than the assignor, the court replied that when an express promise is proved there can be no objection to the assignee's maintenance of the action.

68. Lane v. Winthrop, 1 Bay 116, 118, 1 Am. Dec. 599, 601 (S.C. 1790).

69. Holbrook v. Colburn, 6 Rich. Eq. 289, 300 (S.C. 1854). But those contract provisions whereby finance companies, as assignees of contract rights, have attempted to insulate themselves from defenses of the obligor have been regarded with some disfavor by the courts and prohibited by the RETAIL INSTALLMENT SALES ACT. The UNIFORM COMMERCIAL CODE § 9-318(1) provides, however, that defenses against the assignee are subject to any *enforceable* agreement not to assert defenses or claims arising out of the sale.

70. Woodrow v. Frederick 133 S.C. 431, 442, 131 S.E. 598, 602 (1925).

There is, however, an unfortunately broad statement in *Moffatt v. Harden.*[71]

> We suppose that under certain circumstances [the obligor] . . . might be estopped from denying that he uttered the security or matters of that kind, which would avail the payee as well as any subsequent holder, but he cannot be estopped from setting up *any* defense against the holder, which would be good against the payee himself.[72] [Emphasis added].

But, rather than denying the assertion of *any* estoppel against an obligor, the case stands for the narrower proposition that the execution of a mortgage by an obligor will not estop him from setting up defenses that would be good against the assignor. Execution gives no authority, either express or implied, that the mortgage be sold. And where such securities *are* sold, the purchaser is notified by the law that he takes them at his peril under the principle of *caveat emptor.*[73]

It follows then that the question is not whether the obligor may be estopped by his conduct from asserting defenses against the assignee, but what conduct will be sufficient to constitute such an estoppel.

Defenses Arising Out of the Original Contract

Another exception to the Rule precluding defenses accruing after notice of the assignment involves those defenses that are based on a right of the obligor that is inherent in the contract itself.[74] Thus, if payments under an executory contract are assigned, the obligor may set up by way of recoupment[75] breach of contract on the part of the assignor, though such breach occurs after notice of the assignment.[76] The assignment of a contract is generally held to be subject to all equities including

71. 22 S.C. 9 (1884).

72. *Id.* at 30.

73. *Ibid.*

74. 3 WILLISTON, CONTRACTS § 433 (3d ed. 1960).

75. Unlike set-off, [recoupment] must grow out of the identical transaction that gave rise to the plaintiff's cause of action.
Mullins Hosp. v. Squires, 233 S.C. 186, 197, 104 S.E.2d 161, 166 (1958).

76. Breach of warranty may similarly be asserted against the assignee of a non-negotiable note, if the warranty was given at the time when the note was made though the breach of warranty did not occur until after notice of the assignment.
3 WILLISTON, CONTRACTS § 433, at 214 (3d ed. 1960). See Annot., 87 A.L.R. 187 (1933).

set-off growing out of the contract itself, regardless of when they mature.[77]

Necessity of Notice of the Assignment to the Obligor

It appears to be the well settled rule that the obligor should not be prejudiced by an assignment of which he has no notice.[78] The proposition that equities are cut off at the time of assignment rather than at the time of notice to the obligor "has little else to recommend it, than its tendency to encourage almost every species of covinous combination."[79] Accordingly, if, prior to notice, he pays the debt to the assignor or acquires any set-off, he can use such defense when sued by the assignee.[80]

But defenses against the assignor acquired after notice may not be interposed against the assignee, nor is it necessary that the obligor admit the validity of the assignment. Although he believes the assignment to be invalid, he disregards it at his peril.[81] Assignment law requires that a contract obligor determine, at his own risk, the validity of assignments of claims against him. The obligor's consent to such assignment is not now, and perhaps never has been, requried.[82]

But the question remains as to what is sufficient notice to cut off subsequently acquired defenses. Is mere knowledge of the assignment sufficient or must the assignee give actual personal notice to the obligor? Here the authorities are at variance.

77. Annot., 23 L.R.A. 305, 307 (1894).

> When the rights of an account debtor arise on the contract between the debtor and the assignor it makes no difference whether those rights accrued before or after notification—such rights may be asserted against the assignee.

Foster, South Carolina Reporter's Comments on Uniform Commercial Code § 9-318(1), H. 1399, S.C. Gen. Assembly (1965).

78. Patten v. Mutual Benefit Life Ins. Co., 192 S.C. 189, 6 S.E.2d 26 (1939); Yancey v. Stark, 132 S.C. 171, 129 S.E. 81 (1925); Bank of Johnsonville v. Sovereign Camp W.O.W., 130 S.C. 444, 126 S.E. 332 (1924); Newman v. Crocker, 1 Bay 246 (S.C. 1792). See 3 WILLISTON, CONTRACTS § 433 (3d ed. 1960).

> the rights of an assignee are subject to . . . any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.

UNIFORM COMMERCIAL CODE § 9-318(1)(b).

