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Priorities in the Law of Mortgages (continued)

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PRIORITIES IN THE LAW OF MORTGAGES

(Continued)

IV.

ASSIGNMENTS

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Interests in the Real Security—Equities of Ownership—Defensive Equities—"Mortgages" securing non-negotiable instruments.—Where the personal security and the real security of a *mortgage* are evidenced by one instrument obviously a separation of the two securities would never be expected or contemplated as probable. The *ownership* of both would be vested in one person, the mortgagee or the assignee. But where the two securities are evidenced by separate instruments difficult questions of *ownership* arise. These have already been considered to some extent in the discussion of the necessity of a formal, written assignment. Courts of equity consider the personal security, that is, the debt, the principal part of the *mortgage* transaction or relation and the real security, that is, what is ordinarily called the *"mortgage,"* as the incident or accessory, and take the view that a transfer of the personal security carries with it a transfer of the real security. *Omne principale trahit ad se accessorium.* Even if the personal security is in the form of a promissory note made payable to the mortgagee, or bearer, and so transferable by delivery, any holder of the note can avail himself of the security afforded by the *mortgage* executed to secure its payment. While this doctrine would be applicable in courts of law in "lien" states, it has rarely been involved in a controversy at law in any jurisdiction. The principle has been applied even when the transferee of the personal security was ignorant of the real security at the time of the transfer of the former security.[1] But

1 Tiffany, Real Property (2nd ed.) 2524.

the real security has not been held to follow the personal security as an incident in all cases. Ordinarily a transfer of the real security is intended by the parties to the assignment of the personal security, and has been made, in some instances, by a delivery only; but it is not a necessary conclusion in all cases that such was the intention of the parties. If the transferee of the personal security is forbidden by statute from dealing in real-estate securities, an intent that the real security be transferred can not be inferred from the transfer of the personal security alone.[2] Of course it would be easier for the transferee of the personal security to realize it by using the real security for this purpose where he has possession of the real security as upon a delivery of it. But where there has been no delivery or written assignment of the real security, it is ordinarily considered as being owned in equity by the transferee of the personal security and he can avail himself of it in order to realize his mortgage debt. This principle would apply in the "title" states, for the legal title to the real security would be held, in equity, for the benefit of the owner of the personal security ordinarily. The latter would be entitled to subject the real security to his benefit in realizing the mortgage debt or enjoin its use to his injury. Jones says that "When the debt and the legal title to the mortgaged estate are separated . . . if the holder of the latter will not voluntarily use this title for the benefit of the person entitled to the use of it, it may be necessary to resort to a bill in equity to charge the party who has the legal title as a trustee for the holder of the debt, or to assign the mortgage to him, whereupon he will be compelled either to maintain a suit at law, or to foreclose for the benefit of the assignee, or to assign the mortgage to the holder of the debt. Courts of law will enforce this equitable principle so far as they are able." [3] The principle that control over the personal security involves control over the *legal* interest of

2 See Franklin Sav. Bank v. Colby, 75 N. W. 346 (Iowa 1898).
3 Jones on Mortgages (7th ed.) § 818.

the mortgagee in the mortgaged realty, whether it is the real security itself or the incidental rights that are recognized in some jurisdictions as accompanying the transfer of the legal title to the mortgagee, is well illustrated in the Maine decisions. In *Lord v. Crowell*[4] the plaintiff brought an action at law,—a writ of entry,—to recover possession of the mortgaged land. He was assignee of the mortgage debt evidenced by promissory notes. The defendant was in possession of the mortgaged premises as a purchaser for value, without actual notice of the fact that his grantor's title was any other than a fee simple, under a warranty deed from the mortgagee, who was in possession at the time of the transfer—taking the rents and profits. The plaintiff subsequently sued the mortgagor on the mortgage notes, recovered judgment, and levied execution on the mortgaged land. The effect of these proceedings by the plaintiff was held to be that the mortgage debt was satisfied; that the interest of the mortgagee was extinguished, and, consequently, the interest of the defendant was also extinguished; that the record itself disclosed the nature and infirmity of the interest the defendant assumed to purchase, and that he had no defense even to the action at law.[5] *A fortiori* the same result would be reached where, instead of a conveyance of the mortgaged premises by the mortgagee in possession, under the Maine doctrine, he assigns the real security, by a deed of assignment, to one person and assigns the mortgage debt to another. If the mortgagee assigns the note secured by the *mortgage* to a third person, without assigning the real security, he holds the latter in trust for the holder of the note; and if the mortgagee assigns the real security to still another person, he can not thereby assign a greater right than he

4 75 Me. 399 (1883).

5 This decision is summarized in Hussey v. Fisher, 47 Atl. 525, 528 (Me. 1900), by Emery, J., who was a member of the Maine court at that time. While he did not take part in the decision, his statement as to notice to the defendant must be accepted as a fact, although it does not appear from the decision as to whether the mortgage was recorded.

has, for the *mortgage* itself would constitute notice to the assignee of the nature and extent of the interest transferred.[6]

Where the real security is given to secure two or more promissory notes executed by the mortgagor, the mortgagee is said to hold the mortgaged realty in trust, charged with the mortgage debt. If the mortgagee negotiates one of the notes, without the expression of any intent, either to retain the real security to his own use as security for his remaining note, or notes, to the security of which alone perhaps it is adequate, or to hold it in trust for himself and his indorsee, and when therefore the mortgagee has a beneficial interest in the real security, the question arises as to whether any *resulting trust* would be implied in favor of the indorsee. Of course this question would not be of any importance where the real security is of sufficient value to pay all of the notes or other obligations secured by it; and if the mortgagor is solvent it probably would not be of any great importance. But where the real security is inadequate for this purpose, or the mortgagor is insolvent, many controversies have arisen between the mortgagee-assignor and his assignee of a part of the secured indebtedness, resulting in an irreconcilable conflict of judicial opinion upon the problem. This class of cases is closely allied with the cases involving controversies between successive assignees of all of the several promissory notes, or bonds, or other evidences of indebtedness, secured by a real security in particular transactions; and in some jurisdictions the same rule has been applied to both classes of cases. One view, that seems to be sustained by the numerical weight of authority,[7] is

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6 See Lord v. Crowell, *op. cit. supra* note 4, at p. 403.

7 See collection of cases in Ann. Cas. 1914 C, 149. In some jurisdictions the assignee is not entitled to priority of lien over his mortgagee-assignor, but the same rule of distribution is applied as among several assignees where all of the mortgage notes, or other evidences of debt, are assigned.

