LEGAL AND EQUITABLE SET-OFFS

John A.M. Judge*, Margaret E. Grottenthaler**
Toronto

This article reviews the current state of the law on the topic of equitable set-off of claims, including the decision of the Supreme Court of Canada in Telford v. Holt. It is the view of the authors that the principle is framed too broadly in the current law with the result that the expectations of contracting parties may be defeated. They suggest an analysis consistent with contract theory that emphasizes the interrelatedness of the claims to which it is sought to apply the set-off.

Dans cet article les auteurs passent en revue la situation actuelle du droit en matière de compensation en équité des demandes principales et reconventionnelles, y compris la décision de la Cour suprême du Canada dans Telford c. Holt. Les auteurs sont d'avis que, dans la jurisprudence actuelle, on donne au principe une définition trop étendue, si bien que les attentes des parties à un contrat peuvent se voir déçues. Ils suggèrent, pour les compensations, une analyse en accord avec la théorie des contrats qui insiste sur la corrélation existant entre les demandes des parties.

Introduction

The decision of the Supreme Court of Canada in *Holt* v. *Telford*[1] sparked renewed interest in pleading claims by way of set-off. Now that the courts have had some opportunity to consider this decision in various contexts, it is appropriate to re-examine the various types of set-off, in particular the defence of equitable set-off.[2] Wilson J. for the court in *Telford* articulated a wide formulation of the defence of equitable set-off. No clear statement of the theoretical basis of this type of set-off is offered in the judgment. This is unfortunate, given the significant impact that the defence can have if extended too far.

The defence of equitable set-off can have both substantive and procedural effects. One important substantive effect of the ability to set off one claim against another is that, in effect, a notional fund is created out of which the defendant's[3] claim can be realized without the necessity

* John A.M. Judge, ** Margaret E. Grottenthaler, both of Stikeman, Elliott, Toronto, Ontario.

[1] [1987] 2 S.C.R. 193, (1987), 41 D.L.R. (4th) 385.

[2] In this article equitable set-off refers to transactionally related cross-claims. This article will not address the issue of set-off under section 97(3) of the Bankruptcy Act, R.S.C. 1985, c. B-3, or section 73 of the Winding-Up Act, R.S.C. 1985, c. W-11 (see, J.A. Carfagnini, Proceedings Under the Winding Up Act (Canada) (1988), 66 C.B.R. (N.S.) 77), for which different considerations may apply.

[3] For the purposes of this article and convenience of reference the party against whom the claim of set-off is being asserted will be referred to as the plaintiff and the party asserting the set-off as the defendant.

of initiating court proceedings. The application of equitable set-off answers, in whole or in part, the plaintiff's claim. In this sense it has a self-help remedial aspect. Because equitable set-off applies as against an assignee, a security interest is effectively created in favour of the defendant which takes priority over the claim of the assignee. To date there has been little discussion of the impact of this defence on the position of the assignee. Another substantive effect of the right to set-off in equity is that remedies which would generally be available to a plaintiff upon an event of breach of contract may not be available. There is virtually no discussion in the modern cases of the effect of the defence on the plaintiff's contractual expectations.

In addition, the availability of this equitable defence, and other forms of set-off, confers several significant procedural advantages on a defendant that would not be available with a counterclaim (which is pleaded separately as a cross-action):[4]

1. As a defence to the plaintiff's claim, set-off may raise a genuine issue for trial to avoid a summary judgment. The presence of a counterclaim, even if meritorious, will not preclude a summary judgment.[5] A court may not even stay the plaintiff's judgment while the counterclaim continues.[6]
2. The amount of security for costs to be paid by a plaintiff may be increased as a result of the complexity of issues raised by set-off, but the amount will be unaffected by a counterclaim.[7]
3. Where the plaintiff is an assignee, the defendant may in the appropriate circumstances raise by way of set-off claims as against the assignor in order to reduce or eliminate the debt to the assignee. Counterclaim is available where the claims are based on rights asserted against the plaintiff, whether in the same or different capacities. A plaintiff as an assignee could not be liable on a counterclaim for wrongs of an assignor.[8]

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[4] Legal set-off is characterized as a procedural defence whereas equitable set-off is a substantive defence. The significance of this difference is discussed, *infra.*

[5] *H.D. Madden* v. *Brendan Wood* (1989), 33 C.P.C. (2d) 263 (Ont. Dist. Ct.); *Erie Meat Products Ltd.* v. *Expert Packers Co.* (1980), 39 O.R. (2d) 97 (Ont. C.A.).

[6] *Davis* v. *Spectrix Microsystems Inc.* (1987), 63 O.R. (2d) 151, affd. (1988), 69 O.R. (2d) 639 (Ont. Div. Ct.); *Rosenberg* v. *Greymac Trust Co.* (1983), 2 D.L.R. (4th) 58, 43 O.R. (2d) 463 (Ont. H.C.).

[7] *Mabri Construction Ltd.* v. *Thomas C. Assaly Corp. Ltd.* (1974), 6 O.R. (2d) 178 (Ont. H.C.).

[8] As will be discussed, the court in *Mercantile Bank* v. *Leons Furniture Ltd.* (1989), 42 B.L.R. 1 (Ont. H.C.) (currently under appeal) in fact ordered the plaintiff assignee to pay money to the defendant who successfully raised a set-off for claims against the assignor. This result is contrary to the authorities and common sense. See, *McGowan* v. *Middleton* (1883), 11 Q.B.D. 464 (C.A.); *Stooke* v. *Taylor* (1880), 5 Q.B.D. 569, at p. 576 (Q.B.D.), per Cockburn C.J. Overtopping claims can only be raised as counterclaims and counterclaims cannot be raised against assignees.

4. In an interlocutory injunction, the defendant's assertion of a set-off may directly affect the various tests for the grant of the injunction, particularly the issue of irreparable harm.
5. A counterclaim may be unenforceable because it is time-barred or based on an agreement that is not in writing, but an equitable set-off may still be allowed.[9]
6. A successful set-off which eliminates the plaintiff's claim should result in an order of costs in favour of the defendant. If the defendant is successful on a counterclaim and the plaintiff is successful in the main action, costs would normally be awarded in each action. Therefore, the defendant may be responsible for the plaintiff's costs of the main action even if the amount of the counterclaim exceeds the plaintiff's judgment.[10]

Since the availability of a right of equitable set-off (1) can have significant effects on the expectations of assignees; (2) can alter the strict contractual relationship between the parties; and (3) can confer crucial procedural advantages on a defendant, it is essential that the principles upon which the right of equitable set-off is based be clearly defined. Of particular concern to assignees and contracting parties is minimal disruption of the contractual regime which the contracting parties have created voluntarily. The wide manner in which the principle of equitable set-off is currently framed in the jurisprudence does not offer that clear definition or protection against disruption.

This article proposes that the theoretical basis of the defence of equitable set-off is identified in the earlier cases, which, if expressly recognized by the courts today, would result in the development of appropriate limits to the defence. This article will seek to demonstrate that the point of equitable set-off, as applied in earlier authorities, was to treat the plaintiff's right to performance[11] as being conditional on the defendant's right to performance of obligations owing by the plaintiff, although the transaction creating the various rights to performance did not on a normal contractual analysis create conditional obligations. Clearly, if the transaction created conditional rights (such as in an agreement where the plaintiff's right to payment for goods was made conditional on delivery), then the defendant would have had a substantive defence to the plaintiff's claim based on those consensual arrangements. Where there were no such arrangements the plaintiff was free to assert a claim without perfectly and completely performing the

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[9] P.R. Wood, English and International Set-Off (1989), pp. 6-36, 13-22.

[10] *Hanak* v. *Green*, [1958] 2 Q.B. 9, [1958] 2 All E.R. 141 (C.A.); *Victoria Saanich Motor Trans. Co.* v. *Wood Motor Co.* (1915), 23 D.L.R. 79, 8 W.W.R. 1124 (B.C.C.A.).

[11] By performance we mean a number of things; either performance of contractual rights in the form of an order of specific performance, an action for debt or an action for damages for breach, or performance of equitable duties as trustee, or perhaps even performance of obligations recognized in tort through a claim for damages.

obligations owing to the defendant. Equity recognized that it was not always fair to allow a plaintiff to take advantage of the non-conditional nature of the obligations. Therefore, the courts of equity developed an equitable notion of conditionality, less strict than the common law notion. The plaintiff could succeed in its claim only on the condition that the defendant receive the reciprocal performance. Inherent in equity's position was a conflict between the contractual regime the parties had created and the equitable relief.

The concept of conditionality has been lost in the more recent Canadian and British cases and the concept of fairness has been brought to the forefront. This has led courts to seize on factors in the relationship between the plaintiff and defendant which have little to do with the nature of their respective claims and obligations. Consequently, there is a failure to recognize that the conflict between common law principles and equitable principles may be escalated by an unchecked doctrine of equitable set-off. Traditionally, in other areas, equitable principles have developed carefully so as to limit that conflict.[12] If, upon an objective analysis of the contractual or other arrangements made by the parties, the conclusion is that the rights and obligations are not conditional, the courts should exercise restraint in altering that contractual regime. With the present articulation of the defence of equitable set-off, the potential for unwarranted intervention is too great.

I. *Legal Set-Off*

Before considering the defence of equitable set-off, it is instructive to consider briefly legal set-offs.

A. *By Statute*

In an action for the payment of a debt, the right of a defendant to set up by way of defence a mutual liquidated claim against the plaintiff was not recognized at common law, but has long been recognized by statute. Currently this right is found in various provincial enactments relating to court procedure. For instance, in Ontario this right is set out in the Courts of Justice Act, 1984, section 124.[13] Although well recognized, statutory set-off has a very limited application.