79. Burkett v. Moses, 11 Rich. 432, 438 (S.C. 1858).

80. See notes 21-22 *supra*.

81. 3 WILLISTON, CONTRACTS § 433 (3d ed. 1960).

82. [T]here is clear indication of the view that acceptance by the employer is not necessary in order to give complete effect to the assignment; and this view is supported by the weight of authority in other jurisdictions, though in some states the decisions are affected by statutory regulations. Dunbar v. Johnson, 170 S.C. 160, 163, 169 S.E. 846, 847 (1933).

Williston feels that it is not a question of "diligence" on the part of the assignee but rather of the obligor's knowledge of the essential facts.[83]

> If there is such knowledge, acquired in whatever manner and for whatever purpose, of facts which would operate upon the mind of any rational man of business, and make him act with reference to the knowledge he has so acquired it is enough.[84]

If notice is required solely for the protection of the obligor, then knowledge of the assignment *should* be sufficient. It was said in *Burkett v. Moses*[85] that the rule is based upon the assignee's obligation to communicate to the obligor:

> a doctrine which strongly commends itself to our approval, not less by the sound reasoning by which it is sustained than by the high standard of good faith which it inculcates.[86]

However, this statement does not make it clear whether the assignee's obligation is a prerequisite to the perfection of his rights in the assignment, or if it is in fact required for the protection of the obligor only.

The first indication of which course South Carolina would follow is evidenced from *Wm. Brown & Co. v. Rees*,[87] intimating that a "mere report" would not be considered as notice.[88] And later, in *Harvin v. Galluchat*,[89] it was held that notice to the obligor's husband and to her attorney was not sufficient.[90]

---

83. 3 WILLISTON, CONTRACTS § 437 (3d ed. 1960). See RESTATEMENT, CONTRACTS § 167 (1932) where the assignee's rights against the obligor are subject to defenses and set-offs that are "based on facts" arising prior to *knowledge* of the assignment by the obligor.

84. *Ibid.*

85. 11 Rich. 432 (S.C. 1858).

86. *Id.* at 437.

87. 3 Brev. 191 (S.C. 1815).

88. But in this case it does not appear that he had any notice, except so far as a mere report might be considered as notice. *Id.* at 192. However, it is not clear that a "mere report" would be sufficient even where there is a requisite for knowledge as distinguished from notice.

89. 28 S.C. 211, 5 S.E. 359, 13 A.S.R. 671 (1887).

90. It is laid down in all the authorities upon the subject of assignment of unnegotiable paper (Story, Pomeroy, and in numerous cases), that in order to protect his rights under an assignment, the first duty of the assignee is to *give* notice to the debtor.

Id. at 217, 5 S.E. at 361. *But see* Williams v. Paysinger, 15 S.C. 171 (1880). The obligor executed and delivered to the obligee new notes and mortgage without taking up or even seeing the old notes and mortgage they were intended to replace. The court held that he could not use the execution of the

> It is true that the term "actual" is not used in the authorities as qualifying the notice, but it is said that notice must be *given* to the *debtor*, and . . . we are forced to the conclusion that actual personal notice is what is meant.[91]

It is interesting to consider the language of the court in light of the facts of the case. Notice actually was *given* by the assignee but was not *received* by the obligor. The letter of notification was directed to the obligor but was received by her husband instead. The nature of the family relationship would indicate the probability of the obligor's knowledge of the assignment, but neither knowledge on the part of the obligor nor agency on the part of her husband was proved. And the court added that it would be a short measure of justice to hold that *constructive* notice is sufficient.

Whether *Harvin v. Galluchat* is authority for the proposition that in South Carolina mere knowledge of an assignment is insufficient and that only actual personal notice *by* the assignee *to* the obligor or his agent will insulate the assignee from subsequently arising defenses is open to speculation. It may arise that the *assignor* rather than the assignee notifies the obligor or that the obligor has acquired knowledge of the assignment from some other source. But even should the court modify the apparent holding in *Harvin v. Galluchat* if such a situation arises, the case is a clear illustration of the heavy burden of proof that the assignee must bear under the existing state of the law.[92]

---

new notes and mortgage as a defense when sued by the plaintiff as assignee of the old notes and mortgage.

> There was enough to put [the obligor] on the inquiry, and he must be held to have had notice of everything that due diligence would have discovered.

Id. at 175. But the court further noted that they did not consider the obligor "without fault in the matter". *Id.* at 174. Thus it is arguable that the case actually turned on estoppel of the obligor to assert his defenses against the assignee rather than on inquiry notice. See notes 69-73 *supra,* and accompanying text.

91. Harvin v. Galluchat, 28 S.C. 211, 217, 5 S.E. 359, 361 (1887).

> The object of notice is not only to protect the assignee, but the debtor also. *Ibid.*

92. Whatever the eventual ramifications of Harvin v. Galluchat might be, the case was accepted without question in Patten v. Mutual Benefit Life Ins. Co., 192 S.C. 189, 6 S.E.2d 26, 126 A.L.R. 91 (1938), where the court held that an obligor has a right to deal with his original creditor until he has *actual* notice of an assignment. See Yancey v. Stark, 132 S.C. 171, 129 S.E. 81 (1925); Bank of Johnsonville v. Sovereign Camp W.O.W., 130 S.C. 444, 126 S.E. 332 (1924).