In Donley v. Hays, 17 Serg. & Rawle 400 (1828), a case supporting the minority rule, it was intimated that if the mortgagee-assignor has guaranteed payment of the note assigned a different rule would have been applied. The same suggestion is contained in Cooper v. Ulmann, Walk. Ch. 251 (1843), another

that where the mortgagee assigns or transfers one, or a part, of the notes secured by his *mortgage,* if the *mortgage* secures more than one note, and retains the other, or others, and the real security is not sufficient to pay all the notes, the mortgagee is not entitled to participate in the real security to realize on the note, or notes, retained by him in competition with his assignee. "And the same rule applies where a person to whom all of a series of notes have been assigned assigns one of the series to a third person." In *Lawson v. Warren*[8] the basis of this principle is stated as follows:

"The reason the assignee is to be preferred is founded on the plainest principle of equity. When two notes are assigned to different persons, they are both presumed to have paid value, and they must share equally in the proceeds of the mortgaged property in order to preserve the equality which is equity. But to apply the same rule between the mortgagee and a person to whom he had transferred one of the notes would lead to inequality. For illustration, say that the mortgagee holds two notes for $1,000 each. He assigns one of them for value. The property securing their payment only brings $1,000, or enough to pay one note. If the mortgagee shares in the proceeds he will get out of the debt $1,500, the $1,000 he received for the first note and the $500 he receives from the proceeds of the mortgaged property, while the assignee for half the debt only receives $500. The mortgagee would thus receive more than if he had kept both notes. This is not right."

According to this principle, the assignment of one of the mortgage notes operates, *ipso facto,* as an assignment of the mortgage lien, entitling the assignee to preference of payment out of the real security as against the mortgagee-assignor who retains the remainder of the mortgage notes; and this is true without reference to the order of maturity of the notes.[9] Acquisition of the title to the note assigned, whether it is a *legal* or an *equitable* title, operates to give

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case supporting the minority rule. In such a case the Supreme Court of Texas has suggested that the doctrine of subrogation would probably be applied if the mortgagee-assignor did not assert any interest in the real security; or, if he did assert an interest, the assignee would be entitled to priority of lien. See Cannon v. McDaniel, 46 Tex. 303, 313 (1876).

8 124 Pac. 46, 48, 49 (Okla. 1912).

9 McClintic v. Wise's Adm'ors & Als., 25 Gratt. 448, 18 Am. Rep. 694 (1874).

the assignee the benefit of the real security so far as necessary to enable him to realize the *amount he has paid for the note*. It may seem that if the assignee purchased the note at a price which was much less than the face value of the note, it would be evidence of an agreement that the mortgagee-assignor share equally in the real security. But the adequacy of the consideration paid by the assignee should only be considered, *if at all*, where the terms of the assignment are in doubt. In such a case, if the assignee of the note was unaware of the existence of the real security, there would be a stronger case in favor of the mortgagee-assignor sharing in the real security; still it would impair the value of the assignment if the mortgagee-assignor shares in the real security with the assignee. By analogy, it is said that "The vendor of part of an estate which he has encumbered by his own act, cannot demand contribution of the vendee, being bound, both at law and in equity, to apply the residue in the satisfaction of the debt. . . . Yet the vendee might, with equal plausibility, be said to have got the estate at an under value, in consideration of its bearing a share of the burden on the whole. But the vendor is bound to discharge the encumbrance in case of the vendee, even where the latter has not paid a valuable consideration (*Sir William Harbert's Case*, 3 *Co. Rep.* 11b, 12). And why shall not the assignee of a chattel have the full benefit of the thing, whether the bargain be a good or a bad one?" [10]

The priority of lien in favor of the assignee, where the mortgagee assigns one or more of the mortgage notes and retains the remainder, may be varied by the assignment agreement. A few cases have considered this principle from the viewpoint of the effect of the indorsement on the note or other personal security transferred. Where the mortgagee-assignor indorses a *guaranty of payment* on the note

10 Dissenting opinion of Gibson, C. J., in Donley v. Hays, *op. cit. supra* note 7, at pp. 406, 407. In McClintic v. Wise's Adm'ors & Als. it is said that the same principles apply in both classes of cases.

transferred, the Supreme Court of Texas has considered this as sufficient to give priority of lien to the assignee.[11] In a later case, *Walcott v. Carpenter*,[12] the Court of Civil Appeals of Texas thought that if a guaranty of payment would have such effect, an *indorsement in blank* would also operate to give the assignee priority of lien, saying:

"An indorsement in blank amounts to more than merely a simple transfer of the title to the note. It is also a contract on the part of the indorser to pay the same to the indorsee, or holder, if not paid at maturity by the maker of the note when duly presented for payment, upon due and reasonable notice given to him of its non-payment at the time by the maker. . . . The material point of difference between guaranty and indorsement, as referable to the original payee in the note that is transferred by guaranty or indorsement, is as to the extent of liability when measured by the diligence due from the creditor, in order to charge such guarantor or indorser. . . . Both are agreements to pay the note."

But the court went on to say that *if there was no agreement of priority,* priority should be sustained in order to prevent circuity of action. The action in this case was one to foreclose a vendor's lien,[13] brought by the vendor of certain land who had expressly reserved the lien to secure the payment of certain notes given for the purchase price. One of these notes had been indorsed in blank to one J., who transferred it to Carpenter; the latter was made a party to the foreclosure proceedings. The pleadings of the plaintiff and Carpenter asked that the rights of the parties be adjusted between them out of the sale of the property; and Carpenter further claimed that the plaintiff was personally liable on the indorsement, and that the maker was insolvent. The court held that the fund realized from the sale of the prop-

11 Perry v. Dowell, 38 Tex. Civ. App. 96 84 S. W. 833 (1905), writ of error to judgment refused in Anderson v. Perry, 98 Tex. 493, 85 S. W. 1138 (1905). The court said: "We think that guaranty inconsistent with the retention of a co-ordinate lien for the payment of the notes retained by the company [the indorser] . . ."

12 132 S. W. 981 (Tex. Civ. App. 1910).

13 The principle is the same whether the real security is in the form of a vendor's lien or a real estate mortgage.

erty should be used as the rights of the parties to the transaction required it to be used in order to avoid circuity of action; and that Carpenter was accordingly entitled to priority in payment out of this fund. In *Fitch v. Kennard*[14] the Court of Civil Appeals of Texas held that an indorsee "without recourse" of one of the security notes was not entitled to priority of lien, on the theory that the indorsement negatived any intention to become liable for the payment of the note to the indorsee. The plaintiff had sold certain real property to one *K*, expressly reserving a vendor's lien to secure the payment of four notes given as a part of the consideration for the purchase. The note maturing first was assigned to one *A.K.* by an indorsement "without recourse." The latter was made a party defendant to this action to foreclose the lien. The court said:

"Appellant did not in any manner undertake to pay or guarantee the payment of the note assigned, nor did he agree that, in the event of a foreclosure sale, it should be entitled to priority of payment over the other notes, still held by him, out of the proceeds of such a sale. . . . 'Whatever uncertainty may have attended the solution of this question hitherto, it is believed that the matter is now settled by the decisions of our court, and that with us the rule is that where several notes are given for the same land, having a lien upon it for their payment, and are assigned to different parties, all have equal rights to have satisfaction out of the land, and this without reference to the order in which they may have been assigned or which first matured. . . . Nor do we think the case is different when the vendor himself may retain one of the notes. There is no presumption arising from the transfer of one or more of them that he intends to waive his right to share pro rata in the common fund for that which he has retained. Of course, he may waive his privilege, but that he has done so shall be made to appear by the proof.' "

Where there is no agreement as to priority of lien, there is a conflict in the Texas decisions[15] as to whether the assignee of one of the mortgage notes is entitled to a preference to,

14 133 S. W. 738 (Tex. Civ. App. 1911).