The right to set-off "mutual debts" has, as the term suggests, two obvious, though sometimes misunderstood, limitations. First is the require-

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[12] For example, the principle of substantial performance is a common law doctrine which is limited in effect because the courts are reticent to value part performance of entire contracts. Furthermore, the equitable right of rescission is not permitted where a party seeking the remedy has received part performance, because of the difficulty in valuing that part performance when the contract itself does not do so.

[13] S.O. 1984, c. 11, section 124(1) reads as follows:

In an action for payment of a debt, the defendant may, by way of defence, claim the right to set-off against the plaintiff's claim a debt owed by the plaintiff to the defendant.

ment of mutuality, meaning simply that the debts are due from each party to the other in the same capacities.[14] Mutuality is concerned with the relationship of the parties, not the nature of their claims. An assignment of a debt destroys mutuality.[15] The need for mutuality prevents the assertion of the statutory set-off as against assignees of the debt, such as a receiver. Therefore, if A owes a debt to B which is assigned to C, C may commence an action against A, but A could not rely on the statute to set off a debt owed by B to A, unless A has raised the set off prior to the notice of assignment. However, in another scenario, if plaintiff X, the assignee of third person Y, sues defendant Z for payment of a debt owed to Y, Z can set-off any amounts owed by X to Z. A new mutuality is established. Pursuant to the Ontario statute, the debts or demands have to be held by the parties in the same capacity in which they sued or were being sued.[16-17]

The second limitation of a statutory set-off is that the plaintiff's and the defendant's claims must both be liquidated or ascertainable with certainty.[18] The claims may be of a different nature or arise out of different transactions as long as they are liquidated. If either claim is for general damages or unliquidated damages that cannot be ascertained easily, no statutory set-off can be raised by a defendant. *Mabri Construction Ltd.* v. *Thomas C. Assaly Corp. Ltd.*[19] illustrates this restriction. The plaintiff's claim was for damages for breach of a construction contract. It was alleged that the defendant general contractor had failed to supervise properly the subcontractors, resulting in deficiencies which the plaintiff was required to correct. The defendant attempted to raise in defence, by way of set-off, a claim for damages for breach of the same contract by reason of deficiencies in the carpentry work the plaintiff was required to perform. The statutory right of set-off was not available since the claims of both the plaintiff and the defendant were for general damages and not a debt.

The basic principles of statutory set-off are now clear. The purpose of this statutory set-off, originally derived from the Statutes of Set-Off[20]

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[14] *Holt* v. *Telford*, *supra*, footnote 1, at pp. 204-205, (S.C.R.), 393-394 (D.L.R.). See also Wood, *op. cit.*, footnote 9, p. 14-29.

[15] *Ibid.*

[16-17] *Supra*, footnote 13 s. 124(2), as amended S.O. 1989, c. 56, s. 22.

[18] *Bennett* v. *White*, [1910] 2 Q.B. 643 (C.A.); *Stooke* v. *Taylor*, *supra*, footnote 8. For a full discussion of what constitutes unliquidated damages, see Wood, *op. cit.*, footnote 9, pp. 2-75, 2-130.

[19] *Supra*, footnote 7; see also, *Canada Southern Railway Co.* v. *Michigan Central Railroad Co.* (1983), 6 D.L.R. (4th) 324, at p. 327, 45 O.R. (2d) 257, at pp. 260-261 (Ont. H.C.).

[20] The Insolvent Debtor's Relief Act 1729 (2 Geo. II, c. 22), s. 13, and Debtor's Relief Amendment Act 1735 (8 Geo. II, c. 24), s. 4. These Acts were repealed by section 2 of the Civil Procedure Repeals Act, 1879 and the Statute Law Revision and Civil Procedure Act 1883, but with a saving provision to the effect that the repeal was not to affect rights

enacted in England in 1729 and 1735, was simply to avoid circuity of actions for the enforcement of two distincts debts. In this sense, a statutory set-off is only a *procedural* defence.[21] This is in contrast to a defence of equitable set-off which, as discussed below, is a *substantive* defence to the plaintiff's claim. Since two separate debts exist when a statutory set-off is raised, a defendant may be found in breach of contract even if his statutory set-off is successful. As a result, the defendant will face all of the consequences and contractual penalties of being in breach. Each party will retain its rights and be subject to the same obligations which otherwise exist by reason of being a creditor or debtor, as the case may be.

B. *By Agreement*

The right at law to raise an unliquidated, non-mutual[22] claim by way of defence may be expressly created by the same agreement on which the plaintiff's claim is based. For example, the parties may agree that the price for goods sold by a plaintiff to a defendant may be adjusted or satisfied by other matters to be set off.[23] The plaintiff's claim is theoretically reduced by the amount of the defendant's claim to take into account the other matters. Although the result of such express agreements is similar to a set-off, it is not conceptually necessary to think of these cases in terms of the principles of set-off, as their existence and scope is determined by the express or implied terms of the contract.

C. *Abatement or Common Law Set-Off*

The common law started to develop a concept of set-off which was referred to as a right of abatement. In contracts for the sale of goods or contracts for work and labour, the defendant could set up in abatement of the outstanding price claims for defects in the goods, work or labour. In *Mondel* v. *Steel*,[24] and later in *Hanak* v. *Green*,[25] it was recognized that this type of claim was not a cross-claim, but a defence to the action for the price.[26] It had been the practice in earlier times to bring separate cross actions as the obligation to pay the price was not made conditional upon fulfilment of a warranty. A practice then arose of abating (rather than cross-claiming) the purchase price and this has been accepted as the

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such as rights of set-off (see *Hanak* v. *Green*, *supra*, footnote 10). For a full discussion of the statutory history in England, see Wood, *op. cit.*, footnote 9, pp. 2-6, 2-13.

[21] In the sense that it is generally only effective by judicial determination.

[22] If non-mutual the set-off will not apply in bankruptcy.

[23] I.C.F. Spry, Equitable Remedies (3d ed., 1984), pp. 172-173; Wood, *op. cit.*, footnote 9, p. 5-2.

[24] (1841), 151 E.R. 1288, at p. 1293, 8 M. & W. 858, at pp. 870, 871 (Exch.), per Parke B.

[25] *Supra*, footnote 10.

[26] It would apply in cases where the right to payment was not expressly conditional on full and complete performance.

proper characterization.[27] As stated in *Mabri Construction Ltd.* v. *Thomas C. Assaly Corp. Ltd.*,[28] the "right to reduce or defeat a claim by giving evidence of some matter arising in the course of the same transaction has always been applied in building contract cases where a builder's claim for work done may always be reduced by the cost of making good such defects and deficiencies as may be established". But this type of common law[29] defence has generally been restricted to a contract for the sale of goods or for work and labour. Here we had common law courts treating as conditional obligations which were not made conditional by the terms of the contract. Spry describes it as an anomaly,[30] but it was more likely simply superseded by the development of the doctrine of equitable set-off.[31]

II. *Equitable Set-Off*

A. *Source of Jurisdiction*

The defence of equitable set-off developed from the jurisdiction of courts of equity to grant injunctions to preclude enforcement of an order at law if there existed an equitable ground for being protected from the

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[27] *Supra*, at footnotes 23 and 24. Parke B. stated in *Mondel* v. *Steel*, *supra*, footnote 24, at pp. 1293-1294 (E.R.), 871-872 (M. & W.):

> It must however be considered, that in all these cases of goods sold and delivered with a warranty, and work and labour, as well as the case of goods agreed to be supplied according to a contract, the rule which has been found so convenient is established; and that it is competent for the defendant, in all of those, not to set off, by a proceeding in the nature of a cross-action, the amount of damages which he has sustained by breach of the contract, but simply to defend himself by showing how much less the subject-matter of the action was worth, by reason of the breach of contract; and to the extent that he obtains, or is capable of obtaining, an abatement of price on that account, he must be considered as having received satisfaction for the breach of contract, and is precluded from recovering in another action to that extent; but no more.

[28] *Supra*, footnote 7, at p. 180.

[29] There may also be specific statutory abatements such as the Sale of Goods Act abatement for breach of warranty claims.

[30] I.C.F. Spry, Equitable Set-Offs (1969), 43 Aust. L.J. 265, at p. 265.

