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THE USE OF SET-OFF, COUNTERCLAIM AND RECOUPMENT: AVAILABILITY AGAINST COMMERCIAL PAPER

WILLIAM O. MORRIS

The question as to whether a defendant when sued upon a negotiable instrument may claim the benefit of a set-off, counterclaim or recoupment against the plaintiff has resulted in more than an ordinary amount of difficulty, uncertainty and confusion in the various courts of this country. In spite of the enactment by all the states of either the Uniform Negotiable Instruments Act or Uniform Commercial Code and in many states modern rules, there is to this day a lack of complete uniformity in the decisions respecting the use of a set-off, counterclaim or recoupment when a negotiable instrument is involved. However, it does appear that the courts in the majority of jurisdictions are striving to reach uniform and consistent results. The decisions are definitely showing a pattern based upon rather sound reasoning. While much of this article deals with the laws of West Virginia, it will for the most part express the views of the courts of the majority of jurisdictions. The variations will be found in some state decisions because of statutory modifications and rules of courts. The West Virginia decisions and statutes appear to represent fairly the most acceptable views on this subject.

The discussion of this matter will for the most part be limited to the consideration of the use of set-off, counterclaim and recoupment as a device for endeavoring to reduce or deny to the plaintiff recovery in an action based on the negotiable instrument. For a complete understanding of the problems and the terminology used, it is necessary for background purposes to examine and consider the general laws relating to the use of set-off, counterclaim and recoupment as used by the defendant when sued by the assignee, as distinguished from an indorsee, of a nonnegotiable chose. This will permit a comparison of their availability in litigation involving actions on either a negotiable or nonnegotiable claim.

It is elementary that choses in action whether negotiable or non negotiable, other than those which might be considered highly personal in nature, illegal, immoral or containing a restriction

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1 Bruck v. Taylor, 152 U.S. 634 (1894); Delaware County v. Diebold Safe & Lock Co., 183 U.S. 473 (1889); Arkansas Valley Smelting Co. v. Belden Mining Co., 127 U.S. 379 (1888).
against an assignment\textsuperscript{2} may be transferred from one owner to another party, designated as an assignee, without the consent of the obligor. One's rights in a negotiable instrument may be transferred by either an assignment or a negotiation. Every negotiation by necessity includes all the elements of an assignment, it is equally clear that not every assignment constitutes a negotiation. It should be observed that a true negotiation of order paper may only be accomplished when a negotiable instrument which is payable to the order of a designated party, or negotiable paper which was originally payable to the order of a designated party has been indorsed specially, is substantially indorsed by the payee or special indorsee and delivered to the recipient. If the negotiable instrument were originally payable to bearer or had been indorsed in blank by the proper party, it may subsequently be negotiated to another party by mere delivery, no indorsement being necessary. Negotiation occurs only with the transfer of a negotiable chose when done in such a manner as to enable the acquirer thereof to qualify as a \textit{holder}\textsuperscript{3} of the instrument. The term assignment is used to identify the transfer of a nonnegotiable claim or the transfer of negotiable order paper by mere delivery so as to vest title to the claim in the assignee.\textsuperscript{4}

One acquiring an instrument by negotiation may, but does not always, acquire a superior position than one who comes into possession of the instrument merely by an assignment. This results from the fact that one acquiring an instrument by a negotiation may qualify as a holder in due course of the instrument and thus be free of personal defenses which might have been available if pleaded against a prior party. It is basic law that those defenses which are purely personal in nature may not be used against a holder in due course of a negotiable instrument. The assignee of a negotiable instrument enjoys relatively the same rights as an assignee.

\begin{itemize}
  \item \textsuperscript{2}LaRue v. Groezing, 84 Cal. 281, 24 Pac. 42 (1890); Lockerby v. Amon, 164 Wash. 24, 116 Pac. 463 (1911); White v. Raleigh Wyoming Mining Co., 113 W. Va. 522, 168 S.E. 798 (1933).
  \item \textsuperscript{3}"Holder means the payee or indorsee of a bill or note, who is in possession of it, or bearer thereof." W. Va. Code ch. 46, art. 17 § 1 (Michie 1955); \textit{Uniform Negotiable Instruments Law} § 121.
\end{itemize}
signee of a nonnegotiable chose for in either case any defense which would have been available against the assignor will likewise be available against a claim made by the assignee of either a negotiable or nonnegotiable instrument.

**Right of an Assignee to Institute Suit in Assignee's Name**

Whether an assignee may institute an action in his name or must maintain the action in the name of the assignor for his benefit is now governed in most states by statute.

It has been held in a number of cases that an assignee only acquires the equitable title to the chose by an assignment. In the cases so holding, and in the absence of statute, the assignee would be denied the right to institute a law action thereon in his own name, but would have to institute the action in the name of the last holder of the legal title for the assignee's use. 5

In those states in which a real party in interest statute has been adopted, or the legislature has otherwise enacted permissive legislation, the assignee is at least permitted to sue in his own name. In these states the question whether the assignee acquired the legal or merely the equitable title to the claim is now for the most part only of academic importance.

At common law the transferee of negotiable paper acquired the equitable title to the claim and was only permitted to institute an action thereon in the name of the last holder of the legal title for his use. 6

The West Virginia Code, ch. 33, art. 8, sec. 9, codifies the right of an assignee to sue on the assigned claim by the following language: “The assignee of any bond, note, account, or writing, non-

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6 Stegal v. Union Bank & Fed. Trust Co., 163 Va. 417, 438, 176 S.E. 438, 446 (1934): “This was true because the assignee took only the equitable title to the instrument. He could not sue thereon in his own name either in equity or at law. The suit or action had to be brought by, or in the name of the assignor, for the benefit of the assignee. Whether the suit was brought in equity or at law, the assignee stood at the bar in fact as in name in all respects in the shoes of the assignor . . . .” Two exceptions to the above stated rule were enumerated, but neither are important here. The assignee was from an early date permitted to sue at law in the name of the assignor. Master v. Miller, 4 Term Re. 830 (1791).
negotiable . . . may maintain an action in his own name, without
the addition of 'assignee'; . . . but shall allow all just defenses and
set-off, not only against himself, but against the assignor, before
the defendant had notice of the assignment." Clearly under the
plain language of this statute, the assignee of a nonnegotiable chose
is entitled to institute the action in his own name in any West Vir-
ginia court, and the defendant is permitted to use a set-off, counter-
claim or recoupment against the assignee of any claim which he
might have had against the payee or obligee. It would not seem to
be important in West Virginia and those states having similar
statutes to determine whether the assignee of a nonnegotiable chose
has or has not acquired the legal title to the assigned claim. In an
interesting, but somewhat complicated and confusing case, involv-
ing an assignment of an insurance policy, the court found that even
though the assignee had only acquired the equitable title thereto
and that the legal title was in the assignor, the assignee with only
the equitable title might maintain an action thereon in his own
name or in the name of the assignor for his use.8

