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The Enforceability of Illegal Contracts

By George A. Strong*

The illegality of contracts constitutes a vast, confusing and rather mysterious area of the law. Even the phrase causes difficulty; some writers contending that it presents a contradiction in terms. And the term “illegal” is often used with varying content. Basically, however, it may be said that an illegal contract is one that is unenforceable as a matter of policy because enforcement would be injurious to the best interest of the public. It is relatively immaterial whether the policy forbidding enforcement is declared by the legislature or by the courts. A contract may be illegal because the object or purpose of the contract is illegal. It may be illegal because it contains an illegal promise, although the performance of the promise is not itself illegal. Or, it may be illegal because a lawful promise has been or will be performed in an illegal manner.

The variety of factors which have given rise to problems of illegality seems endless—contract in restraint of trade; purchase by a corporation of its own shares; lack of a contractor’s license; failure of a conditional sales contract to contain required terms; fee splitting contract with an attorney; failure of an exclusive listing agreement to contain a termination date; exculpatory clauses, and provisions for liquidated damages.

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1 6 Corbin, Contracts § 1373 (1951); Restatement, Contracts § 512 (1932). The California courts invariably use the phrase “illegal contract.” See cases discussed in text, infra.


4 Lewis & Queen v. N. M. Ball Sons, 48 Cal. 2d 141, 308 P.2d 713 (1957).


8 For an excellent discussion of liquidated damages and exculpatory clauses see Smith, Contractual Control of Damages in Commercial Transactions, 12 Hastings L.J. 122 (1960).
Public policy may continue to find compelling reasons for refusing enforcement of contracts which in the past have not been considered objectionable but which have become suspect in a changing socio-economic environment. An example is the contract of adhesion or the take-it-or-leave-it contract. In a recent case, Mr. Justice Tobriner defined a contract of adhesion as follows: "The term signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." Courts may refuse to enforce certain contract terms as it becomes more apparent that they are the result of superior bargaining power rather than the free choice of the parties. Naturally, it is understood that the terms decided upon by the parties are generally the result of their relative bargaining positions. But here, as a rule, there are acceptable alternatives. Today, however, because of the concentration of strength, primarily economic strength, freedom to choose between acceptable alternatives may not exist.

Perhaps the most vital and practical problem in the area of illegal contracts is the one of enforceability. One of the reasons for the apparent confusion is the fact that illegality may appear in many forms and in varying degrees. It may result from the lack of a required license or from a contract in restraint of trade. Moreover, the court is confronted with a double problem—the protection of the public welfare and interest and, if consistent with public policy, granting relief to the parties. Another source of confusion seems to be the tendency of some courts to speak in terms of absolute rules, and others in terms of numerous exceptions. Unfortunately, there appear to be several conflicting and competing "absolute" rules. On the other hand, a monotonous and patterned recital of exceptions is apt to obscure the actual rule of decision. It is the purpose of this article to discuss some of the more recent cases dealing with the enforceability of illegal contracts.

I. Raising the Issue of Illegality

Must Illegality Be Pledged?

The illegality of a contract is sometimes thought of as an affirmative defense which, if not specially pleaded, is waived. This rule, fortunately with qualifications, has found expression in several California cases. In *Eaton v. Brock*, the plaintiffs, a licensed retail milk

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distributor and a cooperative entered into a contract whereby the cooperative undertook to collect and to guarantee payment of all accounts of the retailer's customers who were members of the cooperative, and further agreed to solicit new customers for the retailer. A controversy arose between the plaintiffs and Brock, the state Director of Agriculture, who contended that the contract violated the Milk Control Act, California Agriculture Code sections 4200-4420. The plaintiffs brought an action for declaratory relief to have the contract declared valid. This, of course, was not the typical illegality case. Illegality of the contract, although the principal issue in the case, was not an issue between the contracting parties nor was it an issue in an action on the contract. Nonetheless, in upholding the trial court's determination that the defendant had the burden of proving the illegality of the contract, the district court of appeal stated that "... where the illegality of a contract does not appear from the face of the complaint it becomes a matter of affirmative defense that must be specially pleaded. And in such case the burden of proof is on the defendant."

In Cain v. Burns, the plaintiff, an investigator, sought to enforce a fee splitting contract against an attorney. The plaintiff contended that inasmuch as the defendant had merely filed a general denial of the allegations contained in the complaint and had not pleaded illegality as a defense he was barred from later raising it. The court answered:

So far as applicable to the circumstances of this case, the authorities seem clear that although generally illegality of a contract is a defense which must be pleaded, that rule is qualified as follows: (1) where the illegality appears on the face of the contract, or (2) where the evidence which proves the contract discloses the contract's illegality.

Public's Interest in Non-Enforcement

It would appear upon the basis of the above stated rules that the illegality of a contract will not bar recovery on the contract unless such illegality is specially pleaded or unless the illegality appears on the face of the complaint or contract, or is disclosed by the contract. So stated, the rule treats the issue of illegality as one affecting only the interest of the litigants and disregards the interest that the public might have in the nonenforcement of an illegal contract. Certainly the court should not be precluded from considering and weighing the

11 Supra note 10, at 13, 268 P.2d at 60.
13 Id. at 442, 280 P.2d at 890. The court cites 2 Witkin, California Procedure Pleading § 537, at 1531-1533 (1954). The rule stated by the court would appear to be what Witkin refers to as the converse of the "supposed" rule. According to Witkin the basic rule is that illegality may bar recovery although not pleaded.
interest of the public by a mere rule of pleading. The effect to be
given to an illegal element of a contract should not depend upon who
alleges and proves it nor upon the manner in which it comes to the
attention of the court. Rather, it should depend upon how the court
can best serve the interest of the public and, when not inimical to
the public interest, do justice to the parties.14 This thinking has found
strong expression in several recent California decisions.

In Lewis & Queen v. N. M. Ball Sons15 the plaintiff brought an
action for damages for breach of equipment rental agreements and
for the reasonable rental value of equipment alleged to have been
held beyond the agreed rental period. In its answer the defendant
admitted that the equipment had been furnished under the written
rental agreements, but denied that it had breached the agreements.
It did not plead illegality as a defense. The trial court found however
that the plaintiff in reality had agreed to act and had acted as a
contractor within the meaning of section 7026 of the Business and
Professions Code and, being unlicensed, it was barred by section 7031
from maintaining any action for compensation. On appeal the plain-
tiff argued that the trial court was precluded from finding that the
rental agreements were actually subcontracts because it should have
restricted its findings to the issues raised by the pleadings. Speaking
for the court, Traynor, J., stated:16

Whatever the state of the pleadings, when the evidence shows that
the plaintiff in substance seeks to enforce an illegal contract or re-
cover compensation for an illegal act, the court has both the power
and duty to ascertain the true facts in order that it may not unwittingly lend its assistance to the consummation or encouragement of
what public policy forbids. . . . It is immaterial that the parties,
whether by inadvertence or consent, even at the trial do not raise
the issue. The court may do so of its own motion when the testimony
produces evidence of illegality. . . . It is not too late to raise the issue
on motion for new trial . . . in a proceeding to enforce an arbitration
award . . . or even on appeal.