Set-Off of Claims Against Intermediate Assignees

A owes *B* $1000. *B* assigns his rights to *C* and *C* assigns his rights to *D*. Can *A* set off against *D* a debt owing to him by *C*, an intermediate assignee? In other words, is a set-off against an assignee (but not against the original assignor), available also against a sub-assignee?

The Restatement of Contracts answers this question in the negative.

> A sub-assignee's right against the obligor is not subject to the set-off or counterclaim of a right of the obligor against a prior assignee unless the obligor's right was acquired prior to any sub-assignment by the prior assignee, *nor even in that case* if a sub-assignee claiming under such a prior assignee is a bona fide purchaser for value of the assigned right, without notice of the existence of the obligor's right.[93] [Emphasis added].

The rule in South Carolina is not clear. It may or may not depend on a change in the set-off statute. And it may depend on whether the same rules applicable to the maker's right of set-off against a holder of a negotiable instrument transferred after maturity as apply to an assignee of a non-negotiable chose in action.[94]

It was provided in the act of 1798[95] that the obligor could set up any discounts or defense which he would have been entitled to, *had the action been brought in the name of the obligee.*[96] Under the present statute[97] the obligor may avail himself of *any* set-off or defense existing before notice of the assignment. Whether the language of the earlier statute restricts the obligor's rights against a sub-assignee to those he would otherwise have had against the original obligee and precludes defenses against intermediate assignees is subject to question. And, even so, it is not altogether clear that the amended statute would necessarily change this result.

93. RESTATEMENT, CONTRACTS § 167(3) (1932).
94. See notes 114-146 *infra*, and accompanying text.
95. 5 S.C. Stat. 330 (Cooper 1839).
96. *Ibid.*
97. In the case of an assignment of a thing in action the action by the assignee shall be without prejudice to any set-off or other defense existing at the time of, or before notice of, the assignment.
S.C. CODE ANN. § 10-706 (1962).

The earlier South Carolina cases,[98] construing the 1798 statute, held that no right existed in the obligor to set off against a holder a demand he held against an intermediate holder who was not the original payee. In *Nixon ads. English*[99] it was held that, in the hands of a bona fide holder, a negotiable note transferred after maturity was subject only to defenses existing between the original parties to the note.

> [I]t would be destructive of all commercial paper to say that a note payable to bearer should carry along with it all the equities which might subsist between the maker and any or every distinct holder of it.[100]

The same result was reached in *Perry v. Mays*,[101] the court noting that there was an "obvious difference" between a claim of set-off against the original payee and one against an intermediate holder. The fact that the maker has a set-off against an intermediate assignee does not affect the "goodness" of the note.[102]

It is worthy of note that both *Nixon ads. English* and *Perry v. Mays* concerned negotiable paper transferred after it was due. Whether this fact is determinative of the issue is also open to speculation.

The statute was later amended to read that an assignment of other than negotiable paper shall be "without prejudice to *any* set-off or other defense existing at the time of, or before notice of, the assignment."[103] [Emphasis added]. This amended statute was construed in *Bank of Columbia v. Gadsden*[104] as permitting an obligor to set off against an assignee not only claims held against the original assignor but intermediate as-

98. Perry v. Mays, 2 Bailey 354 (S.C. 1831); Nixon ads. English, 3 McCord 549 (S.C. 1826).

99. 3 McCord 549 (S.C. 1826).

100. *Id.* at 551.

> For this would necessarily impose on all who receive such notes the necessity of going back to all who may have held it to ascertain if there were any dealings between them and the maker, which at a future time might be pleaded in discount.

Ibid.

101. 2 Bailey 354 (S.C. 1831).

102. *Id.* at 357.

103. But this section shall not apply to a negotiable promissory note or bill of exchange transferred in good faith and upon good consideration *before due*. [Emphasis added.]

S.C. CODE ANN. 10-706 (1962).

104. 56 S.C. 313, 33 S.E. 575 (1899).

signees as well.[105] Though mention is made of the note and mortgage being "long past due," it is not altogether clear from the case whether they were or were not negotiable. In either event, *this case*, taken in conjunction with the present set-off statute, appears to indicate that under the present state of the law in South Carolina an obligor *may* set-off against a sub-assignee of a non-negotiable chose in action a debt owing to him by an intermediate assignee.

SET-OFF AGAINST HOLDERS OF NEGOTIABLE INSTRUMENTS

A right of set-off inhering in the obligor, and otherwise effective against an assignee of a non-negotiable note, is not available, however, against a holder in due course of a negotiable instrument.[106] For it is almost universally accepted that commercial paper, if negotiated for value and before maturity, is not subject to set-off[107]—a different doctrine would check its circulation and embarrass mercantile operations.[108]

---

105. 'The defendant can plead any set off existing between him and [the intermediate assignee] . . . any time before notice to the defendant of the assignment.'