The West Virginia Supreme Court of Appeals in referring to
this case stated: "The application of 55-8-9 to a transferee of a
negotiable note is precluded by the language used therein, the
right to maintain an action at law being conferred on the assignee
of any . . . note . . . not negotiable."9 The passing of the maturity
date of the instrument does not in and of itself change a negotiable
instrument into a nonnegotiable instrument.10 The fact that the

The Bentley case involved the assignment of an insurance policy in which the
court held that in West Virginia an assignee acquired an equitable title to
the chose, that the legal title remained in the assignor; and that the assignee
under the statute could sue either in his own name or in the name of the
assignor for his use.
8 Ibid.
It should be here observed that the West Virginia court stated in the Odland
case that "An action on a negotiable note which is not payable to bearer,
commenced by the payee and holder, who by special indorsement transfers the
note by another person during the pendency thereof abates, but may be revived
under Code 55-8-5." Even where the note passes after its maturity date
W. VA. CODE, ch. 44, art 8, § 9 (Michie 1955) is not applicable.
Davis v. Miller, 55 Va. (14 Gratt) 1 (1857).
10 W. VA. CODE ch. 46, art. 8, § 17 (Michie 1955); UNIFORM NEGOTIABLE
INSTRUMENTS LAW § 47; Bernstein v. Pacific States Sav. & Loan Co., 19 Cal.
Div. 262 (1933); Federal Trust Co. v. Nelson, 221 Iowa 759, 260 N.W. 509
(1936); Lane v. Hyder, 163 Mo. App. 688, 147 S.W. 514 (1912).
instrument has been indorsed specially and transferred without the indorsement of the special indorsee likewise does not destroy the negotiable character of the note. An instrument originally negotiable will continue to be a negotiable instrument until it has been discharged or is restrictively indorsed.

Section 35 of the Uniform Negotiable Instrument Act provides that a holder of a negotiable instrument may sue in his own name by the following language: "The holder of a negotiable instrument may sue thereon in his own name . . . ." The troublesome portion of this section relates to the intended meaning of the word "holder" as therein used. Section 191 of the same Act defines holder as: "Holder means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof." It would follow that one who acquires negotiable order paper by mere delivery would not fit the definition of a holder but would only be a transferee thereof. If one acquires title to negotiable order paper by delivery alone, as he may do by virtue of section 49 of the Uniform Negotiable Instrument Act, he would not qualify as a holder or holder in due course until he received the indorsement of the payee or special indorsee. For clearly such transferee is not the payee, and not having acquired the instrument by an indorsement he could not be said to be an indorsee. Such transferee for value acquires by the transfer all the rights of the transferor, plus the right to demand the unqualified indorsement of the transferor if it has been omitted by accident or mistake. To determine whether the transferee is a holder in due course we must look only at the situation and facts as they exist at the time the indorsement is actually acquired and not as they were on the date of the transfer of possession of the instrument. Clearly the transferee's rights in this situation are somewhat greater than those of a mere assignee, in

11 The court held that a note payable to the First National Bank of Webster Springs continued to be negotiable until restrictively indorsed or discharged. The fact that it had been indorsed specially did not impair the negotiable character thereof. Odland v. Hamrick, 127 W. Va. 208, 32 S.E.2d. 629 (1944). Gulbranson-Dickinson Co. v. Hopkins, 170 Wis. 326, 175 N.W. 93 (1919).
12 W. VA. CODE ch. 46, art. 3, § 17 (Michie 1955); UNIFORM NEGOTIABLE INSTRUMENTS LAW § 47; Oakdale Mfg. Co. v. Clarke, 29 R.I. 192, 69 Atl. 681 (1908).
13 W. VA. CODE ch. 46, art. 4, § 1 (Michie 1955).
14 W. VA. CODE ch. 46, art. 17, § 1 (Michie 1955).
15 W. VA. CODE ch. 46, art. 8, § 19 (Michie 1955).
16 W. VA. CODE ch. 46, art. 3, § 19 (Michie 1955); UNIFORM NEGOTIABLE INSTRUMENTS LAW § 49; Lawrence v. Citizens' State Bank, 113 Kan. 724, 216 Pac. 262 (1923); Cady v. Bay City Land Co., 102 Ore. 5, 201 Pac. 179 (1921).
that he may demand the indorsement of the transferor if his indorsement has been inadvertently omitted and he is a transferee for value. But he is not in the favorable position of a holder in due course until the indorsement is actually obtained; assuming the other requirements to qualify as a holder in due course have been met.\footnote{17} 

It would be appropriate at this junction to inquire whether such transferee for value of unindorsed order paper has by virtue of the transfer acquired either the legal or equitable or both legal and equitable title to the instrument.\footnote{18} The determination of this question will also determine, in the absence of statute, whether the transferee may institute the action thereon in his own name. Judge Hatcher in \textit{Furbee v. Furbee} in reviewing the rights of the transferee under section 49 of the Act said: "This section changes the law merchant by vesting in the transferee the entire title of the transferor whether legal or equitable or both."\footnote{19} The court in permitting the transferee to sue in his own name found that the rights acquired by the transferee under section 49 included the right to institute suit in his own name, thus giving to the transferee of unindorsed order paper the same right to institute suit in his own name as was given to an assignee of a nonnegotiable claim by chapter 55, art. 8, sec. 9 of the West Virginia Code. The court continued the discussion of this matter by stating: This section (49) "vests [the title] in the transferee without indorsement, and is not affected by section 30 \textit{etc.} and if the transferor had the legal title this must pass though subject to equities."\footnote{20} As section 49 of the Negotiable Instruments Act refers only to transferees for value it would seem logically to follow that in West Virginia a transferee of unindorsed negotiable order paper who had not given value therefor would not

\footnote{17}"The fact that it is transferred without indorsement is sufficient to put the transferee upon inquiry as to all equitable defenses that exist at the time of the transfer. But a set-off is not a defense, as the term is ordinarily used." \textit{Harrisburg Trust Co. v. Sherfeldt}, 87 Fed. 669, 671 (9th Cir. 1898); \textit{Chandler v. Drew}, 6 N.H. 469 (1834).