[31] Given the scope of the defence of equitable set-off there is no need for development of this theory. See the comments of Lord Salmon to this effect in *Aries Tanker Corporation* v. *Total Transport Ltd.*, [1977] 1 All E.R. 398, at p. 408 (H.L.). See also the discussion of *Mondel* v. *Steel*, *supra*, footnote 24, and *Hanak* v. *Green*, *supra*, footnote 10, in *Re Ovington Investments Ltd. & Rexdale Holding (Toronto) Ltd.* (1974), 5 O.R. (2d) 320 (Ont. Co. Ct.), where it was held that this common law defence did not apply where the plaintiff's claim was for breach of a mortgage covenant, where the mortgage was given as part of the purchase price of a building and land and the claim to reduce the amount owing on the covenant was for damages for breach of the purchase agreement. See also, *Gilbert Ash (Northern) Ltd.* v. *Modern Engineering (Bristol) Ltd.*, [1974] A.C. 689, at p. 717, [1973] 3 All E.R. 195, at p. 215 (H.L.).

demand.[32] The principles that developed with respect to the exercise of this jurisdiction formed the basis for the availability of equitable set-off after enactment of the Judicature Act and the consequent fusion of the courts of law and equity. Originally, if the defendant had a cross-demand, whether in equity or at law, a separate writ had to be issued. This led not only to great inconvenience as a result of the multiple proceedings, but also to unfairness to defendants (who at that time might have been sent to debtor's prison for non-payment of a debt), even where they were in fact owed a greater amount by the plaintiff. To prevent this unfairness, courts of equity would grant an injunction to prevent enforcement of the plaintiff's claim pending the result in the proceedings brought by the defendant in the proper court. Thus the exercise of this jurisdiction originally was designed to overcome procedural difficulties.[33]

After the fusion of the courts and the recognition of a right of counter-claim and statutory set-off, the usefulness of this equitable jurisdiction was greatly reduced. However, judges continued to rely on this jurisdiction, although changing its significance and focus in a major way. Because the right of statutory set-off was restricted to liquidated claims there was pressure to exercise some equitable jurisdiction where the claims were unliquidated, yet intrinsically related.[34]

The courts continued to exercise this equitable jurisdiction after the court reforms and did so where there was an equitable ground in favour of the defendant for being protected from the plaintiff's demand. The pre-reform cases were relevant and may remain so to determine when courts of equity would have considered it inequitable to allow the plaintiff to enforce a demand without accounting to the defendant.[35]

B. *Traditional Principles*

Courts of equity acted by analogy to legal rights, recognizing the availability of a set-off based on the statutory provisions for set-off. Equity, therefore, recognized a set-off of mutual debts or liquidated demands and even permitted a limited extension in equity of that set-off. For example, equity recognized set-off in the context of assignments of debts on the basis of the principle that the assignee takes subject to equities. The right of set-off under statute was simply another "equity" to which the assignee

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[32] *Hanak* v. *Green*, *supra*, footnote 10, at pp. 18-19 (Q.B.), 146-147 (All E.R.); Spry, *loc. cit.*, footnote 30.

[33] British Columbia Law Reform Commission, Working Paper No. 4 (1987), pp. 18-19.

[34] *Ibid.* The reforms were restricted to liquidated claims because it was believed that it would add too much complexity to deal with unliquidated claims in this fashion.

[35] See, *Bank of Boston* v. *European Grain and Shipping Ltd.*, [1989] A.C. 1059, at p. 1101, [1989] 1 All E.R. 545, at pp. 551-552 (H.L.), per Lord Brandon, for a procedural history of the development of this defence.

would take subject, provided the debt to be set off arose before notice of the assignment.[36] It is still the case that a debt of the assignor owed to the defendant may be set off against a claim by the assignee, provided the debt existed prior to notice of the assignment.[37]

In addition, equity recognized a broader form of set-off for unliquidated cross demands. It is this latter set-off which is most commonly referred to as equitable set-off and which is the focus of the following discussion.

Equitable set-off is distinguishable from statutory set-off in two important respects:[38]

(1) both liquidated and unliquidated claims may be set-off in equity;

(2) mutuality is not a requirement for equitable set-off which may, therefore, be available where there has been an assignment of a claim.

These characteristics of equitable set-off make it easier to identify what will not establish an equitable set-off than to identify what will.

In the seminal authority of *Rawson* v. *Samuel*[39] Lord Cottenham decided that the mere existence of cross-demands is not sufficient, even if they arise from the same contract. He stated:[40]

> It was said that the subjects of the suit in this Court, and of the action at law, arise out of the same contract; but the one is for an account of transactions under the contract, and the other for damages for the breach of it. The object and subject-matters are, therefore, totally distinct; and the fact that the agreement was the origin of both does not form any bond of union for the purpose of supporting an injunction.

It is, therefore, clear that not every claim or breach of contract raised by a defendant arising from the same contract relied on by the plaintiff will support an equitable set-off. Some will and some will not.

Conversely, other cases have confirmed that the cross-demands need not arise from the same contract if they arise from the same transaction.[41] Indeed, it has been suggested that one claim may be in contract and the other in tort,[42] and it has been held that one claim may be in contract and the other in restitution.[43] In all of these cases, additional elements must be satisfied which Lord Cottenham described in the following terms:[44]

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[36] S.R. Derham, Set-Off (1987), p. 310.

[37] *Ibid.*, p. 312; *Aero Trades (West.) Ltd.* v. *Canada*, [1989] 1 W.W.R. 723 (F.C.A.).

[38] *Holt* v. *Telford, supra*, footnote 1, at pp. 206 (S.C.R.), 394 (D.L.R.).

[39] (1841), Cr. & Ph. 161, 41 E.R. 451 (L.C.).

[40] *Ibid.*, at pp. 178 (Cr. & Ph.), 458 (E.R.); see also *Federal Commerce & Navigation Co. Ltd.* v. *Molena Alpha Inc.*, [1978] Q.B. 927, [1978] 3 All E.R. 1066 (C.A.), per Goff L.J. and Denning M.R., affd., [1979] A.C. 757, [1979] 1 All E.R. 307 (H.L.).

[41] *Holt* v. *Telford, supra*, footnote 1, is now the leading authority in Canada for this point.

[42] Spry, *loc. cit.*, footnote 30, at p. 269.

[43] *Hanak* v. *Green, supra*, footnote 10.

[44] *Supra*, footnote 39, at pp. 178 (Cr. & Ph.), 458 (E.R.).

> ... it will be found that this equitable set-off exists in cases where the party seeking the benefit of it can shew some equitable ground for being protected against his adversary's demand.

And further that:[45]

> Several cases were cited in support of the injunction; but in every one of them except ... [one], it will be found that the equity of the bill *impeached the title to the legal demand.*

The meaning of this element of impeachment is not, on its face, entirely obvious. No court has ever identified or could ever exhaustively identify, those grounds in equity which impeach a plaintiff's legal demand. Any such list would be arbitrarily restrictive. However, Spry[46] distilled from the authorities the meaning of impeachment of title as follows:

> What must be established was such a relationship between the claim of the plaintiff at law and the claim of the defendant that *the right of the plaintiff should be regarded in equity as dependent on satisfaction of the claim of the defendant.* And indeed there were other cases too where the behaviour of the plaintiff was such that his rights would be regarded in equity as *conditional on* the allowing of the claim of the defendant, for the applicable principles were not to be arbitrarily restricted.

A number of years later, while maintaining the need for a significant interrelation between the claims, Spry[47] refined this statement to read as follows:

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

The traditional view of equitable set-off, therefore, clearly requires more than that the cross-demands arise out of the same contract or related transactions. The right of the plaintiff to assert his contractual demand must be impeached by the existence of an interdependent or "conditional" right or claim of the defendant.[48] Generally, if the claims are related in this fundamental way an equitable ground will exist which renders it unconscionable for the plaintiff to proceed without a set-off.

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[45] *Ibid.*, at pp. 179 (Cr. & Ph.), 458 (E.R.). (Emphasis added).

[46] *Loc. cit.*, footnote 30, at p. 268. (Emphasis added).

[47] *Op. cit.*, footnote 23, p. 174.

[48] An example, where claims arise out of the same contract yet do not have the character of interdependence, might be where a manufacturer which has sold goods to a distributor pursuant to a distributorship agreement sues for the price and the defendant attempts to set off a claim for damages for the plaintiff's breach of a covenant to sell exclusively to the defendant. The plaintiff's claim for the price and the defendant's claim for damages do not relate to one another at all.

Contrast this situation with the facts of *Mercantile Bank* v. *Leons Furniture Ltd.*, *supra*, footnote 8, where the claim for the price was clearly related to the defendant's cross-demands for rebates and allowances.

Although not framed in terms of "impeachment of title", the advice of the Judicial Committee of the Privy Council upon hearing an appeal from the Supreme Court of Newfoundland in *Government of Newfoundland* v. *Newfoundland Railway Co.*[49] supports the necessity of a close examination of the facts to determine if the claims are fundamentally related. The respondent company was incorporated for the purpose of constructing and operating a railway and, in pursuance of its objects, had entered into a contract with the Government of Newfoundland. The contract provided, in part, that upon the construction and continuous efficient operation of the railway the government would pay a subsidy two times per year for a period of thirty-five years, "such annual subsidy to attach in proportionate parts and form part of the assets of the said company, as and when each five-mile section is completed and operated, or fraction thereof . . .".[50] After completion of part of the railway line the company abandoned the contract with respect to those portions of the railway that had not been completed. Prior to this termination the company had assigned all of its rights and property, including the right to the subsidy under the agreement, to the trustees of the company's bondholders, who sued for payment of the subsidy. The Privy Council had difficulty in determining whether the obligation to pay the subsidy was truly conditional upon full performance of the contract. It was held, with some reservation, that the right to the subsidy accrued due upon completion of each five-mile section of the railway and not only upon full completion. Nowhere did the contract contemplate partial completion or partial abandonment. The question then became whether the government could set off against the subsidy payable for the benefit of the assignees its claims against the company for damages for breach of the contract.

Counsel for the company and its trustees cited a number of cases that stood for the proposition that debts accruing after the notice of assignment could not be set-off as against an assignee. The Privy Council responded as follows:[51]

> The present case is entirely different from any of those cited by the plaintiffs' counsel. *The two claims under consideration have their origin in the same portion of the same contract, where the obligations which gave rise to them are intertwined in the closest manner.* The claim of the Government does not arise from any fresh transaction freely entered into by it after notice of assignment by the company. It was utterly powerless to prevent the company from inflicting injury on it by breaking the contract. It would be a lamentable thing if it were found to be the law that a party to a contract may assign a portion of it, perhaps a beneficial portion, so that the assignee shall take the benefit, wholly discharged of any counter-claim by the other party in respect of the rest of the contract, which may be burdensome. There is no universal rule that claims arising out of the same contract may be set

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[49] (1888), 13 App. Cas. 199 (P.C.).

[50] *Ibid.*, at p. 204.