Id. at 315, 33 S.E. at 576. The question of the obligor's right to a set-off of a defense against an intermediate assignee was not raised by counsel nor were *Perry v. Mays* or *Nixon ads. English* cited by counsel or discussed by the court.

106. A holder in due course holds the instrument free from any defect of title of prior parties, and free from any defences available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon.

UNIFORM NEGOTIABLE INSTRUMENTS LAW § 57.

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.

UNIFORM COMMERCIAL CODE § 3-305. These exceptions enumerated in the UCC are those which have been generally recognized in the case law under the NIL. See Annot., 44 A.L.R.2d 8, 42 (1955).

107. 47 AM. JUR. *Set-off and Counterclaim* § 84 (1943).

108. Bull v. Kasson First Nat'l Bank, 123 U.S. 105 (1887).

It was said in *Witte v. Williams*[109] that the "conveniences and necessities of commerce" require that negotiable instruments, being used as a ready substitute for coin, must be protected by the same rule that confers title to coin by its mere possession.[110] And, though a thief may not convey good title to a purchaser, however innocent, the highest considerations of public policy excepts from this rule a holder in due course of a negotiable note and makes the title of such holder good against the world.[111]

In the hands of any holder *other* than a holder in due course, a negotiable instrument is subject to the same defenses as though it were non-negotiable.[112] When a note has been given for an illegal consideration, the indorser cannot recover on it if he knew of the infirmity[113]—or if for any other reason he does not qualify as a holder in due course.

Assignment after Maturity

According to the overwhelming weight of authority, the holder of a negotiable note who acquires it after maturity, takes it subject to all equities and defenses arising out of the note itself and attaching to it, and to any agreement between the original parties with relation to the instrument.[114] The prevailing view

109. 8 S.C. 290 (1876).

110. *Id.* at 301.

111. Ehrlich v. Jennings, 78 S.C. 269, 272, 58 S.E. 922, 923 (1907).

112. But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter.

UNIFORM NEGOTIABLE INSTRUMENTS LAW § 58. See UNIFORM COMMERCIAL CODE §§ 3-201, 3-306, 8-301.

113. The defendant admitted the note, but gave evidence that it was given when the British army were in Charleston . . . [and that he] was arrested by process of the British board of police, and being unable to pay the sheriff's fees, he gave this note for the amount of those fees. . . . [T]he defendant, insisted, that the note was given on an illegal consideration, the British board of police having been repeatedly adjudged in this court [as] an illegal body, and all acts done under their authority void.

Brisbane v. Lestarjette, 1 Bay 113 (S.C. 1790).

114. Ex parte Cleveland, 177 S.C. 514, 181 S.E. 890 (1935); Brunson v. Fowler, 143 S.C. 505, 141 S.E. 732 (1927); UNIFORM NEGOTIABLE INSTRUMENTS LAW § 52(2) in connection with § 58. See Annot., 23 L.R.A. 325, 326 (1894).

Unquestionably such a taker is not entitled to the protection of a holder in due course unless he holds through a holder in due course.

11 AM. JUR. 2d *Bills and Notes* § 481 (1963). And where the instrument is payable on demand, the holder is not deemed a holder in due course if the instrument was negotiated an "unreasonable length of time" after its issue. UNIFORM NEGOTIABLE INSTRUMENTS LAW § 53. Under the UNIFORM COMMERCIAL CODE § 3-302(c), a holder is not a holder in due course where he

is that one who takes the instrument after maturity is not a holder in due course,[115] and the only diversity of opinion is as to what claims may be used in set-off.

This rule was enunciated in South Carolina as early as 1792 in *Bell v. Wood*.[116] Finding the note in question to be void in its inception for "illegality and turpitude," the court held that the fact that it was endorsed after it had come due was a circumstance that cast some suspicion on the fairness of the transaction and was sufficient to throw it out of the course of trade.[117] Therefore, the maker could impeach the consideration or "shew" that it was illegal in the same manner as if the note had remained in the hands of the payee.[118]

> It is not contemplated that negotiable paper shall pass current after maturity, and whoever so takes it does so at his own peril. Again it is a reasonable presumption in respect of such paper either that it has been paid, or that payment has been withheld for an adequate reason.[119]

---

takes it with "notice" that it is overdue. However, the Code makes an extensive modification as to when a taker of an "investment security" as opposed to "commercial paper" is charged with notice of a defect in its issue or a defense of the isssuer. Section 8-203 provides that a purchaser of a "security" is charged with notice of defects in the instrument or defenses of the issuer after "an act or event which creates a right to immediate performance of the principle obligation evidenced by the security . . ." A security under this section becomes "stale" two years after default. And where the question is notice not of the issuer's defenses but of claims of ownership Section 8-305 applies. For a collection of cases dealing with equities between intermediate parties, see Annot., 68 A.L.R. 982 (1930).

