De Wolf Vs. Johnson

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Appeal No. : 23 U.S. 367

Appellant : De Wolf

Respondent : Johnson

Judgement :

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De Wolf v. Johnson

23 U.S. (10 Wheat.) 367

APPEAL FROM THE CIRCUIT

COURT OF KENTUCKY

SYLLABUS

In a contract for the loan of money, the law of the place where the contract is made is to govern, and it is immaterial that the loan was to be secured by a mortgage on lands in another state.

In such a case, the statutes of usury of the state where the contract was made, and not those of the state where it is secured by mortgage, are to govern it unless there be some other circumstance to show that the parties had in view the laws of the latter state.

Although a contract be usurious in its inception, a subsequent agreement to free it from the taint of usury will render it valid.

The purchaser of an equity of redemption cannot set up usury as a defense to a bill brought by the mortgagee for a foreclosure, especially if the mortgagor has himself waived the defense.

Under a usury law which does not avoid the securities, but only forbids the taking a greater interest than six percentum per annum, a court of equity will not refuse its aid to recover the principal.

A certificated bankrupt or insolvent, against whom no relief can be had, is not a necessary party to a suit in equity, but if he be made a defendant, he cannot be examined as a witness in the cause until an order has been obtained upon motion for that purpose.

This was a bill filed by the appellant, De Wolf, in the court below, on 4 September, 1818, for a foreclosure of a mortgage given by Prentiss, one of the respondents, on 7 July, 1817, to secure the repayment of the sum of $62,000. The bill alleged that the mortgagor had conveyed his equity of redemption to W. T. Barry by a deed of trust dated 16 March, 1818, describing the lands as

"all those tracts or parcels of land described and contained in a deed of mortgage from the said J. Prentiss to the said J. De Wolf, dated 7 of July, 1817, . . . it being the intention and meaning hereof that after the satisfaction of the debts set forth in said deeds, the remainder of the property described in said deeds . . . shall be hereby conveyed."

According to the provisions of the deed, Barry exposed the premises for sale at public auction on 27 May, 1818,

"subject to the encumbrances of any previous mortgage or deed of trust, particularly a mortgage deed to J. De Wolf, from J. Prentiss, dated 7 July, 1817, . . . recorded in the clerk's office of the Fayette County Court, and to which all persons wishing to purchase are referred for more particular information."

At this sale, the property was purchased by J. Johnson and R. M. Johnson. Prentiss filed no answer to the bill, and it was taken *pro confesso* against him. J. Johnson answered, claiming as a *bona fide* purchaser for a valuable consideration and setting up the defense of

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usury in the contract between Prentiss and the appellant De Wolf and also denying notice of the mortgage except by vague report, which report was accompanied with the suggestion that the mortgage was void as being affected with usury. Barry also answered, admitting the conveyance to himself by Prentiss in trust to sell, which sale he had effected publicly and in good faith before the bill filed, and in pursuance of the sale had conveyed to the defendants, J. and R. M. Johnson, and alleged that he was ignorant of the claim of the plaintiff De Wolf except so far as that claim was recognized in the deed of trust, and also set up the defense of usury between the mortgagor and mortgagee. The other defendant, R. M. Johnson, answered, recognizing and adopting the answer of J. Johnson and denying for himself all knowledge of the mortgage at the date of the conveyance to Barry. He also averred that he was a creditor of Prentiss to the amount of nearly $500,000, for which he had no other security than the assignment to Barry, through which he derived title to the mortgaged premises. The cause went to hearing on the pleadings and proofs, and Prentiss was admitted as a witness on the part of the other defendants, subject to legal exceptions, but it did not appear by the transcript of the record whether the decree of the court below was grounded upon his testimony. It appeared by the other evidence in the cause that the transaction originated in a loan made by De Wolf to Prentiss in the State of Rhode Island

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in the year 1815, the repayment of which was secured by a mortgage upon the lands in Kentucky, which contract was afterwards waived by the parties and a new contract entered into by them in the State of Kentucky in the year 1817. The principal question of fact was whether either or both of those contracts was void under the usury laws of either of those states, and as this question is fully considered in the opinion of this Court, it has not been thought necessary to extract from the voluminous mass of testimony in the court below the general result of the evidence as bearing upon it.