The plaintiff also contended that the parol evidence rule precluded
the admission of other evidence showing the true nature of the rental
agreements because the agreements stated that they contained all of
the provisions agreed to by the parties. Stating that the plaintiff’s
contention was without merit, the court said:17

The policy in favor of narrowing the issues in dispute, which nor-
mally confines the court to those made by the pleadings, and the

14 6 Corbin, op. cit. supra note 1, § 1533, at 1049-50.
15 48 Cal. 2d 141, 308 P.2d 713 (1957).
16 Id. at 147-48, 308 P.2d at 717.
17 Supra note 15, at 148, 308 P.2d at 718.
policy of the parol evidence rule favoring the conclusiveness of integrated written agreements, both give way before the importance of discouraging illegal conduct. To this end, the trial court must be free to search out illegality lying behind the forms in which the parties have cast the transaction to conceal such illegality.

The fact that the defendant has pleaded the illegality of one element of the transaction as a defense does not preclude the court from considering on its own motion another basis of illegality.18

Where First Questioned on Appeal

And, although as a general rule, a question may not be raised for the first time on appeal, an exception is made to the rule when the plaintiff seeks to enforce an illegal contract.19 In Du Pre v. Bogumill,20 the illegal feature of the contract was not pleaded nor did the defendant raise the issue of illegality at the trial. The case was tried on the theory that the contract was valid. Illegality of the contract was raised on appeal and the court said: "A party should not be permitted to completely change his position and adopt a new theory on appeal where questions other than law are presented. Such would be unfair to the trial court and the plaintiff."21 It would seem that if the interest of the public is the paramount consideration when a question of illegality arises, fairness to the trial court and the other party should not be determinative of the court's right or duty to ascertain the true facts so that it may not unwittingly lend its assistance to the consummation of what public policy forbids. In the instant case however, the court did consider the issue.

Must Court Consider Issue Not Pledged?

The above language from the Lewis & Queen case would seem to establish the salutary rule that a court may pursue the question of the illegality of a contract whenever and however it comes to its attention. But must it do so in the absence of pleading? In Dean v. McNerney22 the defendant's original answer did not plead illegality as a defense. After certain testimony tending to support such a defense, the defendant asked leave to file an amended answer pleading the facts shown by the testimony as establishing illegality. The trial court refused permission to file the amended answer and this refusal

18 Wells v. Comstock, 46 Cal. 2d 528, 297 P.2d 961 (1956).
21 Id. at 414, 343 P.2d at 421.
22 91 Cal. App. 206, 266 Pac. 975 (1928).
was assigned as error upon appeal. It was held that the trial court's refusal to permit the defendant to file the amended answer did not result in prejudice because the testimony tending to show the illegality was before the court and if the case presented a question of illegality it had to be considered by the court whether pleaded or not. Using language which has been quoted in part in several more recent cases, the court stated: "The law is very well settled that, where the defendant does not set up the defense of illegality, but that the case made by the plaintiff or the defendant shows illegality, it becomes the duty of the court, sua sponte, to refuse to entertain the action."

Perhaps it should be pointed out in passing that the above quoted language from the Dean case does not distinguish between the court's duty to consider and pass upon an issue of illegality when it arises and the ultimate question of the enforceability of an illegal contract.

In Tevis v. Blanchard, plaintiff brought an action on a promissory note. The defendant did not plead illegality of the transaction as a defense; however, his counsel tried the case throughout upon the theory that the note was void as a part of an illegal transaction and he requested instructions on that theory. The trial court, however, did not recognize the existence of the issue of illegality and refused defendant's instructions, submitting that issue to the jury. Quoting the above passage from the Dean case, the district court of appeal remanded the cause for a new trial and instructed the trial court to permit the parties to amend their pleadings as they might request.

The illegal aspect of the contract in May v. Herron was not pleaded as a defense and apparently the trial court pursued the issue on its own motion and denied plaintiff relief solely on the ground of illegality. In affirming, the district court of appeal stated "... that even though the defendants in their pleadings do not allege the defense of illegality if the evidence shows the facts from which the illegality appears it becomes 'the duty of the court sua sponte to refuse to entertain the action.'" In this case, the trial court did raise the issue of illegality; consequently, the question of whether or not it would be required to do so in the absence of pleading was not actually decided. However, the court used the language of the Dean case regarding the trial court's duty to consider the issue on its own motion.

24 Dean v. Mc Nerney, supra note 22, at 208, 266 Pac. at 976.
25 Id. at 710, 274 P.2d at 486.
27 Id. at 710, 274 P.2d at 486.
In *Agran v. Shapiro*, the plaintiff brought an action to recover the value of accounting services rendered the defendants. Judgment for plaintiff was reversed and the cause remanded for a new trial because, although illegality was not pleaded as a defense, the evidence indicated that the plaintiff's services amounted to the illegal practice of law. The court stated that when the question of illegality develops during the course of a trial, it must be considered by the court on its own motion whether pleaded or not.

The scant authority supporting the proposition that the court must inquire into the issue of illegality whenever it comes to its attention regardless of the state of the pleadings, is buttressed by reason. Illegality is not merely a matter of private concern to the parties. In fact, in some situations it may be to the advantage of both parties to avoid the issue. However, since the public interest, whether declared by statute or the courts, may require the court to refuse to enforce the contract because of the illegal element, the court must press an investigation into the nature and extent of the illegality involved. Of course, the court may ultimately decide that the illegal aspect of the transaction does not require denial of all remedy. But this determination should be made after a careful consideration of all the facts in light of the public interest to be served and not on the basis of when, how or by whom the issue was initially raised.

Retreat From *Lewis & Queen*

In a recent case the supreme court retreated somewhat from the sound position it took in the *Lewis & Queen* case. In *Fomco, Inc., v. Joe Maggio, Inc.*, the element of illegality was the plaintiff's lack of a dealer's or cash buyer's license. The lack of the license was not pleaded, nor did it become evident at the pretrial conference nor during the trial. The issue was first raised by the defendant on motion for new trial as newly discovered evidence. The supreme court in its first opinion, subsequently vacated, stated that the claim of illegality is of a sort which must challenge the attention of the court whenever and however raised. The court then went on to consider the issue of illegality and concluded that it was not of such a nature that all remedy should be denied the plaintiff.

For some reason, not apparent in the opinion, the court granted a rehearing. In the second opinion the court reversed its prior position. The court pointed out that the right to a new trial was purely statutory

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29 55 Cal. —, 358 P.2d 918, 10 Cal. Rptr. 462 (1961). This opinion vacated an earlier opinion found at 356 P.2d 203, 8 Cal. Rptr. 459 (1960).
and that a new trial cannot be granted upon the ground of newly discovered evidence unless the motion therefor is supported by an affidavit reciting facts which show that the evidence could not, with reasonable diligence, have been discovered at the trial. In the instant case, the court said that whether the plaintiff had the required license or not was a matter of public record and could have been discovered by timely inquiry. The court did not inquire into the nature of the illegality claimed; it did not consider the policy of the legislature in requiring the license in question; it did not determine whether the interest of the public demanded nonenforcement of the contract. As a matter of fact, apparently the court did not consider the policy of the legislature in establishing statutory grounds for a new trial. It is difficult to believe that it was the intention of the legislature to preclude the court from investigating a claim of illegality. It is true, of course, that the claimed illegality did not involve serious moral turpitude. But what if it had?