15 See Douglass v. Blount, 55 S. W. 526 (Tex. Civ. App. 1900), and review of the Texas cases therein; and see Fitch v. Kennard, *op. cit. supra* note 14, and review of the Texas cases therein.

or only entitled to share *pro rata* with, the mortgagee-assignor, who retains one or more of the notes secured by the same real security, in the proceeds of the real security upon a foreclosure by the latter.

In *Rolston v. Brockway*[16] the mortgagee transferred a part of the notes secured by his mortgage, with his full indorsement thereon, and, at the time of the transfer, the mortgagee made a memorandum on the *mortgage* to the effect that the notes transferred were paid in full; the indorsee of the notes apparently knew of and consented to the making of this memorandum. The Supreme Court of Wisconsin held that this constituted an agreement that the indorsee should not share, much less have priority of lien, in the proceeds of the real security where the mortgagee had foreclosed the *mortgage.*

A different view is presented in *McClintic v. Wise's Adm'ors & Als.*[17] In this case *W.* sold certain land to *M.*, receiving three bonds as a part of the consideration. One bond was paid in *W.'s* lifetime. The latter assigned one of the remaining bonds to *S.*, and, through a series of successive assignments, *H.* became the ultimate assignee. The administrators of *W.* brought a suit to have the land sold and the bond, that *W.* had retained, paid. The bill alleged that the complainants were uninformed as to the ownership of the bond that had been assigned. The land was sold, and the commissioner was directed to collect the money and pay the complainants. *H.*, upon his petition, which was filed subsequently, was made a party defendant in the suit, and filed his answer, claiming that his bond was still unpaid, and that he was entitled to priority of lien in the proceeds of the sale. The administrators replied that *H.* had lost his right to subject the land to the payment of his bond by his *laches* in not

16 23 Wis. 407 (1868). (After the foreclosure had taken place the indorsee brought this action to enforce payment of the notes assigned to him by a foreclosure of the mortgage.)

17 *Op. cit. supra* note 9.

suing *M.*, who had in the meantime become insolvent. It was held that *H.* was entitled to priority of lien out of the proceeds of the sale, even though the bond assigned to him matured subsequently to that retained by *W.* In discussing the administrators' contention that *H.* had, by his want of due diligence against the obligor, lost his right of recourse against the estate of the latter, the court said:

"I do not think the right of the assignee to subject the land fund results at all from the personal liability of the assignor, or that the failure to pursue the obligor affects the right to enforce the lien upon the land. The assignee. . . has three remedies: An absolute right to resort to the debtor himself; 2d, to the lien upon the land; and 3d, contingently to the assignor himself. The loss of the latter remedy, by the want of due diligence, can no more affect the right of recourse to the land than it can affect the right of reverting to the debtor himself. The assignment of the bond is, *ipso facto,* an assignment of the lien. Having once vested by the assignment, that lien is not divested by the failure to sue the debtor. The assignee having two remedies, both absolute and undoubted, may resort to either. . . . the fact that the assignee had no recourse upon the assignor did not sever the lien from the note; but as he (the assignee) acquired the equitable right to the [bond][18]. . . he acquired with it the equitable right to all remedies for its enforcement. The continued substance of the lien in his (the assignee's) favor, or for his benefit, does not depend upon the subsistence or continuance of a personal liability of the assignor to him, nor upon there being a written transfer of the note passing the legal title."

This seems to be a more desirable view than that presented in the Texas cases heretofore considered. According to the better view, the assignment of one of the mortgage notes, or bonds, *ipso facto,* operates in equity at least, to assign to the transferee *all* of the *remedies* for its enforcement. While the indorsement on the note or bond assigned may withhold one of the remedies, it does not necessarily operate to exclude the other remedies of the assignee. The personal liability of the assignor is quite distinct from right to resort to the real security to enforce payment of note or bond as-

[18] The court here cites and relies upon Ripperdon v. Cozine, 8 B. Mon. 465 (1848), a case that supports the same principle.

signed. The latter right is based upon a *trust arising by operation of law.*[19] While the mortgagee-assignor may exclude this remedy by an express contract, a *restrictive indorsement,* for instance, only operates to exclude any personal liability of the assignor and not to bar all of the remedies of the assignee.[20] The intention of the parties should be directed specifically and expressly to this purpose to have such effect. While the assignee may, by contract with the mortgagee-assignor, be barred from resorting to the real security, yet his right to resort to the real security does not depend on any obligation on the part of the mortgagee-assignor to pay the note or bond assigned. His right appears to depend on the fact that by becoming transferee of the note or bond he thereby purchases an interest in the real security sufficient to reimburse him for what he paid therefor; and an indorsement that *transfers the interest* of the mortgagee-assignor, whether it be restrictive, regular, qualified, or in the form of an assignment, is sufficient for this purpose.

Where the mortgagee assigns only one, or a part, of the mortgage notes, or bonds, to a third person, retaining the

19 "It is perfectly well settled by the decisions of this and other courts, that when a debt is secured by mortgage, the debt is the principal and the mortgage a mere accessory or incident, and that an assignment of the debt, unless otherwise expressed, will be, in equity, an assignment of the mortgage also. . . . When, therefore, Cullman, the mortgagee, transferred the second note falling due to Harding, if there was no express reservation of his interest in the mortgage, the assignment of the note was an assignment of the mortgage, also, *pro tanto,* and if Cullman had retained the remaining notes and the mortgage property had proved insufficient for the payment of the entire debt, his assignee would have been entitled to priority of payment." Per Ormond, J., in Cullman v. Erwin, 4 Ala. 452 (1842).

"If it be true that the law, independent of any contract, transfers the mortgage with the note, so as to entitle the transferee to a preference over the mortgagee who held the first note, the proof in such case should be stronger still to restrict this right. (See Collins vs. Irwin, executor of Hitchcock; 4 Ala. Rep. [This is evidently a misprint, for the case apparently referred to is Cullman v. Erwin, Adm'r., *supra.*]). Indeed, for myself, I confess I am not sure that not only the mortgage, but all contracts to further the collection of this second note, are transferred by operation of law with the note to the holder . . ." Per Lumpkin, J., in Roberts and another v. Mansfield, 32 Ga. 228, 234 (1861).

20 See discussion in McClintic v. Wise's Adm'ors & Als., *op. cit. supra* note 9.

other, or others, and the assignment does not operate at law to transfer the legal interest in the real security to the assignee, the legal interest retained by the mortgagee-assignor is subordinate to the assignee's equitable interest, that is, his priority of lien in the proceeds of the real security on foreclosure and sale of the mortgaged premises. In other words, if the mortgagee-assignor is entitled to maintain ejectment against the mortgagor, he thereby obtains no additional advantage, if he does so, for the assignee is entitled, in equity at least, to this additional benefit.

