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LAW REFORM COMMISSION OF BRITISH COLUMBIA

Working Paper No. 54

SET-OFF

This Working Paper is circulated for criticism and comment. It does not represent the final views of the Commission.

It would be appreciated if comments could be submitted by May 29, 1987.

SUITE 601, CHANCERY PLACE, 865 HORNBY STREET, VANCOUVER, B.C. V6Z 2H4

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January 26, 1987

The Law Reform Commission of British Columbia vs. established by the *Law Reform Commission Act* in 1969 and began functioning in 1970.

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Introductory Note

The Commission makes a general practice of inviting comment and criticism on its research and analysis prior to making a Report to the Attorney General on any particular subject. One of the means by which the Commission carries out this objective is the circulation of Working Papers to those persons, groups or organizations to whom the particular subject under study would be of interest.

This process of soliciting the comments of interested persons and bodies provides the Commission with the benefit of the experience and views of the community, and thereby assists the Commission in making proposals for the reform of the law that are both relevant and sound.

This Working Paper represents the present state of the Commission's research on the subject under study, and marks the point at which the views and comments of others would be of greatest value to the Commission. The final recommendations of the Commission will be developed in the light of the comment and criticism received.

It would be appreciated if comments were received by May 29, 1987 at the following address:

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CHAPTER I INTRODUCTION

A. Introduction

As a matter of common sense, when a person is required to perform an obligation, obligations he is owed in turn are usually taken into account at the same time. For example, A owes B $500. On another matter, B owes A $400. A payment by A to B of $100 would be the most straightforward method of satisfying these competing claims.

In British Columbia, the law, for the most part, adopts this common sense approach. A defendent, by raising a counterclaim, may seek judgment on obligations he is owed by the plaintiff in the proceedings commenced by the plaintiff.[1]

The right to assert a counterclaim was introduced in England in 1873.[2] Before that time, the general rule was that cross demands had to be pursued in separate proceedings.[3] There were several exceptions to that general rule,[4] the most important of which was set-off.

B. Set-off

The inability, before 1873, to pursue cross demands in the same proceeding led to not a little injustice. Rights of set-off were permitted, in a few discrete circumstances, to mitigate that inustice. The law in this context is discussed in some detail in Chapter II. Briefly, however, legislation permitted mutual debts to be set-off in the same proceedings.[5] Courts of Equity would

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[1] B.C. Rules of Court, 1976, R. 21.

[2] *Supreme Court of Judicature Act, 1873*, (U.K.) 36 & 37 Vict. c. 66, s. 24(3) ("*Judicature Act, 1873*"). That section is the predecessor of s. 6 of the *Law and Equity Act*, R.S.B.C. 1979, c. 224.

[3] *See, Stooke* v. *Taylor* (1880) 5 Q.B.D. 569, 575 (C.A.) *per* Cockburn C.J.:

> Set-off and counter-claim are both the creation of statute, the common law not admitting of the action of a plaintiff against a defendant being met by an independent claim of the defendant against the plaintiff, but leaving the defendant to his cross-action.

[4] *E.g.,* the right to an accounting. At common law, various defences could be raised to diminish the value of the plaintiff's claim, such as abatement of rent, abatement of the sum due for work and labour done, and abatement of the price of goods sold and delivered: *Federal Commerce and Navigation Ltd.* v. *Molena Alpha Inc. et al.*, 1978 3 All E.R. 1066, 1077 (C.A.).

[5] *An Act for the relief of debtors with respect to the imprisonment of their persons*, (U.K.) 1729, 2 Geo. II, c. 22, s. 13. Section 13 was made perpetual in *An Act to explain and amend an Act passed in the second year of the reign of his present majesty, intituled, An Act for the Relief of Debtors with Respect to the Imprisonment of their Persons*, (U.K. 1735, 8 Geo. II, c. 24, s. 4. A third statute, *An Act of explaining and amending an Act made in the last session of Parliament intituled, An Act for the Relief of Debtors with respect to the Imprisonment of their Persons*, (U.K.) 1730, 3 Geo. II, c. 27, is a companion piece of legislation to the first two Acts, but did not further alter statutory set-off. These statutes are collectively referred to in this Working Paper as the Statutes of Set-off. In *Canadian Imperial Bank of Commerce* v. *Tuckerr Industries Inc. et al.*, (1983) 149 D.L.R. (3d) 172, 174 (B.C.C.A.) Lambert J.A. notes that the Statutes of Set-off are part of the received law of British Columbia; *see*

also grant an injunction to prevent proceedings on one demand from continuing until proceedings could be brought on a cross demand intrinsically related to it.[6] This was known as equitable set-off.

The original reasons for the law of set-off vanished with the introduction of the right to counterclaim.

C. Assignment

Technical rules govern the making and enforcement of an assignment. The general rule is tht an assignment is subject to the equities that existed between the original parties before notice of the assignment was given.[7] This means that any defence that could have been raised against the assignor can also be raised against the assignee.[8]

Before 1873, the law of set-off determined which cross demands could be raised against the assignor proceeding in his own right. It also served to determine which cross demands could be raised to resist the assignee's claim.

In 1873 it was concluded that virtually any cross demand could be raised against the assignor[9] and, as a result, the law of set-off in this context lost its importance. That procedural change, however, did not affect the rights of the assignee. The law of set-off retained its significance where a claim was assigned.

D. Involuntary Assignments

In a number of circumstances, a third party is entitled to proceed on a demand which has not been formally assigned. This occurs, for example, as a result of death or insolvency. A personal representative, receiver, or trustee in bankruptcy is in a position analagous to that of an assignee.[10] The law of set-off retains its importance in this area as well.

E. Scope of the Working Paper

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also Pos v. *Pos*, (1985) 61 B.C.L.R. 388 (B.C.S.C.); cf. *Victoria Saanich Motor Transportation Co.* v. *Wood Motor Co.*, (1915) 8 W.W.R. 1124 (B.C.C.A.)

[6] The *Common Law Procedure Act, 1854*, (U.K.) 17 & 18 Vict., c. 125, ss. 83-86 permitted courts of common law to recognize some situations of equitable set-off. *See also* s. 24(2) of the *Judicature Act, 1873, supra*, n. 2. That section was the predecessor to s. 5 of the *Law and Equity Act, supra*, n. 2.

[7] *Canadian Encyclopedic Digest (Western)*, (3d ed., vol. 5) 25-61, § 190.

[8] *Ibid*.; Keetom and Sheridan, *Equity*, (2d ed., 1976) 209.

[9] *Supra*, n. 2.

[10] *See infra*, Chapter III.

Over the last several years, the economy has not performed well, resulting in an increase in receiverships and bankruptcies. The law o set-off has been considered in a number of recent cases and has dictated judgments which often appear to prejudice a person liable under an assigned claim. The issue addressed in this Working Paper is how well, the ancient law, formulated as it was in different social and economic conditions and for different purposes, functions to determine the matters which may be raised against an assignee. A further concern is that the principles underlying the law of set-off often appear to be misunderstood and misapplied. Whether the law of set-off should be retained, revised or restated is also considered in this Working Paper.

A number of statutes govern rights of set-off in particular situations. This legislation is described in Appendix A to this Working Paper. No proposals will be made respecting possible amendments to these provisions. When the Commission proceeds to final Report on the law of set-off, however, revising these provisions to accord with the general law of set-off will be considered. Comment on the legislation discussed in Appendix A, consequently, is invited.

The law of set-off is discussed in Chapter II, and its application against assignees is the subject of Chapter III. These Chapters are intended to give the reader some background on the law of set-off as it is applied by modern courts.

Chapter IV discusses the law critically, after reviewing its historical origins and development. It would appear that the modern law, although it purports to be based on precedent, is the result of several significant misconceptions of principle.

CHAPTER II SET-OFF AND COUNTERCLAIM

A. Introduction

The defence of set-off may be advanced pursuant to statute or in equity. Where a defendant is unable to set-off a cross demand, it may be pursued as a counterclaim. This chapter discusses the scope of set-off and its relationship with the procedure of counterclaim.

B. Statutory Set-off

With only a few exceptions, the common law viewed obligations between two or more people as separate matters. Cross demands arising from a single transaction might be joined in the same action, but only where one party's claim constituted a defence to the other party's claim. If A purchased defective goods from B, A would not be able to claim damages for breach of contract in a proceeding by B for the purchase price, but he would be able to raise those defects in defence to such an action to diminish the value recoverable.[1] In general, however, claim A had against B had to be pursued in proceedings separate from those claims B had against A.[2]

This approach was largely inefficient and often led to multiple proceedings. It also led to injustice. In the early eighteenth century a person could be imprisoned for failure to pay his debts. An anomalous situation arose where A and B each owed the other a sum of money. If B was unable to satisfy a judgment obtained by A, or bring his own action, he could be imprisoned. This was clearly unjust where the debt due to B was greater than the debt he owed. The Statutes of Set-off[3] were enacted in the eighteenth century to permit some kinds of cross demands to be pursued in the same proceeding. Where a plaintiff pursued a claim for debt, the defendent was permitted to raise as a defence a debt he was owed by the plaintiff arising from an unrelated transaction. The Statutes of Set-off only applied between the immediate parties and the defence was only available insofar as both cross-demands were for debt.[4]

> And be it further enacted by the authority aforesaid, That where there are mutual debts between the plaintiff and defendant, or if either party sue or be sued as executor or administrator, where there are mutual debts between the testator or intestate and either party, one debt may be set against the other, and such matter may be given in evidence upon the general issue, or pleaded in bar, as the nature of the case shall require, so as at the time of his pleading the general issue, where any such debt of the plaintiff, his testator or intestate, is intended to be insisted on in evidence, notice shall be given of the particular sum or debt so intended to be insisted on, and upon what account it became due, or otherwise such matter shall not be allowed in evidence upon such general issue.

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1 *Supra*, Chapter I, n. 4. *See also Allen* v. *Cameron*, (1833) 1 Cr. & M. 832, 149 E.R. 635; *Mondel* v. *Steel*, (1841) 8 M. & W. 858, 151 E.R. 1288; *Sale of Goods Act*, R.S.B.C. 1979, c. 370, s. 56(1).

2 *Supra*, Chapter I, m. 3.

3 *Supra*, Chapter I, n. 5.

4 *Ibid*., Statute of Set-off (1729), s. 13.

In some cases, a person might owe, and be owed, a debt, but in different capacities. For example, B owes A $500. A, as trustee for C, owes B $400. In this case, the debt owed B could not be set-off against the debt B owed A. The debts are not "mutual."[5]

Halsbury summarizes the scope of the right to statutory set-off as follows:[6]

> The right conferred by the Statutes of Set-off was a right to set off mutual debts arising from transactions of a different nature which could be ascertained with certainty at the time of leading. Thus, no legal set-off could exist against a claim which sounded damages be set off at law against a plaintiff's claim. The fact that a claim was framed in damages precluded the raising of a set-ff at law, notwithstanding that the claim might have been differently framed in a way that would have permitted such a set-off. Where a claim for a liquidated debt was joined by the plaintiff with a claim for damages, set-off at law might only be pleaded in defence to the former claim. Set-off at law operates as a defence.

C. Set-off in Equity

Even before the introduction of the Statutes of Set-off, the Court of Equity recognized that in some circumstances permitting a person to proceed on one claim without taking into account a competing claim would be inequitable.[7] In those circumstances, equity would grant on injunction restraining proceedings until proceedings on the competing claim were concluded. This came to be known as equitable set-off. Briefly, a right of set-off would be recognized whenever the cross demands were so related that it would be unconscionable not to permit the set-off:[8]

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[5] *McMahon* v. *Canada Permanent Trust Co.*, (1980) 17 B.C.L.R. 193, 197 (B.C.C.A.). *See also, Miller Contracting Ltd.* v. *Smith*, [1985) B.C.D. Civ. 943-04 B.C.S.C. **;** *Canadian Imperial Bank of Commerce* v. *Tuckerr Industries Inc. et al.*, (1983) 149 D.L.R. (3d) 172, 174, 46 B.C.L.R. 8, 10 (B.C.C.A.); *In re White- house & Co.*, (1878) 9 Ch. D. 595, 597 (C.A.).

[6] *Halsbury's Law of England*, (4th ed., vol. 42) 246, para. 421.

[7] Keeton & Sheridan, *Equity* (1976) 20:

> A person applying for an equitable remedy must be prepared, or may be forced, to act in an equitable manner himself ... [This principle] is the basis of the equitable doctrine of set-off.

See also Spry, *Equitable Remedies*, (3d ed., 1984), 174- 75; *see also Hanak* v. *Green*, [1958] 2 Q.B. 9, 18-9 (C.ATTY *Aries Tanker Corporation* v. *Total Transport Ltd.*, [1977] 1 W.L.R. 185 (H.L.). At p. 191 Lord Wilberforce notes:

> One thing is certainly clear about the doctrine of equitable set-off - complicated though it may have become from its involvement with procedural matters - namely, that for it to apply, there must be some equity, some ground for equitable intervention, other than the mere existence of a cross-claim.

[8] Spry, *ibid*. This would appear to be a modern formulation of equitable principles. A more rigorous description would observe that set-off in equity was available where transactions were sufficiently connected. Where, however, cross demands arose out of transactions insufficiently connected, "a Court of equity is bound to look into all the circumstances of the case, and see whether an equity is made out for blending the two matters together": *Rennick* v. *Bender*, [1924] 1 W.W.R. 270, 276 (Sask. K.B.); *see also Dodd* v. *Lydall*, (1842) 1 Hare 333, 337-8, 66 E.R. 1060, 1062; *Rawson* v. *Samuel*, (1841) Cr. & Ph. 161, 41 E.R. 451. The more narrow modern formulation, may be traced to the reaction of the common law courts to the reforms introduced by the *Common*

> What generally must be established is a relationship between the respective claims of the parties which is such that the claim of the defendant has been brought about by, or has been contributed to by, or is otherwise closely bound up with, the rights that are relied on by the plaintiff and which is such that it would be unconscionable that he should proceed without permitting a set-off.

When the *Judicature Act, 1873*[9] fused the courts of equity and common law, and introduced rights of counterclaim, injunctive relief was no longer necessary. Competing claims could be litigated in the same proceedings.