On the part of the appellants, it was contended:

1. That the original contract of 1815, if usurious, was not void according to the laws by which it ought to be governed, the laws of Rhode Island not avoiding the contract or the securities given for it, but only forfeiting one-third of the principal and all the interest of the loan as a penalty to be recovered by information or action of debt.

2. That the contract of 1817 was free from the taint of usury.

3. That if either or both those contracts were usurious, the defendants, J. & R. M. Johnson, could not take advantage of the usury, not only because they were not parties to the contract, but because, by the very terms of the deed of trust to Barry under which they claim, they

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took the estate in controversy subject to the prior conveyance to the appellant.

On the part of the respondents it was insisted:

1. That the loan of 1815 was usurious and void.

2. That the transaction of 1817 was a device to secure the repayment of money advanced on an usurious agreement.

3. That money advanced on an usurious agreement cannot be secured and the payment enforced in a court of equity at the instance of the lender by force of any after agreement of the lender to relinquish the usury and of the borrower to repay the money lent.

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MR. JUSTICE JOHNSON delivered the opinion of the Court.

This cause has been discussed very much at large, and with a degree of talent, candor, and research very satisfactory to the Court. In proceeding to consider it, however, we think it advisable to deviate from the order in which the points were examined at the bar and to pursue them as they arise in the progress of the suit.

In the year 1818, the complainant filed his bill in

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the Circuit Court of the United States for Kentucky to obtain a foreclosure of a mortgage given to secure the sum of $62,000 and bearing date July 7, 1817. The debt secured was payable by installments, only one of which was due when the bill was filed, but in the progress of the cause all the installments falling due, they were all, by consent, admitted into the pleadings, as if introduced by supplemental bill.

The bill first sets out the mortgage and the breach, and then proceeds to allege that Prentiss, the mortgagor, had conveyed his equity of redemption to W. J. Barry, who had sold to James Johnson and R. M. Johnson the two latter of whom were then in possession.

Prentiss files no answer, and in due course the bill as to him is ordered to be taken *pro confesso.* James Johnson files an answer, claiming as *bona fide* purchaser for a valuable consideration and setting up the defense of usury in the contract between Prentiss and the complainant and putting the complainant generally upon his proof. He also denies notice of De Wolf's mortgage otherwise than by vague

report, which report, he alleges, was accompanied with the suggestion that the mortgage to De Wolf was affected with usury and void.

At a subsequent day, Barry also answers, admitting the conveyance to himself by Prentiss in trust to sell, which sale, he alleges, he had effected publicly and in good faith before the bill was filed, and in pursuance of such sale had conveyed

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to the Johnsons. He further alleges that at the time of the execution of the deed of trust to him, "he was ignorant of the complainant's claim except so far as that claim is recognized in the deed of trust," and also sets up the usury between the mortgagor and mortgagee in avoidance of the mortgage.

R. M. Johnson also files an answer in which he recognizes and adopts the answer of James Johnson and further denies altogether knowledge of the mortgage to De Wolf at the date of the transfer to Barry. He then sets out that he is a creditor of Prentiss to the amount of near $500,000, for which he has no other security than the assignment to Barry, through which he derives title to the mortgaged premises.

Upon this state of the pleadings, with a few formal and immaterial additions, the parties went into their proofs. And as the complainant exhibited his mortgage in legal form and with all the evidence of authenticity required by law, it followed that the defendants were put upon their proof to maintain the grounds on which they sought to avoid it.

It was not contended that in the immediate contract on which the bill was founded there was any usurious taint belonging to that transaction itself. The ground taken was usury in a transaction anterior by two years, out of which the mortgage in question drew its origin and from which the usurious taint was supposed to be transmitted either directly or incidentally. The case proposed to be established in proof

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was that in the year 1815 there was a negotiation for a loan between these parties, the scene of which was in Bristol, Rhode Island. That the sum to be loaned was $83,000, but which sum in fact was reduced below $80,000, by means which they contended were resorted to for the purpose of disguising the usurious interest, to be retained by way of premium, or bonus or imposition. That the interest actually stipulated for was twelve percent, of which six percent was reserved in a bond executed at the time for $111,000, comprising compound interest, there being no annual interest reserved. The other six percent was secured under the aspect of a rent payable out of lands in Kentucky, for which Prentiss executed absolute conveyances, and De Wolf stipulated to reconvey on the payment of the amount for which Prentiss gave his bond, and a sum annually, by way of rent, equal to six percent upon the $83,000, that is, the sum of $4,980.