Where the mortgagee assigns only one, or a part, of the mortgage notes to *A.*, and the remaining note, or notes, together with the real security, to *B.*, *B.* would not necessarily acquire any precedence from the fact of his holding the legal title to the real security.[21] *B.* might be enabled to invoke the well established principle in equity that if a trustee disposes of the trust estate to a *bona fide* purchaser, for a valuable consideration, without notice of the trust, he will bar the interest of the *cestui que trust.* But ordinarily the instrument evidencing the real security would give *B.* notice of the equity of *A.* which is prior in time. According to this principle, it is important to determine whether one of the assignees acquires a legal or an equitable title to the chose. If the second assignee acquires only an equitable title, then the former assignee, if he has acquired only an equitable title, would be prior in time and prior in right, if the two equities are equal, and would have priority of lien in the proceeds of the real security upon a sale thereof in foreclosure. If

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21 Pomerory's Equity Jurisprudence (4th ed.) § 1202, and cases cited.

"Each assignee is, through the mortgage, charged with notice of the equitable interests of all the other assignees. The holder of a part of the notes, with a formal assignment of the mortgage, acquires no precedence from the fact that he is holding the mortgage." Per Maxwell, C. J., in Studebaker, etc., Co. v. M'Curger, 30 N. W. 686, 678 (Neb. 1886).

But compare the dissenting opinion of Gibson, C. J., in Donley v. Hays, *op. cit. supra* note 7: "In this case, had the subsequent assignees obtained a *legal* assignment of the mortgage, it would have made a difference; for as there would have been equity against equity, the legal title must have prevailed. But as neither party has anything but an equity, priority of title is priority of right."

the first assignee acquires only an equitable title and the second assignee acquires the legal title, in addition to his equitable title, and is not charged with notice of the interest of the prior assignee, he would have priority of lien. If the first assignee acquires a legal title as assignee, then he would have priority of lien as against the second assignee even if the latter had purported to acquire the legal title to the chose.

Where several notes, or bonds, maturing at different times, are secured by *the same mortgage,* and are assigned by the mortgagee to different persons at different times, various rules as to priority [22] of lien in the proceeds of the real security on foreclosure are adopted, in the absence of a special contract between the mortgagee-assignor and one, or a part, of the different assignees. One view is that the *order of maturity* of the various notes, or bonds, determines the priority of lien. Another view is that the *order in which the assignments are made* controls the priority of lien. In a third class of cases the proceeds of the real security are applied *pro rata* in payment of the several notes, or bonds, irrespective of their dates of either maturity or assignment.

Some states that apply the rule that the order of maturity controls priority of lien, do so only in case of simultaneous assignments; if the assignments are not simultaneous, then the order of the assignments controls. But in other states the order of maturity controls priority of lien, irrespective of the order of assignments. In some of the states that apply the rule that the order of maturity controls the priority of lien do so only where the notes were originally given to one payee-mortgagee; but where the different notes secured by

22 See classification of authorities in Ann. Cas. 1914 C, 143 *et seq.*

"Where all the notes stand on the same footing,—that is, they are all payable at the same time,—the equities of all the assignees are equal, and there is no preference or priority among them in enforcing the security of the mortgage. All the assignees are entitled to a *pro rata* share of the proceeds of the mortgaged premises, in case there is not sufficient to pay all the notes in full." Pomerory's Equity Jurisprudence (4th ed.) § 1201.

one mortgage are issued to different payees, the *pro rata* rule is adopted.[23]

The foregoing views as to priority of lien among the assignees of the several notes secured by one real security are generally conceded to obtain only in the absence of a special agreement between the mortgagee-assignor and one, or some, of the assignees indicating a different intent.[24] Thus the mortgagee is entitled, in assigning one of the mortgage notes, to agree that the assignee shall have priority of lien, and such agreement will be binding on subsequent assignees of the other notes, with notice thereof. Again, it is said that since the distribution of the proceeds of the real security on foreclosure among the several assignees of the various mortgage notes is based on equitable considerations, the rule adopted in any particular state will not be applied if the special circumstances of a particular case are such as to render the application of the rule inequitable.[25]

The jurisdictions that adopt the *order of assignment* rule as to priority of lien do so for the reason that the debt secured is the principal and the *mortgage* an accessory, and that the transfer of one of the mortgage notes carries with it so much of the *mortgage lien* as is necessary to pay the note assigned as effectually as the right of realization existed in the mortgagee's favor; and that no second assignment can divest the first assignee of his priority of lien. The priority of lien existed as against the mortgagee-assignor, and the second assignee can acquire no greater right in the real security that the mortgagee had left to transfer after the first assignment.[26] The courts that adhere to the *order of maturity*

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23 Ann. Cas. 1914 C, 145, 147.

24 See authorities in Ann. Cas. 1914 C, 147, 148.

25 Ann. Cas. 1914 C, 148, 149. In this Note it is said: "Thus in Robinson v. Waddell, 53 Kan. 402, 36 Pac. 730, it was held that where the mortgagee indorsed some of the notes generally and indorsed the others without recourse, the latter notes were entitled to priority of payment out of the proceeds of the mortgage. The contrary was, however, held in State Bank of O'Neill v. Matthews, 45 Neb. 659, 63 N. W. 930, 50 Am. St. Rep. 565."

26 Penzel v. Brookmire, 51 Ark. 105, 14 Am. St. Rep. 23 (1838).

rule adopt the same reasoning; but they add that if the mortgagee-assignor has retained all of the mortgage notes until their dates of maturity he is entitled to have them paid out of the proceeds of the real security on foreclosure in the order of their maturity; or, upon default on the note, or notes, falling due first, he is entitled to foreclose and thus satisfy the notes in the order of their maturity. Therefore, the second assignee, succeeding to the rights of the assignee at the time of the assignment, is entitled to exercise the same *right*.[27] The argument is sometimes advanced in support of the latter rule that the notes maturing at different times are to be regarded as so many *successive mortgages*, each giving priority according to the time of maturity.[28] In *Wilson v. Eigenbrodt* [29] the court discussed this reasoning as follows:

"This seems to us a gross misapplication of the maxim that 'he who is first in time has the better right.' The different instalments are not secured by different mortgages of different dates, but by one mortgage executed equally for the benefit of all the instalments. The date of the lien is the date of the mortgage, and not the date of the maturity of the debt."

Again, in *Penzel v. Brookmire* [30] the court says:

"The comparison of a mortgage to secure several notes to successive mortgages given to secure each one of them does not support the doctrine it is made to prove. To make the cases analogous, the mortgages to secure each note must bear the same date, and be executed, delivered, and filed for record, and recorded, at the same time, and the property mortgaged must be the same. In the latter case, the mortgages would be concurrent; neither one would have preference over the others, and all would have equal claims to be paid ratably out of the property mortgaged. If one should be transferred to a third

27 Penzel v. Brookmire, *op. cit. supra* note 26.

Pomerory says that this rule is adopted in the greatest number of states, and "seems to be based upon a correct application of equitable principles and analogies." Also, "The rights of the holders are fixed by what expressly appears upon the face of the writings; the mortgage is a common bond uniting all the notes, and the various assignees have through it a clear notice of each other's rights." Pomerory's Equity Jurisprudence (4th ed.) § 1201, note 2.