\footnote{18} \textit{Community Sav. & Loan Co. v. Eifort}, 111 W. Va. 308, 161 S.E. 564 (1931); \textit{Rothwell v. Taylor}, 303 Ill. 226, 135 N.E. 419 (1922); \textit{Rivenburgh v. Middleburg First Nat. Bank}, 103 App. Div. 64, 93 N.Y.S. 652 (1905); "Some courts hold that the transferee in good faith and for value become vested with legal title; others hold transferee becomes vested with equitable title." \textit{1 Joyce, DEFENSES TO COMMERCIAL PAPER} § 668 (2d ed. 1907).

\footnote{19}117 W.Va. 722, 188 S.E. 123 (1936).

\footnote{20} \textit{id.} at 723, 188 S.E. at 124 See, \textit{Brannon, NEGOTIABLE INSTRUMENTS LAW} § 49 (5th ed. 1926).
be permitted to institute an action thereon in his own name. Not being a holder for value, section 49 of the Act would not be applicable, and since it is a negotiable instrument chapter 58, art. 8, sec 9 of the West Virginia Code heretofore discussed could not apply to a negotiable instrument, being no statutory authorization for a suit in the transferee’s name, the common law would apply and require the action to be in the name of the assignor with legal title for the benefit of the transferee. For neither under the law merchant, common law nor the Uniform Act has the gratuitous transferee of a negotiable instrument been held to have acquired legal title to the instrument in the absence of an indorsement by the last holder of the legal title thereto. This point is well illustrated by an interesting case in which an administrator of the estate of the payee transferred without indorsement a negotiable instrument to himself as the sole heir of the payee’s estate. The transferee clearly had not given value for the instrument nor could he qualify as a holder of the note. The court ruled that the transferee had not by virtue of section 49 of the Act acquired legal title to the instrument. The donee-transferee was thus denied the right to maintain an action on the negotiable instrument in his own name.

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21 It will be observed that the act only refers to the transferees for value. It has been held that neither under prior law nor under the Uniform Negotiable Instruments Act did the gratuitous transferee of a negotiable instrument acquire title to the instrument unless the transferor indorsed. Moore v. Moore, 35 Ga.App. 39, 131 S.E. 923 (1926). Three years later the same court stated that an administrator of the estate of the payee who transferred to himself as sole heir certain promissory notes did not acquire legal title to the notes by virtue of section 49, since such section only applies to holders for value. Bond v. Maxwell, 40 Ga.App. 679, 150 S.E. 860 (1929).

However, in other jurisdictions it has been held that where the donor of unindorsed negotiable instrument delivered same to the donee with intent to make a gift thereof this was in and of itself sufficient to place the title to the instrument in the donee. Brown v. Patella, 24 Cal. App.2d 362, 74 P.2d 119 (1938); Rinard v. Lasley, 143 Ill. App. 450 (1908); In re Nitze, 121 Misc. 18, 200 N.Y.S. 781 (1923); Cosmopolitan Trust Co. v. Leonard Watch Co., 249 Mass. 14, 143 N.E. 827 (1924); Baker v. Moran, 67 Ore. 386, 136 Pac. 30 (1913).

The rule as expressed by the court of Georgia and those other states following the Georgia rule follow the strict language if the statute, while the Massachusetts and California courts have reached a more sound conclusion by not applying such a strict interpretation to the language of the statute.

22 Whether the assignee acquires the legal or equitable title to the instrument may here be of some importance. It has been held in a number of cases that the assignee only acquired the equitable title. Steinhilper v. Basnight, 153 N.C. 293, 69 S.E. 200 (1910); Woods v. Finley, 153 N.C. 497, 69 S.E. 502 (1910).

23 The transferee of negotiable paper at common law took only the equitable title thereto and could not sue at law only in the name of the holder of the legal title. Bank of Bromfield v. McKinley, 53 Cal. 279, 125 Pac. 493 (1912).

The courts of some states by virtue of statute have permitted a donee-transferee of unindorsed negotiable order paper to sue in his, the assignee's, name. As this is largely a matter of procedure, it is difficult to see any reason under our modern concept of practice for placing a donee-transferee in any different position than a transferee for value so far as his right to be the named plaintiff.

To summarize the law in general and in West Virginia specifically, we might state: 1. An assignee of a nonnegotiable chose may by virtue of statute sue on the assigned claim in his own name or in the name of the assignor for the benefit of the assignee. 2. A holder or holder in due course of a negotiable instrument may by virtue of the language of section 51 of the Uniform Negotiable Instruments Act file the action in his own name. 3. The transferee for value of a negotiable instrument has been held to have the right to institute an action thereon in his own name by virtue of the court's interpretation of the meaning of section 49 of the Uniform Negotiable Instrument Act. 4. There is a definite split of authority today whether a gratuitous transferee of a negotiable instrument may maintain the action in his own name. No West Virginia cases have been found directly involving this point.

The Supreme Court of Appeals of West Virginia, in dealing with a transfer of a negotiable note after suit has been instituted thereon, has said: "An action on a negotiable note which is not payable to bearer, commenced by the payee and holder, who by special indorsement transfers the note to another person during the pendency thereof abates but may be revived under Code 56-8-5."26

DRAWEE'S RIGHTS AGAINST DRAWER'S FUNDS

At this point some consideration should be given to the question as to whether a check or bill operates as an assignment of the funds which are in the hands of the drawee. Section 127 of the Uniform Negotiable Instruments Act states: "A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for payment thereof . . . ." While section 189 of the Act states: "A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank . . . ."27

27 W. VA. CODE ch. 46, art. 10, § 2 (Michie 1955).
28 W. VA. CODE ch. 46, art. 10, § 6 (Michie 1955).
As neither a check nor bill operates as an legal assignment of any part of the drawer's credit or funds, then it must follow that the holder of such bill or check would not acquire any rights against the drawee by virtue of owning or acquiring the bill or check, unless and until the drawee has accepted the bill or certified the check. If a check or bill be not an assignment then neither would prevent the drawee from placing a claim against the drawer's funds or credit whether by way of set-off or some type of lien. The bank or other drawee is in a superior position to that of a bill or check so far as the right to obtain a lien or set-off against these funds or credits.

As between the drawer and the holder of a check, the check is deemed to be an equitable assignment of the drawer's funds, but not such an assignment so far as the rights of the drawee are concerned.