This rent, it seems, was paid the first year, together with an additional sum of $498 added as interest and damages.

And a bill for the sum of $4,980 was drawn the second year by De Wolf upon Prentiss payable in Philadelphia, but this was returned under protest, and subsequently taken up by a bill for $5,154, endorsed by J. T. Meder, Jr.

The evasion of the statute against usury supposed to have been practiced upon Prentiss in making up the sum of $83,000 had relation to three items. The first a sum of about

$32,000, admitted into the computation as the price set upon fifteen shares of the Lexington Manufacturing Establishment, transferred by De Wolf to Prentiss. The second, Treasury notes to the amount of $20,211.94, received at par, and the third $30,802.73, bills drawn upon Philadelphia also taken at par. Upon these three items there was an estimated loss sustained of about $3,400.

The contract of 1815 was unquestionably entered into in the State of Rhode Island, and was there reduced to writing, but had a view to Kentucky for its consummation. As it entered into the contract that Prentiss should secure De Wolf

by a conveyance of Kentucky land to a large amount, two agents were employed and entrusted by De Wolf, with the securities to be passed to Prentiss, and a power to draw upon him for the money, to be paid in Philadelphia, which Prentiss was to have the benefit of upon complying with the articles of his contract purporting an absolute conveyance of the land. The place where the contract of repayment of the principal on the part of Prentiss was to be fulfilled appears no further than this that the bond is given to pay generally, without regard to place, and the money to be paid by way of rent, appears by the subsequent acts of the parties respecting the bills drawn for the rent to have been payable in Philadelphia.

The contract of 1817, in which this mortgage originated, was executed in Kentucky, and had its inception in an intimation from Prentiss of a

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design to avail himself of the plea of usury. Upon this, De Wolf repaired to Kentucky, and there instituted a new negotiation with Prentiss personally, having for its object to clear the contract from all usurious incidents and to take security for the sum loaned at the legal interest of Kentucky, which, as well as that of Rhode Island, is six percent. Accordingly, all the instruments of writing which appertained to the old contract were surrendered mutually, and a new mortgage given to secure the balance now sued for, the original sum having been reduced by large actual payments to the sum for which this mortgage was given, and which includes the same premises conveyed under the prior contract.

The defense set up rests upon the assumption that the new contract was not purged of the usury, or rather that the whole contract of 1815 was void, and could therefore form no basis or consideration for the contract of 1817. Or if not wholly void, it comprised several items of an usurious character which ought to be included in the new contract. And here two preliminary questions arose, the first of which was whether the *lex loci* of the contract of 1815 was Rhode Island or Kentucky. By the usury laws of the latter, the contract and all the securities given for it are void both for principal and interest. By the laws of the former, although it is prohibited to take more than six percent interest, and a penalty imposed for the

offense, the act does not render the contract void -- certainly not for the principal sum. By the laws of Kentucky,

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it is supposed that, the principal debt being abolished, there could be no consideration to sustain the new contract, by the laws of Rhode Island, that the reverse would be the effect unless, as was contended in argument, that the simple prohibition of such a contract, which is express in the Rhode Island act, would affect it with the character of an illegal contract, and as such one which a court of equity would not lend its aid to carry into effect.

With regard to the locality of the contract of 1815, we have no doubt, that it must be governed by the law of Rhode Island. The proof is positive that it was entered into there, and there is nothing that can raise a question but the circumstance of its making a part of the contract that it should be secured by conveyances of Kentucky land. But the point is established that the mere taking of foreign security does not alter the locality of the contract with regard to the legal interest. Taking foreign security does not necessarily draw after it the consequence that the contract is to be fulfilled where the security is taken. The legal fulfillment of a contract of loan on the part of the borrower is repayment of the money, and the security given is but the means of securing what he has contracted for, which, in the eye of the law is to pay where he borrows, unless another place of payment be expressly designated by the contract. No tender would have been effectual to discharge the mortgagee unless made in Rhode Island. On a bill to redeem, a court of equity would not have listened to the idea of

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calling the mortgagee to Kentucky in order to receive a tender.