Hanak v. *Green*[10] is an example of equitable set-off arising between immediate parties. The plaintiff's claim was for breach of a building contract. The defendant's claim was for breach of contract, payment for additional work and trespass to the defendant's property by detention of tools. Statutory set-off was not available since the cross demands were not debts. However, since the cross demands arose from the same transaction, they could be set-off in equity.[11]

In *C.I.B.C.* v. *Tuckerr Industries Inc.*,[12] the British Columbia Court of Appeal described equitable set-off as follows:[13]

> Such a set-off has its origin in equity and does not rest on the statute of 1729. It can apply where mutuality is lost or never existed. It can apply where the cross obligations arise from the same contract, though mutuality has been lost, or where the cross obligations are closely related, or where the parties have agreed that a right to set-off may be asserted between them or where a court of equity would otherwise have permitted a set-off, as perhaps, in a case where credit was granted by a debtor to his creditor in reliance on the availability of a set-off.

D. Counterclaim

Law Procedure Act, 1854, (U.K.) 17 & 18 Vict., c. 125, ss. 83-6. The ability to recognize equitable defences, such as set-off, was restricted to those circumstances where equity would grant a permanent injunction and did not extend to circumstances where a temporary injunction would lie: *see, e.g. Wodehouse* v. *Farebrother*, (1855) 5 El. & Bl. 277, 119 E.R. 485, 489; *Sovereign Life Assurance Co.* v. *Dodd*, (1892) 2 Q.B. 573, 578 (C.A.).

9 *Supra*, Chapter I, n. 2.

10 *Supra*, n. 7.

11 *Hanak* has been criticized as confusing equitable set-of f with situations of assignment and of characterizing the test non-rigorously: Spry, *supra*, n. 7, at 177; Spry, "Equitable Set-offs," (1969) 43 Aust. L.J. 265, 270; *see also* Law Reform Committee of South Australia, *Relating to the Reform of the Law of Set-off*, (7 5th Report, 1983) at 7. Several of the claims which were set-off did not impeach the contract upon which the plaintiff was suing.

12 *Supra*, n. 5.

13 *Ibid*., at 175.

One reform introduced in England in 1873[14] was the defendant's right to plead a counterclaim against a plaintiff with respect to any matter that arose between them. The court retained the discretion to strike out a counterclaim or order that the counterclaim be heard separately.[15] At common law, if a defendant raised as a set-off a claim in excess of the amount of the claim against him, the court could not give judgment for the balance in his favour.[16] In British Columbia, Rule 21(15) permits the court to give judgment in favour of the defendant where the set-off or counterclaim exceeds the plaintiff's claim.[17] Because of the similar powers given to the court when dealing with a set-off or counterclaim between immediate parties there are few distinctions between the two pleas.[18]

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[14] *Judicature Act, 1873*, (U.K.) 36 & 37 Vict., c. 66, s. 24(3). That section is the predecessor of s. 6 of the *Law and Equity Act*, R.S.B.C. 1979, c. 224. The Judicature Commission recommended a more restricted right to counterclaim:

> We think, that a defendant, having a right or claim against a plaintiff with reference to the subject matter of the suit, or arising out of the same transaction, which at present he cannot enforce without a separate or cross action or suit, should be at liberty to bring forward such right or claim by his Answer, which, in that case, should have the same effect as if it were a Declaration in a cross action or suit, so as to enable the Court or a Judge to pronounce a final judgment between the parties with respect both to the original and to the cross demand. The same principle might, we think, be extended to the recovery of other demands of the defendant, capable of being set off against the plaintiff's demand, when the balance is in favour of the defendant. But a Judge should be empowered, on application by the plaintiff before trial, to refuse permission to allow such cross right or claim to be brought forward, if he shall be of opinion that it cannot conveniently be adjudicated upon in the case to be tried.

[15] Rule 21(13).

[16] *See, e.g., Stooke* v. *Taylor*, (1880) 5 Q.B.D. 569, 575 (C.A.) *per* Cockburn C.J.:

> The plea can only be used in the way of defence to the plaintiff's action, as a shield, not as a sword. Though the defendant succeeded in proving a debt exceeding the plaintiff's demand, he was not entitled to recover the excess; the effect was only to defeat the plaintiff's action, the same as though the debt proved had been equal to the amount of the claim established by the plaintiff, and no more.

[17] Rule 21(15) provides:

> Where a set-off or counterclaim establishes a defence to the plaintiff's claim, the court may give judgment for the defendant for any balance in his favour or for such other relief as the court thinks just.

[18] Rule 19(13) provided that:

> A defendant in a action may set-off or set up by way of counterclaim any right or claim, whether the set-off or counterclaim is for damages or not, so as to enable the court to pronounce a final judgment on all claims in the same action.

It has been suggested that this rule broadened the right of set-off so that it was the same as counterclaim: *see, e.g., Victoria Saanich Motor Transportation Co.* v. *Wood Motor Co., supra*, Chapter I, n. 5; *Zauscher* v. *Earl*, [1943] 2 W.W.R. 697 (B.C.C.A.); *Stucki* v. *Reed*, (1967) 61 D.L.R. (2d) 351, *rev'd*. but not on this point, (1967) 62 D.L.R. (2d) 535 (B.C.C.A.); the weight of authority, however, is against that proposition: *see Pos* v. *Pos*, (1985) 61 B.C.L.R. 388 (B.C.S.C.), *Coba Industries Ltd.* v. *Millie's Holdings's (Canada) Ltd and Tsang*, [1985] 6 W.W.R. 14 B.C.C.A. **;** *Mersey Steel and Iron Co.* v. *Naylor*, (1882) 9 Q.B.D. 648 C.A.; (1884) 9 App.Cas. 434 (H.L.); *Pellas* v. *Neptune Marine Ins. Co.*, (1879) 5 C.P.D. 34 (C.A.); *Re Milan Tramways Co.*, (1882) 22 Ch. D 122; (1884), 25 Ch. D 587 (C.A.); *Re Leeds and Hanley Theatres of Varieties, Ltd.*, [1904] 2 Ch. 45; *Stooke* v. *Taylor*, (1880) 5 Q.B.D. 569 (C.A.); *Stumore* v. *Campbell & Co.*, [1892] 1 Q.B. 314 (C.A.); *Dominion Trust Company* v. *Brydges*, (1920) 28 B.C.R. 451 (B.C.S.C.); *Kaps Transport Ltd.* v. *McGregor Telephone & Power Construction*

Distinctions between set-off and counterclaim nevertheless exist. One distinction arises when it comes to the determination of costs.[19] Where a successful set-off extinguishes the plaintiff's claim, the plaintiff will have costs awarded against him. The defendant will have judgment for the balance, if any, plus costs.

Where the claim is successfully advanced as a counterclaim, the court gives two judgments, one for the plaintiff and one for the defendant, and awards costs appropriately to each party on the basis of the success of his claim.[20]

In *Hanak* v. *Green*,[21] the defendant succeeded on a counterclaim. The court, however, held that since the claim could have been advanced as a set-off, costs should be awarded to the defendent on that basis, rather than on the basis of a successful claim and counterclaim. In British Columbia, it has been held that an election to plead a counterclaim rather than a set-off binds the defendant for the purpose of awarding costs.[22]

There is a further procedural distinction between set-off and counterclaim. Set-off is characterized as a defence to an action by a plaintiff.[23] When the plaintiff's claim is discontinued, the defendant may not proceed on a cross demand pleaded as a set-off unless further proceedings are commenced.[24] Where, however, a cross demand is pleaded as a counterclaim, the defendant may proceed on it even if the plaintiff discontinues his action. Rule 21(14) provides as follows:

> Where, in an action in which the defendant has set up a counterclaim, the action of the plaintiff is stayed, discontinued or dismissed, the counterclaim may proceed.

Co. Ltd., 1970) 13 D.L.R. 3d 732 (Alta. S.C., App. Div.).

[19] *See*: Williston and Rolls, *The Law of Civil Procedure* (vol. 2, 1970), at 719:

> The right to set-off is optional; no one is ever compelled to plead set-off, but there may be certain advantages in so doing:
>
> (a) Since set-off is a defence, if it is successful for the full amount of the claim, the action will be dismissed and the defendant will be entitled to costs of the action. If the set-off is not for the full amount of the claim, it may nevertheless have the effect of reducing the claim to one within the competency of an inferior court. On the other hand, in the case of a counterclaim, when a plaintiff succeeds on his claim and the defendant on his counterclaim, each party, subject to judicial discretion, is entitled to the costs which he had to incur to recover the claim and counterclaim respectively.

[20] *Victoria Saanich, supra*, Chapter I, n. 5.

[21] *Supra*, n. 7. It should be noted that the case involved a review of an arbitrator's decision so that it may not be characterized properly as a case in which a "counterclaim" was pleaded.

[22] *Victoria Saanich*, Chapter I, n. 5.

[23] *See, Stooke* v. *Taylor, supra*, n. 16.

[24] *Victoria Saanich, supra*, Chapter I, n. 5.

There is some merit in pleading a cross demand as a set-off and as a counterclaim in the alternative. If the set-off is not properly pleaded, judgment may issue on the counterclaim. Moreover, if the plaintiff discontinues his action, the counterclaim may continue.[25]

E. Exceptions

1. Freight

A claim for payment under a voyage charter (known as "freight") is not subject to rights of set-off arising, for example, from deficiencies in the services performed.[26] This has significance only when the right to payment has been assigned:[27]

> However, since the cross-complaint ranks as a counterclaim, and having regard to the practice and procedure in relation to counterclaim, it is rare for the charterer to suffer any disadvantage in practice.

2. Negotiable Instruments

Commerce requires a medium of exchange. For that reason, negotiable instruments are not subject to principles of set-off except to a limited extent between the immediate parties.[28] Bills of exchange are a matter of federal jurisdiction and will not be considered in this Working Paper.

F. Summary

The law of set-off represents early developments of the law to deal with procedural limitations. The inability to pursue cross demands in the same proceeding led to the development of principles which would permit the courts to take into account some kinds of cross demands. In 1873, those procedural limitations were removed. Since the introduction of the right to counterclaim, the law of set-off has been further modified so that, insofar as immediate parties are concerned, there are few distinguishing features between them.

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[25] *See, McGown* v. *Middleton*, (1883) 11 Q.B.D. 464, 470 (C.A.).

[26] *Aries Tanker Corp*. v. *Total Transport Ltd.*, [1977] 1 All E.R. 398, [1977] 1 W.L.R. 185 (H.L.); *The Alfa Nord*, [1977] 2 L1.L.R. 434 (C.A.); James & Co. *Scheep-vaarten Handelmij B.V*. v. *Chinecrest Ltd.*, 1979 1 L1.L.R. 126 (C.A.); in *Federal Commerce, supra*, Chapter I, n. 4, a distinction was drawn between a claim for freight for the carriage of cargo, and hire for the use of a vessel under a time charter party. Set-off was available in the latter instance; *see also Santiren Shipping Ltd.* v. *Unimarine S.A.*, [1981] 1 All E.R. 340 (Q.B.).

[27] *Halsbury's* (4th ed., vol. 42) para. 413.

[28] *Ibid*., at para. 414; *see also* B. Geva, *Financing Consumer Sales and Product Defences* (1984) Chapter 5; Cheshire & Fifoot, *The Law of Contract* (11th ed. 1986) at 508; *Iraco Ltd.* v. *Staiman Steel Ltd.*, (1986) 54 O.R. (2d) 488 H.C.); Crawford & Falcombridge, *Banking and Bills of Exchange*, (8th ed., 1986) Chapter 50.

CHAPTER III ASSIGNMENTS

A. Introduction

A person owed an obligation may assign it to an- other.[1] For example, B owes A $500. The debt obligation represents a property right, which can be conveyed away. A nay sell to C the right to collect the money owed by B. An assignment is said to be "subject to the equities".[2] An assignee, as a general rule, is in no better position than the assignor. Any defences B could have raised against A can also be raised against C. These defences are the "equities" to which an assignment may be subject.[3]

It is difficult to dispute the principle that an assignee should be in no better position than the assignor. The manner in which the law determines that issue, however, is anamolous. It rests on legal principles that lost their validity in 1873. As a result, the law governing those matters which may be raised to resist an assigned claim is exceedingly complex.

B. Set-off Against Assignees

It was mentioned in Chapter II that a defendant can raise a claim against a plaintiff either by counterclaim or, in some cases, by set-off. Where the defendant seeks to raise a claim he has against an assignor in proceedings commenced by an assignee, it may only be raised as a set-off. The principles which determine matters that may be raised as set-offs, discussed in Chapter II, apply in this context as well. Where the plaintiff's demand and the defendant's cross-demand are liquidated, they may be set-off. Where, however, one claim is liquidated and the other unliquidated, or both claims are unliquidated, they must arise from the same or a related transaction before they may be set-off.

The need for cross demands to arise from the same or a related transaction is indicated by two classic cases involving set-off against an assignee.

In the 1878 case of *Young* v. *Kitchin*[4] the plaintiff was assignee of the debt due under a building contract. The defendant alleged that there were breaches of the contract and that he should be entitled to set-off damages against the debt assigned. The debt, the court concluded,

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1 *See, e.g., Law and Equity Act*, R.S.B.C. 1979, c. 224, s. 32, derived from s. 23(6) the *Judicature Act, 1873*. Before that Act, assignments were only recognized in Equity: see G.H. Treitel, *The Law of Contract*, (6th ed., 1983) Ch. 16.

2 *Supra*, Chapter I, n. 7; the "equities" include rights of set-off available against the assignor: *Re Knapman*, (1881) 18 Ch. D. 300 (C.A.); *Re Jones*, [1987] 2 Ch. 190.

3 *Supra*, Chapter I, n. 8.

4 (1878) 3 Ex. D. 127; this decision is regarded as seminal with respect to rights of set-off on an assignment. It might more properly be characterized as a situation of abatement. Logically, however, the abatement cases should be subsumed as part of the law of set-off and counterclaim.

was assigned subject to the equities in existence at the time of notice of the assignment to the debtor and allowed the cross demands to be set-off. Statutory set-off was unavailable because the defendant's claim was for an un- liquidated amount.

The 1888 decision of *The Government of Newfoundland* v. *The Newfoundland Railway Company and others*[5] involved competing claims arising from related transactions. The government contracted with the company to build a railway. By a collateral agreement, the government agreed to provide land grants as the work progressed, and subsidies at various intervals. The railway company assigned the benefits of these subsidies to a third party. The court found that the liability to pay the subsidies was independent of progress on the work. Nevertheless, because of the fundamental relationship between the two contracts, the court ruled that a set-off of the damages for breach of the building contract should be permitted against the amount of the subsidies due.

It is sometimes difficult to determine whether contracts are sufficiently related to permit set-off. In *Aboussafy* v. *Abacus Cities Ltd.*[6] the plaintiff's claim arose from the third of three related contracts entered into over several years. The first contract involved a sale of land. The second involved a building contract for the development of the land. The third involved management of the building once completed. Only a claim for damages arising from the breach of the third contract could be pleaded as a set-off. Unliquidated claims arising from breaches of the earlier contracts could not be set-off against claims on the management contract, even though the contracts were related to some extent.