The court distinguished the Lewis & Queen case on the ground that in that case the issue of illegality was first raised during the trial and not on a motion for a new trial. However, in that case the court said by way of dictum: "It is immaterial that the parties, whether by inadvertence or consent, even at the trial do not raise the issue."31

II. Reliance Upon the Illegal Feature

It has been stated as general rule that a contract which is against public policy or against the mandate of a statute may not be made the foundation of any action, either in law or equity.32 The parties are left where they are found on the principle that any resulting injustice between them is outweighed by the public interest in deterring illegal conduct. To this rule many exceptions have been appended. One such exception is concerned with the extent to which the plaintiff must rely upon the illegal feature of the transaction to establish a prima facie case.

Test of Reliance

In C.I.T. Corp. v. Breckenridge,33 the defendants employed one Sears as a contractor to remodel a building. They negotiated with the plaintiff for a loan to help finance these improvements. For some reason, the defendants prepared a note naming Sears the payee who

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31 Lewis & Queen v. N. M. Ball Sons, 48 Cal. 2d 141, 148, 308 P.2d 713, 717 (1957).
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in turn endorsed the note to the plaintiff when the funds were received. Upon defendants' default the plaintiff brought this action for the unpaid balance. Sears was not a licensed contractor, and the defendants contended that inasmuch as Sears could not have recovered compensation for his services from the defendants, the plaintiff could not recover on the note because the funds were used to pay the unlicensed contractor for the performance of his contract. In reply, the court quoted from the opinion in Berka v. Woodward:

The test... whether a demand connected with an illegal transaction is capable of being enforced at law, is whether the plaintiff requires the aid of the illegal transaction to establish his case. If the plaintiff cannot open his case without showing that he has broken the law, the court will not assist him, whatever his claim in justice may be upon the defendant.

The Converse Rule

The above rule is expressed in its negative form, i.e., the court will not grant relief to a plaintiff who must rely upon the illegal aspect of the transaction to make out his case. However, in the C.I.T. Corp. case, the court actually applied the converse of the rule. The court pointed out that in the instant case the plaintiff could establish its case by proving the due execution of the note, its endorsement by Sears, and the amount of the unpaid balance. Since no proof of the illegal transaction was necessary, the court affirmed judgment for the plaintiff. As applied, the rule states that the court may grant the plaintiff relief if he can establish his case without relying upon the illegal feature. The rule thus formulated came under attack in the case of Wells v. Comstock.

In the Wells case, the plaintiffs, officers of a corporation, promised to sell and Comstock, the general manager, promised to buy a certain number of shares of stock in the corporation. The shares were issued in violation of the permit of the Commissioner of Corporations. Comstock refused to pay the balance owed under the contract and defended the suit for breach upon the ground that the contract was unenforceable because the shares had been issued illegally. However,

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34 Id. at 200, 146 P.2d at 272.
35 125 Cal. 119, 127, 57 Pac. 777, 779 (1899).
36 Corbin would state the rule as follows: "... [A]fter all the factors in the case including the illegal ones are known to the court it should hold a party's claim enforceable only if (1) the lawful ones standing alone are sufficient to sustain the claim and (2) the unlawful ones are not such as to cause enforcement to be against the public interest or unjust to the other party." 6 Corbin, op. cit. supra note 1, § 1533, at 1048.
37 46 Cal. 2d 528, 297 P.2d 961 (1956).
the plaintiffs did not rely in any way upon this aspect of the trans-
action. They alleged and the defendant admitted the execution of
the contract and Comstock's refusal to pay the balance owed. The
illegality first appeared from testimony of witnesses called by the de-
fendants. The plaintiffs relied upon the above quoted language from
the C.I.T. Corp. case and section 597 of the Restatement of Contracts
which states: "A bargain collaterally and remotely connected with an
illegal purpose or act is not rendered illegal thereby if proof of the
bargain can be made without relying upon the transaction." In reply,
the supreme court said that the quoted "test" cannot be understood
to mean that if the plaintiff can open his case without showing the
illegal feature, the court will assist him even though it may subse-
quently appear that he is relying upon an illegal transaction.\footnote{39}

In other words, the converse of the quoted test is not a correct
statement of the law and, as to section 597 of the Restatement, the
court held that comment "b" to that section was more applicable to
the facts of the case. Comment "b" states: "Even though a plaintiff's
case can be made out without indicating anything unlawful, it may be
shown that the bargain is illegal because of facts not brought out in
the plaintiff's case, provided that the facts so offered show a close
enough connection with an illegal transaction." In the Wells case the
court reversed the judgment for the plaintiff, pointing out that at the
time the shares were issued, it was known by all of the parties that
the issuance violated the permit and that it was their intent subse-
quently to sell the shares to Comstock. The illegal aspect of the trans-
action was intimately connected with the sale.

It seems evident that the enforceability of an illegal contract or
a contract associated with an illegal act or transaction should not de-
pend upon the plaintiff's skill in avoiding the illegal element in his
pleadings and proof. Frequently, a plaintiff can make out a good case
without divulging its illegal features. For example, in the Lewis &
Queen case,\footnote{40} the action was brought on an equipment rental agree-
ment and it was not until the court inquired into the relationship
between the parties and the nature of the work that had been done,
that it became apparent the plaintiff had acted as a subcontractor
without a license. Normally, the ultimate purpose or object of a con-
tract need not be pleaded. Consequently, by not revealing an illegal
purpose, the plaintiff can make out a good cause of action. In May
v. Herron,\footnote{41} the illegal factor involved was the defendant's fraudulent
procurement of a veteran's priority for the construction of a residence

\footnote{39} Wells v. Comstock, supra note 37, at 532-33, 297 P.2d at 963-64.
\footnote{40} 48 Cal. 2d 141, 308 P.2d 713 (1957).
\footnote{41} 127 Cal. App. 2d 707, 274 P.2d 484 (1954).}
when it was not his intention to reside in the home. On the other hand, it does not follow that a plaintiff must be denied all relief because his case reveals an illegal factor. And this is true although he may be the wrongdoer. In *Nichols v. Boswell-Alliance Construction Corp.*,\(^\text{42}\) the plaintiff was permitted to recover commissions for selling houses under an exclusive listing agreement although it violated section 10176 of the Business and Professions Code in that it failed to specify a termination date which was obvious on its face.

In none of the last three mentioned cases did the court consider the test of the *C.I.T. Corp.* case. Had the test been applied, the results would have undoubtedly been different. The court correctly applied the more cogent tests of the nature of the illegality, the public interest, the fault of the parties and the merits between the parties.