115. Ives v. Rutland, 135 S.C. 173, 133 S.E. 539 (1926); Willoughby v. Ray, 131 S.C. 317, 127 S.E. 441 (1924); Freeman v. Bailey, 50 S.C. 241, 27 S.E. 686 (1897); Pittman v. Raysor, 49 S.E. 469, 27 S.E. 475 (1897); UNIFORM NEGOTIABLE INSTRUMENTS LAW § 52(2); 11 AM. JUR. 2d *Bills and Notes* § 481 (1963).

116. I Bay 249 (S.C. 1792).

117. [T]he note in question [was] given to . . . avoid going to gaol, [and] it is void by the common law. All contracts made to compound felonies, or to prevent the due execution of the law, by the connivance of magistrates, sheriffs, or other officers, are void. . . . The circumstance of the note being in the hands of an indorser ignorant of the original transactcion, for illegality and turpitude, it can never afterwards be valid, so as to charge the drawer.

Id. at 251. However, being void in its inception for fraud, this instrument would fit with the exception recognized in § 3-305(c) of the Uniform Commercial Code as being a good defense against a holder in due course. See note 106 *supra*.

118. *Id.* at 252.

119. 3 R.C.L. *Bills and Notes* § 250 (1914), superceded by 8 AM. JUR. *Bills and Notes* § 423 (1937).

> Negotiable paper, after maturity, often bears on its face notice of dishonor, and a holder who takes an instrument after its maturity is not a holder in due course, since one of the requisites of such status under the NIL is

The cases are unanimous in holding that a defense between the maker and the payee of a negotiable instrument is available against one *not* a holder in due course where the defense arose out of the same transaction as the instrument itself and existed at the time of transfer by the payee.[120] And it is uniformly held that the maker cannot plead a set-off which neither arose out of the original transaction nor before notice of the transfer of the note.[121] But where the maker's right of set-off arises out of a transaction independent of that of the instrument itself, the cases are fairly evenly divided as to whether such claim should be allowed as a set-off.[122]

Arguably, if, as under the NIL,[123] a transferee after maturity is not a holder in due course, he should acquire no higher rights than the assignee of a non-negotiable note and thus should be vulnerable to *all* set-offs acquired by the maker before notice of the assignment. There is a line of cases, however, holding that only such defenses as fraud or failure of consideration which are said to attach to the note itself or defenses that are based on infirmities in the instrument are available against a transferee after maturity.[124] And, though different reasons have been given in support of this view, the principal one is the lack of mutuality.[125]

This is the principle expounded in *Jervey v. Strauss*,[126] the court stating, by way of dictum, that a negotiable instrument does not lose its negotiability when it is overdue.[127]

---

that the holder become holder of the instrument before it is overdue. Unquestionably such a taker is not entitled to the protection of a holder in due course unless he holds through a holder in due course.

11 AM. JUR. 2d *Bills and Notes* § 481 (1963).

120. Annot., 70 A.L.R. 245, 246 (1931).

121. Annot., 70 A.L.R. 245, 258 (1931).

122. See 47 AM. JUR. *Set-Off and Counterclaim* § 89 (1943); Annot., 70 A.L.R. 245, 248 (1931).

123. UNIFORM NEGOTIABLE INSTRUMENTS LAW § 52(2).

124. See, *e.g.*, Stegall v. Union Bank & Fed. Trust Co., 163 Va. 417, 176 S.E. 438 (1934), holding that a post maturity transferee of a negotiable instrument takes the instrument free from a mere set-off which the maker has against the payee at the time of transfer, notwithstanding the Virginia set-off statute. See Annot., 78 A.L.R. 245, 254 (1931); 46 L.R.A. 753, 787 (1900).

125. A mere right of set-off under the statute designed to enable mutual debtors to discount their claims against each other is not such an equity as attaches to a negotiable note and follows it into the hands of an indorsee after maturity . . . .

46 L.R.A. 753, 792 (1900).

126. 11 Rich. 376 (S.C. 1858). This case, however, does not concern a negotiable instrument.

127. *Id.* at 384.

> [A]lthough [it is] subject to such equities, arising out of the note or the transaction connected with it, as the payee was subject to, [it] is not subject to a set-off arising out of collateral matter. . . .[128]

However, the earlier case of *Perry v. Mays*,[129] though disallowing the set-off of a claim against an intermediate holder, had said, also by way of dictum, that the holder took the note subject to *all* the equities which existed against the original payee.[130]

> Such I suppose to be the law of our State as established by long practice.[131]

There is no scarcity of cases where the South Carolina Supreme Court has said that a transferee after maturity of a negotiable instrument takes it subject to *all* defenses, whether or not arising out of the note transaction, which the maker may have against the original payee.[132] But there certainly is no wealth of cases whose facts are such as to have definitively nailed down the proposition.[133]

Nevertheless it is manifestly apparent from our set-off statute[134] that this same result would be reached in South Carolina. For there it is said that all assignments shall be without preju-

128. *Ibid.*

129. 2 Bailey 354 (S.C. 1831).

130. *Id.* at 357.

