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MORTGAGES - SET-OFF IN ACTION AGAINST ASSUMING GRANTEE ON THIRD PARTY BENEFICIARY THEORY

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MORTGAGES — SET-OFF IN ACTION AGAINST ASSUMING GRANTEE ON THIRD PARTY BENEFICIARY THEORY — Evans and Fulmer entered into an agreement for an exchange of two pieces of property. Fulmer assumed two morgages on the property conveyed to her. According to the agreement, Evans gave a first mortgage on the property conveyed to him to a third person and a second mortgage to Fulmer. Evans defaulted on the first mortgage assumed by him; Fulmer, who held the second mortgage, foreclosed and as a result suffered a $17,000 loss. Later, Evans regained possession of the promissory notes evidencing the second mortgage on the property conveyed to Fulmer, and assigned them to Goldfarb who sued Fulmer, the assuming grantee. Fulmer cross-claimed for her $17,000 loss on the other property. *Held,* the rights of a mortgagee or his assignee against an assuming grantee are those of a third party beneficiary and under the Tennessee Code are subject to set-off of the default by Evans on the mortgage asumed by him. *Fulmer v. Goldfarb,* 171 Tenn. 218, 101 S. W. (2d) 1108 (1937).

The rights of a mortgagee [1] against the assuming grantee are usually based on two theories, subrogation to the promisee's rights in equity, or an action at law as a third party contract beneficiary.[2] Since, historically, mortgages have been equity business, many jurisdictions still approach the problem primarily as one of equity jurisdiction, though it closely resembles the third party case.[3] It makes much difference whether the subrogation in equity or the enforcement at law approach be adopted in a particular jurisdiction, for on the former theory the courts reason that the mortgagee's right is derivative and that he must recover in the right of the mortgagor-promisee against the promisor-grantee in equity, which case admits of set-off.[4] On the other hand, suing as a third party beneficiary at law, the mortgagee's rights are independent of the mortgagor-promisee's rights and are subject only to defenses arising out of the very transaction, such as conditions, breach of counter-promise, failure of consid-

[1] As hereinafter used, the word mortgagee applies to those claiming through him as well.

[2] See 6 R. C. L. 884 (1915) for the rule in the various jurisdictions; 2 WILLISTON, CONTRACTS, rev. ed., § 384, p. 1116 (1936), wherein the various theories are discussed and criticized; 6 CIN. L. REV. 361 (1932); 2 JONES, MORTGAGES, 8th ed., § 949 (1928); 81 A. L. R. 1271 (1932).

[3] 2 WILLISTON, CONTRACTS, rev. ed., § 384, p. 1116 (1936).

[4] Green v. McDonald, 75 Vt. 93, 53 A. 332 (1902); Keller v. Ashford, 133 U. S. 610, 10 S. Ct. 494 (1890), somewhat misleading in that the court talks in terms of failure of consideration, but otherwise a leading set-off subrogation case; Episcopal City Mission v. Brown, 158 U. S. 222, 15 S. Ct. 833 (1894).

eration, etc.[5] Stated generally, a mortgagee's rights against the assuming grantee may be greater on the third party theory than in subrogation in equity. A set-off is not a defense to an action; it represents a cross-claim arising out of a separate transaction for which the defendant would have an action against the plaintiff.[6] On this basis, the mortgagee suing the assuming grantee in a subrogation jurisdiction is subject to the state of accounts between the parties to the promise at the time of the transaction, on the theory that if the promisee sues he is subject to set-off and that the mortgagee has no greater rights than he has. In Tennessee, a mortgagee's rights against the assuming grantee are those of a third party beneficiary.[7] Although the court in the case under discussion states that the mortgagee's claim is subject to set-off, the facts present a clear case of failure of consideration in that Evans did not perform his counter-promise to pay the mortgage on the property conveyed to him.[8] The Tennessee code [9] provides that the defendant may plead by way of set-off or cross action, "(3) Any matter growing out of the original consideration of any written instrument, for which the defendant would be entitled to recover in a cross-action. (4) Any equities between the defendant and the original party under whom the plaintiff claims, which by law have attached to the demand in the plaintiff's hands, and for which defendant would be entitled to recover against such original party." On the basis of this case, the code has not assimilated defense and set-off. The section had previously been held to be declaratory of the common law,[10] and subsection (3) clearly so states; subsection (4) is not this case, for the third party sues in his own right and not under the promisee. It has never been contended that set-off is proper in third party beneficiary cases, but the courts are very careless in using terms, as was done here, and while it arrived at the proper conclusion, it is well to avoid possible misunderstanding by a close adherence to the proper choice of rules and reasons in such important cases.

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[5] First Carolina's Joint Stock Land Bank v. Page, 206 N. C. 18, 173 S. E. 312 (1934); Hagman v. Williams, 56 S. D. 414, 228 N. W. 811 (1930); Shult v. Doyle, 200 Iowa 1, 201 N. W. 787 (1925); Malanaphy v. Fuller & Johnson Mfg. Co., 125 Iowa 719, 101 N. W. 640 (1904); Hagadine-McKittrick Dry Goods Co. v. Swofford Bros. Dry Goods Co., 65 Kan. 572, 70 P. 582 (1902); Dunning v. Leavitt, 85 N. Y. 30, 39 Am. Rep. 617 (1881), a leading case; WALSH, MORTGAGES, § 51 (1934); 2 JONES, MORTGAGES, 8th ed., § 943 (1928).

[6] Naylor v. Smith, 63 N. J. L. 596, 44 A. 649 (1899); Richardson v. Penny, 10 Okla. 32, 61 P. 584 (1900); Avery v. Brown, 31 Conn. 398 (1863).

[7] Title Guaranty & Trust Co. v. Bushnell, 143 Tenn. 681, 228 S. W. 699, 12 A. L. R. 1512 at 1528 (1920).

[8] First Carolina's Joint Stock Land Bank v. Page, 206 N. C. 18, 173 S. E. 312 (1934), facts almost identical; Dunning v. Leavitt, 85 N. Y. 30, 39 Am. Rep. 617 (1881); Hagman v. Williams, 56 S. D. 414, 228 N. W. 811 (1930).

[9] Tenn. Code (1932), § 8768.

[10] Holland v. Cooperage Co., 154 Tenn. 174, 285 S. W. 569 (1926).