**Degree of Relationship Between Contract and Illegal Factor**

If the plaintiff can make out a good case without relying upon an illegal act or transaction, it is probably because the act or transaction is only collaterally and remotely related to the cause of action. The closeness of the relationship between the contract and the illegal factor is an important consideration in the determination of the ultimate enforceability of the contract. The closer the relationship, the more tainted the contract becomes and the stronger the argument for non-enforcement. However, if the factor is collateral and remote, it may be considered insignificant and immaterial. On the other hand, if the factor presents a serious question of illegality, it may taint the contract although otherwise it might be considered merely collateral. This thinking could have been applied in *Lee On v. Lang*\(^\text{43}\) and *Brenner v. Haley*,\(^\text{44}\) as apparently it was in *Leonard v. Hermreck*,\(^\text{45}\) with the same results achieved. However, the court there relied upon the rule in the *C.I.T. Corp.* case.

In the *Lee On* case the plaintiff brought an action against the sheriff and the district attorney to recover money seized while in use in gambling games. The court held that the test to be applied was whether the plaintiff could establish his case otherwise than through the medium of an illegal transaction to which he was a party.\(^\text{46}\) The court went on to say that plaintiff could not prove his right to possession of the money without disclosing that it was the subject of illegal gambling activities. One could disagree with this last conclusion of

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\(^{42}\) 181 Cal. App. 2d 584, 5 Cal. Rptr. 546 (1960).

\(^{43}\) 37 Cal. 2d 499, 234 P. 2d 9 (1951).

\(^{44}\) 185 Cal. App. 2d ---, 8 Cal. Rptr. 224 (1960).


\(^{46}\) *Supra* note 43, at 502, 234 P.2d at 11.
the court and Mr. Justice Carter did so in a dissenting opinion. But, assuming that the plaintiff could establish his ownership of the money and that it was taken by the sheriff who still retained it without the necessity of showing the nature of its use, recovery could still be denied because of the closeness of the illegal factor and the seriousness of the illegality involved. Two recent cases furnish a good contrast to the Lee On case.

In the Leonard case the defendants, who were awarded a contract to construct a section of a state highway, entered into a contract with the plaintiff who agreed to furnish a loader and to haul dirt to the road bed. The plaintiff did not have a contractor's license. He ceased work before the contract was completely performed and commenced an action against the defendants based upon two causes of action. The first was a common count for the value of services rendered the defendants and the second was for damages for the defendants' wrongful detention and use of plaintiff's loader. The court held that the plaintiff could not recover compensation for his services as a contractor by virtue of section 7031 of the Business and Professions Code but that he could recover, if ultimately proved, for the defendants' conversion of his property. The defendants contended that the transaction to which the second cause of action pertained was tainted with illegality because it arose from an illegal relationship. The court did not agree. It pointed out that the fact that there had been a relationship founded upon an illegal contract did not give the defendants the right to appropriate the plaintiff's property to their own use after the relationship had come to an end. This is sound because the acts which were alleged to amount to conversion were collateral to the contract, and the illegality involved, the lack of a contractor's license, was not serious.

In the Brenner case, the plaintiff had possession of a fence based upon a lease. He used the fence for advertising purposes. The defendant, claiming permission of the owners to do so, on several occasions painted over signs that the plaintiff had placed on the fence. The defendant defended the action against him for trespass on the ground that the plaintiff's lease was illegal because it violated a zoning ordinance. Here again, the court relied upon the rule that whether a demand connected with an illegal transaction is capable of being enforced depends on whether the plaintiff requires the aid of an illegal transaction to establish his case. The court then went on to say that the legality of the plaintiff's lease was not important because he was entitled to maintain the action merely upon his possession of

47 Id. at 507-08, 234 P.2d at 12 (dissent).
48 Supra note 44, at 222, 8 Cal. Rptr. 227.
the fence. The issue of title, and hence the legality of the lease, was
collateral to the issue of the invasion of his possessory rights.

It is regrettable that the court saw fit in the Brenner case to use
the so-called "reliance" test after its validity and usefulness had been
challenged in the Wells case. At best it is a superficial approach to
the problem of the enforceability of illegal contracts where supposedly
the public interest is involved.

III. The Effect of a Statutory Penalty

Expressio unis exclusio alterius. This rule has found its way into
several recent California opinions and presents a rather interesting
commentary on the development of decisional law.

In City Lincoln-Mercury Co. v. Lindsey the underlying facts
are as follows: the defendant purchased a new Lincoln on a condi-
tional sale contract from the plaintiff company, trading in as the down
payment his 1948 Packard which left a balance of 4,232.38 dollars.
At the time the defendant signed the sales order the time price dif-
ferential and the contract balance were not filled in as required by
subdivision (a) of section 2982 of the Civil Code. After making two
installment payments the defendant returned the automobile to the
seller who in turn resold it and brought an action against the defend-
ant for the deficiency. The defendant answered and filed a cross-
complaint contending that the contract was illegal and unenforceable
and that he was entitled to recover the consideration that he had paid.
Subdivision (e) of section 2982 provides that in the event of a vio-
lation of subdivisions (c) or (d), the buyer may recover from the
seller in a civil action the "total amount paid" on the contract bal-
ance. However, in the instant case only subdivision (a) was allegedly
violated.

The code makes no provision whatsoever governing the effect of
violations of subdivision (a). It could be inferred that inasmuch as
the legislature provided a penalty for violations of subdivisions (c)
and (d) and none for (a), that it was the intention of the legislature
that there be none. The court, however, inferred that for a failure
to comply with subdivision (a) the buyer could recover the consid-
eration that he had given. The result, then, is this: for a violation of
(c) and (d) the expressed statutory penalty is that the buyer may
recover the "total amount paid" and for a violation of (a) the inferred
penalty is that the buyer may recover the "consideration that he has
given."

Exclusiveness of Statutory Penalty

It will be noted that the difference between the two penalties discussed in City Lincoln-Mercury Co. is that one provides for “total” recovery and the other simply for recovery. This intriguing difference became of utmost importance in one branch of the case. The plaintiff asked for a setoff against the defendant’s recovery of his installment payments and the value of the Packard. The claim for setoff was based upon the depreciated value of the Lincoln caused by the defendant’s use of the car. In resolving the question of whether the plaintiff should be permitted the setoff the court relied upon the rule that “the courts will not impose penalties for noncompliance with statutory provisions in addition to those that are provided expressly or by necessary implication.” Applying this rule to the statute as interpreted, the court concluded that to deny the plaintiff a right of setoff would amount to an increase in the penalty intended by the legislature for a violation of subdivision (a). The court pointed out that inasmuch as the buyer could recover the total amount paid for a violation of subdivisions (c) or (d), it must have been the intent of the legislature to deny a right of setoff in cases involving violations of those subdivisions. The court held that the statute implied a penalty for violations of (a) which differed from the express penalty for violations of (c) and (d) and then went on to hold that a denial of setoff would increase the implied penalty which the above rule forbids.