C. Notice of the Assignment

The rights of an assignee are subject to the equities in existence at the time of notice to the person liable under the assigned obligation.[7] For example, A owes B $500. H assigns that amount to C. A, without notice of the assignment, allows H to incur a debt for $400. C then gives notice of the assignment from B. A may set-off the claim for $400 against the assigned claim and as a result only owe C $100.[8] If C had given notice to A before B incurred the debt, C would have been entitled to the full amount of $500.

Notice fixes the rights of the parties to the assignment. No claims can be made against the assignee with respect to new matters arising between the debtor and assignor after notice of the

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5 (1888) 13 App. Cas. 199 (P.C.).

6 (1981) 124 D.L.R. (3d) 150 (Alta. C.A.); *see also Watson* v. *Mid Wales Railway Company*, (1867) L.R. 2 C.P. 593.

7 *Supra*, Chapter I, n. 7; *supra*, m. 1; *see also Cottage Club Estates Ltd.* v. *Woodside Estates Co. (Amersham Ltd.*, [1928] 2 K.B. 463, 467; *Jones* v. *Farrell*, (1857) 1 DeG. & J. 208, 44 E.R. 703; *Royal Bank of Canada* v. *Gustafson*, (1924) 33 B.C.R. 379 (S.C.); *Canadian Admiral Corp*. v. *L.F. Dommerich & Co. Inc.*, [1964] S.C.R. 238. This position is equally true with respect to equitable assignments of legal choses in action: *Dennison* v. *Knox*, (1864) 24 U.C.Q.B. 119; *Whitehouse* v. *Roots*, (1860) 20 U.C.Q.B. 65.

8 *Canadian Admiral Corp. Ltd.* v. *L.F. Dommerich & Co. Inc., ibid*.9.

assignment.[9] There is some hazard to the assignee who delays giving notice. New obligations may arise between the debtor and assignor. The assigned claim may well be subject to these obligations.

D. Involuntary Assignments

It was mentioned in Chapter I that when a person dies or becomes insolvent, a third party may proceed on a demand that has not been formally assigned. Defences that may be raised against a personal representative, liquidator, receiver or trustee in bankruptcy are determined by the law of set-off.

In these situations, "notice of the assignment" occurs on the person's death,[11] on the commencement of the liquidation,[12] on the appointment of the receiver[13] or on the receiving order being made in bankruptcy.[14]

1. Receivers

A receiver may be appointed by court order or pursuant to a security instrument:[15]

> A receiver is a person appointed for the collection or protection of property. He is appointed either by the court or out of court by individuals or corporations. If he is appointed by the court, he is an officer of the court deriving his authority from the court's order. If he is appointed out of court, he is an agent and has such powers, duties and liabilities as are defined by the instrument or statute under which he is appointed and derive from the general law of agency.

The duty of the receiver is to liquidate the assets over which he has been appointed, and collect on claims. A person appointed as a receiver manager has the additional power to run the business over which the appointment is made.[16]

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[9] *Ibid.; see also Royal Bank of Canada* v. *Gustafson, supra*, n. 7. An exception is made if the claim arises from the assigned contract: *infra*, n. 34.

[11] *Milan Tramways Co.*, (1884) 25 Ch. D. 587 (C.A.); *Sankey Brook Coal Co.* v. *Marsh*, (1871) L.R. 6 Ex. 185; *United Ports and General Insurance Co.*, (1877) 46 L.J. Ch. 403.

[12] *Mersey Steel* v. *Naylor*, (1884) 9 App. Cas. 434 (B.L.).

[13] In *Biggerstaff* v. *Rowatt's Wharf Ltd.*, [1896] 2 Ch. 93 (C.A. it was argued by the debenture holder that the assignment was complete when the debenture was issued. The court held that the assignment was complete upon the appointment of the receiver.

[14] *Bankruptcy Act*, R.S.C. 1970, c. B-3, s. 50(5); *Re Bright's Settlement*, (1880) 13 Ch. D. 413 (C.A.); *Re Daintre* , 1900 1 Q.B. 546 (C.A.); *Re Wallis*, [1902] 1 K.B. 19.

[15] *Halsbury's Laws of England*, (4th ed., vol. 39) 403, para. 801.

[16] The distinction between a receiver and manager is noted in *Re Manchester & Milford Railway Co.: Ex parte Cambrian Railway Co.*, (1880) 14 Ch. D. 645, 653 (C.A.):

> "A receiver" is a term which was well known in the Court of Chancery, as meaning a person who receives rents or other income paying ascertained outgoings, but who does not, if I may say so, manage the property in the sense of buying or selling or anything of that kind. We were most familiar with the distinction in the case of a partnership. If a receiver was appointed of partnership assets, the trade

A court appointed receiver is an officer of the court[17] and owes a fiduciary duty to the debtor, the party who sought the appointment and the other creditors.[18] A privately appointed receiver is usually deemed to be the agent of the debtor by the security document under which he is appointed.[19] For some purposes, however, he is also the agent of the secured creditor making the appointment.[20] This "double agency" can cause problems with respect to rights and duties of the receiver.[21]

The appointment of a receiver crystallizes the rights of the secured creditor under the security document and entitles the secured creditor to realize on the assets of the debtor.[22] Realization is usually done by the receiver but, in some instances, the secured creditor may exercise its rights directly.

Following the appointment of a receiver, the debtor ceases to have the power to carry on the business.[23] If the receiver is also appointed manager, the persons who deal with him are for some

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> stopped immediately. He collected all the debts, sold the stock in trade and other assets, and then under the order of the Court the debts of the concern were liquidated and the balance divided. If it was desired to continue the trade at all, it was necessary to appoint a manager, or a receiver and manager as it was generally called. He could buy and sell and carry on the trade... [s]o that there was a well known distinction between the two. The receiver merely took the income, and paid necessary outgoings, and the manager carried on the trade or business in the way I have mentioned.

17 *See Company Act*, R.S.B.C. 1979, c. 59, s. 111.

18 *See, e.g., Royal Bank of Canada* v. *Vista Homes Ltd. et al.*, (1984) 54 C.B.R. 124 (B.C.S.C.); *Ostrander* v. *Niagara Helicopters Ltd.*, (1973) 1 O.R. (2d) 281 (Ont. S.C.); *Royal Trust Co.* v. *Montex Apparel Industries Ltd.*, [1972] 3 O.R. 132 (Ont. C.A. . The *Vista Homes* decision motes the independent status of a court appointed receiver and that in some situations the receiver manager should have independent counsel. Where a receiver is instrument appointed, s. 113 of the *Company Act, ibid*., provides that the receiver or receiver manager "stands in a fiduciary relationship to the corporation."

19 Such a provision is usually included in the document itself but in British Columbia s. 112(1) of the *Company Act, supra*, n. 17 provides that

> Every receiver or a receiver manager appointed under an instrument is an officer of the corporation and not an agent of the persons by, or on whose behalf, he is appointed ...

For an application of this section *see Attorney General of Canada* v. *Banque Nationale de Paris (Canada)*, (1984) 57 B.C.L.R. 360 B.C.S.C.

20 In *Peat Marwick Ltd.* v. *Consumers' Gas Co.*, (1981) 29 O.R. (2d) 336, 344 (C.A.) Houlden J.A. noted that notwithstanding the "deemed agency" provision of the debenture that:

> It seems to me that the receiver and manager in a situation, like the present, is wearing two hats. When wearing one hat, he is the agent of the debtor company; when wearing the other, the agent of the debenture holder. In occupying the premises of the debtor and in carrying on the business, the receiver and manager acts as the agent of the debtor company. In realizing the security of the debenture holder, notwithstanding the language of the debenture, he acts as the agent of the debenture holder, and thus is able to confer title on a purchaser free of encumbrance.

21 Bennett, *Receiverships*, (1985) at 112-4.

22 *Supra*, n. 13.

23 The appointment of a receiver completes the assignment of the assets of the company granting security. Because the company does not own the assets free and clear, and does not have the power and authority to sell the assets on behalf of the secured creditor, the business is frozen.

purposes dealing with a new party. Rights that arise after the appointment of the receiver cannot be balanced or set-off against rights that existed before the appointment.

2. Bankruptcy

The vesting of property in the trustee in effect allows the trustee to step into the shoes of the bankrupt for the purposes of realization:[24]

> Upon bankruptcy, the assets of the bankrupt vest in the trustee who ordinarily takes subject to all equities and subject to every right which can be asserted against the bankrupt itself.

The trustee is able to realize on the property for the benefit of the bankrupt's creditors. In so doing the general law of set-off applies. Section 75(3) of the *Bankruptcy Act* provides that:

> The law of set-off applies to all claims made against the estate and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were plaintiff or defendant, as the case may be, except insofar as any claim for set-off is affected by the provisions of this Act respecting frauds or fraudulent preferences.

The phrase "the law of set-off" refers to the law of set-off of the province in which the application for set-off is made.[25]

The law of set-off is not uniform across Canada. Some provinces such as British Columbia, rely on the Statutes of Set-off and the common law while others have statutory provisions on set-off.[26] While these modern statements tend to adopt the concept of mutual debts between parties,

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[24] Holden and Morawetz, Bankruptcy Law of Canada, vol. 1 (1984), section F § 49, p. F-89. New Brunswick in the *Supreme Court Act*, C.S.N.B., 1903, c. 111, ss. 117 and 118 provided for a right of set-off but that statutory provision is not expressly found in the present legislation. These sections provide that:

> 117. A defendant in any action may set- off against the claim of the plaintiff any right or claim whether such set-off sound in damages or not.
>
> 118. Such set-off shall have the same effect as if relief were sought in a cross action and so to enable the Court to pronounce a final judgment in the same action, both on the original and the cross claim.

The *Supreme Court Act* was repealed by the *Judicature Act, 1909*, S.N.B. 1909, c. 5.

[25] *See, Re Merker*, (1985) 54 C.B.R. 153 (Ont. S.C.); *Coopers & Lybrand Limited* v. *Lumberland Building Materials Ltd.*, (1983) 49 B.C.L.R. 239 B.C.S.C.).

[26] *See, Courts of Justice Act, 1984*, S.O. 1984, c. 11, s. 124; *The Queen's Bench Act*, R.S.M. 1970, c. C-280 ss. 78-9. Other provinces appear to rely on the Statutes of Set-off and on the common law.

some jurisdictions such as Ontario, allow a set-off where the debts may not be owed by or to the person in the same capacity.[27]

In most of the cases noted by Houlden and Morawetz,[28] set-offs claimed against a trustee in bankruptcy involve mutual debts. Recently, however, some cases have involved equitable set-offs of related claims.[29]

E. Specific Issues

1. Demands Not Matured at Time of Notice of Assignment

Although there is some authority to the contrary,[30] it would appear that set-off will only be permitted where both cross-demands have matured before notice of the assignment. In C.I.B.C. v. *Tuckerr Industries Inc.*,[31] the defendants raised an overdue account as a set-off against rent payments accruing due after notice of the assignment. In *Business Computers Ltd.* v. *Anglo-African Leasing Ltd.*,[32] the defendants raised as a set-off payments owed to them under a hire-purchase agreement accruing due after notice of the assignment. In neither case was the set-off permitted.[33]

An exception is made where the cross demands arise from the same contract.[34]

2. Agreements Respecting Set-off

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[27] The Ontario *Courts of Justice Act, 1984, ibid*., s. 124(2) provides that:

> Mutual debts may be set off against each other, notwithstanding that they are of a different nature or that one debt is owed to or by a person in a personal capacity and the other debt is owed by or to the person in a capacity other than personal.

[28] *Supra*, n. 24 at F§95, p. F-168.

[29] *See, Lumberland Building Materials Ltd., supra*, n. 25.

[30] *Ibid.; Ex. p. Bates*, (1870) 39 L.J. Ch. 496 (on a winding-up); *see also, West Street Properties Pty. Ltd.* v. *Jamison*, [1974] 2 N.S.W.L.R. 435 (S.C.); *Re Pinto Leite and Nephews*, [1929] 1 Ch. 221, 235; *Jeffryes* v. *Agra and Masterman's Bank*, (1866) L.R. 2 Eq. 674, 680; *Christie* v. *Taunton*, [1893] 2 Ch. 175.

[31] (1983) 149 D.L.R. (3d) 172, 46 B.C.L.R. 8 (B.C.C.A.); *cf. West Street Properties Pty. Ltd.* v. *Jamison, ibid*.

[32] [1977] 2 All E.R. 741 (Ch.).

[33] *See also Felt & Textiles* v. *R. Hubrich Ltd.*, (1968) N.Z.L.R. 716 (S.C.); *Rapid Data* v. *Government of Canada*, (1978) 23 N.R. 54 (Fed. C.A.); *Simpson* v. *Keir*, (1982) 6 W.W.R. 307 (Sask. K.B.).

[34] *Canadian Encyclopedic Digest (Western)* (3rd ed., vol. 5 25-65, 209; *see also Biggerstaff* v. *Rowatt's Wharf Ltd., supra*, n. 13; *Parsons* v. *Sovereign Bank of Canada*, [1913] A.C. 160 (P.C.); *Graham* v. *Johnson*, (1869) L.R. 8 Eq. 36; *William Pickersgill & Sons Ltd.* v. *London & Provincial Marine & General Insurance Co. Ltd.*, [1912] 3 K.B. 614; B. Geva, *Financing Consumer Sales and Product Defenses*, (1984) Ch. 3 at 52.

It is open to the parties to agree whether or not particular obligations may be set-off.[35] The agreement may be express or implied.[36]

In *Rother Iron Works Ltd.* v. *Canterbury Precision Engineers Ltd.*[37] the plaintiff owed the defendant L124 The plaintiff had sold goods to the defendant for L159. The goods were ordered before, but not delivered until after, the appointment of a receiver. There was no mutuality of parties, nor were there cross demands arising from the same or similar contracts. Nevertheless, the court found that there was an implied agreement to set-off the obligations:[38]

> ... if the obligation of the defendant to pay L159 be regarded as a chose in action on its own it never, in our view, came into existence except subject to a right of set-off the L124 as, in effect, payment in advance. That which became subject to the debenture charge was not L159, but the net claim sustainable by the plaintiff of L35.