The provision of section 18930 of the Act "[W]as designed for the protection of the bank rather than a provision effecting the relation between the maker of a check and the payee, and as against the drawer, the check should be considered an equitable assignment pro tanto." The result of such a view is well illustrated in case of Hulings v. Hulings Lumber Co. wherein the West Virginia court held that a check operated as an equitable assignment from the time it was delivered as between the drawer and holder. Thus a general assignment for the benefit of the drawer's creditors after its delivery did not affect the rights of the check holder.

20 The West Virginia court held that a check operates as an equitable assignment from the time it is delivered as between the drawer and holder; that a general assignment made by the drawer for the benefit of his creditors after its delivery does not defeat the right of the check holder. Hulings v. Hulings Lumber Co., 88 W. Va. 351, 18 S.E. 620 (1893).

A check is an equitable assignment of the drawer's funds as between the drawer and holder and such assignment as far as the drawee is concerned. 2 DANIEL, NEGOTIABLE INSTRUMENTS § 1643 (6th ed. 1933).

But see Mountaineer Eng'r Co. v. Bossart, 133 W. Va. 668, 670, 57 S.E.2d 633, 634 (1955) wherein the court in distinguishing the Central Trust Co. case said: "The statute does not deal directly with liability as between the drawer and the drawee or where third parties may assert claims. It does say, however, that a mere check, of itself, does not necessarily create an equitable assignment."

32 88 W. Va. 351, 18 S.E. 620 (1893).
The Iowa court held that in equity an intent to assign makes the check an equitable assignment of the drawer's funds and the holder should be protected against subsequent claimants, notwithstanding the negotiable instruments act.  

Recoupment, Set-off and Counterclaims

After having given consideration to who has the legal and equitable title to the chose in the event of an assignment, and in whose name and under what circumstances an action thereon may be maintained, let us now examine the meaning and use of recoupment, set-off and counterclaim.

Recoupment

Recoupment at common law is defined as the "right of the defendant, in the same action, to claim damages from the plaintiff, either because he has not complied with some cross obligation of the contract on which he sues, or because he has violated some duty which the law imposes on him in the making or performing the contract."  

This remedy is of common law origin, and only enables the defendant by pleading a claim of his own which grew out of the same transaction to be used to diminish the amount of recovery allowed to the plaintiff. In the absence of a statute the one using recoupment would not obtain a recovery in excess of the sum demanded by the plaintiff. Recoupment was and is purely a method allowed for mitigating the amount of recovery to the plaintiff and not a method of establishing an affirmative right to an amount in excess of the plaintiff's claim.

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34 BALLENTINE, LAW DICTIONARY (1931).
35 Recoupment may only be used to diminish the amount of the plaintiff's recovery. In the absence of statutory authorization the defendant is not permitted to recover any damages in excess of the amount of the plaintiff's claim. Baltimore R. Co. v. Jameson, 13 W. Va. 833 (1879).
36 "The doctrine of recoupment rests upon the principle that it is just and equitable to settle in one action, thus avoiding a multiplicity of suits, all claims growing out of the same contract or transaction. ... Recoupment is a defense arising out of the subject matter of the plaintiff's claim." STORY, EQUITABLE JURISPRUDENCE § 878 (14th ed. 1918); Mayberry v. Leech, 58 Ala. 389 (1877); Home Sav. Bank v. Boston, 131 Mass. 277 (1881).
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Set-off

Because of the apparent limitations on the use of a claim by way of recoupment, the legislatures of all of our states have provided a remedy of set-off. The use of a set-off as permitted today was totally unknown to the common law. 3

Waterman in his work on Set-off states: "Set-off signifies the subtraction or taking away one demand from another opposite or cross demand, so as to extinguish the smaller demand and reduce the greater by the amount of the less; or if opposite demands are equal to extinguish both." 38 It is then clear that a set-off is a counter suit used both as a defense measure and as a basis of a claim against the plaintiff based on a matter arising independently of the cause on which the plaintiff is seeking recovery. 39 The claim which the defendant is using as the basis of his right of set-off necessarily arises from an extrinsic obligation to that of the plaintiff. 40

It is submitted that in England the use of a set-off was first recognized and authorized by the Bankruptcy Act of 4 Anne, ch. 17, sec. 11 of 1705. By 1729 the statute of 2 George 11, ch. 22, sec. 13 expressly authorized the use of set-offs in the following language: "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. . . ." Six years later in 1735 by the enactment of 8 George 11, ch. 24, sec. 6 the right of set-off was further enlarged and amplified, section 6 providing: "Mutual debts may be set against each other, either by being pleaded in bar, or given in evidence on the general issue, notwithstanding such debts are deemed in law to be of different nature. . . . And in case the plaintiff shall recover in such action or suit, judgment shall be entered for no more than shall appear to be truly and justly due the plaintiff after one debt being set-off against the other as aforesaid." 41

37 Spurr v. Snyder, 35 Conn. 172 (1888); Waterman, Set-off § 10 (2d ed. 1872).
38 Waterman, Set-off § 1 (2d ed. 1872).
39 "Technically speaking, a set-off is a counter demand which the defendant holds against the plaintiff arising out of a transaction extrinsic to the plaintiff's cause of action." Avery v. Brown, 31 Conn. 398 (1863).
40 "The distinction between payment of set-off has been tersely expressed thus: A payment is by consent of the parties, either express or implied, appropriated to the discharge of the debt." Waterman, Set-off § 1 (2d ed. 1872).
The Supreme Court of Appeals of Virginia in the footnotes to the case of Stegal v. Union Bank and Federal Trust Co.\(^{42}\) stated: "Setting off at law cross-demands arising from unconnected transactions was introduced in Virginia long before it was allowed in England. The first statute of set-offs enacted in Virginia was the act of 1644-45 (1 Hen. St. 276). This, so far as we have been able to ascertain, was the first statute of set-offs enacted in any state or country which has the English common law as the basis for its legal system."\(^{43}\)

Chapter 56, art. 5, sec. 4 of the West Virginia Code is the source of the law of this state relating to the right of set-off in this state. By careful examination of this portion of the code one would find that five essential conditions must exist to enable the defendant to claim the right of set-off. These conditions are discussed and enumerated in a note in the West Virginia Law Review, and may be set forth as follows: "1. The plaintiff's demand must be in the nature of a debt, 2. The demand proposed to be set-off must also be in the nature of a debt, and not a claim for unliquidated damages, but may be either legal or equitable, 3. The demands must be due between the same parties, 4. The debts must be due in the same right, and 5. The debts to be set-off must be due and payable."\(^{44}\)

A set-off then is not a defense within the meaning of the term "defense" as a fact which may be set up as a bar to an action, but is a cross suit or action.\(^{45}\) To constitute a set-off the defendant must

\(^{42}\) 163 Va. 417, 176 S.E. 438 (1934).