In stating the rule that the courts will not impose penalties for noncompliance with statutory provisions in addition to those that are provided expressly or by necessary implication, the court cited as authority the cases of Grant v. Weatherholt and Comet Theatre Enterprises v. Cartwright. The Grant case, which involved the violation of a licensing requirement, in turn cites the Comet Theatre Enterprises case, which also was concerned with a licensing statute and which cites no authority. Neither case discusses the rule beyond its mere statement. However, an earlier federal court case, Macco Constr. Co. v. Farr, stated the rule as follows:

A considerable number of recent cases have held that where the violation of a licensing statute is merely malum prohibitum and does not endanger the public health or morals and where penalties for noncompliance are specifically set forth and no declaration that a contract in relation thereto is void or its enforcement prohibited,
such additional punishment should not be imposed unless the legis-

lative intent is expressed or appears by clear implication.

It will be noted, of course, that the rule in the Macco case is

stated with significant qualifications which do not accompany its

statement in the Grant and City Lincoln-Mercury cases. As a matter

of fact, the rule purports to deal only with those situations wherein

penalties are “specifically set forth” for the violation of a statute.

**Penalty Statutes Silent on Enforceability**

The rule of the Macco case points up the question as to whether

a contract is invalid which is entered into in violation of a statute

which imposes a penalty for such violation, but does not specifically

provide that the contract shall be void. As a general rule, a contract

in violation of a criminal statute is void although the statute does not

declare it so. In Bartlett v. Vinor, Lord Holt, Ch. J., stated:

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\text{...[E]very contract made for or about any matter or thing which is}
\text{prohibited and made unlawful by any statute, is a void contract,}
\text{tho’ the statute itself doth not mention that it shall be so, but only}
\text{inflicts a penalty implies a prohibition, tho’ there are no prohibitory}
\text{words in the statute.}
\]

To this general rule of nonenforcement of a contract in violation

of a statute imposing a penalty, exceptions have been made upon a

basis of an inferred legislative intent. In fact, the thinking has pushed

to the point of establishing the rule under consideration. In Lewis &

Queen v. N. M. Ball Sons, the court said by way of dictum: “In some

cases, on the other hand, the statute making the conduct illegal, in

providing for a fine or administrative discipline excludes by implica-

tion the additional penalty involved in holding the illegal contract

unenforceable . . . .”

Less than three weeks prior to the decision in the Lewis & Queen

case, the court stated:

The general rule controlling in cases of this character is that where

a statute prohibits or attaches a penalty to the doing of an act, the

act is void, and this, notwithstanding that the statute does not ex-

pressly pronounce it so, and it is immaterial whether the thing

forbidden is *malum in se* or merely *malum prohibitum*. . . . The

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54 See Annot., 55 A.L.R.2d 482 (1957).
56 48 Cal. 2d 141, 151, 308 P.2d 713, 719 (1957). This language is quoted in Ni-

57 Contractor’s Safety Ass’n v. California Compensation Ins. Co., 48 Cal. 2d 71, 76,

307 P.2d 626, 629 (1957), quoting Severance v. Knight-Counihan Co., 29 Cal. 2d 561,

588, 177 P.2d 4, 8 (1947).
imposition by statute of a penalty implies a prohibition of the act
to which the penalty is attached, and a contract founded upon such
act is void.

It is not the purpose of this article to choose between the merits
of these apparently conflicting rules. It is enough to point out that
there may be a new reason for uncertainty in an already very confused
area of the law. And perhaps what is most regrettable is the fact that
in the City Lincoln-Mercury case the court pointed out that it could
have, and indeed had in prior cases, reached the same results without
the elaborate analysis of the statutory language and without estab-
lishing the rule of the case.

IV. Relative Fault

Seldom does a California court refer to the general rule that no
relief in law or in equity will be granted to one who is a party to an
illegal contract, without acknowledging that in many circumstances
the interests of the public, for whose protection the rule exists, can
be adequately safeguarded while extending some form of relief to
the party who is blameless or relatively less at fault.

Reference is sometimes made to a significantly qualified version
of the general rule: “The principle that participants to an illegal con-
tract who are in pari delicto can secure no relief based on such con-
tract, is an ancient and most salutary one. It is part of the general
rule that he who comes into equity must come with clean
hands.” (Emphasis added.) And quite often disparity of fault between the
parties is treated as the basis for an exception to the rule of no relief:
“However, to these settled rules there are certain recognized excep-
tions in favor of a party who is not in pari delicto with the other party
to the contract, and who as the more innocent of the two, seeks re-
covery.” (Emphasis added.)

Whether a disparity of relative fault is regarded as a qualification
or as an exception to the rule, it should be borne in mind that any
consideration of the relative merits between the parties should ulti-
mately depend upon the extent of protection required in each case
for the public interest. Stated otherwise, public policy must be the
final measure of available relief in each case.

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58 Tiedje v. Aluminum Taper Milling Co., 46 Cal. 2d 450, 453, 296 P.2d 554, 556
(1956).
60 Tiedje v. Aluminum Taper Milling Co., supra note 58, at 454, 296 P.2d at 556.
61 “By ‘public policy’ is intended that principle of law which holds that no citizen
can lawfully do that which has a tendency to be injurious to the public or against the
public good. . . .” Safeway Stores v. Retail Clerks Ass’n 41 Cal. 2d 587, 575, 261 P.2d
When Are Parties in Pari Delicto?

When are the parties said to be in pari delicto? Simply translated, the phrase means "in equal fault." Since the comparison is based upon the degree of legal guilt ascribed to each party, it presupposes the determination of prior legal issues. And when they have been determined, the court, as Corbin observes, "... has reached its decision by a process that is certainly not a mere deduction from the Latin maxim."62 No constant answer can be given to the question of when parties are in pari delicto. The answer will depend upon the circumstances in each case. It will also depend upon whether the public interest has been weighed in with the balance of fault between the parties or whether it is weighed separately against the balance of relative fault, in determining what relief will be given in each case where the parties are, or are not, in pari delicto.

Since the legislature is considered the primary policy-making body, statutes expressly forbidding relief in certain cases of illegality seem to be determinative.63

In Lewis & Queen v. N. M. Ball Sons,64 the supreme court denied an award of damages to a subcontractor who, in violation of the Business and Professions Code,65 had failed to obtain a license. The Code provides that noncompliance with the licensing requirement precludes a recovery of compensation for work done in the capacity of a contractor. It was held that the court would not resort to equitable considerations in defiance of the statute.66

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62 6 CORBIN, op. cit. supra note 1, § 1534, at 1058.

63 In Agran v. Shapiro, 127 Cal. App. 2d Supp. 807, 273 P.2d 619 (1954), where an accountant was not allowed recovery for services which constituted the practice of law, made a misdemeanor under CAL. BUS. & PROF. CODE § 6125, the court held that a contract, express or implied, the performance of which necessarily involves a violation of a penal statute, may not give rise to a cause of action.