Similarly, it is open to the parties to agree that particular obligations are not subject to set-off.[39]

3. Set-off of a Cross Demand Acquired By Assignment

Occasionally, a person under an obligation to another will acquire a cross-demand from another. Where this cross-demand is acquired after receipt of notice of assignment of the primary obligation, it may not be set-off.[40] This is consistent with the general rules concerning assignments. Moreover, in terms of policy, on a receivership or bankruptcy, consolidating claims in this way is likely to prejudice secured creditors. Where the cross-demand is acquired before notice of the assignment is received, however, it may be set-off.[41]

F. Summary of Set-off in Assignment Situations

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[35] *C.I.B.C.* v. *Tuckerr, supra*, n. 31; *Freeman* v. *Lomas*, (1851) 9 Hare 109, 68 E.R. 435; *Re Go & Co. Ltd.*, [1900] 2 Ch. 149, 154; *Mangles* v. *Dixon*, 1852 3 H.L.C. 702; *Re Agra and Masterman's Bank*, (1867) L.R. 2 Ch. App. 391 (C.A.).

[36] *Watson* v. *Mid Wales Rl Co., supra*, n. 6; *Smith* v. *Parkes*, (1 16 Beav. 115, 119, 51 E.R. 720, 722.

[37] [1974] 1 Q.B. 1 (C.A.).

[38] *Ibid*., at 6; *see also Sigurdson* v. *Regina* (1982) 33 B.C.L.R. 190 (B.C.C.A.). In some cases this view of set-off has been overlooked. Instead, the principle claim is regarded as being assigned to the debenture-holder before the pre-existing set-off can attach to it: *C.I.B.C.* v. *Tuckerr, supra*, n. 31; *see also*, P.C. Lee, "The Law of Set-off," *Receivers*, Continuing Legal Education, June 1985.

[39] *Phoenix Assurance Co. Ltd.* v. *Earl's Court Ltd.*, (1913) 30 T.L.R. 50 (C.A.); except, perhaps, in bankruptcy: *Halsbury's Laws of England*, (4th ed., vol. 3) para. 751 40. *See, e.g., Bennett* v. *White*, [1910] 2 K.B. 1 *rev'd*. [1910] 2 K.B. 643 (C.A.); *N.W. Robbie & Co. Ltd.* v. *Witne Warehouse Co. Ltd.*, [1963] 3 All E.R. 613 (C.A.).

[40] *See, e.g., Bennet*, v. *White*, [1910] 2 K.B. 1 *rev'd* [1910] 2 K.B. 643 (C.A.); *N.W. Robbie & Co. Ltd.* v. *Witney Warehouse Co. Ltd.*, [1963] 3 All E.R. 613 (C.A.).

[41] *Thibaudeau* v. *Garland*, (1896) 27 O.R. 391 (Div. Ct.).

An assignee will be subject to the same rights of set-off that would have been available against his assignor before notice of the assignment was given to the defendant. This principle holds true where the assignment is involuntary and occurs because of the death or insolvency of a party. In particular,

1. Mutual debts in existence between the assignor and defendant at the time of notice of the assignment may be set-off;[42]

2. A defendant may set-off liquidated or unliquidated claims arising from related contracts where those claims were in existence at the time of notice of the assignment, provided they go to the very root of the assignee s claim;[43]

3. A defendant may set-off liquidated or unliquidated claims arising from the contract which has been assigned, whenever they arise;

4. A defendant may set-off any claim where the assignor and defendant agreed to allow a set-off;[44]

These appear to be the principles of the law of set-off that are being applied by modern courts. For their justification, courts refer to nineteenth century precedents. A review of the former law, however, reveals that this is a modern synthesis which is based upon several mis-conceptions.

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[42] *Biggerstaff* v. *Rowatt's Wharf Limited, supra*, n. 13; *Coopers & Lybrand Limited* v. *Lumberland Building Materials Ltd., supra*, n. 25; a defendant may not acquire a debt for the purposes of set-off subsequent to notice of the assignment either by assignment from a third party or by agreement with the receiver or trustee in bankruptcy: *N.W. Robbie & Co. Ltd.* v. *Whitney Warehouse Co. Ltd., supra*, n. 40; *see also United Steel Corp. Ltd.* v. *Turnbull Elevators of Canada Ltd.*, [1973] 2 O.R. 540 (C.A.); *Lynch et al.* v. *Ardmore Studios (Ireland) Limited and Hayes*, [1966] I.R. 133 (S.C.); *Northern Electric Company Limited* v. *Auto Service Company Limited*, (1961) 2 C.B.R. 218 (Nfld. S.C.); *Royal Bank of Canada* v. *Wallace Investments Limited*, (1961) 3 C.B.R. 34 (B.C.Co.Ct.); *Felt and Textiles of New Zealand* v. *R. Hubrich Limited in Receivership, supra*, n. 33; *Simpson Shatula Redi-Mix & Building Ltd.* v. *Keir Tire Ltd.*, (1982) 45 C.B.R. 26 (Sask. Q.B.); *Fair* v. *M'Iver*, (1812) 16 East. 130, 104 E.R. 1038; *Lackington* v. *Combes*, (1839) 6 Bing. N.C. 71, 133 E.R. 28; *Re Gillespie*, (1885) 14 Q.B.D. 963; *Forster* v. *Wilson*, (1843) 12 M. & W. 191, 152 E.R. 1165.

[43] *Aboussafy* v. *Abacus Cities Ltd., supra*, n. 6.

[44] *Supra*, nn. 35, 36 and 39.

CHAPTER IV HISTORICAL OVERVIEW

A. Introduction

In previous chapters, the modern law of set-off has been outlined, generally by a review of cases and principles developed since the introduction of the Judicature Acts. The preceeding discussion has tended to be more descriptive than analytic.

In this Chapter we examine the law of set-off from a different perspective. Why is it in its current form? This involves an analysis of the policies underlying the law of set-off. It also requires an historical overview of its development. It will be seen that the modern law of set-off is a peculiarity, and largely the result of confusion arising from sweeping nineteenth century legal reform.

B. Procedural Problems Before the Judicature Act

Before the fusion of law and equity, courts had defined and limited jurisdictions. Courts of common law could not grant equitable remedies. Courts of equity could not grant common law remedies.[1] Moreover, procedure was aimed at precisely defining the issues between the parties. As a general rule, claims parties had against each other were viewed as unrelated. Each proceeding was limited to a specific claim. A cross demand had to be the subject of a separate

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[1] The *Common Law Procedure Act, 1854*, 17 & 18 Vict., c. 125, attempted to alter this state of law, with limited success. The Judicature Commissioners, for example, observed that:

> The authority now possessed by the Court of Chancery to decide for itself all questions of Common Law has no doubt worked beneficially. But the mode of taking evidence orally before an examiner, instead of before the Judge who has to decide the case, has justly caused much dissatisfaction; and Trial by Jury, - whether from the reluctance of the Judge or of the Counsel to adopt such an innovation, or from the complexity of the issues generally involved in the suit, or because the proceedings in Chancery do not give rise to so many conflicts of evidence as proceedings in other Courts, - has been attempted in comparatively few cases.
>
> In the Common Law Courts the power to compel discovery has been extensively used, and has proved most salutary; but the jurisdiction conferred to those Courts to grant injunctions and to allow equitable defences to be pleaded has been so limited and restricted, - the former extending only to cases where there has been an actual violation of the right, and the later being confined to those equitable defences where the Court of Chancery would have granted a perpetual and unconditional injunction, - that these remedies have not been of much practical use at Common Law, and Suitors have consequently been obliged to resort to the Court of Chancery, as before, for the purpose of obtaining a complete remedy.
>
> Much therefore of the old mischief still remains, notwithstanding the changes which have been introduced; and the Court of Chancery necessarily continues to exercise the jurisdiction of restraining actions at law on equitable grounds, and even claims to exercise that jurisdiction in cases where an equitable defence might be properly pleaded at Common Law.

Judicature Commission, *First Report*, (1869) at 6-7.

proceeding. This was most clear in the common law courts. To permit a cross demand to be raised in a proceeding would be to permit "an action without a writ, consequently without authority."[2]

A further problem was perceived with respect to liquidated and unliquidated claims. If a party's claim was fixed or ascertained, it was easier to deal with. If it required assessment, this would complicate the proceedings. The Statutes of Set-off, consequently, permitted set-off only of liquidated demands. To permit set-off where one demand was unliquidated would add too much complexity to a proceeding. Once an unliquidated claim had been reduced to judgment, however, it was a liquidated claim and could be set-off.[3] The nature of the claim, consequently, was irrelevant. What was relevant were perceived procedural difficulties.

Many of the complaints made of the administration of justice in England during the eighteenth and nineteenth centuries were leveled at the circuitous and multiple proceedings that resulted from these basic principles concerning procedure.[4] Moreover, injustice frequently arose where the cross demands were intrinsically related.

Equity responded where the claims were sufficiently related.[5] The procedural difficulties, the divided jurisdictions of the courts and the problems presented by unliquidated claims were overcome by restraining proceedings on one demand until proceedings on a cross-demand could be brought in the appropriate court.[6] This was equitable set- off. It is clear that, in its formulation, it was not a *defence* to a claim. It was a procedural device. It was, however, characterized as a

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[2] *Green* v. *Farmer*, (1768) 4 Burr. 2214, 98 E.R. 154.

[3] *See, Edwards* v. *Hope*, (1885) 14 Q.B.D. 922 (C.A.); *Kallio* v. *Russell Timber Company Limited*, [1942] S.C.R. 346; *Kohen* v. *Cully Breay & Dover*, (1925) 57 O.L.R. 533 (Ont. C.A.).

[4] *Supra*, n. 1.

[5] The procedure by which set-off in equity was applied embraced the equitable remedies of injunction and account: *Rawson* v. *Samuel*, (1841) Cr. & Ph. 161, 41 E.R. 451; *Clark* v. *Cort*, (1840) Cr. & Ph. 154, 41 E.R. 449. Once an action at law was commenced against which a cross-demand could be established, the defendant could file a bill in equity requesting an injunction restraining the action from proceeding. An affidavit in support of the bill had to disclose sufficient equitable grounds for injunctive relief. An answer to the affidavit, by the plaintiff at law would follow by way of replication. If sufficient equity were found, the court would issue either an interim or perpetual injunction. An interim injunction would issue where a temporary halt to the proceedings at law was required. During the stay, a cross demand could be pursued at law. Alternatively, an account might be taken in equity and the balance thus determined set off against the amount recovered in the action at law: *Rawson* v. *Samuel, ibid*., at 458. A perpetual injunction, would issue where the plaintiff at law was found to have no claim against the defendant: in circumstances of fraud, or the cross-demands exceeded the plaintiff's claim: *Ex parte Stephens*, (1805) 11 Ves. Jun. 24, 32 E.R. 996. A defendant who established a claim in equity, in excess of the plaintiff's at law, was not able to recover the surplus under equity's jurisdiction. Thus, set-off in equity came to be understood as a plea in bar to the plaintiff's action at law. Equity would also restrain, where necessary, a judgment from proceeding to execution until a cross demand had been determined: *Rawson* v. *Samuel, ibid*. But terms could be imposed upon the applicant for the injunction. For example, a stay of execution on a judgment might be granted to an applicant upon payment of the amount of judgment into court pending the cross-claim. Set-off in equity was grounded upon equity's special procedures: injunction, discovery and account: Smith, *An Analysis of Smith's Principles of Equity*, (4th ed. 1909) at 144.

[6] *Ibid*.

defence in the *Common Law Procedure Act, l854*[7] and the *Judicature Act, 1873*.[8] Much is made by modern courts of the distinction between set-off, which identifies those cross demands that may be regarded as defences, and counterclaim, which permits a defendant to pursue a cross demand in proceedings brought by the plaintiff.[9] The distinction is artificial. It was a nineteenth century fiction designed to overcome procedural limitations.

C. The Judicature Acts

The primary purpose of the *Judicature Act, 1873* was to resolve the procedural problems mentioned in the last section. It did that by fusing law and equity, and creating the High Court to take the place of the several common law courts and the court of equity and by permitting any cross demand to be brought as a counterclaim in proceedings commenced by the plaintiff. It is curious, consequently, that the law of set-off survived these reforms. So far as immediate parties were concerned, the right to counterclaim entirely removed the need to rely on rights of set-off. The law of set-off retained its vitality for three reasons.

The first reason is to be found in the rules of court promulgated with the *Judicature Act, 1873*. Rule 20 of those rules is the predecessor of Rule 19(13) of the British Columbia Rules, which provides as follows:

> A defendant in an action may set off. or set up by way of counterclaim any right or claim, whether the set-off or counterclaim is for damages or not, so as to enable the court to pronounce a final judgment on all claims in the same action.

The proper interpretation of this rule and its predecessors has been addressed by English and British Columbia courts on many occasions.[10] The issue is whether the rule provides that any matter may be set-off by a defendant, or whether it applies only to those matters capable of set-off before 1873 so that all other cross demands must be the subject of a counterclaim. Authority tends to favour the latter construction.[11]

Rule 20 of the rules promulgated with the *Judicature Act, 1873* is subtly different:

> 20. A defendant may set off, or set up, by way of counter-claim against the claims of the plaintiff, any right or claim, whether such set-off or counter-claim sound in damages or not, and such set-off or counter-claim shall have the same effect as a statement of claim in a cross action, so as to enable the Court to pronounce a final judgment in the same action, both on the original an on the cross claim. But the Court or a Judge may, on the application of the plaintiff before trial, if in the opinion of the Court or Judge such set-of f or counter-claim cannot be conveniently disposed of in the pending action, or ought not to be allowed, refuse permission to the defendant to avail himself thereof.

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7 *Supra*, n. 1, ss. 83-6.

8 36 & 37 Vict., c. 66, s. 24(3).

9 *See, Pos* v. *Pos*, (1985) 61 B.C.L.R. 388 (B.C.S.C.). *See, infra*, Chapter V, n. 1.

10 *Supra*, Chapter II, n. 18.

11 *Ibid*.

The meaning of this rule is far from plain. It uses the concepts of set-off and counterclaim in contradistinction. The significant point, however, would appear to be an intention that set-off differ in no material way from pursuing a cross demand by counterclaim. The rule provides that a set-off is *made* by way of counterclaim, and shall have the same effect as a cross action. An inference that may be drawn is that the law of set-off was to be submerged in rights of counterclaim.[12]

Whether or not this consequence was intended, it was workable only so far as immediate parties were concerned. Set-off could not function as a counterclaim when it was asserted against an assignee.[13] This point was underscored by another innovation introduced by the *Judicature Act, 1873*. This brings us to the second reason for the survival of the law of set-off.