28 Pomerory, *op. cit. supra* note 27; Wilson v. Eigenbrodt, 30 Minn. 4, 13 N. W. 907 (1882).

29 *Op. cit. supra* note 28.

30 *Op. cit. supra* note 26.

person it would not thereby become paramount to the others, but all would stand on an equality. Hence the comparison does not sustain the doctrine that the notes, while in the hands of different persons, are entitled to priority of payment according to the order in which they mature."

Many jurisdictions adopt the rule that the proceeds of the real security are to be applied to all the mortgage notes, in the hands of the various assignees, in the proportion of their respective amounts without regard to the dates when the notes were assigned or the dates when they respectively matured.[31] The real security is executed for the benefit of all of the several notes secured by it. It does not provide that one note shall be preferred to the others. The rights and interests acquired by the various assignees of the mortgage notes begin with the date of the real security, and not from the maturity or assignments of the notes. The first assignee is in a position to protect himself, ordinarily, by requiring a special agreement of priority. The subsequent assignee, or assignees, should be charged with notice of the first, or prior, assignment. So it seems that they should participate ratably in the proceeds of the real security on foreclosure thereof.

The problem of competing interests in the real security may, also, arise in cases involving the *title* of two claimants to the real security itself, or in cases involving the enforcement of the real security. In previous parts of this paper the aspect of the real security as creating an interest in the mortgaged land, that is, a property interest, has been considered; also, the theory that the real security accompanies the personal security as an incident thereto, has been discussed. The latter principle involves problems connected with the transfer of the *ownership* of the real security. The question of the title of two claimants to the real security is, to some extent, allied with that involving the enforcement of that

31 The greatest number of jurisdictions are said to adopt this rule. Ann. Cas. 1914 C, 143. But see note 27, *supra*. And compare the quotation from Pomerory's Equity Jurisprudence, *op. cit. supra* note 22.

security. Here we consider the aspect of the real security as a chose in action—a transferable chose in action; and, as such, its ownership involves not only the right to possess *a thing* but *the right to sue the obligor.* As a chose in action, the right to hold the thing and the right to enforce the obligation are in the same person. A case may involve only the ownership of the thing itself,—the *mortgage deed;* or it may involve the right to enforce the obligation represented by this instrument,—the right to foreclose. So interests in the mortgage relation must be classified as they relate to the *ownership of the mortgage* instrument or to *liability on the obligation* evidenced by it. A mortgagee who has parted with his *mortgage* may want it back so that he may collect it at maturity; and an assignee, who has transferred the *mortgage,* may want it back so that he may collect it at maturity. A person who never had title to a *mortgage* may have an equitable claim to its ownership because it is held in trust for him. If the trustee disposes of the *mortgage* deed the *cestui que trust* has an equitable right to restitution of his property. He may assert his equitable right to ownership in an action of trover just like a person from whom a horse has been bought by fraud.[32] Or he may bring an action to have the *mortgage* adjudged to be held in trust for his benefit.[33] But here, of course, another doctrine may be applicable. The purchaser may be a *bona fide* purchaser for a valuable consideration, without notice of the trust, and so bar the claim of the *cestui que trust.*

The equitable claim to *ownership* has nothing to do with *liability.* Neither the mortgagee, his assignee, nor the *cestui*

32 *Cf.* Ames, Cases on Bills and Notes, II, 693; Mercer v. Jones, 3 Camp. 477 (1813) (Trover for bills of exchange.).

33 In Dillaye v. Commercial Bank of Whitehall, 51 N. Y. 349 (1873), the question was whether one who held a *mortgage* in trust with an apparently unrestricted power of disposition could transfer it free from the claim of the *cestui que trust* to a *bona fide* purchaser for value, without notice of the trust. It was held that he could, in an action brought by the *cestui que trust* against the purchaser to have the *mortgage* adjudged to be trust property for her benefit. This case involved the title of two claimants to the *mortgage* itself, *i. e.,* ownership of the chattel.

que trust is liable on the instrument. The remedy is *affirmative—not defensive.*

The maker of a *mortgage* who has been induced to part with it without consideration or by fraud has a *defense* at law when he is sued on the *mortgage.* He may not wait until he is sued at law on the *mortgage* and set up this defense, but he may use it as a basis of a bill to enjoin the transfer of the instrument and to have it surrendered and cancelled. The latter type of relief, though *affirmative in form,* is *defensive in substance.* The obligor is not seeking a return of the instrument so that he may enforce it; and if there is a decree of cancellation, the instrument does not go back to the obligor but it is canceled and kept by the clerk of the court.[34]

This distinction between a claim asserted to the *ownership* of the *mortgage* deed and rights asserted in defense to actions to enforce the *mortgage* has not always been observed by the courts. There seems to be no doubt as to the general rule that the assignee, or purchaser, of a non-negotiable chose takes subject to defenses, valid as between the original parties.[35] On the other hand, the rule seems to be well settled that the *bona fide* purchaser for value of a non-negotiable chose from an assignee may obtain a valid title as against the former owner who had assigned the chose. The general rule, in the latter class of cases, is that the *bona fide* purchaser for value of a non-negotiable instrument from an assignee of the owner upon whom that owner has by assignment conferred the *apparent* absolute ownership acquires a

34 This whole matter is considered at length by Professor Chafee in his valuable article entitled "Rights in Overdue Paper," 31 Har. L. Rev. 1104.

35 Since the non-negotiable note or bond secured by the *mortgage* are subject to equities of defense or ownership, the *mortgage* would likewise be subject to such equities. For these purposes the *mortgage* is considered as an incident of the debt, and as a non-negotiable chose in action also.

"A mortgage under our laws is a mere chose in action; and aside from the force of the recording statute, an assignee thereof—so far as concerns his right as such to enforce the same—must be treated like the assignee of any other chose in action." Per Earl, J., in Westbrook v. Gleason, 79 N. Y. 23, 29 (1879).

valid title as against the owner. This rule is based on the ground of *estoppel,* and it is held that the owner has, by his act of investing another with the apparent ownership of the property, *estopped* himself from disputing the title of one who thereafter acquires it in good faith from such assignee. This is a modification of the rule that *one cannot sell more than one has.* If *A.* sells *B.* a horse which he has stolen, as a general rule, *B.* is not entitled to claim title to the horse as against the true owner; but if that owner happened to be standing by at the sale, and saw *B.* purchase the horse and pay for it, without objection from him, he might find it difficult to reclaim the horse. The same principle would be applicable to the *mortgage* in so far as the equity of ownership is concerned. But the doctrine of *estoppel,* thus applied, does not have the effect of making non-negotiable choses negotiable. The assignee, or purchaser, takes the chose subject to *equities of defense,* valid as between the original parties; and this distinction must be observed in reference to rights *of ownership,* whether the ownership is asserted by the *mortgagee* or by an *assignee.*

While a purchaser of a non-negotiable chose in action takes it subject to the defenses existing between the original parties thereto, it has been held that he does not take the chose subject to the *latent defensive equities of third persons.* Thus in *Simpson v. Del Hoyo* [36] the vendor of certain real property was induced by the fraudulent representations of *L.* to convey the property to his daughter, Miss *L.* The latter mortgaged the property to *L.* as security for the payment of her bond. Subsequently *L.* assigned the bond and mortgage to *P.,* who was assumed to have paid value for the same and to have had no notice of the fraud. It was held that *P.* took free from the claim of the defrauded vendor.