\(^{43}\) The court in the Stegal case, id. at 435, 176 S.E. at 445, said the question involved was: "Does a post maturity transferee of a negotiable instrument, who is a bona fide purchaser for value thereof from the payee, take it subject to a mere set-off (as distinguished from a payment and from a matter of recoupment) existing against the payee at the time of the transfer?"

The court went on to say "our examination of this question convinces us that it must be answered in the negative, both under the law as it existed in Virginia prior to the enactment of the Negotiable Instruments Law and under the law as it now exists. . . .

"Under the common law, cross-demands arising out of unconnected transactions require separate actions for their enforcement. And, save in a few cases which present peculiar equities, a defendant cannot avail himself of such a cross-demand against the plaintiff to prevent a recovery, in whole or in part, on his promise, without statutory authority for its being done. A mere cross-demand was not an equity which could be pleaded even in a court of chancery. Therefore, prior to the enactment of a statute of set-off, there was no occasion for the question here under considered to have arisen."

\(^{44}\) Note, 28 W. VA. Law Rsv. 139 (1922).

\(^{45}\) "Under an unbroken line of decisions, in so far as I am informed, it has been held that the right of set-off of an independent claim is neither a defense nor an equity, and was unknown at common law. It is purely a statutory right to satisfy one demand by another, and thus prevent several suits between the same parties, when the whole controversy could be settled in one suit." Worden v. Gillett, 275 Fed. 654, 656 (1921).
allege facts which would in themselves constitute an independent cause of action. As the right to claim a set-off is a procedural matter, the laws of the forum determines its availability. The defendant is denied the right to show the existence of a set-off or counterclaim under a plea of payment. The defendant setting up such matters as recoupment, or set-off or counterclaim has the burden of proof. The converse is likewise true, where the defendant pleads a set-off evidence of payment may not be properly introduced under this plea nor may want of consideration.

**Counterclaim**

The right to use a counterclaim, like the right to use a set-off, was unknown at common law. The term counterclaim as used in our statutes generally includes the right of recoupment where the defendant's claim arises from the same transaction as that of the plaintiff. For a demand to be permitted as a counterclaim, it must have developed from the same obligation which formed the basis of the plaintiff's suit.

The only source of statute law in West Virginia dealing with the use of counterclaims is found in chapter 50, art. 5, sections 1 to 6. This chapter applies only to practice before justices of the peace. West Virginia has no statute applicable to counterclaims in circuit courts. Section 1 authorizes the use of a counterclaim in the following language: "If the plaintiff's demand in the action be found on a judgment or contract, express or implied, the defendant may

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47 If the plaintiff institutes an action in a given state he must be satisfied with the rights given to the defendant regarding the use of a claim of set-off. Davis v. Noll, 38 W. Va. 66, 17 S.E. 791 (1895); 1 Daniel, Negotiable Instruments § 890 (6th ed. 1938).
48 Dixie Industrial Co. v. Bank of Wetumpka, 207 Ala. 293, 92 So. 786 (1922); Bingham v. Domer, 94 Wash. 253, 162 Pac. 355 (1917).
49 Recoupment used as a defense see, Spiro v. Shapleigh Hardware Co., 153 Miss. 81, 118 So. 429 (1928).
50 Bloom v. Lehman, 29 Ark. 489 (1876); Hurst, Miller Co., v. Everett, 91 N.C. 399 (1884).
51 Ibid.
set forth as a counterclaim a cause of action against the plaintiff, whether liquidated or not, arising directly out of the contract or transaction set forth in the complaint as the foundation of plaintiff’s demand, or a liquidated demand founded on a judgement or contract, express or implied, whether arising out of the same contract or not; but every counterclaim shall be subject to the following provisions: . . .”

It was unfortunate that the judges of the common law courts felt themselves unable or were at least unwilling to permit one defending a law action to show that the plaintiff was indebted to him on another contract, or was indebted to the defendant on the same obligation for an amount in excess of that claimed by the plaintiff. It was clearly because of this inadequacy, and necessity being the mother of invention, that the legislatures established the right of set-off and counter claim to fill the void caused by the inadequacy of the remedy afforded by the right of common law recoupment.

To summarize the similarities and dissimilarities between the rights under a claim of recoupment, set-off and counterclaim it might be stated as follows: 1. Recoupment may only be pleaded by the way of a defense to mitigate the amount of the plaintiff’s recovery. The amount claimed need not be for a liquidated amount, but must arise from the same transaction that supported the plaintiff’s claim. 2. The right to use a set-off is of statutory origin, must be for a liquidated amount, need not be for a sum equal to or less than that claimed by the plaintiff, and would involve an extrinsic demand to that of the plaintiff. 3. The counterclaim is more or less of a cross between a claim by way of recoupment and one of set-off. The amount claimed by way of counterclaim need not be liquidated need not be for a sum equal to or less than that claimed by the plaintiff, but must arise from and be connected with the same transaction which forms the basis of the claim of the plaintiff.

But for the statutory authority creating the doctrine of set-off and counterclaim, a defendant who held a claim in excess of that of the claimant had to either resort to a separate action at law or pray that the court of equity would set-off or discount the amount of his claim from the adversary’s judgment. It is obvious that such a procedure was entirely unsatisfactory in many situations.

We may now advance to consider in what situations an assignee or holder of negotiable instrument may encounter a claim of recoupment, set-off or counterclaim when suing on the instrument.
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Recoupment, Set-off and Counterclaim
As Used Against an Assignee

To place the discussion in proper perspective to the principal problem, some consideration must be given to the rights of an assignee of a nonnegotiable chose when met with defendant’s claim which he held against the assignor by way of a plea of recoupment, set-off or counterclaim when sued by the assignee.52

It is generally recognized that an assignee acquires by the assignment the same rights in the chose as were enjoyed by the assignor.53 The assignee may protect himself from such claims by making inquiry of the debtor before accepting the assignment. If the debtor-third party in answer to the inquiry states that he has no claim of set-off or other claim against the assignor, the assignee would be protected against a future assertion of a set-off or claim by the doctrine of estopped.54 Otherwise the debtor might claim any set-off against the assignee which he would have had if sued by the assignor instead of by the assignee.