D. Assignments

Before 1873, assignments were recognized only in equity,[14] and the manner in which they were enforced depended upon the nature of the demand assigned.[15] If the demand was one that could be enforced in a court of equity (an equitable chose in action) the assignee was permitted to sue in his own right.[16] If the demand was one that could only be enforced in a court of law (a legal chose in action), equity would compel the assignor to bring the action on behalf of the assignee.[17]

An assignment is subject to the equities. This meant that a person liable under an assigned obligation could raise any defence available against an assignor as well as any cross demand that the law of set-off would characterize as a defence.[18] Before 1873, proceedings on the assigned claim would be restrained until the completion of separate proceedings against the assignor on a cross-demand raised as a set-off.[19] Judgment in those separate proceedings would either be satisfied by the assignor, or set-off as a liquidated demand against the assignee's claim.[20]

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[12] *See, e.g., McDonnell & East Ltd.* v. *McGregor*, [1936] 56 C.L.R. 50, 58 (H.C.A.).

[13] *Young* v. *Kitchen, supra*, Chapter III, n. 4.

[14] *Supra*, Chapter III, n. 1; *see also Row* v. *Dawson*, (1749) 1 Ves. Sen. 331, 27 E.R. 1064.

[15] *Ibid*.

[16] *Cator* v. *Croydon Canal Co.*, (1841) 4 Y.&C. Ex. 405, 593, 160 E.R. 1064, 1149; *Donaldson* v. *Donaldson*, (1854) Kay 711, 69 E.R. 303. If the assignment of an equitable chose in action was non-absolute, *e.g.*, by way of charge or conditional on some event, the proceedings could only be brought by the assignor: *Re Steel Win Co.*, [1921] 1 Ch. 349; *Durham Brothers* v. *Robertson*, 1898] 1 Q.B. 765 (C.A.); *see* Cheshire & Fifoot, *The Law of Contract* (11th ed., 1986) at 496.

[17] *See* Treite 1, *supra*, Chapter III, n. 1 at 495.

[18] *Supra*, Chapter III; *see also Stoddart* v. *Union Trust Ltd.*, [1912] 1 K.B. 181 (C.A.).

[19] *Supra*, n. 5.

[20] *Ibid*.

The important point to remember here is that an assignee would not be responsible for any portion of a cross demand in excess of the assigned claim.[21] The law prior to 1873 accomodated this fact well. The ability to counterclaim did not, since it permitted the court to grant judgment on the excess. Clearly, insofar as assignees were concerned, there was an important distinction between rights of set-off and rights of counterclaim. This is the second reason for the survival of the law of set-off.

The third reason for set-off's persistence stems from the introduction of statutory assignments in the *Judicature Act, 1873*.[22] Section 25(6) provided that assignments that observed certain requirements, were enforceable by the assignee, "subject to all equities which would have been entitled to priority over the right of the assignee if this Act had not passed." This provision preserved the law of equitable set-off.[23]

E. After 1873

1. Generally

Following the Judicature Acts, the rules respecting equitable set-off were applied with some flexibility. *Young* v. *Kitchen*[24] and *Government of Newfoundland*[25] referred to in the previous chapters as "classic" cases, are actually among the first statements respecting equitable set- off in the light of the reforms introduced by the Judicature Acts. This more liberal view persisted up until *Hanak* v. *Green*,[26] a case now often criticized as stating the test for equitable set-off non-rigorously.[27]

In British Columbia, the courts for several decades also approached equitable set-off in keeping with the reforms introduced in the Judicature Acts. In 1915, for example, in *Victoria Saanich Motor Transportation Co.* v. *Wood Motor Co.*[28] a five member panel of the Court of

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[21] *Young* v. *Kitchen, supra*, Chapter III, n. 4; *Government of Newfoundland, supra*, Chapter III, n. 5; *see also* B. Geva, *Financing Consumer Sales and Product Defences*, (1984) 60-1.

[22] *Young* v. *Kitchen, ibid*., at 130-31.

[23] This section paralleled statutory assignments with equitable assignments of equitable choses in action. It should be observed that an assignment which does not qualify as a statutory assignment is subject to the old rules for their enforcement: *William Brandt's Sons & Co.* v. *Dunlop Rubber Co. Ltd.*, [1905] A.C. 454 (H.L.); *Re Hart Bros. Construction Ltd.*, (1954) 34 C.B.R. 116 (B.C.S.C.). An action on an assignment of a legal chose in action which does not satisfy the statutory requirements must be brought in the name of the assignor and the action would, consequently, be subject to any counterclaim maintainable against the assignor. This should be a point of some significance in the context of receiverships, but it is entirely overlooked. Note, however, that common law courts would not permit set-off of cross-demands arising after notice of an assignment of a legal chose in action: *supra*, Chapter III, n. 7; *see also*, J. Kehoe, *The Law of Choses in Action*, (1881) at 60.

[24] *Supra*, Chapter III, n. 4.

[25] *Supra*, Chapter III, n. 5.

[26] *Supra*, Chapter II, n. 7.

[27] *Supra*, Chapter II, n. 11.

[28] *Supra*, Chapter I, n. 5.

Appeal held that set-off was equated with rights of counterclaim. Similarly, in 1924, in *Royal Bank of Canada* v. *Gustafson*,[29] rights of set-off and counterclaim are not distinguished.

Recently, English and Canadian courts have approached equitable set-off more strictly. The British Columbia Court of Appeal, for example, in *Coba Industries Ltd.* v. *Milie's Holdings (Canada) Ltd.* observed that:[30]

> I do not think that there will be many cases in which a court will allow equitable set-off. The cases will be confined to those where it would be manifestly unjust to refuse the relief.

This observation embodies a view markedly different from that expressed by courts following the enactment of the Judicature Acts. It reflects, in part, the difficulties modern courts have in applying nineteenth century equitable concepts to situations alien to the context in which they were developed. These difficulties may be traced, on the one hand, to the problems of understanding equitable concepts divorced from the procedural law they were designed to overcome, and on the other hand to the use of a vocabulary derived from legal concepts antiquated even by the nineteenth century. We have already discussed the procedural problems that forced the development of the law of set-off. We turn now to a consideration of some of the concepts of set-off.

2. Antiquated Concepts

Before 1873, set-off as it is ordinarily understood today was only permitted with respect to liquidated demands. This was expressed as a requirement for "mutual debts" which was interpreted as requiring two conditions be satisfied: the debts be of the same nature, and they must be due to and from the same parties in the same capacities.[31] Both of these concepts require some explanation.

The law formerly distinguished between different kinds of liquidated demands. A simple debt was treated differently from a specialty debt (a bond, mortgage or debt secured by writing under seal) and from penalties. Joint debts were treated differently from several debts and debts owed jointly and severally. Few of these distinctions hold any modern significance.[32] The

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[29] (1924) 33 B.C.R. 379 (S.C.); *see also Stucki* v. *Reed*, (1967) 61 D.L.R. 351, *rev'd*. but not on this point, (1967) 62 D.L.R. 535 (B.C.C.A.).

[30] [1985] 6 W.W.R. 14, 29 (B.C.C.A.).

[31] *Supra*, Chapter II, inn. 5 and 6.

[32] The modern law has developed so that specialty debts, for the most part, are accorded the same status as simple debts. Penalties continue to be treated differently from liquidated demands. The special status of joint debts will end when recommendations made in *Report on Shared Liability* (LRC 88, 1986) are implemented; *see, Middleton* v. *Pollock*, (1875) L.R. 20 Eq. 515; note also that a joint debt can be set off against a separate debt, if incurred in consideration of the separate debt: *Vulliamy* v. *Noble*, (1817) 3 Meriv. 593, 617, 618, 36 E.R. 228.

ambiguity over the reference to "mutual debts" was resolved by the third Statute of Set-off.[33] The term, however, continues to be used and cause confusion to this day.[34]

The second condition, that the debts be due to and from the parties in the same capacities, is also perplexing to modern courts.[35] The concept itself is simple enough, and the best example was given in Chapter II. If B owes A a sum of money and A, as trustee for C, owes B a sum of money, set-off is not available, since the cross demands involving A are in different capacities.[36] In the nineteenth century, where a demand was voluntarily or involuntarily assigned no change of capacity was considered to have occurred.[37] For example, an involuntary assignment by reason of

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[33] *Tidd's Practice* (9th ed., 1828) at 663; 8 Geo. 2, c. 24, s. 4:

> ... That by virtue of the said clause.., mutual debts may be set against each other, either by being pleaded in bar, or given in evidence on the general issue, in the manner therein in mentioned, notwithstanding that such debts are deemed in law to be of a different nature; unless in cases where either of the said debts shall accrue by reason of a *penalty* contained in any bond or specialty; and in all cases where either the debt for which the action hath been or shall be brought, or the debt intended to be set against the same, hath accrued, or shall accrue, by reason of any such penalty, the debt intended to be set off shall be pleaded in bar, in which plea shall be shewn how much is truly and justly due on either side; and in case the plaintiff shall recover in any such action or suit, judgment shall be entered for no more than shall appear to be truly and justly due to him, after one debt being set against the other as aforesaid.

[34] Jessel M.R. noted that statutory set-off "only applied in the case of mutual debts, whatever that may be." Today the term is confined generally to mean liquidated demands: *In re Whitehouse & Co.*, (1878) 9 Ch. D. 595, 597 (C.A.).

[35] In *Tuckerr*, this aspect of the concept of mutuality seems to have been applied to determine whether the contracts from which cross demands arose were sufficiently related. A similar approach was adopted in *O'Mahony* v. *Dickson*, (1805) 2 Sch. & Lef. 400, 413.

[36] *Whitaker* v. *Rush*, (1761) Amb. 407, 27 E.R. 272.

[37] Equity required that there be some connection between the cross demands for set-off to be allowed: *Whitaker* v. *Rush, ibid*., at 273, citing *Downam* v. *Matthews*, (1721) Prec. Ch. 580, 24 E.R. 260. The degree of connection between the cross demands was not critical. It was sufficient if a party to an action could demonstrate the existence of cross demands indicating an equity requiring relief. For example, a debtor could set-off a debt owed to him by the assignor against the claim by an assignee without regard to mutuality: *Peters* v. *Soame*, (1701) 2 Vein. 429, 23 E.R. 874. *See also Curson* v. *African Company*, (1682) 1 Vein. 122, 23 E.R. 358 where a debt owed by the Old Company was allowed against the New Company, subject to set-off. In both these cases set-off was allowed against parties not original to the action. With the enactment of the first of the Statutes of Set-off in 1729, equity came to follow the stricter rule at law that required mutuality and connection between the demands: *Green* v. *Farmer, supra*, n. 2, at 158 (E.R.):

> [F]or had they done otherwise, they would have stopped the course of law, in all cases where there was a mutual demand.

Story suggests a similar change in equity's view of circumstances allowing for a set-off: *Commentaries on Equity Jurisprudence* (1886) vol. II, (13th ed.) at 767-8:

> [Equity] at first assumed jurisdiction on the ground that one demand in justice should compensate a counter-demand, and it was unjust to attempt at law to enforce payment of more than the balance, - now the court exercises it only (1) when a legal demand is interposed to an equitable suit, (2) when an equitable demand cannot be enforced at law, and the other party is suing there, or (3) where both the demands are partly legal, and the party seeking the benefit of the set-off can show some equitable ground of protection.

a person's death was no bar to statutory set-off.[38] A broad right of set-off was provided in circumstances of bankruptcy twenty years before the first Statute of Set-off was enacted.[39] With respect to voluntary assignments, where an action could only be brought by the assignor there was no question of change of capacity.[40] Where the assignee was permitted to sue on an assigned claim, equity permitted all defences to be raised as if the assignee were the assignor.[41]

Some modern courts, however, have taken this aspect of the requirement for mutuality and applied it in an entirely different fashion. It is used as a means of distinguishing between obligations owed to an assignor and to an assignee. Hence, the suggestion in *Coba Industries* [24] that circumstances of equitable set-off will be rare, and the suggestion in *Tuckerr*[43] that statutory set-off is not available once there is an assignment.

It would appear, consequently, that methods nineteenth century courts used to ensure that no distinction was drawn between assignee and assignor are being used by twentieth century courts to emphasize the distinctions between them.

F. Involuntary Assignments

We have used the term "involuntary assignments" to refer to those situations, arising from the death or insolvency of a person, where a third party is entitled to proceed on various claims. It is well to emphasize at this point the policy of the law with respect to involuntary assignments.

Where the assignment is to a personal representative as a result of the death of a party, with only a few exceptions, any claim that could have been brought against the deceased while he lived can be brought against his estate. If the personal representative seeks to recover a demand, the defendant may raise any cross demand by counterclaim. The law of set-off only has significance in this context when the estate is insolvent.[44]

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[38] *Supra*, Chapter II, n. 5.

[39] (1705) 4 & 5 Anne, c. 17; (1718) 5 Geo. 1, c. 24.

[40] Chapter III, n. 7.

[41] It has been suggested that modern courts are mistaken in assuming that principles of set-off determine those equities to which an assignment may be subject. Certainly demands which could be set-off against the assignor may be set-off against the assignee. But the equities may well embrace demands which could only have been brought against the assignor by counterclaim: Spry, "Equitable Set-offs," (1969) 43 Aust. L.J. 265, 269.

[42] *Supra*, n. 30.

[43] (1983) 149 D.L.R. (3d) 172, 46 B.C.L.R. 8 (B.C.C.A.).

[44] The *Judicature Act, 1873*, s. 25(1), paralleled proceedings against an insolvent estate with those in bankruptcy; s. 10 of the *Judicature Act, 1875*, c. 77 paralleled proceedings on a liquidation with those in bankruptcy. British Columbia legislation does not address the issue of rights to set-off against an insolvent estate.