[51] *Ibid.*, at pp. 212-213. (Emphasis added).

> against one another in all circumstances. But their Lordships have no hesitation in saying that in this contract the claims for subsidy and for non-construction ought to be set against one another.
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> ... Unliquidated damages may now be set off as between the original parties, and also against an assignee if flowing out of *and inseparably connected* with the dealings and transactions which also give rise to the subject of the assignment.

Although the full completion and operation of the entire railway was not a condition precedent to the contractual right to payment of the subsidy for that portion of the railway constructed and operated, full completion was clearly part of the overall consideration for the Government's obligation. The contractual right to the payment of the subsidy was not strictly conditional upon performance of the reciprocal obligations within the common law meaning of that term, but was closely enough connected to be recognized as conditional in equity. It was, therefore, appropriate that the claims be characterized as sufficiently interrelated to give rise to a right of set-off. The contract was effectively altered to recharacterize rights to performance as conditional, but the violence done to those rights was minimal given the expectations of the parties.

These authorities suggest an analogy to another principle, the doctrine of substantial performance. Early on the common law became familiar with conditions precedent, these being terms creating an obligation to be performed by one party to the contract upon the performance of which a reciprocal performance became due.[52] This type of condition precedent has also been termed an "entire obligation". Originally at common law a party to a contract had to perform this entire obligation perfectly and completely in order to be entitled to the reciprocal performance under a contract. The only exception arose where the requirement of entire performance had been waived.[53] Later the common law relieved against the harshness of this rule by developing the principle that the reciprocal performance could be obtained with an abatement so long as the promisee had substantially performed the contractual obligations.[54] This doctrine has developed with the courts articulating guidelines as to what constitutes substantial performance. For example, such factors as percentage of work completed, true value of work completed, and the difficulty of completing performance are applied to make the required determination. The development has not been extended so far as to disrupt seriously the contractual

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[52] A. Beck, The Doctrine of Substantial Performance: Conditions and Conditions Precedent (1975), 38 Mod. L. Rev. 413.

[53] Beck, *ibid.*, at p. 419; *Glazebrook* v. *Woodrow* (1799), 8 Tr. 366, 101 E.R. 1436 (K.B.).

[54] *H. Dakin & Co. Ltd.* v. *Lee*, [1916] 1 K.B. 566 (K.B.D., C.A.); *Hoenig* v. *Isaacs*, [1952] 2 All E.R. 176 (C.A.). Although the current view of this doctrine has been criticized as analytically flawed (see Beck, *loc. cit.*, footnote 52), for the purpose of our analysis it is sufficient that, however it developed, it did so to relieve against the perceived harshness of the common law rule.

scheme which the parties created for themselves. The doctrine of entire obligations would be completely emasculated by a broader doctrine of substantial performance which attempted to value the part performance of contractual promises. Although the overriding consideration in development of this principle may have been fairness to the promisor, fairness, as an independent concept, is not offered as the reason for applying the principle in any particular case. Through careful development of the principle the courts have ensured that the conflict between strict contractual rights and obligations and equitable considerations are minimized.

The right of equitable set-off as discussed in the early authorities might be viewed as the "flip side" of the coin to the doctrine of substantial performance.[55] In the set-off context the courts are not dealing with a contract where the contractual obligations and rights are strictly conditional (as with an entire obligation), but with a contract or transaction where the rights and obligations are intentionally not conditional or independent, in the strict contractual sense of that term.[56] It may be unfair for a plaintiff to assert a right to performance where the plaintiff has not fully performed other obligations owed to the defendant, in the same way that it would be unfair for a defendant to deny a right to performance as against a plaintiff who had substantially performed. The doctrine of substantial performance as applied to entire obligations recognized that a contractual right which is dependent under the strict terms of the contract, may *not* be treated as entirely dependent as far as the courts are concerned. Similarly, the doctrine of equitable set-off, as applied to non-entire contracts or obligations, or, in other words, non-conditional rights, may be treated as conditional by the courts. Both doctrines are designed to relieve against the harshness of the strict common law. The doctrine of substantial performance has developed with the clear recognition of the relationship between the contractual promises. But, as the following discussion will demonstrate, the arguably analogous doctrine of equitable set-off has not been developed with that same recognition. Consequently, it is articulated too widely and can result in a serious compromise of the contractual relationship.

The requirement of impeachment of the plaintiff's title[57] as an essential element of equitable set-off is also perfectly consistent with a full range of other equitable defences which can be raised to contract claims. For example, in response to a contract claim, the defendant may show that

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[55] It is recognized, however, that the doctrines do not have a common origin. Nevertheless, the analogy is a pertinent one.

[56] *Boone* v. *Eyre* (1777), 1 H. Bl. 273n, 126 E.R. 160n (K.B.); *Kingston* v. *Preston* (1773), noted 2 Doug. 689, 99 E.R. 437 (K.B.).

[57] In the remainder of this article the concept of impeachment of title should be treated as being synonymous with the concept of conditionality in equity or interrelatedness of claims.

the plaintiff's contractual right or title to payment is not absolute on a variety of grounds including duress, undue influence, unconscionability, mistake or misrepresentation. In such cases, the impugned conduct goes directly to vitiate the defendant's consent to the plaintiff's right to payment. The plaintiff's right to payment is dependent or conditional on the defendant's consent to the creation of the assigned obligation.

In *Tito* v. *Wadell (No. 2)*,[58] Megarry V.C. considered an aspect of the law of assignment closely related to the issue of equitable set-off. In discussing the type of contractual obligation that might be binding on an assignee he explained as follows:[59]

> (a) CONDITIONAL BENEFITS AND INDEPENDENT OBLIGATIONS
> One of the most important distinctions is between what for brevity may be called conditional benefits, on the one hand, and on the other hand independent obligations. An instrument may be framed so that it covers only a conditional or qualified right, the condition or qualification being that certain restrictions shall be observed or certain burdens assumed, such as an obligation to make certain payments. Such restrictions or qualifications are an intrinsic part of the right: you take the right as it stands, and you cannot pick out the good and reject the bad. In such cases it is not only the original grantee who is bound by the burden: his successors in title are unable to take the right without also assuming the burden. The benefit and the burden have been annexed to each other ab initio, and so the benefit is only a conditional benefit.

Although Megarry V.C. is, in this passage, suggesting that an assignee might be bound to perform the contractual obligation,[60] his statement succinctly explains the relationship that must exist between the contractual rights before an assignee can take subject to the promisor's own right.

C. *Modern Application of Traditional Principles*

The application of the traditional principles has led to a divergence in the authorities in England and in Australia. In England, the courts have given such a broad meaning to "good equitable ground", that in some cases it has been difficult to identify the ground, apart from the mere fact that the claims arise from the same transaction. As a result, the requirement of an impeachment of the plaintiff's title or, in more modern

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[58] [1977] Ch. 106, [1977] 3 All E.R. 129 (Ch. D.).

[59] *Ibid.*, at pp. 290 (Ch.), 281 (All E.R.).

[60] Although if this is what Megarry V.C. is suggesting it seems a rather radical theory given the doctrine of privity of contract. He would have the assignee becoming bound to the obligations of the contract in the absence of a novation of the contract and even in circumstances where the assignee made it clear that it did not assume the contractual burdens. The only traditional contract theory that could explain such a result is if the written agreement itself could be explained as a standing offer to an assignee to the effect that if you accept the benefits of this contract you are bound to its burdens. In accepting an assignment with notice of the agreement's terms, the assignee in effect accepts the offer. This seems rather artificial and it seems more likely that Megarry V.C. is actually concerned with the principle of equitable set-off.

parlance, interconnectedness of the demands, has been undermined or in some cases completely neglected. For example, in *Henriksens Rederi A/S* v. *T.H.Z. Rolimpex (The Brede)*,[61] Lord Denning proposed that equitable set-off is "available whenever the cross-claim arises out of the same transaction as the claim; *or* out of a transaction that is closely related to the claim", without any mention of impeachment of the plaintiff's title. In *Federal Commerce and Navigation Co. Ltd.* v. *Molena Alpha Inc.*,[62] Lord Denning appeared to temper this statement in the following passage, frequently cited as an authoritative statement of the modern rule:

> We have to ask ourselves: *what should we do now so as to ensure fair dealing between the parties*? See *United Scientific Holdings Ltd.* v. *Burnley Borough Council* [1978] A.C. 904 *per* Lord Diplock. This question must be asked in each case as it arises for decision; and then, from case to case, we shall build up a series of precedents to guide those who come after us. But one thing is quite clear: it is not every cross-claim which can be deducted ... *it is only cross-claims which go directly to impeach the plaintiff's demands, that is, so closely connected with his demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim.*

By defining the concept of impeachment with reference to the concepts of fair dealing and manifest unjustness, this statement imports a broader discretion permitting the court to assess the fairness or unfairness in any given case without regard to accepted equitable principles for which relief may be granted. Reliance is placed merely on the "close connection" of the demands as constituting impeachment without identifying *how* the defendant's demand relates to and impeaches that of the plaintiff. As a result, it is more likely contractual rights arising out of the same contract will suffice, even though performance of these rights may be distinct and not interdependent or conditional one upon the other.

The House of Lords has recently considered the test for an equitable set-off, but without fully exploring its theoretical underpinnings. In *Bank of Boston* v. *European Grain and Shipping Ltd.*,[63] the rule against set-off in cases of claims for freight was revisited. The charterers accepted that an ordinary cross-claim for breach of warranty could not be set off against a claim for freight, but argued that where the breach was much more serious, one entitling repudiation, a set-off should be permitted. In this context, Lord Brandon commented generally on the nature, origin and basis of the defence of equitable set-off:[64]

> The authority most relied on as providing the relevant test is *Rawson* v. *Samuel* (1839) 1 Cr & Ph 161 in which Lord Cottenham L.C. said, at p. 179, that a

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[61] [1974] Q.B. 233, at p. 248, [1973] 3 All E.R. 589, at p. 595 (C.A.). (Emphasis added).