64 48 Cal. 2d. 141, 308 P.2d 713 (1957). See Albaugh v. Moss Constr. Co., 125 Cal. App. 2d 126, 269 P.2d 936 (1954), where the court held that neither language in a contract under which compensation is being sought, nor any presumption or implication arising therefrom will serve as a substitute for the allegation that the plaintiff has obtained a license as required by CAL. BUS. & PROF. CODE § 7031.

65 "No person in the business or acting in the capacity of a contractor, may bring or maintain any action in any court of this state for the collection of compensation for the performance of any act or contract for which a license is required by this chapter, without alleging and proving that he was a duly licensed contractor at all times during the performance of such act or contract." CAL. BUS. & PROF. CODE § 7031.

66 In Marshall v. Von Zumwalt, 120 Cal. App. 2d 807, 262 P.2d 363 (1953), defendant who constructed plaintiff's home without a license was allowed to set up sums credited to plaintiff on the construction work, as a defense to the latter's action to recover for a loan and services rendered to defendant. The court stated that CAL. BUS. & PROF.
Where the contract is violative of express or implied legislative policy, but the statute contains no provision denying relief to the parties, that policy is usually weighed in with the balance of fault or even made the sole measure of pari delicto. In the Lewis & Queen case the court said:\textsuperscript{67}

It is true that when the legislature enacts a statute forbidding certain conduct for the purpose of protecting one class of persons from the activities of another, a member of the protected class may maintain an action notwithstanding the fact that he has shared in the illegal transaction. The protective purpose of the legislation is realized by allowing the plaintiff to maintain his action against a defendant within the class primarily to be deterred. In this situation it is said that the plaintiff is not \textit{in pari delicto}.

This rule has been applied in several cases involving contracts which are considered illegal because one of the parties does not have a required license.

There appears interesting dictum in the Lewis & Queen case to the effect that the class protected by a licensing statute includes anyone who deals with a person required to have such a license.\textsuperscript{68}

In \textit{Marshall v. La Boi},\textsuperscript{69} a contractor brought an action for breach of contract and to foreclose a mechanics lien. The defendant, a non-veteran, used his nephew, a veteran, as a subterfuge to obtain a permit to construct a residence pursuant to wartime housing regulations designed to protect veterans.\textsuperscript{70} In joining with the defendant in applying for the permit, the contractor was unaware of the fraudulent scheme. Defendant wrongdoer refused to pay the balance due under the contract and set up the illegality of the contract under the regulations contending that the contractor could not recover since he was not a member of the class (veterans) protected under the statute. Nonetheless, the court held that the plaintiff was entitled to recover

\textsuperscript{67} 48 Cal. 2d 141, 153, 308 P.2d 713, 720 (1957). See also Williams v. Caruso Enterprises, 140 Cal. App. 2d Supp. 973, 978, 295 P.2d 592, 596 (1956). Compare the language used in Fischer v. Otby, 127 Cal. App. 2d 528, 532, 274 P.2d 221, 223 (1954): "A court will protect the right of a party not \textit{in pari delicto} with his adversary... and this is especially true where the parties occupy a position of confidence and the one against whom relief is sought induced the action of the other... ."

\textsuperscript{68} Lewis & Queen v. N. M. Ball Sons, \textit{supra} note 67, at 153, 308 P.2d at 721, (dictum).


damages for breach of the contract. Affirmative relief was granted although the plaintiff was not in the class protected by the statute. A denial of relief would have resulted in unjust enrichment of the defendant.

Following the approach that the party seeking relief need not be in the class protected, the case of 
*Cain v. Burns* placed greater emphasis on whom the prohibition of the statute is directed against, as the determining factor of pari delicto. Thus an investigator was permitted to recover on an illegal contract entered into with an attorney to split the attorney's fees derived from certain cases. The court stated that the statute prohibiting fee splitting prohibits only the attorney, not the layman and that the punishment for doing so is directed at attorneys only. The court held that “... whenever the statute imposes a penalty upon one party and none upon the other, they are not to be regarded as *par delictum*."

In contrast is the case of *Holt v. Morgan*, which applied the purpose and policy of the statute involved as the measure of relief available rather than of the issue of pari delicto.

Plaintiff brought an action to quiet title to his interest in a liquor license pledged to him as security for a loan. A statute made the transfer for this purpose illegal, and both parties were required to verify a statement that the transfer was not made in violation of the statute. This requirement was absent in the case of *Cain v. Burns*, but further reasoning in the *Holt* case would seem applicable to both. The court pointed out that quite frequently it is the individual who does not fall within the prohibition of that statute who is interested in enforcing the contract. To permit enforcement by the plaintiff merely because the statute is not aimed at him would make the statute wholly ineffective. Consequently, it was held that since the policy of the statute is to prohibit all use of liquor licenses as security, any such use is unlawful and void, regardless of whether the parties were in pari delicto. The court held further that no illegal contract can be enforced as a matter of protection for the public interest. Pari delicto will be resorted to only as a test of the right of a party whose fault is less to recover the consideration he has given.

*May v. Herron* involved facts substantially similar to the *Marshall v. La Boi* situation under federal wartime housing legislation.

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72 Id. at 443, 280 P.2d at 890, citing with approval Irwin v. Curie, 171 N.Y., 409, 413-14, 64 N.E. 161, 162 (1902).
74 CAL. BUS. & PROF. CODE § 24076.
In the *May* case however, the party against whom the prohibition was not directed, actually instigated the illegal scheme in violation of the statute. The court said the fact that only one of the parties to a contract is amenable to a penal statute does not prevent the other from being in pari delicto concerning the fraud and deceit involved. Neither of the parties who understood the purpose, nature and probable result of the agreement entered into could escape his share of liability.

The measure of public policy was applied in this manner by the court in the earlier case of *Severance v. Knight-Counihan*. It was held that an executory contract between an employer and his employee giving the employee an option for the purchase of the employer’s property in fraud of rights of the latter’s creditors will not be enforced merely because the employee was less at fault than the employer. It was held however, that if the parties are not in pari delicto, the party who is only slightly at fault can recover money paid under an executory contract. Moreover, even if the party is equally at fault, such relief may be given if he repudiates the contract before the illegal part of the bargain is executed.

The approach in these cases is to first determine what, if any, relief can be afforded to the parties without endangering the public interest. Then, according to a separate balancing of the relative fault between the parties, the appropriate remaining remedy, if any, is chosen in each case.

By separating the interests of the public and the interests of the parties and applying them in this order as measures of available relief, it appear more probable that adequate consideration will be given to both interests in each case.

**Private Rights vs. Public’s Interests**

Where, as in the case of express or implied statutory policy, the consideration of the public interest becomes raveled in the determination of whether the parties are in pari delicto, a court is liable to determine that issue without any consideration of the merits between the parties. Yet this result should obtain only when the granting of any relief whatever between the parties would be inimical to the public interest. Obviously, they are not irreconcilable in every case. The desire of the courts to give the greatest deference to legislative policy may at times result in over-protection of that policy at the expense of a remedy between the parties which would not in fact result in a conflict.

Fortunately, a growing awareness of this balance seems to be developing in many recent California decisions. Varying remedies are

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being made available for varying degrees of fault, depending ultimately however, on the extent of protection necessary in each case for the public interest.