In bankruptcy, the current Act preserves the law of set-off in section 75(3).[45] This section may be traced back to English legislation of 1705.[46] Set-off in bankruptcy, until modern times, never involved the considerations respecting intrinsically related cross demands applied in the context of equitable set-off. Liquidated and unliquidated demands arising from the dealings between a person and the bankrupt could be set-off.[47] The law took the view that the trustee in

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[45] The current formulation, first adopted in the *Insolvent Act of 1875*, S.C. 1875, c. 16, s. 107, was based in turn on the *Insolvent Act of 1864*, S.C. 1864, c. 17, a statute of Upper Canada. It is framed more narrowly than the English legislation of 1705, but it would appear not to have been intended to narrow the concept: *see*, W.F. Hamilton, *Company Law* (3rd ed., 1911) Can. ed. at 492 *et seq*. The legislation in 1705 created the concept of set-off. Early Canadian legislation referred instead specifically to the concept of set-off, and did not draw the distinction between set-off where insolvency was involved and set-off in the ordinary assignment case. An identical provision was adopted for liquidations under the federal *Winding-Up Act*, R.S.C. 1970, Chap. W-10 Each provision was construed as a reference to provincial legislation: *see, e.g., The Liquidators of the Maritime Bank of the Dominion of Canada Under the Winding-Up Act* v. *Troop*, (1888) 16 S.C.R. 456, 464, where the legislation was construed by reference to the first Statute of Set-off; and *Crain* v. *Wade*, (1917) 55 S.C.R. 208, where the legislation was construed by reference to contemporary Ontario legislation restating the first Statute of Set-off. The argument was not made that English bankruptcy legislation or the provisions of the Judicature Acts were more appropriate guides. In British Columbia, the English bankruptcy legislation, including the rules relating to set-off in bankruptcy, were confirmed as the law of bankruptcy and insolvency in the Colony of Vancouver Island and in the Colony of British Columbia: *see* R.S.B.C. 1871, No. 6 (particularly ss. 1 and 109), and No. 59, s. 1. The manner in which Bill C-17, second session, Thirty-second Parliament, 32 Elizabeth II, 1983-84, the last in a series of bills to reform bankruptcy legislation, deals with set-off is of interest. 5. 246(1) as follows:

> **246.** (1) Where two persons have debts owing, one to the other, and an arrangement or bankruptcy order is made in respect to either of them,
>
> (a) an account shall be taken of such debts;
> (b) any debt that is owing shall be set-off against any debt that may be claimed; and
> (c) the balance of the account may be claimed as a debt or shown as a debt payable.

The definition sections of the Bill operate so that any obligation to pay money, whether liquidated or not, absolute or contingent, certain or disputed may be the subject of set-off.

[46] (1705) 4 & 5 Anne, c. 17; (1718) 5 Geo. 1, c. 24. Early equity decisions indicate that Equity was concerned about an unfair advantage being obtained by one party against another, particularly where a new party stood in place of an original party to the action. In *Peters* v. *Soame, supra*, n. 37, the assignor became bankrupt after assigning a bond to the assignee. The assignee, not being able to sue at law, brought a bill in equity against the debtor to be paid on the bond. The Court of Chancery allowed the debtor's cross-demand for rent as against the assignee's claim:

> ... the assignees have no better right than the bankrupt himself; and as the bankrupt is bound by the assignment, the assignee under the statute must be bound likewise, and stand in his place.

See also Chapman v. *Derby*, (1869) 2 Vein. 117, 23 E.R. 684, 685 where Lord Hale said that a debtor should only "answer to the bankrupt's estate the balance of the account." *Jeffs* v. *Wood*, (1723) 2 P. Wins. 128, 24 E.R. 668, 669.

[47] *Halsbury's Laws of England* (4th ed., vol. 3) para. 751 *Mersey Steel* v. *Naylor*, (1884) 9 A.C. 434 (H.L.); it would appear, however, that unliquidated demands based on tort were excluded claims in bankruptcy: *see* Gower, *Modern Company Law* (4th ed., 1979) 730-31; at para. 751; *Tilley* v. *Bowman*, [1910] 1 K.B. 745.

bankruptcy stands in the bankrupt's shoes.[48] A similar position was adopted in proceedings to liquidate a company.[49]

Where an assignment resulted from circumstances of insolvency, the unfairness of requiring a person to satisfy a demand, but go without a remedy on a cross demand, led to the development of these principles.[50] The argument that permitting set-off in these circumstances gave an unsecured creditor priority over secured creditors was dismissed:[51]

> Where parties have had dealings so as to produce mutual debts or credits or reciprocal demands growing out of the same transaction, it is the balance only which exists as the debt; and, in the case of bankruptcy of one of the parties, a set- of f of their mutual demands is not a means of paying one debt in preference to other debts which the bankrupt owes, for, to the extent of the demands set off or compensated, there was no debt. From the moment they were contracted they extinguished each other. Hence, the operation of a set-off is, not to pay, but to ascertain a debt made up of the difference between the amounts of respective debits and credits.

This policy has largely been lost sight of. Modern courts when faced with these issues, appear to be involved in discovering the ancient technical law rather than identifying the policies that law was designed to promote. The distinction formerly drawn between principles of equitable set-off, and principles of set-off when an assignment occurs by reason of insolvency,[52] is seldom

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[48] *Mitford* v. *Mitford*, (1803) 9 Ves. Jun. 87, 32 E.R. 534, 539:

> But is an assignee under a Commission of Bankruptcy placed in a different situation from that of the bankrupt himself? I have always understood, the assignment from the Commissioners, like any other assignment by operation of law, passed his rights precisely in the same plight and condition as he possessed them.

[49] *Supra*, n. 47; *see also, Re Gedney*, [1908] 1 Ch. 804.

[50] *See, High on Injunctions*, 4th ed. (1905) at 233.

[51] *Judicial and Statutory Definitions of Words and Phrases*, (1905) vol. 7 at 6439.

[52] In *Ex parte Hanson*, (1806) 12 Ves. Jun. 345, 33 E.R. 131, the petitioner wished to set off his separate demand upon the estate of the bankrupt against a debt to the estate on a joint bond of himself and another. The petitioner was the principal and the other was surety on the bond. The assignees in bankruptcy brought an action against both on the joint bond. The court allowed the set-off because had the bankrupt remained solvent, the petitioner would have recovered through a separate action the amount owed to him and applied it to extinguish his obligation to the surety. Lord Chancellor Erskine said at 132:

> I am not obliged to do more than Courts of equity were in the habit of doing, before the Statute of Set-off existed; which Statute was made only to prevent circuity ... there is a clear principle, that decides this case; that assignees in the bankruptcy take, subject to all equities, attaching upon the bankrupt; and... the condition of the bankrupts, if they had continued solvent.., must be the condition of the assignees.

See also James v. *Kynnier*, (1799) 5 Ves. Jun. 108, 31 E.R. 496, 497:

> Is there any doubt, that, where there are upon account mutual credits between two parties, though they cannot be set off at law, yet it is common ground of a bill [in equity] ... When there comes a case of bankruptcy, it is much stronger. Between solvent persons, there might be a ground to say, indulgence was given, the credit extended; and therefore that credit ought to be continued. But the moment a bankruptcy comes the account is to be settled.

acknowledged. That these policies have been lost sight of is most clear in the context of receivership.

G. Receivership

When a company goes into receivership, the general principles of set-off apply and not those developed in the context of bankruptcy. This is curious, since receivership tends to be the result of financial difficulties experienced by the company signalling insolvency. Modern courts view receivership as analagous to a voluntary assignment rather than an involuntary assignment.

A receiver may be appointed in a number of circumstances. Where he is appointed to realize on fixed charges against a company's property, the law of set-off is not involved. Where a receiver is appointed pursuant to a security instrument that creates a floating charge which does not crystallize until the company's insolvency, the receiver is involved in proceeding on claims due the company and the law of set-off becomes relevant. In this context, there is little difference between receivership, liquidation or bankruptcy. It is surprising, consequently, that in the context of the law of set-off, a receivership is viewed as being different from a liquidation or bankruptcy. This inconsistency may be attributed to several causes.

First, receivership resembles an ordinary assignment, and may conceivably, but seldom does, arise in circumstances not involving insolvency. The parallels between receivership, liquidation and bankruptcy, consequently, are obscured.

Second, courts have overlooked the historical distinctions drawn depending upon whether insolvency was involved. Set-off in bankruptcy is governed by a statutory provision which refers to the law of set-off.[53] This provision appears to direct the courts proper inquiry to the general law of set-off. As a result, courts did not look back to the manner in which set-off had been historically applied in situations of insolvency.[54]

Third, the appointment of a receiver pursuant to a floating charge is a relatively new kind of security arrangement. It first gained acceptance about the time of the Judicature Acts and it is only in the past several decades that difficult issues of set-off have arisen in that context. In fact, today these issues seem to arise more frequently in the case of receivership then in any other situation.

H. Summary

The modern law of set-off is a curiosity. It consists of legal and equitable principles formulated to overcome procedural problems and jurisdictional limitations which were resolved in 1873. The complexities of those principles serve no modern purpose, and obscure the under-

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[53] 5. 75(3).

[54] *Supra*, n. 46.

lying policies of the law to a degree that they are frequently overlooked by modern courts. Following the Judicature Acts, it appeared that the law of set-off had more or less been submerged in rights of counterclaim. More recently, courts have gone back to nineteenth century law to resolve modern problems, and have reinforced the distinctions between set-off and counterclaim. In this process, several important policies, namely that an assigmee should be in no better positiom than his assignor, and that a broad right of set-off is available in situations of involuntary assignment, have been overlooked or forgotten.

CHAPTER V REFORM

A. Introduction

The policy before the Judicature Acts was that a person entitled to pursue a claim by voluntary or involuntary assignment was in no better position than the assignor. The reforms of the latter part of the nineteenth century have obscured this policy. The principles modern courts apply to determine when a cross demand may be asserted as a set-off against an assignee were developed to deal with procedural and jurisdictional problems that no longer exist. They are being used to prejudice a person under an obligation that has been assigned to another. The complexity of the law in this context has caused courts to overlook several fundamental issues of policy, and the principles of set-off are often mis-stated or misapplied.[1] It is our tentative view that the law of set-off should be restated in legislation.

B. Summary of Principles Which Should Be Revised

The last chapter discussed various aspects of the law of set-off, described the original reason for their formulation and pointed out that, in many cases, they serve no modern purpose. For convenience, we summarize these aspects of the law of set-off in this section.

1. Liquidated and Unliquidated Claims

Modern courts do not face the same problems pre-Judicature Act courts faced with unliquidated damages. There is no reason to continue to distinguish between claims on the basis of whether or not they have been ascertained at the time the set-off is raised, or before an assignment has been completed. The modern law of set-off has adopted this position.

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[1] Numerous instances may be cited: *see, McGee (Irwin)* v. *Irwin*, (1986) 8 C.P.C. (2d) 86 (Ont. Prov. Ct.) where the set-off of mutual debts was characterized as equitable, overlooking the fact that it was based on the Statutes of Set-off and governed by contemporary Ontario legislation; the court avoided the problem by deciding that provincial courts could exercise equitably jurisdiction; *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.*, [1986) B.C.D. Civ. 3580-01 (B.C.S.C.) where the right of set-off was characterized as being in the nature of a cross-action, each cross- demand a separate claim. That is, in fact, a description of counterclaim and the usual point raised in distinguishing it from set-off; *Hanak* v. *Green*, [1958] 2 Q.B. 9 (C.A.), often criticised for applying principles developed in the context of identifying the equities to which an assignment is subject, to a case involving set-off between immediate parties (where the test is somewhat more rigorous); *Coba Industries Ltd.* v. *Millie's Holdings (Canada) Ltd.*, [1985] 6 W.W.R. 14, where the British Columbia Court of Appeal summarized the principles that govern the determination of the equities to which an assignment is subject by reference to the principles that determine when set-off is available between immediate parties. In fairness, the dicta in *Coba* is consistent with contemporary decisions respecting set-off in assignment situations, although the courts seem to have arrived at this position accidentally, overlooking that nineteenth century courts applied quite a different test. The experience in Canada is not unique: Spry, "Equitable Set-offs," (1969) 43 Aust. L.J. 265:

> [Since the Judicature Acts]...there have been a number of cases where these principles appear to have been misunderstood, and the regrettable position has arisen that there are now many conflicts in authorities, and, moreover, different practices have been established in different jurisdictions.

2. Mutuality

The concept of mutuality, as it relates to a party claiming in the same right or capacity, has led to much confusion.

The concept is difficult to describe. Before set- of f is available, there must be cross-demands between two persons. In a few cases, a person may owe and be owed obligations in different capacities (as in the trustee example), hence the requirement for mutuality.

The concept of mutuality, however, is being applied by courts when there is a voluntary or involuntary assignment to distinguish between assignors and assignees. Mutuality serves no purpose here that is not served by the concept of cross demands in existence before the assignment is completed.

Ontario attempted to address this problem by providing that mutuality exists where:[2]

> ... one debt is owed to or by a person in a personal capacity and the other debt is owed by or to the person in a capacity other than personal.

This would appear to provide that set-off is available where a person is owed a debt in his own right, but owes a debt as a trustee. It is difficult to see any justification for permitting set-off in that situation.

The requirement that cross demands must be in the same right or capacity arises in other contexts of the law and, curiously, causes little difficulty. For example, a defendant's ability to raise a cross demand by counterclaim is subject to that requirement. If a plaintiff brings an action as a trustee, a defendant will not be able to raise a counterclaim against the plaintiff in his personal capacity. Similarly, a judgment creditor with a judgment against B may not execute upon property B holds in trust for another.

The law of set-off need not be expressed in terms of a need for mutuality. Implicit in revising legislation would be the obvious requirement that cross-demands must be owed to or from the same persons. The focus of legislation should be upon the rules that apply when a third party is entitled to proceed on one of the demands.

3. Set-off as a Defence

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[2] *Courts of Justice Act, 1984*, S.O. 1984, c. 11, s. 124(2); this section does not seem to have caused problems, however: *see, Richardson* v. *Richardson*, (1986) 1 R.F.L. (3d) 67 (Ont. C.A.) where the defendant sought to set—off an overpayment of maintenance to his wife, the plaintiff, in an action brought to recover arrears of child maintenance. Set-off was not permitted.

Set-off is characterized as a defence. Technically, however, set-off is no more a defence than any other matter which may be raised as a counterclaim.[3] Problems addressed by this nineteenth century fiction should be addressed directly.

Characterizing set-off as a defence answered two problems. It allowed the courts to determine when a cross-demand should be heard before proceedings were taken on another demand. It also explained the manner in which the cross-demand should be handled in the first proceeding. Judgment on the cross-demand would be set-off against judgment on the first demand to diminish or exhaust it.

There is no modern need to characterize set-off as a defence.[4]

4. Related Transactions

The discussion in Chapter III suggests that the exercise of determining whether cross demands are sufficiently related is exceedingly artificial. Today, this concept applies where there is a statutory assignment, an equitable assignment of an equitable chose in action, and on a receivership. It does not apply in bankruptcy,[5] on a liquidation, on the death of a person or on an equitable assignment of a legal chose in action.

5. Policy

In those situations where the test of related demands is not applied, it is because it is clear that the third party is claiming through the person originally entitled to enforce the obligation. This is consistent with the general policy that an assignee should be in no better position than the assignor.