Recoupment, Set-off and Counterclaim
Against a Negotiable Instrument

Section 58 of the Uniform Negotiable Instruments Act55 provides: “In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defences as if it were nonnegotiable. . . .” This section raises the question whether a prior party to a negotiable instrument may claim the right of recoupment, set-off or counterclaim against a transferee other than a holder in due course.

If a negotiable bill or note finds its way into the hands of a holder in due course, or a holder with the rights of a holder in due course, clearly the defendant when sued on the instrument would be denied the right to assert a claim by the way of recoupment, set-off or counterclaim which he held against a prior owner of the

52 See Sanborn v. Little, 3 N.H. 539 (1826) for an early discussion on this matter.
53 Utica Ins. Co. v. Power, 3 Page (N.Y.) 365 (1832); Burill, Assignments 483 (2d ed.).
54 By the way of analogy “Under the common law a payment made to the payee of a nonnegotiable instrument at any time before the promisor received notice that the instrument had been assigned to another was a defense pro tanto to the instrument in the hands of the assignee.” Stegal v. Union Bank & Fed. Trust Co., 163 Va. 417, 176 S.E. 438 (1934).
55 W. VA. CODE ch. 46, art. 4, § 8 (Michie 1955).
bill or note. Of course any set-off which the defendant held personally against the plaintiff may be asserted successfully. If the right of set-off was against a prior holder of the instrument, the right to use the set-off is lost with the negotiation of the instrument to a holder in due course or a holder with the rights of a holder in due course.56

In the event that the defendant pleads and proves a right of set-off as a cause of action, the burden is thereafter on the plaintiff to prove that he is in fact a holder in due course of the instrument or that he can trace his title through a prior holder in due course. One is not denied as a matter of law the status of a holder in due course merely because he knew that a counterclaim or set-off might come into existence before the maturity of the instrument.57

In discussing this problem one should not lose sight of the wording of section 49 of the Uniform Negotiable Instruments Act58 which states: "Where the holder of an instrument payable to his order transfers it for value without indorsing it, the transfer vests in the transferee such title as the transferor had therein. . . ." Such a transfer as referred to in this section amounts to an assignment

56 "Holding only the equitable title it naturally follows that the assignee took the instrument or claim subject to all defenses and other equities (in favor of the promisor) with which it was encumbered in the hands of the assignor and subject further to any equity which the original promissor had acquired since the assignment but before receiving notice thereof." BIGLOW, BILLS, NOTES & CHECKS § 10 (3rd ed. Lile 1928).

... [N]o set-off can be allowed the maker of a negotiable instrument against a purchaser thereof for value before maturity even though he had notice of the claim." First Nat'l Bank v. Danser, 70 W. Va. 529, 532, 74 S.E. 628, 624 (1912).

The case of Manufacturers' Fin. Corp. v. Vye-Neill Co., 62 F.2d 625 (1933) is worth examining at this point. Vye-Neill Co., the drawee and acceptor of a trade acceptance drawn by Freed-Eisenman Radio Corp., payable to Freed-Eisenman Radio Corp. The trade acceptance was indorsed by Freed-Eisenman Radio Corp., and delivered to Earle Corp., which in turn negotiated the instrument by delivery to the plaintiff, a holder in due course. The plaintiff sued the acceptor which in turn counterclaimed by way of set-off, consisting of sixty items, both against trade acceptance and also against the account on which the second count was based. The plaintiff being a holder in due course, no right of set-off as between the defendant and the Freed Corp. is available against the plaintiff, and the plaintiff is entitled to recover under the first count the face amount of the trade acceptance with interest.

Even though the plaintiff were not a holder in due course, if the trade acceptance were taken in good faith and for value, by the weight of authority, only equities connected with the transaction would be available. A Massachusetts act provided that a nonnegotiable instrument is subject to all "defenses" by the maker, but not that a counter claim or set-off is not a "defense" in the sense in which that term is ordinarily used.

57 Elmo State Bank v. Hildebrand, 108 Kan. 705, 177 Pac. 6 (1918).

58 W. VA. CODE ch. 48, art. 3 § 19 (Michie 1955).
as distinguished from a negotiation. The recipient of a note in accordance with this section may be generally treated as an assignee of the instrument.⁵⁹

While it may be said that the transferee of unindorsed order paper acquires the bill or note subject to all equities and defenses which were available against the transferor, the courts have experienced difficulty in determining what the legislature meant by the terms equities and defenses. We must determine whether a claim of recoupment or counterclaim is an equity and whether a set-off is a defense.

Daniel in his work on Negotiable Instruments stated: "A set-off is not an equity; and the general rule stated is qualified and restricted to those equities arising out of the bill or note transaction itself, and the transferee is not subject to a set-off which would be good against the transferor, arising out of a collateral matter."⁶⁰

The courts of this land do not seem to follow the law as suggested by Mr. Daniel. The deviations from Mr. Daniel's statement will be shown by the following cases.

The South Dakota court in a much cited case expressed the law on this point in somewhat different terms. The South Dakota Court speaking through Judge Miser said: "Therefore, whatever may be the rule as to other defenses and equities, it may be fairly stated that the set-off that may be enforced against a negotiable promissory note transferred without indorsement, in good faith, and for value, must be a set-off which existed as a present right when the transfer was made. This is in accord with the language of section 49, N. I. L. . . ."⁶¹

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⁶⁰ 3 DANIEL, NEGOTIABLE INSTRUMENTS, § 1693 (1933).
⁶¹ E executed his negotiable promissory note to Moody County Bank for $221.50 due April 1, 1926. H bought note on January 18, 1926. Note not endorsed by payee. On May 22, 1956, the bank was taken over by superintend of banks for liquidation. On day of transfer 7 had on deposit $7.94. When bank suspended business E had on deposit $183.22. E claims set-off of $183.22 against H, bank's transferee. Jury found H's first knowledge of transfer of note obtained May 31, nine days after bank closed and allowed set-off of $183.22. The question thus raised: Is a negotiable promissory note, transferred without written indorsement by a payee bank to a transferee in good faith and for value, subject to an off-set in favor of the maker for the maker's balance in the bank, when the bank later becomes insolvent? The court here held that the transferee, without indorsement, though in good faith and for value, takes subject to equities and defenses, remains the rule. The fact that it is transferred without indorsement is sufficient to put the transferee upon inquity as to
It seems to be now settled when a counterclaim existed for the benefit of the maker of a negotiable promissory note against the payee and existed at the time of the transfer to one other than a holder in due course, it may likewise be available against any subsequent transferee who may thereafter institute an action thereon.\(^6\) However, any recovery on the counterclaim must necessarily be for a sum equal to or less than that claimed by the transferee in his suit for there is no obligation on the part of the assignee of a note to be responsible for the debts or obligations of the transferor.