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[36] 94 N. Y. 189 (1883).

In *Murray v. Lylburn* [37] Chancellor Kent divided rights (generally designated as "equities") of ownership into "latent" (those not in the apparent chain of title) and "patent," and advanced the doctrine that the assignee of a non-negotiable chose in action takes it free of latent, but subject to patent, equities of ownership. Pending a suit against a trustee of real estate for a fraudulent breach of trust, in which an injunction had been obtained restraining him from disposing of any part of the estate, he sold a part to one *D.*, who executed a bond and *mortgage* for the purchase money, which the trustee afterwards assigned to *L.*, whose representatives were made defendants. The Chancellor was of the opinion that the *cestui que trust* might, at his option, affirm the sale and claim the bond and *mortgage*, saying:

"It is a general and well-settled principle that the assignee of a chose in action takes it subject to the same equity it was subject to in the hands of the assignor. . . . But this rule is generally understood to mean the equity residing in the original obligor or debtor, and not an equity residing in some third person against the assignor. . . . The assignee can always go to the debtor and ascertain what claims he may have against the bond, or other chose in action, which he is about purchasing from the obligee; but he may not be able,

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[37] 2 Johns. Ch. 441 (1817).

"Chancellor Kent's doctrine, advanced in Murray v. Lylburn . . . and other cases of that period, that the assignee of a non-negotiable chose and mortgage takes them free of latent, though subject to patent, equities, retains some following; for example, in Pennsylvania (Mifflin County Bank's Appeal, 98 Pa. 150) . . . . But Kent's doctrine was disapproved in New York in Bush v. Lathrop . . . and has been definitely rejected there as well as in a majority of the states of this country; Central Trust Co. v. West India Imp. Co., 169 N. Y. 314 (1901)." Campbell, Cases on Mortgages, 434, note.

"It has been held . . . in both Ohio and Illinois, that a holder in due course of a negotiable note who also receives an 'assignment' of the mortgage takes the latter, as well as the former, free from 'latent' equities. First National Bank v. Brotherton, 78 Ohio St. 162 (1908); Silverman v. Bullock, 98 Ill. 11, 19 (1881)." Campbell, Cases on Mortgages, 439, note 2.

"It is further the settled law of this state, though a different rule prevails not only in England, but in the Federal courts and in some of the states, that a bona fide purchaser for value of a chose in action takes it subject not only to the equities between the parties, but also to latent equities in favor of third persons, and that to secure his superiority it is not necessary that the earlier assignee should give any notice of his assignment to the debtor trustee." Per Cullen, J., in Central Trust Co. of New York v. West India Improvement Co., 169 N. Y. 314 (1901).

with the utmost diligence, to ascertain the latent equity of some third person against the obligee. He has not any object to which he can direct his inquiries. . ."

The case was not, however, decided on that principle, but on the ground that the *lis pendens* constituted a notice to all parties dealing with the trustee respecting the trust estate.

The distinction between latent and patent equities was repudiated by the New York Court of Appeals, in *Bush v. Lathrop.*[38] In this case one *N.*, the plaintiff's intestate, owned a bond and *mortgage* for $1,400, and being indebted to *P.*, in the sum of $268.20, gave *P.* his note for that sum, and assigned the bond and *mortgage* by an absolute and unconditional assignment to secure that note. *P.* subsequently assigned the bond and *mortgage* to *S.*, and *S.* assigned them to *D.*, for a valuable consideration. The plaintiff brought his action to obtain a re-transfer of the bond and *mortgage* on payment of the $268.20, with interest. Denio, J., in delivering the opinion of the court, reviews the decision of Chancellor Kent, in *Murray v. Lylburn,* and other cases, on the subject of "latent" equities, disapproving of the doctrine of Chancellor Kent, and came to the conclusion that *N.*, "the last absolute owner of the bond and mortgage, never parted with his title except on condition that it should be returned to him on payment of a comparatively small sum of money . . ."; that *D.*, who claimed under that assignment, was bound by it, though he may not have actually been aware of the fact that it was conditional; and that an assignee of a chose in action takes but an equitable interest, notwithstanding the provisions of the Code which authorize him to sue in his own name. The question of *estoppel* does not seem to have been considered. Perhaps it would not have been applicable since the assignment upon which the *estoppel* would have been predicated, if at all, expressed a consideration of only $268.20 for a mortgage of $1,400,

[38] 22 N. Y. 535 (1860).

a circumstance calculated to excite inquiry. If the assignment had conferred the apparent absolute ownership of the bond and *mortgage* on *P.*, the doctrine of *estoppel* would seem to have been applicable. In his opinion, Denio, J., said:

"All the cases agree that the purchaser of a chose in action takes the interest purchased subject to all the defenses, legal and equitable, of the debtor who issued the security. It is unnecessary to refer to authorities for this general principle, or to point out the exceptions to it which have been created by the custom of merchants or by positive statutes. It is enough that the present case is not claimed to fall within any of those exceptions. . . . The defendant claims that this is a latent equity, available only between the parties to it, and that it did not accompany the security when it passed into the hands of a subsequent owner. The rule, as generally stated, is that the purchaser takes only the interest which his assignor had to part with; or, as expressed by Lord Thurlow, 'a purchaser of a chose in action must always abide by the case of the person from whom he buys.' "

In holding that the assignee took only such title as the seller had, he admitted that this rule might constitute an impediment to the free negotiation of this class of choses in action, but said that if sound policy required that it should be removed it was for the legislature to so provide.[39]

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39 ". . . the assignee of a mortgage takes it subject to all the defenses which were valid between the original parties, and this principle was borrowed from Lord Thurlow's rule in Davies v. Austen, 1 Ves. Jr. 247. Within its legitimate application, its correctness has not been disputed in this court; but because of the broadness of its intended application in Bush v. Lathrop, it was soon found necessary to place limitations upon the authority of that case in the decisions in McNeil v. Bank, 46 N. Y. 325, and Moore v. Bank, 55 N. Y. 41. They . . . held that a bona fide purchaser for value of a non-negotiable chose in action, from one upon whom the owner has, by assignment, conferred the apparent absolute ownership, where the purchase is made upon the faith of such apparent ownership, obtains a valid title as against the real owner. The decision in the latter case was based upon the doctrine of estoppel . . . The doctrine of Bush v. Lathrop was so broad as to be inequitable in applying a principle otherwise correct and undisputed to cases such as those of shares of corporations, or other personal property, the legal title being capable of transfer by assignment, the true owner has apparently conferred upon another full power of disposition." Per Gray, J., in Merchant's Bank v. Weill, 57 N. E. 749, 750 (N. Y. 1900).