In the effort to sustain his defense under the laws of Rhode Island, the defendants have introduced into the cause the examination of their co-defendant, Prentiss, taken at the instance of themselves, and received in the court below subject to legal exceptions. We are not informed whether the court below actually recognized

it as competent evidence, since the grounds on which that court dismissed the bill are not spread upon the record. It is enough that it does not appear to be rejected; we are now called upon to pass an opinion upon it.

The only grounds upon which an argument has been made in support of the admissibility of Prentiss' deposition have been that the complainant avers him to be insolvent, which fact the testimony in the cause goes also far to establish, and that his deposition was taken before he was in reality made a party by the service of a subpoena. But on no principle can his evidence be adjudged competent. It is true that cases occur in which certificated bankrupts are struck out of a record and made witnesses, but if this was a case in which a motion to strike out could have been sustained, the motion should have been made and the party's name expunged from the record. On no principle could he be made a witness while he was himself a party. He may have had little or no interest in the event of the suit except as to the costs, but still, while a party to the record, he could not be examined. We

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know of no exception to this rule, whatever be the court in which the question occurs, except it be in the administration of certain branches of the admiralty jurisdiction. From the views that we take of the case, however, we do not find it necessary to inquire whether there is sufficient evidence in the cause, after rejecting the evidence of Prentiss, to sustain the facts on which the defense rests. If, with the aid of that testimony, the defense cannot be sustained, *a fortiori* it cannot be without it. And here it may be proper to premise, as was very correctly remarked in the argument, that there has not been in fact any contrariety of opinion expressed by the counsel on the law of usury. Usury is a mortal taint wherever it exists, and no subterfuge shall be permitted to conceal it from the eye of the law; this is the substance of all the cases, and they only vary as they follow the detours through which they have had to pursue the money lender. But one difficulty presents itself here of no ordinary kind. It is not very easy to discover how the taint of Rhode Island usury can infuse itself into the veins of a Kentucky contract. The defense would not admit of a moment's reflection if it rested on the

direct effects which laws against usury have upon contracts. Whatever sums may have been derived through the usurious contract of 1815 to the contract of 1817, they would not affect the latter with usury, unless introduced in violation or evasion of the laws of Kentucky, for the two contracts are governed by laws that have no connection. But it makes very little difference

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in this case, since if the contract of 1817 is, either in whole or in part, unconscionable, this Court would not lend its aid to execute it as far as it was unconscionable, and the argument goes to show that it partakes of that character, because, admitting that the law of Rhode Island did not render the contract of 1815 null and void for the principal sum loaned, yet the sum exhibited in that contract as principal and so transmitted to the latter contract contained sundry items which it is contended were passed upon Prentiss at a great loss and under circumstances calculated to serve as a disguise to usury.

And first, as to the shares in the Lexington Manufacturing Company. These were fifteen in number, and appear to have been taken by Prentiss on account of the $83,000, about $2,000 a share, the whole of which, there is reason to think, was sunk in his hands in the general wreck of the adventure.

It cannot be denied that this is a suspicious item, it does not in general comport with a negotiation for a loan of money that anything should enter into the views of the parties but money or those substitutes which, from their approximation to money, circulate with corresponding, if not equal facility. Still, however, like every other case, it is open to explanation, and the question always is whether it was or was not a subterfuge to evade the laws against usury. And here it is to be observed that it is not every sale which, in a negotiation for a loan, will taint the transaction with usury, for it may

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comport perfectly with the general views of the borrower to make such a purchase, or to take the article even in preference to money. I would illustrate this by the

case of a merchant who proposes to borrow a capital to adventure in trade, and who, instead of money, receives an assortment, at a fair price, adapted to that trade. There would be no ground for attributing to such a transaction a design to evade the statute. But in what does the present case vary from that? Prentiss had embarked in a manufactory, of the prospects of which he entertained the highest hopes. He either believed or endeavored to persuade others that it would yield fifty percent. The De Wolfs had embarked, on his representations, $30,000 in the enterprise. No experiments had been yet made from which any doubts could be excited, nor is there any proof that the stock was falling. Under these circumstances, he proposes to take back the shares if he could procure money to complete the establishment. The connection between the actual loan and taking the shares as part of the loan was easy and natural, and the interest of twelve percent, with other incidental advantages held out for the loan, may well be estimated as the actual inducement, without supposing that De Wolf was conscious of passing this item upon Prentiss at an inflated price. Prentiss had himself put a value upon these shares but a short time before, in the sale to De Wolf, at nearly the same price, and De Wolf was either his dupe or the shares were resold at their value. Prentiss' continuing