It appears that most courts today will allow a claim of set-off which had matured before the transfer of the negotiable note to be used against a taker thereafter who for one reason or another is unable to qualify as a holder in due course. The courts following this doctrine erroneously treats a set-off on the same footing as a defense pro tanto.

When the claim which is being used as the basis of a set-off is shown to have arisen subsequent to the transfer of the instrument, the decisions have been consistent in denying its availability. That is a claim which arose subsequent to the transfer of the instrument which forms the basis of the suit cannot be used against the transferee thereof.

The Virginia court in *Davis v. Miller* stated: "But whatever conflict of authority there may be upon the question, whether the equities, subject to which an indorsee takes an overdue negotiable

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all equitable defenses that exist at the time of the transfer. But a set-off is not a "defense", as the term is ordinarily used.

The rule that a party taking an overdue bill or note takes it subject to equities to which the transferor is subject does not extend so far as to admit set-offs which might be available against transferor.

In *Norton v. Foster*, 12 Kan. 44 (1873) it was held that the right of the maker to use, by way of defense, a counterclaim arising out of breach of the contract for which the note was given was available against a past maturity transferee, but not for any excess in amount of the note.

See also Stevens v. Keegan, 103 Kan. 79, 172 Pac. 1025 (1918).

\(^6\) It seems then that where the maker has a right to use a set-off or counterclaim at the time of the assignment by the payee the right to use this set-off or counterclaim is not lost by assignment of the note to one unable to qualify as a holder in due course or holder with the rights of a holder in due course. Of course the assignee would not qualify in his own right as a holder in due course as not having taken the note by a negotiation.

Indorsee would acquire note after maturity sued the maker thereof who successfully pleaded a set-off of a note given the maker by the payee. The court allowed the defendant to show that the payee's note was intended as evidence of payment of the principal note. Sargent v. Southgate, 22 Mass. (5 Pick.) 312 (1827).

Failure of consideration was allowed as a defense against a post-maturity assignee. Ford v. Thompson, 1 Head 265 (Tenn. 1858).
note, embrace set-off in favor of the maker against the payee, existing at the time of the endorsement, I have been able to find no case in which it was held, or even said, that set-off between the parties, arising or acquired after the indorsement, even though without notice thereof, are [sic] good against the endorsee.”

In West Virginia the court would deny the right of set-off against a transferee of a negotiable instrument, irrespective of whether the set-off was obtained before or after the transfer of the instrument. The West Virginia court expressed itself in this way:

“The common law, declared by the modern English decisions, is that the indorsee of an overdue bill or note takes it subject to equities growing out of the transaction and existing at the time of the transfer, not as to a set-off arising out of collateral and wholly independent matters; and this though the indorsee had notice, gave no consideration for, and took the paper on purpose to defeat the off-set. This is now held to be a fixed principle of commercial law, although several of the States repudiate the doctrine, and all off-sets to be pleaded which existed at the time, but not those procured after the transfer.”

The court in determining that the passing of the maturity date did not destroy the negotiable character of the instrument said: “[T]he transferee takes it subject to such equities as attach to the note itself. . . .” The court decided that the right of set-off is neither an equity nor lien recognized by the law merchant as attaching to a negotiable instrument, and a bona fide purchaser is not required to take notice of an existing off-set in the absence of legislative action. If an off-set

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63 It is not imperative that the equities existed at the time of the creation of the obligation. It is sufficient if the assignee can protect himself by inquiry at the time of the assignment. Warner v. Whittaker, 6 Mich. 193 (1858); Eldred v. Hazlett, 38 Pa. 307 (1858).

To be allowed as a set-off the claim asserted by the defendant must have been owned by him at or before the time that the assignment took place. Martine v Willis, 2 E.D. Smith 524 (N.Y. Ct. C.P. 1854); Duncan v. Stanton & Ruger, 30 Barb. 533 (N.Y. Sup.Ct. 1859).

Until the claim which is sought to be used as a set-off has matured it may be defeated as a set-off by an assignment by the owner of the primary claim. This is true even though the assignor be insolvent and his claim has not become payable when assigned. Myers v. Davis, 22 N.Y. 489 (1861); Martin v. Kunzmuller, 23 N.Y. Super. Ct. 16, aff’d 37 N.Y. 306 (1862). Where a promissory note was transferred for value in good faith, before maturity, the court denied the claim of set-off even though the assignee knew of the claim of set-off before acquiring the instrument. Williams v. Brown, 41 N.Y. 486 (1866).


64 55 Va. 1, 8 (1857).


66 Id. at 68, 17 S. E. at 791.
was disallowed as a claim before the adoption of the Uniform Negotiable Instruments Act, then there is little reason to think that the drafters of the act intended that section 58\textsuperscript{67} was to alter the accepted common law rule.

It should be noted from the clear language in the *Davis* case that there is a definite split of authority in this country as to whether a claim arising from a separate transaction, but existing at the time of the transfer, may be used to diminish the amount of the plaintiff's recovery.

The two leading cases cited for the allowance of a true set-off against the transferee are *Simpson v. Hall*\textsuperscript{68} and *Bissell v. Curran*.\textsuperscript{69} Both of these cases, however, were decided before the adoption of the Uniform Negotiable Instruments Act. In both of these cases the court seemed to treat a set-off purely as a defense. Ten other states likewise follow this view.

In England and in at least ten states and the District of Columbia the courts have clearly denied the defendant the right of set-off against the transferee of negotiable paper.\textsuperscript{70}

In at least six states, Alabama, Iowa, Maine, New Hampshire, Pennsylvania and Wisconsin, cases will be found both allowing and disallowing the use of a set-off against a transferee of negotiable paper.