[62] *Supra*, footnote 40, at pp. 974-975 (Q.B.), 1078 (All E.R.). (Emphasis added).

[63] *Supra*, footnote 35.

[64] *Ibid.*, at pp. 1101-1102 (A.C.), 552 (All E.R.). The case itself was decided on the narrow grounds that set-off was not available against claims for freight charges.

cross-claim, in order to give rise to a defence by way of equitable set-off, must be such as "impeached the title to the legal demand". He then gave examples of cross-claims of that character. One case referred to was *Beasley* v. *D'Arcy* (1880) 2 Sch & Lef. 403n. There a tenant was entitled to redeem his lease on payment to his landlord of rent due. The landlord had previously caused damage to the land let and the tenant was held to be entitled to deduct from the rent due the amount of the damage so done. Another case referred to was *Piggott* v. *Williams* (1821) 6 Madd 95. There a solicitor brought claim against a client for the costs of work done. The client cross-claimed on the ground that the incurrence of the costs had been caused by the solicitor's negligence. It was held that the client was entitled to rely on such cross-claim as a defence.

The concept of a cross-claim being such as "impeached the title to the legal demand" is not a familiar one today.

Lord Brandon was also of the view that a different, alternative version of the relevant test was espoused by the Judicial Committee of the Privy Council in *Newfoundland Government* v. *Newfoundland Railway Co.*[65] The criteria the court applied in deciding that the Government's claim for unliquidated damages could be set-off against the company's claim was not that the "cross-claim" impeached the title to the legal demand, but rather that it was a cross-claim flowing out of and inseparably connected with the dealings and transactions giving rise to a claim.[66] Unfortunately, Lord Brandon does not choose between the two tests, but appears to accept that either may be applied to any given case.[67] Nor does he examine the possibility that the tests are really one and the same, the concern being to define those situations whether the claims are conditional in an equitable sense.

The Australian courts have tended to follow a traditional statement of equitable set-off and have more vigorously reviewed the facts of each case to determine that the defendant's cross-claim impeaches the plaintiff's claim. In *Galambos and Son Pty. Ltd.* v. *McIntyre*,[68] the court reviewed the respective claims to determine how they were related, particularly as to time and subject matter, before concluding that an equitable set-off should be permitted. Since *Galambos*, it is interesting to note that a set-off was denied in a case in which a plaintiff was suing for money due under a mortgage of land given by the defendant to the plaintiff when the defendant asserted a cross-claim against the plaintiff for breach of an alleged agreement by the plaintiff to lend other monies to the defendant on the security of other lands purchased by the defendant from the plaintiff.[69] These facts can be compared to those in *Holt* v. *Telford.*

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[65] *Supra*, footnote 49.

[66] *Bank of Boston* v. *European Grain and Shipping Ltd.*, *supra*, footnote 35, at pp. 1103 (A.C.), 553 (All E.R.).

[67] *Ibid.*, in particular, at pp. 1106 e-h (A.C.), 555 f-h (All E.R.).

[68] (1974), 5 A.C.T.R. 10, at p. 26 (S.C. A.C.T.).

[69] *United Dominions Corporation Limited* v. *Jaybe Homes Pty. Ltd.*, [1978] Qd. R. 111 (Q.S.C.).

The pre-*Telford* Canadian cases are inconsistent in their articulation and application of the equitable principle. A number of cases apply the expansive, discretionary version of the defence.[70] For example, in the earlier case of *Canada Southern Railway Co.* v. *Michigan Central Railway Co.*,[71] the plaintiff had a broad range of claims against the defendants for breaches of leases, abuse of a majority shareholder position and mismanagement arising out of a period of time when the defendants controlled the board of directors of the plaintiff company. A new board of directors of the plaintiff, excluding the defendants, declared a dividend to be paid by the plaintiff to its shareholders, including the defendants. In an unusual set of facts, the plaintiff sought to set off from the dividend owing to the defendant shareholders an unliquidated damage claim for the prior breaches. Relying on statements from Spry noted above,[72] the court allowed the set-off because it would have been unconscionable to allow the majority to share in the profits.[73] Absent from the reasons is any discussion of an impeachment to the shareholders' claim to the dividend aside from a notion of fairness or fair play. Apart from creating a fund against which execution could be levied, the right to dividends was completely unrelated to the unliquidated claim against the defendants for abuse as majority shareholders. There was no discussion as to how the one related to the other. The dividend was *not* declared by the defendants, thereby evidencing the abuse of position. The dividend was declared by a completely new board unrelated to the defendants. The claims did not arise from the same transaction at all. The only connection was that the dividends and the unliquidated claim related to the defendants' status as shareholders. Unfairness in the abstract was the sole basis for the set-off. It is unfortunate that the principles of equitable set-off were so distorted in the case when the same result was readily achieved on alternate grounds under the Railway Act.[74]

In *Coba Industries Ltd.* v. *Millies Holding (Canada) Ltd.*,[75] the court recognized the conditional nature of specific contractual terms in determining the inter-relatedness of the contracts. In that case, M. agreed to purchase

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[70] *Canadian South Railway* v. *Michigan Central Railway*, *supra*, footnote 19; *Norbury Sudbury Ltd.* v. *Noront Steel (1981) Ltd.* (1984), 11 D.L.R. (4th) 686, 47 O.R. (2d) 548 (Ont. H.C.); *Hattori Overseas (Hong Kong) Ltd.* v. *Phillips Cox Agency Ltd.* (1985), 2 C.P.C. (2d) 257 (Ont. Div. Ct.).

[71] *Supra*, footnote 19.

[72] *Supra*, the text at footnote 47.

[73] *Supra*, footnote 19, at pp. 328-329 (D.L.R.), 262 (O.R.).

[74] *Ibid.*, at pp. 328 (D.L.R.), 261 (O.R.); see also the Ontario District Court decision in *H.D. Madden* v. *Brendan Wood*, *supra*, footnote 5, where the court permitted a plea of set-off of the plaintiff's claim for a share of partnership profits (arising out of his participaion in the marketing of a report) against the defendant's claim for breach of unrelated equitable duties owed to the partnership.

[75] (1985), 20 D.L.R. (4th) 689, [1985] 6 W.W.R. 14 (B.C.C.A.).

real estate from P. with a vendor take-back mortgage. The agreement was conditional on the property being leased to P. and P. guaranteeing the lease payments which were to be sufficient to cover the mortgage payments. P. assigned the mortgage to the plaintiff. When P. defaulted on his lease obligations, M. refused to pay the mortgage payments until the lease payments were also received. When the plaintiff brought a foreclosure proceeding, M. successfully sought a declaration that it was entitled to an equitable set-off of the money due under the lease up to the date of notice of the assignment and damages for breach of the lease including accelerated rent for the balance of the term. The following conclusions from a review of the English authorities were drawn by MacFarlane J.A.:[76]

> 1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands: *Rawson* v. *Samuel* (1841), Cr. & Ph. 161, 41 E.R. 451.
>
> 2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed: ... [*British Anzani Felixstowe Ltd.* v. *Int. Marine Mgmt. (U.K.) Ltd.*, [1980] Q.B. 137, [1979] 2 All E.R. 1063.]
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> 3. A cross claim must be so clearly connected with a demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross claim: ... [*Federal Commerce & Navigation Co.* v. *Molena Alpha Inc.*, [1978] Q.B. 927, [1978] 3 All E.R. 1066.]
>
> 4. The plaintiff's claim and the cross-claim need not arise out of the same contract: *Bankes* v. *Jarvis*, [1903] 1 K.B. 459; *British Anzani.*
>
> 5. Unliquidated claims are on the same footing as liquidated claims: ... [*Newfoundland* v. *Newfoundland Railway Company* (1888), 13 App. Cas. 199 (P.C.).]

This statement of conclusions is not a very satisfactory analysis given that the relationship between conclusions one through four is not explored. In our view, conclusions four and five are simply descriptive and do not form part of the test. Conclusion one is unhelpful without any instruction as to the meaning of "equitable ground". Conclusion two is simply an extension of conclusion one that expresses the important condition that the defendant's claim must be interrelated in a conditional sense with the plaintiff's claim. This could certainly be expressed more clearly. Conclusion three is simply a different way of stating conclusions one and two and again is unhelpful without a discussion of what "manifestly unjust" means. However, when the British Columbia Court of Appeal applied these conclusions to the facts at hand, a conditional analysis was prevalent. The evidence clearly demonstrated that it was at the "heart" of M.'s liability on the mortgage that P. would provide and assure the payments under the lease, sufficient to satisfy the mortgage.

The analysis based on the conditional nature of the rights is also supported in cases where an equitable set-off has been denied. In *Aboussafy* v. *Abacus Cities Ltd.*,[77] the plaintiff and defendant had entered into three

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[76] *Ibid.*, at pp. 696-697 (D.L.R.), 22 (W.W.R.).

[77] (1981), 124 D.L.R. (3d) 150, [1981] 4 W.W.R. 660 (Alta. C.A.).

contracts at different times. The first was for the sale of land by the plaintiff to the defendant. The second was for the construction of a building by the plaintiff for the defendant. The third was for management of the buildings by the plaintiff for the defendant. On a motion to determine the availability of equitable set-off for damages for breach of covenants in the three agreements, the court held that each contract was "unrelated to the other in the sense that no term of one [was] *conditional* upon the performance of any other terms in the other".[78] Similarly in *Touche Ross Limited* v. *Alberta Mortgage and Housing Corporation*,[79] the court did not allow a claim for equitable set-off where the two cross-demands arose from independent and unrelated mortgage agreements "in the sense that no one agreement [was] conditional upon any other agreement".