131. *Ibid.*

132. However, as indicated below, these cases either concern a non-negotiable instrument or a defense in the maker that does in fact arise out of or attach to a note transaction. *E.g., Ex parte* Cleveland, 177 S.C. 514, 181 S.E. 890 (1935) (failure of consideration); Folk v. Felder, 168 S.C. 103, 167 S.E. 27 (1932) (dictum), (the holder found not to hold the note in his capacity as an individual but as receiver of the payee); Brunson v. Fowler, 143 S.C. 505, 141 S.E. 732 (1927) (fraud in inducing the maker to execute the note); Ives v. Rutland, 135 S.C. 173, 133 S.E. 539 (1926) (defense arising out of the note transaction); Gibson v. Hutchinson, 43 S.C. 287, 21 S.E. 250 (1894) (fraud in inducing the maker to execute the note). *But see* note 133 *infra.*

133. But, in Quackenbush v. Miller, 4 Strob. 235 (S.C. 1850), it was held that the maker might set off an independent demand not arising out of the note transaction—the holder of the instrument having had the misfortune to take it after maturity. However, though the set-off asserted did arise independently of the original transaction and subsequent to it, the maker and the payee did agree that by the maker's assumption of a debt owing by the payee to a third person that the amount owing on the note transaction would be reduced. Therefore, although not arising out of the note transaction, it did attach to it. *But see* Bank of Columbia v. Gadsden, 56 S.C. 313, 33 S.E. 575 (1899). Though it does not appear with any degree of certainty whether the instrument was in fact negotiable, there is mention made of its being "long past due." The maker was allowed to set off a demand that he had against an intermediate holder of the note, the demand neither arising out of the note transaction or attaching to it. See notes 103-05 *supra.* and accompanying text.

134. S.C. CODE ANN. § 10-706 (1962).

dice to *any* set-off existing before notice. And the qualifying sentence exempts from this rule only those negotiable instruments that are "transferred in good faith and upon good consideration *before due.*"[135] [Emphasis added].

Necessity of Notice to the Maker

There is authority that, where a negotiable note is transferred after it is due, the maker can avail himself of only such set-offs as existed at the time of the actual endorsement and transfer even though he did not have notice of such transfer.[136] That was the rule announced in *Baxter v. Little*,[137] the Massachusetts court basing its decision on the hypothesis that a note does not cease to be negotiable because it is overdue.[138] In the case of a non-negotiable note, notice of the assignment must be given by the assignee to the debtor, to prevent him from making payment to the assignor.[139] But the maker of a negotiable instrument, even if it be overdue, has no right to presume, without proof, that the promisee is still the holder of the note.[140]

> [The maker] has a right to have his note given up, if paid in full, or to see the payment, indorsed, if partial. Should he insist on this right, in the case proposed, he would at once

135. *Ibid. But see* Stegal v. Union Bank & Fed. Trust Co., 163 Va. 417, 176 S.E. 438, 453 95 A.L.R. 582 (1934), holding that the term "defenses" as used in a statutory provision that "in the hands of any holder other than a holder in due course a negotiable instrument is subject *to the same defenses as if it were non-negotiable,*" means technical defenses and does not embrace set-offs arising out of an independent transaction. However, in Foley v. Smith, 73 U.S. (6 Wall.) 492 (1868) and Pickett v. Fulford, 211 N.C. 160, 189 S.E. 488 (1937), the holding is that a taker after maturity is subject to defenses between the maker and all former holders. For a general discussion of this point see 11 AM. JUR.2d *Bills and Notes* § 482 (1963); Annot., 70 A.L.R. 245, 260 (1931). For a discussion of the South Carolina cases see notes 94-105 *supra.* and accompanying text.

136. Baxter v. Little, 47 Mass. (6 Metc.) 7, 39 Am. Dec. 707 (1843). See 57 C.J. *Set-Off and Counterclaim* § 164 (1932). The *Corpus Juris* article inadvertently cites Cain v. Spann, I McMul. 258 (S.C. 1841) as following this rule and Jervey v. Strauss, 11 Rich. 376 (S.C. 1858) as recognizing it by way of dictum. In truth, the statements in both cases are dictum, as in neither was the court called upon to determine whether a defense acquired after the transfer of a *negotiable* instrument but before notice would avail against the transferee. And further, neither case supports the proposition for which it is cited. The unfortunate statement in *Cain v. Spann* appears to have been made through mere inadvertence; and the court in *Jervey v. Strauss* expressly "chose, however, to reserve all questions concerning notice . . . ." *Id.* at 383.

137. 46 Mass. 7, 39 Am. Dec. 707 (1843).

138. *Id.* at 10, 39 Am. Dec. at 708.

139. *Id.* at 10, 39 Am. Dec. at 709.