A careful search has disclosed no case in which the maker of a negotiable note has been successful in pleading a claim by the way of set-off which arose from an extrinsic transaction or claim subsequent to the transfer of the instrument in question. Cases have been found wherein the court denied the maker of a note the right

\textsuperscript{67} W. VA. CODE ch. 46, art. 4, § 8 (Michie 1955).
\textsuperscript{68} 47 Conn. 417 (1879). Action by the assignee of a negotiable note, the defendant was permitted to plead as a set-off a claim rising from a separate transaction.
\textsuperscript{69} 69 Ill. 20 (1878). Post-maturity purchaser of negotiable instrument held to take subject to any defense that could have been employed had such been brought by the original payee. If payee owned the maker any sum at the date of the assignment, that amount could have been set-off.
\textsuperscript{70} Lincoln v. Grant, 47 App. D.C. 475 (1919); Kilcrease v. White, 6 Fla. 45 (1855); Roundtree v. Culpepper, 40 Ga. App. 629, 150 S.E. 859 (1929); Hankins v. Shoup, 2 Ind. 342 (1850); Annan v. Houck, 4 Gill. 325 (Md. 1846); Holland v. Makepeace, 8 Mass. 418 (1812); Hunleth v. Leahy, 146 Mo. 408, 48 S.W. 459 (1898); Cumberland Bank v. Hann, 18 N.J.L. 222 (1841); Haley v. Cogdon, 59 Vt. 65 (1884); First Nat'l Bank v. Danser, 70 W. Va. 529, 74 S.E. 623 (1912).
to claim as a set-off a claim against an assignor of the instrument after the assignor had transferred the instrument to the plaintiff.\textsuperscript{71}

In few cases have the courts been called upon to consider whether a claim against an intermediate party, existing at the time of the transfer of the instrument, would be available as a set-off against subsequent assignee of a negotiable instrument. It appears that the numerical majority of the few cases discussing this point permit the maker of a negotiable note who has a counterclaim or set-off against an intermediate holder to use it against a past maturity purchaser, or one otherwise unable to qualify as a holder in due course.\textsuperscript{72} In cases where such procedure was permitted, it appears that this result was only reached by the aid of a statute. In the cases holding the contrary, no mention was made of any statute.\textsuperscript{73}

Judge Shaw stated in \textit{Baxter v. Little} what he thought to be the rule regarding the use of a set-off of a claim against an intermediate party acquired after the transfer of the instrument by the

\textsuperscript{71} Judge Gilbert in \textit{Harrisburg Trust Co. v. Shufeldt}, 87 Fed. 699 (1898) summarized the rule as follows: "When a defendant is sued by an assignee of a chose in action, he cannot plead against the assignee a set-off existed at the time of the assignment, and belonged to the defendant in good faith, before notice of such assignment."


In the leading English case, \textit{Burrough v. Moss}, 10 Barn. & Cress. 558, 21 Eng. C. L. R 128 (1830) the court expressed the English view that a past maturity indorsee of a negotiable bill or note is liable to such equities as attach on the bill or note itself; and not as to claims arising from extrinsic transactions, such as technical set-off.

The case of \textit{Goodrich v. Stanley}, 23 Conn. 79 (1854) involved the situation where payee assigned the note after its maturity date. The maker was notified of the assignment. The court then denied to the maker the right to set-off an indebtedness of the payee acquired subsequent to receipt of the notice of the assignment.

\textsuperscript{72} Bull v. First Nat'l Bank, 14 Fed. 612, rev'd on other grounds, 123 U. S. 105 (1887). Suit on two drafts drawn by defendant in favor of LaDuc indorsed by LaDuc and delivered to Edison. Edison after maturity sold the drafts to plaintiff. Bank pleads a set-off against Edison. \textit{Held}: that by virtue of a Minnesota statute it is entitled to off-set any valid claim held by it against Edison while the drafts belonged to him.

Wyman v. Robbins, 51 Ohio St. 98, 37 N.E. 264 (1894). Plaintiff acquired note from her husband who had acquired after maturity from the payee. While her husband held the note he was indebted to the maker. Court in construing the statute permitted the maker to use as a set-off against this act a claim which he held against an intermediate holder.

\textsuperscript{73} The California court in referring to the case of \textit{Vinton v. Crowe}, 4 Cal. 309, stated: "[T]he law was there held that while a note received overdue is subject to all subsisting equities between maker and the payee, there was no contenance or authority whatever for subjecting it to equities only subsisting between the maker and an intermediate holder, and such a rule, it was declared, would be both dangerous and absurd." Haywood & Co. v. Steams, 39 Cal. 58 (1870).

following statement: “When a negotiable note is indorsed and transferred after it is due and the defendant relies upon matter of set-off which he may have against the promisee, he can avail himself only of such matter of defence as existed between himself and the promisee, at the time of the actual indorsement and transfer of the note to the holder.”\(^7\) Here the second endorsee acquired the note after it had been previously dishonored. The maker was denied the right to set-off a claim which he held against the first indorsee, except such as existed at the time of the transfer of the note to the present plaintiff, even though he had no notice of the transfer at the time he acquired his claim against the first indorsee.

The general rule is that, in an action by an indorsee after maturity, independent demands against the payee cannot be set off but only such equities as arise out of the instrument itself.\(^7\)

A subsequent holder of a nonnegotiable note is not liable to the maker for damages for breach of a separate and independent contract between original payee and maker.\(^7\)

In conclusion it may be said that in the absence of a statute the better and more workable view is that a strict set-off is not a defense to a negotiable instrument and for that reason should not be available against either an assignee, holder, holder in due course, or holder with the rights of a holder in due course. The only reasonable exception being that such set-off might be allowed against an assignee to the extent that the right to a set-off had matured against the assignor prior to the assignment of the chose and prior to the time the third party learned of the assignment of the instrument.

A claim of recoupment or counterclaim necessarily arises out of the transaction which gave rise to the instrument.\(^7\) For this reason it would seem proper to permit the use of any claim by way of recoupment or counterclaim against any transferee of a negotiable instrument other than a holder in due course or a holder with the rights of a holder in due course. A claim by the way of recoupment or counterclaim should be on a different footing than that of a set-off. The cases seem so to indicate.

\(^7\) 47 Mass. (6 Mete.) 7 (1844).
\(^7\) Birmingham Trust & Sav. Co., v. Jackson County Mill Co., 41 Fla. 498, 27 So. 43 (1899).
\(^7\) First State Bank v. Horton, 57 Okla. 702, 157 Pac. 312 (1916).
\(^7\) As to claims arising subsequent to the transfer see: Root v. Irwin, 18 Ill. 147 (1856); Downey v. Tharp, 65 Pa. 322 (1869); Baxter v. Little, 47 Mass. (6 Mete.) 7 (1844).