It was in the context of these general principles and the divergence of authorities in Australia and England that the Supreme Court of Canada in *Holt* v. *Telford* undertook a review of the principles of equitable set-off.

D. *The Decision in Holt v. Telford*

This decision of the Supreme Court has already had and no doubt will continue to have a significant impact on the development of equitable set-off in Canada. The case involved a complicated series of transactions between three parties, the Telfords, the Holts and Canadian Stanley Development Limited ("Canadian Stanley"). The original transactions involved the "swapping" of lands, between the Telfords and Canadian Stanley. The Telfords sold a parcel of land to Canadian Stanley for a purchase price of $265,000, payable by $165,000 on closing and a second mortgage back of $100,000. Canadian Stanley sold another parcel of land to the Telfords for the same price with $115,000 payable on closing and a first mortgage back of $150,000. On closing Canadian Stanley in fact paid approximately $50,000 representing the net balance due ($165,000 - $115,000) subject to usual adjustments. The interest rates on both mortgages were identical. Under the mortgages, the Telfords were to make three payments of $50,000 each on three different dates and Canadian Stanley was to make two such payments of $50,000 each on the same dates as the last two payments due from the Telfords. Without notifying the Telfords, Canadian Stanley assigned the first mortgage taken back from the Telfords to the Holts as security for another transaction. The Telfords tendered their first payment of $50,000 prior to its due date to the solicitors for Canadian Stanley, conditional on receiving a discharge of the mortgage, given that both parties would then owe each other the exact same amounts

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[78] *Ibid.*, at pp. 153 (D.L.R.), 663 (W.W.R.).

[79] Unreported, March 25, 1987 (Alta. Q.B.); see also *Winters* v. *Borg-Warner Acceptance Canada Ltd.* (1989), 77 C.B.R. (N.S.) 171 (B.C.S.C.).

due at the same times under their respective mortgages. Eventually, the new solicitors for Canadian Stanley informed the Telfords prior to the due date of the first payment that the mortgage had been assigned to the Holts. It was not until after the due date that the Telfords first heard from a representative of the Holts, who demanded payment of the $50,000 then due. The Telfords finally received a return of the $50,000 from the Canadian Stanley solicitors which sum was paid into court when the Holts filed a statement of claim against the Telfords, claiming the full amount due under the mortgage, namely $150,000, pursuant to an acceleration clause in the mortgage.

In the action by the Holts, the Telfords sought to set off the $100,000 owed to them under the mortgage given by Canadian Stanley even though it was not yet due from Canadian Stanley at the commencement of the action.

The trial judge disallowed the set-off claim on the narrow basis that there could be no right to set-off where one of the debts was not enforceable at the time the set-off was directed. By virtue of the wording of section 41 of the Alberta Law of Property Act,[80] no action on a covenant to enforce a mortgage debt would lie against the Telfords in their personal capacity as mortgagors, whereas an action to enforce a debt could be taken against the mortgagor, as a corporation. With this analysis the Alberta Court of Appeal agreed.

In the Supreme Court of Canada, the Telfords had three arguments. First, they argued that there was an agreement to set-off. This was not accepted on the facts as the documents themselves made no reference to such a right and the parties had deliberately chosen to structure the agreement as separate, distinct transactions, indicating that no such agreement existed. Secondly, they argued that they had a right to a statutory set-off pursuant to the rules of court. Because the debt had been assigned however, destroying the mutuality of whatever debts existed, this claim was not accepted. It remained for the court to consider the third argument, namely a right to a set-off in equity.

Wilson J. began her discussion of the law by emphasizing that the two main requirements of legal set-off, namely a liquidated claim and mutuality, did not apply to an equitable set-off. She stated:[81]

> Equitable set-off is available where there is a claim for a money sum whether liquidated or unliquidated: see *Aboussafy* v. *Abacus Cities Ltd.*, [1981] 4 W.W.R. 660 (Alta. C.A.), at p. 666. More importantly in the context of this case, it is available where there has been an assignment. There is no requirement of mutuality. The authorities to be reviewed indicate that courts of equity had two rules regarding the effect of a notice of assignment on the right to set-off. First, an individual may set-off against the assignee a money sum which accrued and became due prior to the notice

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[80] R.S.A. 1980, c. L-8.

[81] *Supra*, footnote 1, at pp. 206 (S.C.R.), 394 (D.L.R.). (Emphasis added).

> of assignment. *And second, an individual may set-off against the assignee a money sum which arose out of the same contract or series of events which gave rise to the assigned money sum or was closely connected with that contract or series of events.*

These comments regarding the effect of notice require some explanation. In equity, and also under section 53 of the Ontario Conveyancing and Law of Property Act,[82] an assignee of a chose in action takes subject to all equities, including any rights of set-off. The issue of notice is completely irrelevant to the existence of an equitable set-off based on the interrelatedness of the cross-claims. The test remains the same whether there has been an assignment or not.[83] Equity may also recognize set-off on a different basis for which notice is fundamental. The statutory set-off for mutual debts is not at law available against an assignee. However, equity will nevertheless confer a right of set-off as against an assignee where the debtor may have been able to raise a statutory set-off for liquidated claims (even arising in unrelated transactions) as against the assignor, provided the debt exists or is due before the date of the notice of assignment.[84] In equity, which alone originally recognized assignments, the assigned debt was the property of the assignee, not the assignor. After notice, the debtor should not be able to secure a priority over the assignee by obtaining payment by set-off against the assignee for a debt created by the assignor after notice. Notice is relevant only to a set-off in equity against an assignee that is based on the statutory set-off. Notice is not, however, relevant to equitable set-off based on the interrelated cross demands. To be conditional in equity the claims, at the very least, need to arise at the same time. Therefore, the debtor is never misled, because of the lack of notice, into believing there is security for the claim. This latter set-off is recognized independently in equity and is not an exception to the general notice rule that normally applies.

Wilson J. then went on to consider the basis of a claim for equitable set-off. Although a "close-connectedness" criteria is mentioned, the fundamental basis upon which the right of equitable set-off for interrelated cross demands was recognized by her was fairness to the debtor.[85] This was made clear by Wilson J.'s extensive discussion of the authorities, including the British Columbia Court of Appeal decision in *Coba Industries Limited* v. *Millies Holdings (Canada) Ltd. and Tsang*.[86] The only reference to

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[82] R.S.O. 1980, c. 90.

[83] This is emphasized in the recent House of Lords decision in *Bank of Boston* v. *European Grain Ltd.*, *supra*, footnote 35, at pp. 1105-1106, 1111 (A.C.), 555, 559 (All E.R.).

[84] British Columbia Law Report Commission, *op. cit.*, footnote 33, pp. 16-17; Derham, *op. cit.*, footnote 16.

[85] *Supra*, footnote 1, at pp. 214-215 (S.C.R.), 400-401 (D.L.R.).

[86] *Supra*, footnote 75.

impeachment of title or conditionality in Wilson J.'s decision are the quotations from *Coba* and the citation with approval of Lord Denning's statement in *Federal Commerce & Navigation Co. Ltd.* v. *Molena Alpha Inc.*,[87] both noted above. Wilson J. interpreted the result in *Federal Commerce* as holding that "it would be unfair for the creditor"[88] to be paid without allowing an equitable set-off. Wilson J. clearly adopted the recent modified English approach to set-off which emphasizes unfairness and pays lip service to the relationship between the cross demands, without recognizing the traditional approach still reflected in Australian cases. For example, the court approved the English Court of Appeal decision in *Hanak* v. *Green*,[89] even though this decision has been the subject of much criticism.[90] In that case, the plaintiff sued a builder for failure to perform properly certain work and the builder claimed in part in *quantum meruit* for *additional* work. The equitable set-off was allowed, even though on the traditional authorities the two claims were not connected, either on the basis of the work at issue or in the nature of each claim. The defendant's cross-claim did not directly impeach the plaintiff's claim.

In applying the relevant principles Wilson J. noted that the debts that the Telfords were seeking to set off did not accrue due before the dates of the notice of assignment, and thus could be set off only if it could be demonstrated that they arose out of the same contract or a closely interrelated contract. They succeeded in so demonstrating since, in essence, the transaction was characterized as a swap of two parcels of land and the mortgage from Canadian Stanley was part of the consideration for the reciprocal transfers. Since the mortgages were closely connected, it would have been *unfair* to enforce only one side of the land exchange agreement.[91] There is absent from the decision any discussion as to how the Telfords' mortgage claim impeached the Holts' mortgage claim, other than a bare finding that the mortgages were closely related in a land swap deal. This is surprising since the court expressly rejected the argument that there was a set-off by agreement arising from the structure of the transaction. The parties had by distinct agreements created separate, non-conditional obligations, instead of simply setting off the amounts due and creating one mortgage for $50,000 due from the Telfords. Because the

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[87] *Supra*, footnote 40.

[88] *Supra*, footnote 1, at pp. 214 (S.C.R.), 400 (D.L.R.).

[89] *Supra*, footnote 10. See Wilson J., *ibid.*, at pp. 213 (S.C.R.), 399 (D.L.R.).

[90] Spry, *loc. cit.*, footnote 30, at p. 270; Spry, *op. cit.*, footnote 23, p. 177.