By considering the matter of public policy apart from, rather than as determinative of, the issue of relative fault, the Holt and Severance cases avoid the inconsistencies arising in the statutory cases which make pari delicto turn on whether a party is a member of a protected class or one against whom the statutory prohibition is directed. Both, however, presumed that public policy restricts, in all cases, the recovery of a party not in pari delicto, to the return of consideration given. Any relief which required enforcement of the illegal bargain, it was felt, could not be countenanced.

**Relief to Parties in Pari Delicto**

There are cases, however, in which the courts have enforced to some extent at least, illegal bargains in granting relief to parties who are in pari delicto as well as between those who are not. There are, indeed, instances where such relief has been accorded to the party who is more responsible for the illegal feature of the transaction.

These are the so-called "accounting of proceeds" cases, where relief is sought between parties upon an agreement which is incidental to a contractual relation between one or both of them with certain third parties.

In the case of *Norwood v. Judd*, plaintiff brought an action against his partner in the contracting business for dissolution of the partnership and for an accounting. The trial court had taken notice on its own motion that no license had been secured for the partnership as required, and thereupon determined that the plaintiff was entitled to no equitable relief since both parties had illegally engaged in the contracting business. On appeal Mr. Justice Peters acknowledged the rule that participants to an illegal contract who are in pari delicto can secure no relief based upon the contract because the court will not lend its aid to the enforcement of an illegal agreement. The rule, it was said, is a most salutary one insofar as it protects the public and the courts from imposition, but Mr. Justice Peters, distinguishing the present type of illegal agreement from engaging in a business which is itself illegal, cautioned:

But the courts should not be so enamored with the Latin phrase "in pari delicto" that they blindly extend the rule to every case where illegality appears somewhere in the transaction. The fundamental

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78 Id. at 289, 209 P.2d at 31.
purpose of the rule must always be kept in mind, and the realities of the situation must be considered. Where, by applying the rule, the public cannot be protected because the transaction has been completed, where no previous moral turpitude is involved, where the defendant is the one guilty of the greatest moral fault, and where to apply the rule will be to permit the defendant to be unjustly enriched at the expense of the plaintiff, the rule should not be applied.

The court felt that the exception was proper in this case, and reversed the decision of the trial court which had denied plaintiff's action for dissolution and an accounting.

*Norwood v. Judd* distinguished the instant action from those licensing cases where the firm or person required to be licensed fails to secure a license and directly sues a third person for services rendered or materials furnished. In such cases, it was said that the unlicensed firm or person cannot recover because to do so would be to defeat the very purpose of the licensing statute. In this perspective, whether a party is a member of the class to be protected is a factor in determining the extent to which the public interest must be protected.79

*Lewis & Queen v. N. M. Ball Sons*80 involved an action by a subcontractor against the principal contractor for breach of rental agreements to furnish construction equipment. The unlicensed plaintiff was denied any relief primarily on the basis of the licensing statute,81 which expressly provides that noncompliance is a bar to any action for the recovery of compensation. The court went on, however, to distinguish the facts from *Norwood v. Judd* and limit the holding in that case strictly to suits for an accounting against a partner or joint venturer.

Although the court appears to cast some doubt upon "... whether the indirect encouragement of an illegal enterprise resulting from the allowance of such an action [for the accounting of proceeds] is sufficient to outweigh the evil of unjust enrichment,"82 the principle that the public interest should be the final measure of available relief is not questioned.

The test in *Norwood v. Judd* has been applied in somewhat analogous situations, by recent decisions. For instance, in *Nichols v. Boswell-Alliance Constr. Co.*,83 a broker was allowed to recover com-

79 Thus, in the case of Fenolio v. McDonald, 171 Cal. App. 2d 508, 340 P.2d 657 (1959), the court, in granting enforcement, extended the rule of *Norwood v. Judd*, supra note 77, where the parties were neither partners nor joint venturers, emphasizing that in this case, defendants were not in the class intended to be protected by the statute.

80 48 Cal. 2d 141, 308 P.2d 713 (1957).

81 CAL. BUS. & PROF. CODE § 7031, text quoted supra note 65.

82 Supra note 80, at 152, 308 P.2d at 720.

83 181 Cal. App. 2d 584, 5 Cal. Rptr. 546 (1960).
missions earned under a listing agreement with defendant real estate developer despite his failure to include certain required information in the agreement. The litigants were not partners or joint venturers. The statute provided that plaintiff's license could be temporarily suspended or permanently revoked for noncompliance. The court, to some degree at least, enforced the illegal contract on behalf of a party in pari delicto, or perhaps the one most responsible as far as the illegal aspect of the contract was concerned. The enforcement was limited to the recovery of commissions earned under the executed aspects of the contract. Plaintiff was not permitted to recover commissions he had been prevented from earning, since the executory aspects of the contract would not be enforced.

In resolving the issue of relative fault the court followed the application by Wilson v. Stearns of the "... well reasoned and considered opinion ..." of Norwood v. Judd to a similar factual situation. It was held that since the third party purchaser, for whose protection the statute was enacted, had satisfactorily completed his transaction, protection of the public was no longer a consideration. The court applied, with emphasis added, what it referred to as the "unjust enrichment" rule of the Norwood case.

In view of the recurrence of the above quoted portion of the opinion from the Norwood case in several later opinions, it appears that it is emerging as a rule of exception to the pari delicto principle.

But it is uncertain whether the court in the Nichols case was loosely referring to the rule as one of "unjust enrichment," as a composite of the other factors in the Norwood exception, (viz., no serious moral turpitude involved, defendant guilty of the greatest moral fault, and a completed transaction from which the public could no longer be protected) or whether unjust enrichment was a separate factor, cumulatively applied with the other factors in determining what, if any, relief would be available.

If unjust enrichment is regarded as a separate factor, May v. Herron would be pertinent. In this case it was held in part that recovery was properly denied parties who were in pari delicto even though one party would thereby reap an undeserved windfall. Whether an undeserved windfall, without more, would be considered as "unjust en-
richment” within the Norwood test, might depend on the degree to which the other factors, such as defendant’s greater moral guilt, were implicit in the term as it is used there.

The opinion in Nichols added that in each case how the aims of policy can best be achieved depends on the kind of illegality and the particular facts involved. To this extent, it overruled the view that “... a statute prohibiting the making of a contract except in a certain manner ipso facto makes it void if made in any other way.”

Justifiable Ignorance of Illegality

Moreover, when one party is considered to be justifiably ignorant of facts which make the contract illegal, and the other party is not, the decisions have followed the Restatement view that the illegality does not preclude enforcement of the contract to some degree. Recovery will be allowed the innocent party for losses incurred or gains prevented by the other’s nonperformance. This would seem to be another modification of the rule that no illegal contract or right arising out of an illegal transaction can be enforced by the court whether the parties are in pari delicto or not. If one party is justifiably ignorant or completely innocent, it seems it could be said that he is not in pari delicto. However, the traditional concept of one who is not in pari delicto refers to one whose fault is slight in comparison with the fault of the other party to the transaction. Both parties are blameworthy, but to an unequal extent. Where this notion is accepted, justifiable ignorance is necessarily treated as a distinct concept.