140. *Id.* at 10, 39 Am. Dec. at 708.

perceive that the person, to whom he is making payment or giving credit, is no longer the holder of the note.[141]

And, although the transfer of an overdue note takes it with notice on its face that it is discredited,[142] he does take legal title. Knowing that the note is discredited, he is put upon inquiry and must be bound by such facts of which a diligent inquiry would apprise him. But the most diligent inquiry by the keenest and most perceptive of transferees would only inform him of demands *then acquired* by the maker against the payee.[143]

The question would appear to have been rendered academic in states which have passed the NIL. For there it is said that "in the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable."[144] And one cannot become a holder in due course unless he has taken the instrument "before it was overdue."[145] However, some courts have construed the provisions of the NIL in connection with the locally prevailing statutory provisions concering set-offs and have held them not to alter the scope of the set-off statutes.[146]

Accommodation Paper

Though not dealing explicitly with set-offs, the question arises as to whether the accommodation maker of a negotiable instrument is liable to a post maturity transferee. Suppose that *B*, unable to obtain credit, prevails upon *A*, without consideration, to execute a negotiable note to him as payee. *B*, the accommodated party, discounts *A*'s note at the bank, later reacquires it and *after maturity* transfers it to *C*. Can *A*, the accommodation party, set up the accommodation character of the note as a defense against an action by *C*?

There has been a conflict in the cases as to whether transferees like *C* who take accommodation paper after maturity *from the*

141. *Ibid.*

142. *Id.* at 11, 39 Am. Dec. at 709.

143. It would seem however, that if not the only, certainly the most effective method of inquiry as to the maker's defenses, is to inquire of the maker himself. And when such inquiry is made, the maker does in fact have notice of the transfer.

144. UNIFORM NEGOTIABLE INSTRUMENTS LAW § 58.

145. Id. at § 52(2).

146. *E.g.* Worden v. Gillett, 275 Fed. 654 (S.D. Fla. 1921). However the cases enunciating this proposition do not deal with the question of necessity of notice here discussed but generally deal with the type of defenses available against a holder not in due course. See note 122 *supra*. See 57 C.J. *Set-Off and Counterclaim* § 166 (1932).

accommodated party are subject to defenses between the accommodation and accommodated parties; and this divergence of opinion continues to exist despite the passage of the NIL.[147] One line of authority applies the same rule to accommodation paper as applies to negotiable instruments generally, holding that a transferee who takes such paper after it becomes due takes it subject to the equities between the original parties.[148] And, consequently, the accommodation party is liable on the note only when the transferee became a holder in due course before maturity of the instrument. However, even under this line of authority, one who takes accommodation paper from a holder who gave value for it before maturity may enforce it to the same extent that his transferee could.[149] So if *C* had obtained the note from the bank, *A* would be liable to him even though the bank knew of its accommodation character.

The opposite view holds that an accommodation party is liable absolutely to every party although the instrument was overdue when transferred and the taker had knowledge of its accommodation character.[150] This rule is predicated upon the theory that the parties to the accommodation hold themselves out to the public by their signatures to be *absolutely* bound to every person who shall take the note for value. This rule has been adopted in England and has found favor in several American cases. The Connecticut Supreme Court of Errors applied the principle in *Mersick v. Alderman*,[151] expressing the opinion that the cases holding otherwise "do not have the support of sound reason or safe policy."[152]

> We are not prepared to introduce into the law commercial a principal so repugnant to its spirit, and so fraught with danger.[153]

Under the Uniform Commercial Code, however, the accommodation party is liable in the capacity in which he has signed (here the maker) only when the instrument is taken for value

147. See 11 AM. JUR.2d *Bills and Notes* § 485. See Annot., 48 A.L.R. 1280 (1927).

148. Annot., 48 A.L.R. 1280, 1285 (1927).

149. 11 AM. JUR.2d *Bills and Notes* § 485 (1963). See Annot., 48 A.L.R. 1280, 1290 (1927).

150. Annot., 48 A.L.R. 1280, 1281 (1927).

151. 77 Conn. 634, 60 Atl. 109, 2 Ann. Cas. 254 (1905).

152. *Id.* at 635, 60 Atl. at 110.

153. *Ibid.*

before it is due.[154] Therefore those cases in jurisdictions originally following the English rule but later adopting the Commercial Code are overruled.

SET-OFF IN EQUITY

A court of equity, or a court possessing equitable jurisdiction, has the inherent power to allow or compel a set-off. This power is independent of set-off statutes. It was recognized and exercised prior to the enactment of such statutes and has not been taken away by their passage.[155] Although courts of equity generally follow the law in regard to matters of set-off, the strict requirements of maturity of the claims and mutuality are relaxed where it is necessary to prevent wrong or injustice.[156]

> The Courts have uniformly applied the principle of equitable set-off with great liberality to prevent injustice even in cases where elements requisite to legal set-off have been lacking.[157]

So when the assignor becomes insolvent and subsequently assigns the obligor's note, the obligor, when sued on the note by the assignee, may set-off an unmatured claim he holds against the insolvent assignor.[158]

> This rule, it is said, is based upon considerations of equity, and is adopted to prevent one party from losing his own demand on account of the insolvency of his immediate debtor, and from being at the same time compelled to pay the debt originally owing by himself to the insolvent assignor.[159]

---

154. When the instrument has been taken for value *before it is due* the accommodation party is liable in the capacity in which he has signed even though the taker knows of the accommodation. [Emphasis added.]
UNIFORM COMMERCIAL CODE § 3-415(2). The *Code* in § 3-415(1) would eliminate the requirement that to come within the definition of an accommodation party he must have signed the instrument "without receiving value therefor" that is embodied in S. C. CODE ANN. § 8-846 (1962).