[91] *Supra*, footnote 1, at pp. 215 (S.C.R.), 401 (D.L.R.). Further, the argument that found favour with the trial judge relating to the unenforceability of the mortgage covenant personally against the Telfords was not accepted by Wilson J. Section 41(1) of the Alberta Law of Property Act, *supra*, footnote 80, did not render the debt unenforceable but merely removed one remedy, namely a personal judgment on the covenant; the remedy of foreclosure was still available. Set-off did not require either symmetry of remedies or of amounts.

parties had so deliberately created separate contracts, it is difficult to accept that payment on one mortgage was in any way dependent or conditional upon payment of the other.

Certainly, the transaction could be characterized as a swap. But the Telfords obtained all that they bargained for; the parcel of land and a mortgage on the land which they sold. They may not have expected to make any actual payments of money, but they had completely protected themselves in the event that they did by securing the Holts' obligation. They could have protected themselves further by providing that their obligation could not be assigned. No doubt some commercial advantage was obtained from the chosen structure, but, when that structure was no longer convenient in the circumstances they sought to characterize the separate transactions as one.

If the concept of conditionality had been employed there would probably have been a different result. By applying a "fairness" approach it is easy to be swayed by the fact that the Telfords never intended to make any purchase payments beyond the first $50,000. (However, one might wonder how "fair" the result was to the assignee whose purchase turned out to be worth two-thirds less than contemplated and who had no notice of the right of set-off). Although the Telfords and the Holts may have had expectations of conditionality of the purchase payments, such expectations were at complete odds with the clearly non-conditional agreements.

E. *Implications of a Broader Doctrine*

The Supreme Court of Canada has now endorsed a broader application of the doctrine of equitable set-off espoused in the more recent English cases and typified by the statements of Lord Denning in *Federal Commerce & Navigation Co. Ltd.* v. *Molena Alpha Inc.*[92] As noted above, this trend has also become apparent in some earlier, lower court decisions in Ontario. Impeachment of the plaintiff's demand is no longer the pivotal element in the sense that the particular rights and obligations of the cross demands are dependent or conditional on one another. The emphasis has shifted to a broader test of unfairness in allowing the plaintiff to recover without set-off. Impeachment of title or independence of claims is clearly a narrower concept which more explicitly articulates the principle as to why it may be fair or equitable to allow a set-off. A test of unfairness, beyond the narrower impeachment of title, expands the scope of the defence with few limitations or guidelines. At the very least, the unfairness must exist where the cross-demands arise from the same contract or the same transaction. However, Lord Denning has extended it further to "cross-claims that arise out of the same transaction or *are closely connected with*

[92] *Supra*, footnote 40.

it".[93] The extent, degree or nature of the necessary linkage of the rights is not as stringent under the unfairness test. Indeed, the requirement that the cross-demands are closely connected to the same contract or transaction has now become the principal criterion for the defence. One need not assess how the particular right of the plaintiff is dependent or conditional on or impeached by the right asserted by the defendant. For example, it is now difficult to conceive that a set-off will be refused if the cross-claims arise from the same contract, whatever the particular rights. As a matter of fairness, it appears readily acceptable that breaches of the same contract be set-off. With respect to cross-demands arising from the same transaction or those closely connected with it, the evidentiary focus will be on what constitutes the transaction. The definition or characterization of the transaction so as to include or exclude the specific rights underlying the cross-demands will in all likelihood determine the availability of set-off based on a fairness test. Fundamental in *Telford* was the Supreme Court's acceptance that the mortgages of each party were part of a single transaction and were not distinct transactions.

A recent example of confusion generated by the *Telford* decision is *Ingle* v. *Fish*.[94] There, the plaintiff was entitled to the return of a money deposit from the defendant as a result of an aborted transaction to acquire the defendant's shares of a company. The company had a separate claim for money had and received against the plaintiff, which claim was assigned eventually to the defendant. Montgomery J. merely cited *Telford* and *Federal Commerce & Navigation Co. Ltd.* v. *Molena Alpha Inc.*[95] and allowed an equitable set-off without any further analysis of the relationship between the rights asserted in each cross-demand. It was clear that the claims arose from separate transactions involving different parties which were not dependent on one another in any way. This was not an appropriate case for equitable set-off arising from rights arising in one transaction. The decision is even more surprising in that the same result could have been achieved on other grounds either in law or equity. The cross-claims were both for liquidated amounts, although arising in separate transactions. A statutory set-off might have been allowed. The defendant, in his capacity as assignee, had a claim against the plaintiff. Section 124(2) of the Ontario Courts of Justice Act[96] removes the difficulty of debts being owed and owing in different capacities, so what the case really involved was two liquidated mutual debts. There should have been no difficulty in recognizing a statutory set-off. Equity also would allow a set-off against an assignee on the basis of the statutory set-off if the debt to be set off arose before notice of assignment. Conversely, an assignee, as a defendant, can in equity rely

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[93] *Ibid.*, at pp. 974-975 (Q.B.), 1078 (All E.R.). (Emphasis added).

[94] Unreported, released February 13, 1989 (Ont. S.C.), per Montgomery J.

[95] *Supra*, footnote 40.

[96] S.O. 1984, c. 11.

on the statutory set-off against the other unless it is unconscionable to do so.[97] Clearly, there was no countervailing equity to preclude the set-off.

The most dramatic impact of the extended principle for equitable set-off confirmed in *Telford* will arise when a secured creditor enforces security over receivables and is met by a defence of equitable set-off. Indeed, the impact is significant even on the application of the narrower view of the scope of the principle. This occurred in *Mercantile Bank* v. *Leons Furniture Ltd.*[98] Acting on its security under section 178 of the Bank Act,[99] the Bank had sued on receivables due from Leons to Admiral Corporation as at the date the Bank took possession of its security. Leons had claims against Admiral based on certain agreements with respect to the following:

> (1) *Volume rebates*: the defendant was entitled to a 5% rebate once a plateau of $1.7 million in sales was reached payable at the end of the year but due once the plateau had been reached.
>
> (2) *Advertising amounts*: the defendant was entitled to a 2% discount from the invoice price plus an excess allowance for real costs after the Bank took possession.
>
> (3) *Warranty and service claims*: part of the price of the goods (segregated on the invoice) was payment for warranty and service contracts which could no longer be fulfilled by Admiral after the Bank took possession.
>
> (4) *Agreements to take back damaged goods*: the defendant was entitled to return damaged goods without question to Admiral.

The Bank argued that these claims could only be made against the trustee in the bankruptcy. They could not be set off against the rights of the Bank to the receivables under its section 178 security when section 178 did not permit a set-off. The court found that section 178 did not deprive a party of the right of set-off. Furthermore, the Bank's security permitted Admiral to deal in the ordinary course of business and allow third parties buying in the ordinary course to take free of the secured interest. Therefore, the Bank's interest was subject to a right of equitable set-off. After quoting extensively from *Telford* and *Federal Commerce & Navigation Co. Ltd.* v. *Molena Alpha Inc.*,[100] the court concluded that the claims of Leons were so closely bound up with the rights of the Bank in the receivables, that it would be unconscionable not to allow the set-off. The set-off amount exceeded the receivable due to the Bank, providing a complete defence to the Bank's claim. The court also ordered that the Bank pay the excess to Leons and in that the court clearly erred. The Bank assumed no obligation to pay the debts of Admiral. However, there can be no objection to the equitable set-off since the claims of Leons did impeach the right of the Bank to the receivables. The right of Admiral and of the Bank to payment

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[97] Derham, *op. cit.*, footnote 36, p. 322.

[98] *Supra*, footnote 8.

[99] R.S.C. 1985, c. B-1.

[100] *Supra*, footnote 40.

of the receivables on the running account was conditional upon and subject to various rights of Leons directly affecting the purchase price of the goods sold.

On a strict common law contractual analysis Admiral's right to the payment of the purchase price was not conditional. For example, with respect to the volume rebates, Admiral was entitled to the full invoiced price throughout the year and Leons had a separate contractual claim for a rebate at the end of the year if certain conditions were met. However, Leons' rebate claim was directly related to the price of the goods. In a sense Admiral's claim was defeated by the condition subsequent. Each of Leons' claims bore a conditional type relationship to the price.[101]

The defence of equitable set-off also defeated the rights of an assignee in the Alberta case, *Re First Investors Corporation Ltd.*[102] A number of investors held investment contracts in two corporations which contracts were intended to generate income from the corporations. The corporations loaned money to the investors to help them purchase the contracts. At the time of the corporations' receiverships the investors owed money to the corporations and the corporations held security for those loans. The receiver wished to collect the amount owing on the loans and the investors desired to set off the amounts owing under the investment contracts. In considering whether equitable set-off was available Berger J. cited the five "principles" from *Coba Industries Ltd.* v. *Millies Holding (Canada) Ltd.*,[103] as approved in *Telford*, as defining the availability of equitable set-off. As in those cases, there is no discussion of how the five principles relate to one another. Berger J. did, however, examine the relationship between the cross-claims. He stated:[104]

> In my opinion, these contract holders are clearly entitled to equitable set-off. The essence of their arrangement with ... [the corporations] was to create mutual cross-obligations—the very money advanced to create the debt owing to these companies was utilized to create a debt owed from these companies. In my view, the fact that these debts may have been created by separate and apparently unrelated contracts is not a bar to set-off. Moreover, the terms of the loan advance agreement in each instance conferred a discretion upon ... [the corporations] to set off any investment contract balance against any loan advance. The equitable ground contemplated by *Coba Indust.* has been made out; it would be manifestly unjust to refuse set-off.