In Moore v. Metropolitan National Bank, 55 N. Y. 41, 14 Am. Rep. 173 (1873), *P.*, the owner of a non-negotiable certificate of indebtedness, was induced by false representations to assign it to *M.* The assignment was in writing and stated that value had been received therefor. *M.* agreed to get it cashed in three weeks or return it to *P.* Instead, *M.* assigned the certificate to the Bank

to secure a loan then made, the latter taking it on the faith of the written assignment and without notice of the relations between *P.* and *M.* *P.* brought this action to restrain disposition of and to recover possession of the certificate. It was held that *P.* could reclaim the certificate only by paying the Bank the amount of its loan to *M.* The court apparently relied on two reasons: (1) *P.*, having by the assignment conferred the apparent absolute ownership on *M.*, was estopped to assert his ownership as against the Bank; and (2) Where one of two innocent parties must suffer a loss from the fraud of a third, such loss shall fall on the one, if either, whose act has enabled the fraud to be committed. *P.* had by the assignment transferred all of his rights to the instrument to *M.* for only one purpose. *Cf.* International Bank v. German Bank, 71 Mo. 183, 36 Am. Rep. 468 (1879).

In McNeil v. Tenth National Bank, 46 N. Y. 325, 7 Am. Rep. 341 (1871), *P.*, owner of a certificate of stock, delivered the certificate, indorsed with an assignment and irrevocable power of transfer, to his brokers as collateral security for a balance of $3,000; the brokers pledged it to *X* as collateral, and *X* pledged it to the Bank as collateral security for a larger amount than $3,000, the latter acting in good faith and without notice of the relations between *P.* and his brokers. *P.* sued the Bank to compel surrender of the certificate. It was held that *P.* could redeem the certificate only by payment of the amount of the loan made by the Bank that remained unpaid. The owner of the certificate by conferring upon the broker complete authority to sell and transfer it by indorsing thereon the form of assignment for value received, and irrevocable power to make all necessary transfer, clothed the broker with apparent ownership which he could transfer to an innocent third person for value, so as to *estop* the owner from questioning the title of the innocent purchaser.

In the *Moore* case it was said that where the owner of *shares* or *chattels* delivers to another the "script or the chattels, together with an absolute written transfer of all his title thereto, he enables him to hold himself out as owner and, as such, obtain credit upon and make sales of the property." According to this statement, shares of stock and chattels come within the doctrine of *estoppel.* It is not necessary to consider here whether shares of stock are of a *quasi*-negotiable nature. See Williston on Sales (2nd ed.) § 311. It seems sufficient to say that the assignee of shares of stock may, under the doctrine of *estoppel*, acquire a better right than his immediate transferor had. The same is true where ordinary chattel property has been transferred by one who has only a limited interest but has the apparent power of absolute disposition. In the application of the doctrine of *estoppel* in this class of transactions there seems to be no reason for inquiring whether the assignee acquires a *legal* or an *equitable* interest. If the assignee acquires an equitable interest *estoppel* will prevent the assertion of the legal title by the former absolute owner of the chose in action. The same factual situation will *estop* one from asserting either a legal or an equitable title. It may be contended that an assignee acquires a legal title and an equity equal to that of the former absolute owner, so that the doctrine that where the equities are equal the legal title will give priority of right applies; or, on the other hand, that the assignee acquires only an equitable title and the doctrine that where the equities are equal that which is prior in time is prior in right applies. These principles may be applied where the owner of the prior equity has created both interests in the thing claimed; but they have no scope of operation in the cases involving the type of problem under consideration, where the prior owner has created the situation wherein the assignee acquires his interest. One is not to be deprived of one's interest in a thing, whether it be an ordinary chattel or a non-negotiable chose in action, merely because another has possession of that thing with the owner's consent and purports to create an interest in the assignee. There is not necessarily any

In *Davis v. Bechstein*[40] the plaintiff brought an action to have a "bond and mortgage set aside and cancelled." She had executed them to *E.*, without consideration, to be used by him as collateral security for his own note, upon which he proposed effecting a loan for himself. *E.* failed to procure the loan and, after a request from the plaintiff to return them, assigned the bond and *mortgage* to the defendant

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appearance of ownership here like there would be where the owner of a chattel or of land purports to create successive competing interests therein in favor of different persons.

An analogous proposition has arisen in a few cases, involving principles of the law of agency. Thus in Bogert v. Stevens, 69 N. J. Eq. 800, 63 Atl. 246, 115 Am. St. Rep. 627 (1906), *R.* executed a *mortgage* to *E.* to secure a bond of the same date, conditioned for the payment of $3,000. *R.* did not, in fact, receive any part of the $3,000, for the *mortgage* and bond were given to enable *E.* to raise the $3,000 in cash and pay the same over to *R.* *E.* assigned them to *A.* and received the proceeds but did not pay them over to *R.* The court held that *A.* took the *mortgage* and bond free from the defense of lack of consideration that *R.* might have had to an action brought by *E.* to enforce them, on the theory that *R.* had clothed E. with apparent absolute ownership and authority to transfer a title to *A.* free from *R.'s* defense of lack of consideration. In Bunt v. D'Andrea, 198 N. Y. S. 304 (1922), the assignee of a *mortgage* and bond executed a power of attorney to his son authorizing the latter to release or assign them, and the son transferred them to *A.*, forging his father's name to a formal written assignment and appropriating the proceeds. The court held that *A.* acquired a valid title to the *mortgage* and bond as against the father, in an action brought by the father to cancel the assignment and to foreclose the *mortgage.*

Professor Campbell, in referring to McNeil v. Tenth National Bank and Moore v. Metropolitan National Bank, says: "Such cases are sometimes said to involve the doctrine of *estoppel* by representation; a more accurate statement of the rule is that, when one having an interest in a chose in action which is embodied in a document . . . delivers the document to another person who falls within its tenor, an assignee of the latter, if he be a *bona fide* purchaser or incumbrancer for value and without notice, and if he receives delivery of the document, is protected accordingly. Williston on Contracts, § 438." Campbell, Cases on Bills and Notes, 582, note. But what is it that brings the transferee within the tenor of the instrument? If it is the act of the former owner in conferring upon the assignor of the transferee the apparent *indicia* of absolute ownership, then the doctrine is to be rationalized on the basis of *estoppel.*

See criticism of the doctrine of *estoppel* in 1 Har. L. Rev. 1, 7, 8 (Ames, Purchase for Value Without Notice); and see article by Chafee on "Rights in Overdue Paper," *op. cit. supra* note 31.

40 69 N. Y. 440, 25 Am. Rep. 218 (1877).