155. 57 C.J.S. *Set-Off and Counterclaim* § 5 (1953).

156. The courts have repeatedly held that the absence of strict mutuality does not prevent the allowance of an equitable set-off, where justice demands it. Carwile v. Metropolitan Life Ins. Co., 136 S.C. 179, 198, 134 S.E. 285, 291 (1925).

157. *Ibid.*

158. Brown v. Lowe, 182 S.C. 9, 188 S.E. 182 (1936); Carwile v. Metropolitan Life Ins. Co., 136 S.C. 179, 134 S.E. 285 (1925); *Ex parte* Mechanics Fed. Savings and Loan Ass'n, 199 S.C. 23, 18 S.E.2d 592, 139 A.L.R. 714 (1942).

159. 47 AM. JUR. *Set-Off and Counterclaim* § 62 (1943).

The question has arisen in South Carolina in an action by the receiver of an insolvent bank against the obligor of a note discounted at the bank, the obligor attempting to set off a time deposit he held in the bank. The court in *Brown v. Lowe*[160] conceded that when a bank fails, a depositor who has borrowed from the bank occupies a more desirable position in relation to his deposit than one who has not borrowed. But the rule that a borrower-depositor may set off his deposit is too well established to be questioned, and a time depositor whose withdrawal is deferred for a stated time is just as much a depositor as one whose deposit is subject to check and immediate withdrawal.[161] It is immaterial to the right of set-off that the demands of the parties may not be due at the time of the failure of the bank.

> Insolvency alone, whether the demands of the parties by their terms are immediately payable or not, is sufficient to give rise to the right to have one demand offset against the other.[162]

However, it must be remembered that, though the assignee takes the note subject to set-offs and defenses in the obligor at the time the notice of the assignment is given, his rights are not affected by any matter or claim subsequently arising. Therefore, the insolvency of the assignor to give rise to an equitable set-off must occur *before* notice of the assignment.[163]

Another interesting problem concerning equitable set-offs arose in *Rives v. Rives*.[164] The defendant had a judgment against the plaintiff and the plaintiff bought a bill in equity to set off against the judgment a debt that was owed him by the defendant but was barred by the statute of limitations. The plaintiff charged that unless the court would lend its aid, he would be forced to pay the decree against him without having any remedy for the debt owed him by the defendant, the defendant being then insolvent.[165] The chancellor felt that the abstract justice of

160. 182 S.C. 9, 188 S.E. 182 (1936).

161. *Id.* at 12, 188 S.E. at 183.

162. *Ibid.*

163. The *subsequent* insolvency of the assignor cannot defeat the assignment or raise an equity that would enable the debtor to set off a debt not due. . . . [Emphasis added].
47 AM. JUR. *Set-Off and Counterclaim* § 62 (1943).

164. 7 Rich. Eq. 353 (S.C. 1855).

165. *Id.* at 355. There was some question as to the insolvency of the defendant, but he did concede that he was engaged in "mechanical pursuits" and that his circumstances were "exceedingly humble," and the court proceeded on the assumption that he was in fact insolvent.

the case was with the plaintiff but that "neither in this court nor in any other well regulated human tribunal, will the decision of the court always reach the pure equity of the particular case."[166] Finding only "an old case, cited in Francis' Maxims," in opposition to the rule,[167] the chancellor held that the plaintiff, having lost his legal remedy by laches, could not come into the court of equity for relief.[168] The law protects the vigilant, not those who sleep upon their rights.

CONCLUSION

The only major divergence between the law in South Carolina and what appears to be the prevailing view elsewhere in the apparent holding in *Harvin v. Galluchat*[169]—that the obligor must have actual personal notice of an assignment before his subsequently acquired set-offs and defenses are cut off. The rule appears to be an attempt at balancing the equities; for though the assignment of which the obligor is notified may be valid or invalid, the obligor must determine its validity at his peril. If he pays the assignee and the assignment is later found to be invalid, he must pay it over again to his original creditor; if instead he pays his original creditor and subsequently discovers that the assignment is in fact valid, the money is still owing to the assignee. In what better way may the courts protect the obligor than to require the purported assignee to confront him personally.

The rule may produce an inequitable result in cases where the assignment *is* valid and the assignee has acted with utmost good faith and believes himself to be protected. When he later confronts the obligor saying "Render to me that which is mine," he may learn to his sorrow that the obligor has already rendered it to the assignor. However, as fascinating as a system built solely on the basis of natural justice might be, the courts have found it both wise and expedient to set certain standards by which their equity powers are circumscribed—one of which is the principle that they are guided by the positive rules of case law.

J. KENDALL FEW

166. *Id.* at 356.
167. *Ibid.*
168. *Id.* at 357.
169. 28 S.C. 211, 5 S.E. 359 (1887).