The facts clearly demonstrated an interrelatedeness between the creation of the claims. The corporations' rights would not have existed but for

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[101] For a recent case which characterizes the Leon's Admiral arrangement as an agreement for set-off see, *Royal Bank of Canada* v. *Lion's Gate Fisheries Ltd*, unreported, January 23, 1990 (B.C. Co. Ct.), aff'd. without discussion of the characterization of the relationship, Jan. 2, 1991 (B.C.C.A.).

[102] (1989), 76 C.B.R. (N.S.) 185 (Alta. Q.B.).

[103] *Supra*, footnote 75.

[104] *Supra*, footnote 102, at p. 191.

the investors' rights against the corporation. The loan agreement was effectively credit for the price of the investment contracts. The receiver was really suing for the price where the consideration for that price had not been delivered. It is directly analogous to a sale of goods where a seller sues for the full price of defective goods. It is this finding of interrelatedness that leads Berger J. to state that it would be manifestly unjust not to permit the set-off. "Unjustness" or unfairness is not made a ground in and of itself for the set-off. Such is the conclusion that follows from a findings of interelatedness of the claims. This is an appropriate analysis, but it would be preferable if this were articulated more clearly.

The cases of *Mercantile Bank* v. *Leons Furniture Ltd.*[105] and *Re First Investors Corporations*[106] illustrate how an unsecured creditor may be able to secure a priority over a secured creditor by relying on the defence of equitable set-off. Had the equitable set-off been unsuccessful in the *Mercantile Bank* case, Leons would itself have suffered the loss since Admiral was insolvent. The same is true of the investors in *Re First Investors Corporation.* Where the claims raised by the defendant impeach the title of the claim by the plaintiff or are interrelated or conditional in an equitable sense, there can be no objection in principle to the unsecured defendant in effect obtaining priority over the plaintiff who is a secured creditor.

Where the requirement of impeachment of title, interrelatedness or conditionality is undermined in the extended doctrine of equitable set-off, there is a much greater risk of a secured creditor as plaintiff losing his security to the defendant relying on an equitable set-off. That defendant is normally unsecured, hence his reliance on set-off. If successful on his equitable set-off, the defendant's claim will be paid in full, or at least to the extent of the plaintiff's claim. Therefore, equitable set-off in effect gives an unsecured defendant priority over all secured and unsecured creditors. Such a result is disruptive of a complex and sophisticated system developed for establishing priorities amongst creditors of various types, particularly where registration of a secured interest is required. The broader principle of equitable set-off has evolved case by case without any recognition of a concern for this impact. If a defendant is permitted to found an equitable set-off on a more general notion of fairness in the context of the original transactions, as in *Telford*, we will find with greater frequency that a secured creditor has lost his security to the unsecured defendant to satisfy the set-off. That defendant's unsecured claim will take priority over all others. That result itself is not objectionable. However, that result should obtain not on a basis of unfairness in the original transaction or breach, but only when one can say with confidence that the rights on which the cross-demands are based are directly related and dependent on one another

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[105] *Supra*, footnote 8.

[106] *Supra*, footnote 102.

and that the plaintiff's claim was thereby impeached by the defendant's claim.

Coba Industries Ltd. v. *Millies Holding (Canada) Ltd.*[107] and *Mercantile Bank* v. *Leons Furniture Ltd.*[108] clearly indicate the risks faced by any assignee. It is well understood that an assignee takes subject to the equities. An assignee of any right or security should take the necessary precautions to protect himself by making inquiries to and giving notice to the debtor. Where that is impractical, the assignee must recognize the risk of set-off and discount the value of the assignment as security accordingly. Perhaps then, this branch of the law should not be overly concerned with the rights of secured creditors. Over time secured creditors, such as banks and other financing institutions, will be able to calculate the appropriate discount rate. Secured creditors might also require that the debtor's future trade contracts preclude rights of set-off so that the equities are cut off on assignment. Unsecured creditors with cross-demands are not in as good a position to protect their own interests. However, the more flexible and uncertain the test for equitable set-off, the greater the discount will have to be. This has obvious disadvantages for debtors seeking financing and is clearly not the most economically efficient result.

An extended doctrine can also have other effects outside an assignment context. It is instructive to consider carefully the nature of equitable set-off as a defence. Equitable set-off is a *substantive* defence which goes directly to the question of whether, in equity, any debt or liability of the defendant exists at all in favour of the plaintiff.[109] If an equitable set-off is established, the plaintiff is not entitled in equity to treat the defendant as being indebted to him. The debt may exist in law, but not in equity. This is in contrast to the statutory set-off which contemplates the existence of mutually exclusive debts. Prior to judgment where statutory set-off is claimed the rights of a creditor attach as do the liabilities consequent upon being a debtor. It is for this reason that equitable set-off is more appropriately regarded as an instrument of self-help.[110] This description of the nature of equitable set-off is supported by the requirement established in *Rawson* v. *Samuel*[111] that the equity must impeach title to the plaintiff's demand. It is not simply a challenge to a procedural right to obtain judgment, as in the case of statutory set-off. Other contractual consequences may flow from a successful equitable set-off with the result that the defendant will be regarded in equity as not being in breach of his contract. Where the contract expressly provides for certain penalties or remedies in the event of a default, these

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[107] *Supra*, footnote 75.

[108] *Supra*, footnote 8.

[109] Derham, *op. cit.*, footnote 36, p. 47.

[110] See Goff L.J. in *Federal Commerce & Navigation Co. Ltd.* v. *Molina Alpha Inc.*, *supra*, footnote 40, at pp. 982 (Q.B.), 1083-1084 (All E.R.).

[111] *Supra*, footnote 39.

contractual remedies will no longer be available, there being no event of default. Therefore, for example, in the *Federal Commerce & Navigation Co. Ltd.* v. *Molena Alpha Inc.*,[112] a ship owner was not entitled to exercise a contractual right to take possession of a ship when a charterer made a reasonable deduction in good faith from rental payments on grounds that supported an equitable set-off. These contractual consequences demonstrate the importance of limiting the conflict between the contractual structure and the equitable doctrine and call for a careful and principled development of the defence.

The nature of the equitable set-off can also be contrasted to that of statutory set-off in the context of the application of limitation periods. Statutory set-off contemplates the assertion by the defendant of an enforceable debt enabling a court to order set-off on judgment. If a limitation period has passed and the enforcement of the debt is statute-barred, the defendant cannot raise that debt by way of a statutory set-off. The expiry of a limitation period will take away the right to enforce the debt although it will not extinguish the debt. On the other hand, equitable set-off, as a true defence, may be raised in respect of a claim or demand even though the right of action at law to enforce the claim may otherwise be statute-barred. As a defence, equitable set-off may never be defeated by lapse of time alone.[113]

If it is accepted that broad notions of fairness are the basis of the recognition of an equitable set-off it becomes impossible to predict in advance when the set-off will be available. Certainty in contractual relations is compromised. Strict contractual rights might be interfered with on the basis of equitable principles such as unconscionability or fraud, and these principles will also operate so as to affect the rights of an assignee. But it is quite a different matter to discover these elements of unfairness or inequity simply from the fact that the claims arise out of the same agreement or agreements that bear some relationship to each other. Where the parties have deliberately arranged their contractual obligations and rights in a manner that does not expressly or impliedly create rights of set-off, then recognition of such rights, arising out of no more than the fact that the transactions are related, with no reference to the manner in which the rights are related, is in direct conflict with the contractual order that the parties have created. If the doctrine of equitable set-off is confined to cases where the claims are conditional or interdependent the extent of this conflict is manageable and will promote fairness. However, if there is wider availability, then the expressly created contractual relationship can be completely overborne.

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[112] *Supra*, footnote 40, at pp. 973-974 (Q.B.), 1077-1078 (All E.R.).

[113] *Ibid.*, at pp. 973 (Q.B.), 1077 (All E.R.).

Conclusion

The most significant question in determining whether an equitable set-off is to be allowed is whether the plaintiff's right to performance of obligations owing by the defendant is impeached by or conditional upon the defendant's right to performance of obligations owing by the plaintiff or the assignor of the plaintiff. If the rights are related in this way then the "unfairness" to the defendant, as that term is used in various formulations of the test for equitable set-off, is shown. In the absence of such interrelation of claims, no unfairness to the defendant in the relevant sense results from having to pursue the claim separately. Claims should not be characterized as conditional if to do so would be inconsistent with the freely negotiated contractual arrangements. Although the concept of conditionality in the equitable sense is not as strict as that concept applied in common law contract theory, neither should it be so broad as to impair seriously the common law concepts. Many courts do not undertake a close analysis of the nature of the plaintiff's and defendant's respective claims. As exemplified in *Telford* the focus has been on whether the dealings or contracts constitute a single transaction. There has been no discussion of the effect on the parties' expectations on entering the contract or transaction. Finding that the dealings constitute a single transaction can never answer the question of whether equitable set-off is appropriate. Neither can a broad consideration of the unfairness of not allowing a set-off in the circumstances. By expressing the idea of "unfairness" or "unjustness" as part of the test the court detracts from the true basis of equitable set-off.

However, the Supreme Court of Canada in *Telford* did recognize, albeit somewhat covertly, that impeachment of the plaintiff's title is an element of the test. As *Mercantile Bank* v. *Leons Furniture Ltd.*[114] and *Re First City Investors Corporation Ltd.*[115] demonstrate, it is still open to courts to insist upon a close examination of each of the plaintiff's and defendant's claims to assess their relationship to each other. Simply finding that the claims arise out of the same contract, transaction or series of transactions can never be enough. Any court applying *Telford* may recognize interrelatedness or conditionality in the sense described above as a necessary element of equitable set-off, and recognize that "unfairness" derives from that finding.

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[114] *Supra*, footnote 8.

[115] *Supra*, footnote 102.