"One who takes an assignment of a bond and mortgage . . . takes it subject not only to any latent equities that exist in favor of the mortgagor, but also subject to the like equities in favor of third persons and strangers." Per Allen, J., in Schaefer v. Reilly, 30 N. Y. 61 (1872). The court was considering *defensive equities* in this case.

for value and without notice of the plaintiff's equity of defense. It was held that the plaintiff was entitled to have the bond and *mortgage* surrendered and cancelled. While *E.* had possession of the instruments, his authority to use them for any purpose had terminated. Yet if the defendant had had enforceable right on the instruments the plaintiff was not entitled to have them surrendered and cancelled. The case came under the general rule that the assignee of a non-negotiable chose in action takes it subject to the *equities of defense* as between the original parties to the instrument. While the relief sought by the plaintiff is affirmative in form, it is defensive in substance. She had no right to a return of the instruments and to sue on them. So defensive equities may be set up in defense of an action brought against the obligor on the instrument; or they may be used as the basis of an action to have the instrument surrendered and cancelled. There was no basis for an *estoppel* here except the mere possession of the instruments. Possession of other chattels does not *per se* create an *estoppel.* So the possession alone is not sufficient to constitute a representation on the part of the plaintiff that *E.* will not *divert* the instruments by using them as he did. Neither was there any purpose on the part of the plaintiff to defraud assignees. Probably the only way that the defendant could have obtained protection against the plaintiff's defensive equity would have been for him to have secured a statement from her that she had no defense to an action to enforce the instruments.[41]

A mortgagor, or other obligor, in a non-negotiable chose in action may not only estop himself from asserting *equities of ownership* as against an assignee, but he may estop himself, by a writing, or by his actual representations, or by conduct, or by his silence towards the assignee from setting up

41 *Cf.* Schaefer v. Reilly, 50 N. Y. 61 (1872). See McMullen v. Weuner, 16 Serg. & R. 18, 16 Am. Dec. 543 (1827).

defensive equities. Thus where *R.* executed to *E.*, without consideration, a *mortgage* on certain real estate for $20,000, and *A.* bought the *mortgage* from *E.* at a large discount, $16,000, relying upon an affidavit made by *R.* that the amount expressed in the *mortgage* was the true consideration, it was held that *R.* was estopped from asserting a want of consideration, to the full extent of the face value of the *mortgage.*[42]

Defensive Equities—Collateral Agreement.—While the assignee of a non-negotiable chose in action, in all jurisdictions that have considered this question, takes subject to *defensive equities* of the obligor, generally, in reference to *mortgages,* they relate to defenses growing out of the original transaction, and affecting their legal inception as obligations of the mortgagor, such as lack of consideration, fraud, duress, and usury, but not those which are collateral or incidental. The assignee is not required to inquire as to such defenses; and he does not take subject to them unless he has notice of them or they constitute a part of the consideration for the *mortgage.*[43] In *Merchants' Bank v. Weill* [44] the mortgagor in a purchase-money *mortgage* attempted to exercise, after the assignment, an option conferred by a secret agreement to rescind the sale of the mortgaged property and thus be relieved of the obligation of the bond and *mortgage.* This collateral agreement, and an attempt to exercise the option, were relied on as a defense to an action brought by the assignee to foreclose the *mortgage.* The court held that the mortgagor was not entitled to assert this defense in the action by the assignee who had acquired the bond and *mortgage* without notice of it. An assignee is not concerned with

42 Grissler v. Powers, 81 N. Y. 57, 37 Am. Rep. 475 (1880).

43 "Mortgages," 41 C. J. 692, and authorities cited.

44 163 N. Y. 486, 57 N. E. 749, 79 Am. St. Rep. 605 (1900). Accord, McMasters v. Wilhelm, 85 Pa. 218 (1877). In the latter case the court said: ". . . this agreement in no respect related to the validity of the instrument assigned, to the existence of the debt it secured, or to the amount of it that was due."

an agreement between the original parties to the non-negotiable chose that is inconsistent with the purport or legal effect of the instrument. The assignee should not be and is not bound to call upon the obligor for information about matters, the existence of which he has no reason to suspect.

Defensive Equities—Where There is a Right of Set-Off Against the Assignor.—In *Waterman on Set-Off* [45] the principles governing the right of set-off against an assignor are stated as follows:

"Where, when a chose in action is assigned, there is an equitable right of set-off against the assignor, the assignee will take the chose in action, subject to such right of set-off. The equities need not exist at the inception of the debt. It is sufficient if they exist prior to the assignment; as the assignee can protect himself against them by inquiry of the debtor before the assignment."

The equitable right of set-off seems to come within the general principle that the assignee succeeds only to the rights of the assignor. Not only is the assignee required to inquire of the obligor in the non-negotiable chose in action as to whether he has any defenses inherent in the inception of the obligation evidenced by the instrument but also as to the state of accounts existing between the obligor and the obligee-assignor.[46] Actions to enforce real securities, or to compel a surrender thereof, have seldom included a set-off within the controversy. In *Norrish v. Marshal* [47] the mortgagor brought an action to have the mortgage deeds delivered up and to restrain the assignee from pledging them. The plaintiff had demised certain premises to *C.* and delivered the title-deeds to the premises as security for a loan. The plaintiff repaid part of the loan before and part after *C.* had assigned the deeds to *M.;* but he had no knowledge of the assignment

45 § 103 (2nd ed.).

46 ". . . the assignee is not bound to call on the obligor for information about matters, the existence of which he has no reason to suspect; the necessity of inquiry being limited as I have said to want of consideration and set-off." Per Gibson, J., in Davis v. Barr, 9 Serg. & Rawl. 137, 141 (1822).

47 5 Madd. 475 (1821).

at the time of payment. In referring the matter to a master to enquire as to what part of the debt had been paid, the court said:

"The principle is that, as against an assignee without notice, the mortgagor has the same rights as he has against the mortgagee, and whatever he can claim in the way of set-off, or mutual credit, as against the mortgagee, he can claim equally against the assignee."

Statutes have been enacted in most, if not all, of the states providing in substance that in case of an assignment of a chose in action, *the action of the assignee shall be without prejudice to any set-off or other defense existing at the time of or before notice of the assignment.* Some statutes expressly except negotiable promissory notes and bills of exchange, and others except negotiable bonds also, from the operation of the principle, where they are transferred before maturity. Under the Georgia Civil Code, excepting "negotiable securities," the Supreme Court of Georgia stated the following principles as controlling the right of set-off:

". . . in a suit upon [a negotiable instrument]. . . brought by a plaintiff who took the same from the payee after it was due, the rule is that the maker cannot set off a demand against the payee, unless such demand is connected with or grew out of the original transaction for which the [instrument]. . . was given, or attaches to the [instrument] . . . itself. He cannot set off a demand arising out of collateral matters. A different rule, however, applies to non-negotiable instruments, and that is 'that every person who takes an instrument not assignable by the terms of it must take it principally on the credit of him from whom he receives it, for it is always liable to be defeated by equitable circumstances subsisting between the original parties, being taken legally subject to all equities of the original debtor.' This distinction is recognized in the . . . Civil Code . . ." [48]

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48 Third Nat. Bank v. Western & A. R. Co., 114 Ga. 890, 40 S. E. 1016 (1902). The Georgia statute, referred to in this case, provided: "All choses in action arising upon contract may be assigned so as to vest the title in the assignee, but he takes it, except negotiable securities, subject to the equities existing between the assignor and debtor at the time of the assignment, and until notice of the assignment is given to the person liable."

See Note on "set-off" as a defense against an assignee, 14 Har. L. Rev. 546.