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confidence in their value is positively deduced from the efforts he made to complete, at every hazard and sacrifice, the establishment to which those shares appertained. He still thought it a profitable investment, and so had De Wolf thought it or he would not have made so large an investment without an atom of security but what was to be found in his anticipations from the establishment itself. It is conclusive that this was no heterogeneous disconnected article forced into the negotiation, but intimately connected with, if not the primary object of, the loan; that the price, however inflated, was that which both parties had by previous unequivocal acts set upon it; and if it could be said to have a market value, there is no evidence that it was above its market value; and finally that it was an actual transfer of interest with a view to acquire the article, and not merely to throw it upon the market in order to raise money. It was a real transaction, and not a

subterfuge.

On the subject of the Treasury notes and bills drawn on Philadelphia, we can perceive nothing usurious, or even unconscionable, in this part of the transaction. As to Treasury notes, they were thrown into circulation as money, and it is an historical fact that they were worth all they purported to be worth, notwithstanding the casual depreciation which the embarrassments of the country and the scarcity of gold and silver may have produced, and as to the bills on Philadelphia, we are induced to believe that payment in that form was a benefit conferred on the borrower.

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From the well known course of trade between Kentucky and Philadelphia, it would scarcely have been possible, at that time or perhaps at any time, to have suited them better in making a payment of money intended to be transported to, and used in, Kentucky. With regard to the bills, it is in evidence that there was no loss incurred, and, on the Treasury notes, not as much as the transportation of gold and silver would have cost, calculating all the incidents to actual transportation. But what if these payments had been made in Rhode Island bank bills? Would there have been a pretext of lurking usury in such a payment? Yet who can doubt that the payment would have been less convenient than that actually made? In all probability, with reference to gold and silver, and the exchange or depreciation in Kentucky, the paper of Rhode Island would have been equally if not more disadvantageous. It is not on such vague and equivocal grounds that courts infer the presence of usury. But there is one consideration with reference to this part of the cause which is conclusive. There is no evidence in the record that these payments were in any way forced upon Prentiss. On the contrary, for anything that appears in the evidence, it may have been in both instances the payment of his own choice. In a letter not long before the loan, he actually quotes bills on Philadelphia from four to six percent advance. Nothing of that chaffering appears in the cause which distinguishes all the cases in which attempts are made to evade usury laws

at the moment of extorting extravagant profits on the advance of money.

With regard to the two payments made by way of rent, we have to remark, that there never was any payment of interest for two years on the $83,000 besides what was made in that form, and had the payments been direct and absolute and confined to the sum of $4,890 each, there could no question have been raised respecting those payments. They would have amounted only to the legal compensation for the use of the money. With regard to the second year, it is obvious that as yet nothing has been actually paid; but as it may be said to be secured or acknowledged by another bill, we will consider both sums as paid. And then the only exceptionable parts of the payment will be the sum of $498, added to that actually paid for the first year, and $174.30 added to the bill drawn for the rent of the second year. As to the cash, it is a simple allowance of interest upon a bill drawn for the $4,980, upon its being returned and taken up by another, and cannot be excepted to. And as to the first, we perceive in the transaction about the second payment a sufficient explanation of the origin of the addition made in that instance. As Prentiss acquiesced in having a bill drawn for the second year, payable in Philadelphia, we may reasonably conclude that the agreement was to pay the rent or interest, whichever it may be called, by drawing such a bill. If, then, such a bill was drawn and returned for nonpayment, it may

afford an easy solution of the question upon what principle the addition was made.

But why for so inconsiderable a sum should we perplex ourselves with difficulties in so large a transaction? It could, at most, in common with all the items we have been examining, have furnished only a ground for a deduction -- certainly not for dismissing the bill. Nor should we have proceeded to examine these items in detail were it not that the court below will have to make a decree upon which it will be necessary to allow or disallow these items. Nor, when it is considered under what circumstances this second contract was entered into, would this Court upon slight

grounds be induced to open it.