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[3] Set-off is characterized as a defence, and this quality is often cited as the chief distinction between set-off and counterclaim. It is difficult to see what advantage flows from this characterization. Matters which may be set-off are a class of cross-actions which, before 1873, could be raised in equity by a defendant in proceedings commenced by the plaintiff. They differ in no material respect from cross-actions which may be raised by counterclaim. In the sense that a set-off operates to resist, diminish or extinguish a plaintiff's claim, a set-off is a defence. Matters which may be only raised by counterclaim, however, also have that capacity. It is a distinction, consequently, without substance. It originated in the *Common Law Procedure Act, 1854*, s. 83 and was repeated in s. 24(5) of the *Judicature Act, 1873*, which provided that any matter which formerly would have supported an injunction could be relied upon "by way of defence." *See* now *Law and Equity Act*, R.S.B.C. 1979, c. 224, s. 8. Arguably, the *Judicature Act, 1873* was intended to replace rights of set-off with rights of counterclaim: *see* text at Chapter IV, n. 12; *see also* s. 24(3), now *Law and Equity Act, ibid*., s. 6. Those sections characterize rights of counterclaim as cross-actions. It is difficult to see what is gained by classifying some cross-actions as defences, based on the fact that they were recognized in equity prior to the *Judicature Act, 1873* and classifying other cross-actions as separate matters which may, procedurally, be heard at the same time as the plaintiff's action.

[4] Ontario has recently enacted legislation that confirms that set-off is a defence: *Courts of Justice Act*, 1984, S.O. 1984, c. 11, s. 124. This perpetuates an historical anomaly. Strictly speaking, the law of set-off is procedural, and claims which may be set-off are distinct from matters which may be raised as substantive defences: *see* R.M. Goode, *Legal Problems of Credit and Security*, (1982) Chapter V.

[5] It should be noted that the principles of set-off currently being applied in bankruptcy are not entirely clear. Certainly, in England, and in British Columbia before 1875, a broad right of set-off was available. *See* Chapter IV, n. 45.

In those situations where the test of related demands is being applied, the law uses nineteenth century principles taken out of context to distinguish between the rights of the assignor and of the assignee.

The current law, which draws distinctions based on the nature of the assignment and the types of cross demand involved, reflects a tension between two competing policies. One policy would appear to be based on the view that an assigned demand is a property right which, for the needs of commerce, should only be subject to cross demands closely related to it.[6] Certainly, the law makes an exception of this nature with respect to negotiable instruments, but it is dictated by the acknowledged commercial need for free assignability in that context.

The competing policy is that an assignee should occupy no better position than the assignor. This position rests on the view that the assignor should not be able to limit unilaterally the rights of one under an obligation to him. The current law, where there is a marked identity of interest between the assignor and his assignee, goes some distance toward accomplishing that end.

The refinement of legal principles usually involves a synthesis of related concepts, so that the process tends towards simplication. After the *Judicature Act, 1873*, the synthesis appeared to favour the policy of protecting the person liable under an assigned obligation. More recently, the courts appear to be adopting a synthesis of the law of set-off that favours the negotiability of choses in action to protect an innocent assignee."[7] The British Columbia Court of Appeal recently summarized the principles of equitable set-off as follows:[8]

> From that review of the law, which I accept as accurate, can be extracted the following principles:
>
> 1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands ...
>
> 2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed ...
>
> 3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross-claim ...
>
> 4. The plaintiff's claim and the cross-claim need not arise out of the same contract ...
>
> 5. Unliquidated claims are on the same footing as liquidated claims ...

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[6] The current law of set-off in the general assignment and receivership case accomplishes this result with one exception. Unrelated debts may be set-off. From this perspective, the Statutes of Set-off created an anomaly with respect to assigned claims.

[7] The term used in *Coba Industries, supra*, n. 1 at 29.

[8] *Ibid*., at 22.

The court appears to have been unaware that those principles represent the application of the law of set-off pre-1873 in only one context. A more accurate summary of the law of set-off, in the event of an assignment, is as follows:

(i) a liquidated demand may be set-off against a liquidated demand unrelated to it;

(ii) when the assignment is the result of a statutory assignment, an equitable assignment of an equitable chose in action or receivership:

  (a) a liquidated demand or an unliquidated demand may be set-off against an unliquidated demand arising from a different contract only if it is so clearly connected that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into account the cross demand;

  (b) an unliquidated demand may be set-off against a liquidated demand only if it is so clearly connected that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into account the cross demand;

(iii) when the assignment is the result of bankruptcy,[9] liquidation or death:

  (a) a liquidated or unliquidated contractual demand may be set-off against a liquidated or unliquidated contractual demand whether or not they are related;

  (b) an unliquidated demand in tort may not be set-off against a liquidated or unliquidated demand on a liquidation or bankruptcy;

(iv) when the assignment is an equitable assignment of a legal chose in action or a non-absolute equitable assignment of an equitable chose in action:

  (a) any liquidated or unliquidated demand may be raised by counterclaim, subject to the court's discretion to sever the counterclaim. (Curiously, a receiver appointed under a floating charge security is not regarded as an equitable assignee of a legal chose in action.)

The fine distinctions drawn between the operation of the law of set-off, depending on the nature of the setoff, represent unnecessary technical complexities created by procedural and jurisdictional problems that no longer exist. That those distinctions continue to be made casts a shadow on modern law. The efforts of the courts to achieve a satisfactory synthesis of general principle in this context are not only salutory but essential. Nevertheless, it is our tentative view, that synthesis is based on incorrect assumptions respecting the various policies to be advanced. It

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[9] *Supra*, n. 5.

is inconsistent with concepts fundamental to the law of assignment to alter the law of set-off to enhance the negotiability of choses in action:[10]

> The law of negotiable instruments is, in effect, a response to the commercial need for freely assignable debts in contrast to the protection of the obligor represented by the rule that an assignee takes subject to the equities.

6. A Broader Right of Set-off

In our view, the law of set-off should be revised so that in any situation of voluntary or involuntary assignment, any liquidated or unliquidated contractual demand that could have been asserted against the assignor and which is in existence before notice of the assignment or, where that concept is inappropriate, the assignment is completed, may be raised as a set-off.

An issue which has been the subject of some concern is whether a similar approach should be adopted for unliquidated demands arising in tort. On balance, it is our view that it is an unnecessary refinement to distinguish between the sources of unliquidated demands.

The Law Reform Committee of South Australia, in its report *Relating to the Reform of the Law of Set-off*,[11] concluded that reform of the law of set-off was appropriate. The Commission noted:[12]

> Once one gets to the position where some unliquidated demands can be the subject of a set-off, there is really no logical reason why all cannot be.

It was recommended that any cross demand could be the subject of set-off:[13]

> ... set-off [should] be an allowable plea in relation to all cross-claims, liquidated or unliqui- dated, whether assessed or not assessed at the date of the plea, and whether arising out of the same transaction or series of transactions or not.

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[10] *See, e.g.*, Waddams, *The Law of Contracts*, (2d ed., 1984) 199.

[11] (75th Report, 1983).

[12] *Ibid*., at 9.

[13] *Ibid*.

A similar position has been adopted by the *Uniform Commercial Code*[14] and the (U.S.) *Restatement of the Law of Contracts 2d.*[15]

As between immediate parties, a defendant may raise any cross demand as a counterclaim against the plaintiff. To ensure that assignment does not prejudice the person liable under an assigned obligation, he should be permitted to raise any cross demand by counterclaim against an assignee that could have been raised against the assignor, before notice of the assignment or, in situations of involuntary assignment, before the assignment is completed.

7. Unmatured Claims

Once one accepts that a broad right of set-off is appropriate between immediate parties, there are few, if any, arguments that can be raised against permitting a broad right of set-off to be asserted against an assignee. There is a timing problem, however, which has the potential to transform the result of legislation along these lines from revising principles of set-off to fundamentally altering the law governing assignments.

Currently, notice of an assignment marks the point from which no further "equities" may arise that may be asserted in defence to an assigned demand. There is an exception to this general rule. A future cross demand arising from the same transaction as the assigned demand may be

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[14] Uniform Laws Annotated (1981) vol. 3. Section 9-318(1) of the U.C.C. provides as follows:

> (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.

"Contract" is accorded a broad meaning, and may encompass performance expected by reason of the "course of dealing or usage of trade or course of performance as provided" in the U.C.C.: § 1-201(3), and, perhaps, related contracts: see L.D. Bishop, "Commercial Transactions: Protection of the Account Debtor Within and Without UCC § 9-318(1)," (1982) 35 Oklahoma L. Rev. 415, 417. This last issue seems to have presented American courts with many of the difficulties Commonwealth courts have faced in determining whether transactions are sufficiently related to permit the set-off of competing claims arising from them: *ibid*. 5. 38 of the *Model Uniform Personal Property Security Act*, adopted by the Uniform Law Conference of Canada in 1983 is the same as s. 9-318(1).

[15] The American Law Institute, (1981) § 336 provides as follows:

> (1) By an assignment the assignee acquires a right against the obligor only to the extent that the obligor is under a duty to the assignor; and if the right of the assignor would be voidable by the obligor or unenforceable against him if no assignment had been made, the right of the assignee is subject to the infirmity.
>
> (2) The right of an assignee is subject to any defense or claim of the obligor which accrues before the obligor receives notification of the assignment, but not to defenses or claims which accrue thereafter except as stated in this Section or as provided by statute.
>
> (3) Where the right of an assignor is subject to discharge or modification in whole or in part by impracticability, public policy, non-occurence of a condition, or present or prospective failure of performance by an obligee, the right of the assignee is to that extent subject to discharge or modification...

raised in defence to a proceeding on the assigned demand. This, strictly speaking, is not set-off but a plea of abatement or in the nature of an accounting.

The modern rule would appear to be that set-off is only permitted where both cross-demands have matured before notice of the assignment.[16] This rule results in some unusual consequences. Suppose A owes B $500 to be paid on November 15, 1986, and B owes A $400 to be paid on the same date. A assigns his claim to C, who gives B notice on November 1, 1986. On November 15, 1986, C may sue B for $400. C's claim is not subject to B's claim against A, since it had not matured before notice of the assignment. It is doubtful that the former law would have dictated this result.[17]

An issue, which was the subject of much debate, was whether other claims enforceable at some time after notice of assignment has been given should be capable of being set-off against an assigned demand.

Various categories of claims enforceable at some future time may be identified:[18]

(i) a binding obligation subject to no condition other than, perhaps, the effluxion of time, such as a debt obligation not due until a particular date.

(ii) an obligation subject to a condition, other than the effluxion of time, that must be satisfied before it is binding. For example, A guarantees a loan made to B. A's obligations as guarantor will only arise if B defaults.

(iii) inchoate obligations which depend upon an event that may or may not occur at some future time. For example, A is slandered by B. No rights arise until A suffers damages.

(iv) obligations which do not arise until some future time.

With respect to the first category, it is difficult to see why obligations which are binding but not due until some future time should be distinguished from obligations that are currently due. The only argument that can be raised in support of that distinction is based on the concept of loss of mutuality used in such a way to distinguish between the assignor and assignee. The concept of mutuality is, however, inappropriate in this context. It is our tentative conclusion that claims based on binding obligations not payable until some time after notice of an assignment has been received, should not be distinguished from claims due and payable before that time.

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[16] *Supra*, Chapter III, E, 1, *Demands Not Matured At Time of Notice of Assignment*.

[17] *Supra*, Chapter III, n. 30. The (U.S.) Uniform Commercial Code, with this problem in mind, provides that an account debtor can assert against an assignee "any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment:" s. 9-318(1) (b). This provision, however has been interpreted to mean that a defence or claim "accrues" when the account debtor is entitled to enforce it. The claim or defence, consequently, must be due, or the assignor must be in breach, before notice of the assignment is received: *Seattle-First National Bank* v. *Oregon Pac. Indus*., (1972) 262 Or. 578, 500 P.2d 1033. Ironically, it has been suggested that this narrow construction can be avoided by relying on rights of equitable set-off: *see* Bishop, *supra*, n. 14.

[18] *See Report on the Attachment of Debts* (LRC 39, 1978) at *et seq*. for a similar analysis respecting garnishment.

Whether claims falling into the other categories should be capable of being set-off depends upon defining the appropriate balance between the rights of persons subject to assigned obligations ("obligors") and third parties who acquire rights to enforce an obligation ("assignees"). Consider the following examples. From the perspective of A (the obligor) it seems unjust that B's unilateral act should deprive him of rights of set-off. It is not clear, however, that the rights of D (the assignee) should be limited by events arising after notice of the assignment.

Example 1: a category 2 obligation

January 1	A owes B $1000.
February 1	B borrows $1000 from C. A guarantees the loan.
March 1	B assigns A's debt to D and notice is given to A.
April 1	B defaults on the loan from C. A pays C $1000.
June 1	D demands A pay the assigned loan from B.

Example 2: a category 3 obligation

January 1	A owes B $1000.
February 1	B advises A to enter into a binding agreement to buy certain shares at a certain price on May 1. A relies on the advice and enters into the agreement.
March 1	B assigns A's debt to D and notice is given to A.
April 1	It is discovered that B's investment advice was given negligently and A has a cause of action against B. Whether A will suffer a loss and what it will be, however, cannot be determined until the shares are transferred to him.
May 1	A's loss is quantified at $1000.
April 1	C demands payment of the $1000 from A.

Example 3: a category 4 obligation

January 1	A, a supplier of raw materials, purchases equipment for $10,000 from B on credit. A expects to satisfy this debt through future deliveries of raw materials to B.
February 1	B assigns A's debt to D and notice is given to A. March 1 A supplies materials to B worth $2,000.
April 1	B becomes insolvent.
May 1	D demands payment of the $10,000 from A.

The general principle underlying the law of assignments is that the assignee should be in no better position than the assignor. That would suggest that an obligor should be able to raise any claim he has against the assignor to resist the enforcement of obligations assigned to the assignee, whenever the claim arose. Example 2 above, involving the guarantee, demonstrates the injustice that may arise by limiting rights of set-off. If B anticipated default on the guaranteed loan, the assignment borders on a fraudulent conveyance. The law in other contexts prevents a person from alienating property or rights in an effort to impede the enforcement of another's claim against him. Arguably, the law of set-off, to be consistent, should be framed in such a way as to limit a person's ability to unilaterally limit or extinguish another's rights.

The Commission recognizes the validity of the general principle that an assignee should occupy no better position than the assignor. Nevertheless, it has been tentatively concluded to adopt a more pragmatic approach. The commercial need for negotiable choses in action is apparent in at least one context.

Often a business can only borrow money on the strength of its accounts receivable. Diminishing the value of that asset to a creditor will impair the creditworthiness of the business. For that reason, the negotiability of choses in action is of some importance, and should be retained to the degree that it does not unduly prejudice the rights of a person liable under an assigned obligation. The Commission, consequently, has tentatively concluded that un- matured claims falling into categories two to four should not be capable of set-off.

This is an issue upon which comment would be particularly useful.

It should be observed that many commercial arrangements currently address rights of set-off. A lender may require the borrower to agree that rights of set-off may not be asserted against a particular obligation. A subsequent assignee of that obligation will be able to pursue it free of rights of set-off. Where a borrower requests an obligation be assigned (for example, a mortgage) the assignee may require the borrower to enter into such an agreement. On the other hand, where broader rights of set-off are desirable, as in Example 3 above, it is open to the parties to so agree. In many cases, consequently, the parties can decide for themselves on the appropriate operation of rights of set-off.

8. Procedural Issues

Legislation implementing the tentative conclusions of the Commission relating to revision of the law of set- off, discussed above, would remove virtually all distinctions between set-off and counterclaim. This suggests that there is little need to retain the concept of set-off.

Consideration was given to abolishing the law of set-off and enacting legislation to ensure that a person liable under an assigned obligation may assert by counterclaim those claims or defenses available against the assignor against the assignee. A danger to this approach is that procedural traps may be created for the unwary.

Consequently, it has been tentatively decided to retain the concept of set-off, revised in several important respects. That decision raises two procedural issues. Currently, the manner in which a cross-demand is raised, by set-off or counterclaim, will affect the manner in which judgment is given, and the awarding of costs. Where a cross-demand is raised by set-off, only one judgment will issue, and costs will be calculated as if only one proceeding took place. Where a cross-demand is successfully raised by counterclaim, judgment is given for both the plaintiff and defendant, and costs are awarded to the parties as if the proceedings on the original claim and on the counterclaim were separate. It is our tentative conclusion that the manner in which a cross-demand is asserted should not determine these issues. Currently, the courts have a broad discretion with respect to awarding costs. That discretion should not be fettered by the form

adopted for raising a cross-demand.[19] The courts should enjoy a similar discretion with respect to the issue of whether one judgment, or separate judgments on a demand and a cross-demand, should be granted.

9. Non-Monetary Claims

It has been said that "no balance can be struck between the conflicting rights of the parties"[20] where one of them seeks a non-monetary remedy, such as specific performance. Hut this is not true, as Spry observes:[21]

> ... there appears to be no proper basis for a conclusion that there cannot be other equitable set- offs in proceedings for specific performance. In such a case relief depends not on the possibility of balancing two claims against each other, but on equitable considerations by which it appears to be proper that the plaintiff be prevented from establishing his rights until the claim of the defendant has been satisfied.

There is, consequently, no need to distinguish between monetary and non-monetary claims.[22]

In some circumstances, a cross-demand may be raised to obstruct or delay the plaintiff. In other cases, an assignee should not be put to the expense of contesting the validity of a claim asserted against the assignor and raised as a set-off. Where a counterclaim is inconveniently brought, the court has a broad discretion to handle matters.[23] It should possess a similar discretion with respect to set-of fs. Where a defendant improperly raises a counterclaim or defence, the court currently has jurisdiction to deal with the matter.[24]

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[19] The discretion of courts in England to award costs is not fettered by whether a cross-demand is pleaded as a set-off or counterclaim: *Hanak* v. *Green*, [1958] 2 Q.B. 9 (C.A.); moreover, courts in England are encouraged to make a special order respecting the awarding of costs on the basis of a single proceeding: *Chell Enineerin Ltd.* v. *Unit Tool and Engineering Co., Ltd.*, 1950 1 All E.R. 378 (C.A.); *Childs* v. *Gibson*, [1954] 1 W.L.R. 809 (C.A.); *see also* B.A. Harwood, *Odgers on Pleading and Practice*, (*16th ed.*, 1957) 227.

[20] *Gathercole* v. *Smith*, (1881) 7 Q.B.D. 626, 631 (C.A.).

[21] "Equitable Set-offs," (1969) 43 Aust. L.J. 265, 271.

[22] The Rules already contemplate a similar procedure where default judgment is obtained. Rule 25(10) provides:

> 25. (10) Unless the court otherwise orders, where there is a counterclaim the plaintiff shall not issue execution on a judgment obtained under this rule until the entire action has been disposed of.

[23] Rule 21(13) provides:

> 21. (13) Where, on the application of a party against whom a counterclaim is made, it appears that the subject matter of the counterclaim ought to be dealt with separately, the court may order that the counterclaim be struck out or tried separately or may make such other order as it thinks just.

Rule 5(7) provides:

> 5. (7) Where a counterclaim or a third party proceeding ought to be disposed of by a separate proceeding, the court may so order.

[24] Rule 19(24) provides:

> 19. (24) At any stage of a proceeding the court may order to be struck out or amended the whole

10. Indemnity for Diminished Claim

Where the value of an assigned claim is diminished as a result of a set-off, the assignee has been deprived of part of the benefit of his bargain with the assignor. Legislation broadening the concept of set-off will further reduce the value of choses in action. We have considered whether an assignee whose claim has been diminished or extinguished by a set-off should be entitled to an indemnity from the assignor.

In many cases, the consideratiom received for an assigned claim is based on the value of the claim, discounted to take into account a variety of factors. One factor will be the likelihood that the claim will not be collected. For example, B owes A $500. A assigns that claim to C for $200. It is doubtful that the claim will be collected, so A is willing to accept a small amount for the assignment, while C is willing to take the risk that it will be uncol- lectable. If B successfully sets-off a cross-demand that extinguishes the assigned claim, should C be entitled to an indemnity for the value of the assigned claim ($500) or for the value of the consideration he gave for it ($200)? These concerns are usually addressed by agreement between the assignee and the assignor. It is our tentative view, however, that in the absence of agreement, the assignee should be entitled to an indemnity from the assignor to the extent that the assignor is relieved from liability by the set-off of a cross-demand.

11. Contracts Affecting Rights of Set-off

Currently, parties may agree, even in situations where set-off would not ordinarily be available, that certain cross-demands may be set-off. They may also agree that certain claims are free of rights of set-off. There can be no objection to parties defining their rights by agreement in this context. Our proposals should be subject to a contrary agreement.

12. Settlement Offers

A defendant wishing to facilitate settlement of an action may make a payment into court. If the plaintiff does not accept the payment, and receives an amount equal to or less than the amount paid into court, he will be responsible for the defendant's costs incurred after notice of the payment.[25]

Where a defendant asserts a counterclaim, an offer to surrender it operates in a similar manner to a payment into court. Rules 37(22)-(24) provide as follows:

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or any part of an endorsement, pleading, petition or other document on the ground that

(a) it discloses no reasonable claim or defence as the case may be, or
(b) it is unnecessary, scandalous, frivolous or vexatious, or
(c) it may prejudice, embarrass or delay the fair trial or hearing or the proceeding, or
(d) it is otherwise an abuse of the process of the court,

and may grant judgment or order the proceeding to be stayed or dismissed and may order the costs of the application to be paid as between solicitor and client.

[25] Rule 37(17); *see Report on Settlement Offers*, (LRC 77, 1984) for a full discussion.

37. (22) Where a counterclaim is asserted, a defendant may offer to surrender his counterclaim, or may pay into court a sum of money and offer to surrender his counterclaim, in satisfaction of one or more of the plaintiff's claims in settlement of the action and counterclaim.

(23) Where a counterclaim is accepted in satisfaction or part satisfaction, the counterclaim is stayed.

(24) Subrules (1) to (21) apply mutatis mutandis to the offer to surrender a counterclaim as though it were payment of money into court.

It is our tentative conclusion that an offer to surrender a set-off should operate in the same way. Rules 37(22)-(24) should be revised to apply to the surrender of a set-off.

13. Negotiable Instruments

Special rules apply where the principal claim is a negotiable instrument. These rules are designed to promote the negotiability of a class of choses in action intended to function like currency. Negotiable instruments are a matter of federal jurisdiction. The province has not the capacity to alter these rules, and our proposals are not intended to do so.

14. Statutes of Set-off

Legislation restating the law of set-off will remove the need to retain the Statutes of Set-off as part of the received law of British Columbia.

15. Proposals

The Commission proposes that:

1. For the purposes of these Proposals,

   (a) "notice" means written notice to a person under an obligation that a successor in interest is entitled to enforce the obligation; and

   (b) where the entitlement of a successor in interest to enforce an obligation does not depend upon giving notice to the person under the obligation, "notice" refers to the time when the entitlement of the successor in interest to enforce the obligation vests.

2. Any matter which may be raised as a counterclaim may be raised as a set-off.

3. Where the right to proceed on an obligation owed by one person to another becomes vested in a successor in interest, whether by assignment, operation of law or otherwise, the person under the obligation may raise as a set-off or counterclaim any matter which could have

been raised as a set-off or counterclaim against the person formerly entitled to enforce the obligation.[26]

4. Under Proposal 3, rights of set-off or counterclaim are subject to the following principles:

   (a) the set-off or counterclaim may only be raised to diminish or extinguish the claim of a successor in interest;

   (b) subject to Proposals 4(c) and (d), no claim or defence that arose, or was acquired, after notice may be raised as a set-off or counterclaim.

   (c) where a successor in interest seeks to enforce an obligation arising from an agreement, any claim or defence arising from the agreement whether before or after notice may be raised as a set-off or counterclaim.

   (d) a claim which is capable of being ascertained before notice but which does not fall or accrue due until a later date, may be raised as a set-off or counterclaim.

5. Whether a claim is raised as a set-off or counterclaim, the court may give separate judgments or a judgment based wholly or in part upon the difference between the claims of the plaintiff and the defendant.

6. The court's discretion to award costs is unaffected by whether a claim is raised as a counterclaim or a set-off, and costs may be awarded on the basis of a successful claim and counterclaim or on the basis of one claim offsetting another claim as may be appropriate in the circumstances.

7. Where, on the application of a party against whom a set-off has been raised, it appears that the subject matter of the set-off ought to be dealt with separately, the court may order that the set-off be struck out or tried separately or may make such order as it thinks just.

8. Where the claim of a successor in interest is diminished by the operation of Proposal 3, he is entitled to an indemnity from a person formerly entitled to enforce the claim, to the extent that person has benefitted from the operation of Proposal 3.

9. Unless prohibited by an enactment, rights of set-off may be altered or waived by agreement.

10. Rules 37(22)-(24) should be revised to apply to a surrender of a set-off.

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[26] This Proposal alters the current law in an additional way. Currently, only those equities arising between the obligor and the original assignor may be raised against the assignee enforcing the obligation. Equities attributable to an intermediate party do not attach to the assigned obligation: *see, Re Milan Tramways Co.*, (1884) 25 Ch. D. 587 (C.A.); *Banco Central S.A. & Trevelan Navigation Inc*. v. *Lingoss & Falce Ltd. (The Raven)*, [1980] 2 Ll. R. 266 (Q.B.). Under Proposal 3, equities attributable to an intermediate party may be raised against the assignee seeking to enforce the assigned obligation.

11. The following Acts of the Imperial Parliament should have no further force or effect in this province:

2 Geo. II, c. 22
3 Geo. II, c. 27
8 Geo. II, c. 24

The proposals are only tentative. Final recommendations will be made in the light of comment and criticism received on this Working Paper.

Appendix A

Specific Legislation on Rights of Set-off

Some statutes provide for or modify the right of set-off in specific situations. The operation of these statutory provisions is outside the scope of this Working Paper.

1. Consumer Protection Legislation

The *Consumer Protection Act, 1967*, R.S.B.C. 1979, c. 64, s. 17 and the *Consumer Protection Act*, R.S.B.C. 1979, c. 65, s. 3 both contain provisions which limit the right of a debtor under a contract to which the respective Acts apply to claim against an assignee. The statutes note that the claim being set-off is limited to the amount owed by the debtor at the time of the assignment. The same result would occur in absence of these provisions under the general law.

2. Set-off Before Inferior Courts

Monetary limits are placed on the jurisdiction of the county and provincial courts: *County Court Act*, R.S.B.C. 1979, c. 72; *Small Claim Act*, R.S.B.C. 1979, c. 387. The courts are, however, competent to recognize a claim pleaded as a set-off where it exceeds the monetary limit of the court as a defence to the plaintiff's action: *County Court Act*, R.S.B.C. 1979, c. 72, s. 20; *Small Claim Act*, R.S.B.C. 1979, c. 387, s. 29. Section 29 of the *Small Claims Act* authorizes the Provincial Court to recognize the claim of set-off and to give judgment to the defendant for any amount in excess of the plaintiff's claim to a maximum limit of $2000.00.

3. Set-off Against the Crown

The *Crown Proceeding Act*, R.S.B.C. 1979, c. 86, restricts the right of set-off against the Crown in certain cases. Section 11(3) prohibits a person from claiming a set-off where the Crown is seeking recovery of "taxes, duties or penalties" or where the set-off sought against the Crown is for repayment of "taxes, duties or penalties". Also, section 11(5) restricts the right of a person to claim a set-off against one government ministry in respect of a claim due from another government ministry.

4. Other Special Relationships

Special types of relationships give rise to special rules respecting set-offs. The *Builder's Lien Act*, R.S.B.C. 1979, c. 40, provides that no set-off by the owner may be claimed against a lien claimant other than the contractor. However, where the claim of lien is being enforced in court, section 29(3) permits a claim of set-off arising from the same transaction to be advanced.

The *Credit Union Act*, R.S.B.C. 1979, c. 79, provides that shares of the credit union may not be set-off against claims by the credit union for a member's indebtedmess.

The *Fire Services Act*, R.S.B.C. 1979, c. 133, s. 22 provides that an occupier of premises required to pay the cost of complying with an order under the Act, in the absence of an agreement to the contrary, has a right to set-off that amount against the owner of the premises.

The *Negligence Act*, R.S.B.C. 1979, c. 298, in sections 2 and 3 provides for set-off and judgment for the balance where two persons are liable to each other and damages and costs are awarded. The party in whose favour the balance exists will have judgment for the balance.

The *Pawnbroker's Act*, R.S.B.C. 1979, c. 314, s. 19 provides that the pawnbroker is to pay over the surplus from any sales that meet certain criteria. However, the section also provides that where within 12 months before or after a sale in which a surplus exists the sale of a pledged article results in a deficit, the pawnbroker may set-off the surplus against the deficit.

Other legislation including the *Sale of Goods Act*, R.S.B.C. 1979, c. 370, s. 66, the *Residential Tenancies Act, 1984*, S.B.C. 1984, c. 15, ss. 15 and 19, and the *Workers' Compensation Act*, R.S.B.C. 1979, c. 437, s. 15, have provisions relating to set-off.