The parties had previously entered into a contract avowedly usurious with relation to the interest reserved. The defendant intimates his intention to avail himself of the defense of usury, and the parties sit down together for the sole and express purpose of purging it of all usurious taint and to arrange a new contract respecting the same loan which should be legally obligatory.

Is it then probable that any deduction would have been withheld which, by being retained, could affect the new contract with usury or with any of the incidents of usury? Would De Wolf have trusted himself again in the hands of Prentiss by mixing anything with this contract on which a legal exception could be sustained? We think not.

But one of the counsel for the appellees has placed the objection to the complainant's right to

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relief on a more general ground than the receipt of usury or the avoidance of the contract under statute. He insists that it is enough for this Court to refuse its aid that the contract of 1815 was prohibited by law, although not avoided by law.

That a court of equity will not lend its aid to an illegal or unconscionable bargain is true. But the argument carries this principle rather too far as applied to this case. The law of Rhode Island certainly forbids the contract of loan for a greater interest than six percent, and so far no court would lend its aid to recover such interest. But the law goes no further; it does not forbid the contract of loan nor preclude the recovery of the principal under any circumstances. The sanctions of that law are the loss of the interest, and a penalty to the amount of the whole interest and one-third of the principal if sued for within a year. On what principle could this Court add another to the penalties declared by the law itself?

But the case does not rest here. The subsequent legal contract of 1817 rescued the case from the frowns of the law. Courts of justice will not shut the door in the

face of the penitent, and hence it has been decided in a case very analogous to the present that although a contract be in its inception usurious, a subsequent agreement to free it from the illegal incident shall make it good. 1 Campb. 165, note; 2 Taunt. 184.

According to the views, then, which we have

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exhibited of the case, the principal sum of the loan of 1815 was a subsisting debt at the date of the contract of 1817, and unaffected by any of the deductions contended for in the several items which we have considered. There was, then, a good consideration for the contract of 1817, and it is legally valid to the amount which it purports on the face of it.

But if it were otherwise, there are two views of this subject upon which the court below ought to have sustained the bill.

It is very clear that the Kentucky contract must be considered as a new and substantive contract. It is governed by a distinct code of laws from the Rhode Island contract, and cannot be affected by the taint of usury which might have been transmitted to it under some circumstances had it taken place in Rhode Island. It was, then, equivalent to a payment and reloan, and no one can doubt that money paid on an usurious contract is not recoverable back beyond the amount of the usury paid.

Again, it is perfectly established that the plea of usury, at least as far as to landed security, is personal and peculiar, and however a third person having an interest in the land may be affected incidentally by a usurious contract, he cannot take advantage of the usury. Some exceptions may exist to this rule under bankrupt systems, but they are statutory and peculiar.

Here, then, the case presents a third person, the assignee of an equity of redemption, setting up a defense which, in one aspect, Prentiss himself

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cannot set up, and which in another aspect he has not set up, but, on the contrary, under the state of the pleadings, must be supposed to have refused to set up or have abandoned. These views are independent of the effect of notice, of the peculiar circumstances of the notice in this case.

It is true the Johnsons deny the notice prior to the deed of trust. But previous notice is immaterial, since the notice with which the law affects them, is that which the deed to Barry, under which they claim, communicates to him as assignee. In the actual case, the notice is peculiarly strong and pointed, since the only description of the lands in question in the deed to Barry is contained in a reference for description to the mortgage to De Wolf, and the purpose is explicitly declared to give priority to that mortgage. Technically and morally, therefore, they required no more than what should remain after satisfying De Wolf. But had they purchased from Prentiss in the most absolute and general manner and altogether without notice actual or constructive, they still could have acquired no more than the equity of redemption, and that would not have transferred to them the right of availing themselves of the plea of usury. We have examined the cases quoted to this point, and are satisfied with their application and correctness. It would indeed be astonishing were it otherwise, for the contrary rule would hold out no relief to the borrower; it would be only transferring his money from the pocket of the

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lender to the pocket of the holder of the equity of redemption.

Upon the whole we are of opinion that the decree must be

Reversed and the cause sent back to have a decree of foreclosure entered and carried into effect according to the exigencies of the case.