In Marshall v. La Boi, the court approved the findings that plaintiff was not in pari delicto with defendants, who were grievously at fault while plaintiff was only slightly at fault, if at all. The defendant contended that even though the plaintiff was not in pari delicto he was not entitled to affirmative relief. The court upheld the findings

91 In Holland v. Morgan & Peacock Properties Co., 168 Cal. App. 2d 206, 210, 335 P.2d 769, 772 (1959), the court held that in such circumstances the illegality does not bar recovery by the innocent party of compensation for performance rendered while he remains justifiably ignorant of the facts establishing the illegality. See also Dias v. Houston, 154 Cal. App. 2d 279, 281-82, 315 P.2d 885, 886-87 (1957). See also 12 CAL. JUR. (SECOND) Contracts § 104, at 304 (1953), collecting cases.
92 Restatement, Contracts § 599, at 1111 (1932).
94 Restatement, Contracts § 804, at 1120 (1932).
of the trial court that the plaintiff was ignorant of the facts underlying the illegality and concluded that affirmative relief could be granted upon that ground.

Other cases have treated justifiable ignorance as a degree of disparity of fault. Where one party is justifiably ignorant of facts of which the other is not, the ignorant party is not in pari delicto. For example, in *Owens v. Haslett*, 29 appellant refused to make payment due at an agreed stage of the construction of a house. The refusal was based upon the alleged faulty performance by the contractor. Appellant thereafter was required to pay a higher sum to another contractor hired to complete the house. Motion for nonsuit was sustained against the original contractor who sought to recover for his performance since he had failed to obtain a license required by a statute which precluded one who had not complied from recovering any compensation. 30 Appellant cross-complained for damages arising from the contractor's alleged defective performance. Appeal was taken from denial of the cross-complaint. Following what was termed the Restatement's "exception" to the rule of no enforcement where parties were in pari delicto, the court held that if appellant was justifiably ignorant of the fact which made the contract illegal, that is, contractor's lack of a license, then she could, on proper pleading and proof, have made her case come within the exception. 31

If she was not in pari delicto, and if the disparity of fault was such that she was justifiably ignorant of the facts which made the contract illegal and the other party was not equally unaware of such facts, the illegality would not have prevented her recovery of losses incurred or gain prevented by the other's nonperformance. It was noted, however, that while illegality of the contract would not preclude recovery in such a case, any other ground for denying recovery was still open. Appellant was not freed from the ordinary requirements for the recovery of damages for breach of contract. She had to establish that 1) at sometime during the performance of the contract, she discovered the facts that rendered it illegal; 2) she ceased her performance because of this illegality; 3) she had until that time performed the contract in good faith and 4) was ready, able and willing, but for the illegality, to continue to perform. 32

Appellant based her refusal to continue performance not upon the illegality, but rather upon the claim that the other party had not performed. Nor after the illegality was brought to light did she amend

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97 CAL. BUS. & PROF. CODE § 7031.
98 *Restatement, Contracts* § 599(b), at 1111 (1932).
99 *Restatement, Contracts* § 329, at 503 and § 599(b), at 1112 (1932).
her pleadings to set forth the illegality or any exception in her favor to the general rule of no relief. The trial court's judgment denying any relief to appellant was affirmed.

**Illegal Purposes, Methods of Performance**

If a contract, though otherwise legal in every respect is entered for an unlawful purpose, it is void. In *Severance v. Knight-Counihan*¹⁰⁰ for example, an executory contract, the immediate object of which was lawful, but which was entered for the purpose of defrauding creditors, was held invalid.

Nevertheless, if an agreement which does not provide for a method of accomplishing its purpose can be accomplished by any legal method, it must be assumed that such method was contemplated when the contract was made and will be pursued, and it will not be presumed that the parties intended to perform in an illegal manner.¹⁰¹

In *West Covina Enterprises, Inc., v. Chalmers*,¹⁰² the trial court had awarded plaintiff damages for the breach of a contract by an architect who had agreed to draw up plans and specifications for a hospital. Defendant was not licensed as an architect in California, but recited this fact in the contract itself. Plaintiff asserted that neither the contract nor the performance had been illegal, since the statute provided: "... [A]n unlicensed person may render architectural services if, prior to performing any services, he informs the client in writing that he is not a licensed architect."¹⁰³ The court, however, relied on the section of the Administrative Code which requires that plans and specifications for a hospital be prepared by a licensed architect or a registered civil engineer.¹⁰⁴

In reversing the award of damages, the supreme court held that a presumption regarding legality of performance would arise only when a contract does not provide for an illegal mode of performance. It was determined that the contract in this case called for a performance which would be a violation of a statute. Defendant could not have lawfully performed without a license and was therefore justified in repudiating the contract when he subsequently learned of the requirements of the Administrative Code.

*Du Pre v. Bogumill*¹⁰⁵ illustrates an extension of the presumption.

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¹⁰³ CAL. BUS. & PROF. CODE § 5537.
¹⁰⁴ 17 CAL. ADMIN. CODE § 406.
Plaintiff was seeking to recover the price under a contract for the sale of a restaurant and liquor license. A section of the Administrative Code provides inter alia that the transferor shall not permit the transferee to exercise any of the privileges of a license until it is transferred, and that transfer of the title shall coincide with the transfer of the license. Plaintiff had transferred possession of the property to the defendant, who operated the business without a license and raised the illegality of the contract as a defense to plaintiff’s action.

The court held that since the contract, which did not itself provide for an illegal performance, could have been performed in a legal manner, the presumption that the parties intended to perform the contract in such a legal manner was applicable. The contract could have been legally performed if the defendant had applied for a transfer of the license and had operated the business during pendency of his application, pursuant to a written agreement as the plaintiff’s agent, with the approval of the licensing division. The Administrative Code section further provided that the transferor was required to join in the application for the transfer. Although no application was made, the court, citing from California Jurisprudence, Second, continued: “Moreover, where the contract can be performed in a legal manner as well as in an illegal manner, it will not be declared void because it was in fact performed in an illegal manner.”

The court made no mention of the qualification placed on the extension of the presumption by California Jurisprudence, Second:

This last principle is applied, however, only where the contract itself manifests no intent or purpose that it is to be performed in an illegal manner and where the party seeking to enforce its terms does not participate in or cooperate with the illegal performance.

The court did say that there was every indication that plaintiff had not the slightest idea that he was the party to the breaking of any law, rule or regulation. The facts revealed that plaintiff had relied on the representations of the defendant’s attorney that the “contract and the proceeding were proper.” Plaintiff was aided by the exception to the rule of nonenforcement in favor of “... a party who was not acquainted with minor statutory or executive regulations relating to a particular business and who was justified in presuming special knowledge by the other party of such regulation.”

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106 4 CAL. ADMIN. CODE § 60(d).
109 RESTATEMENT, CONTRACTS § 599(b), at 1111 (1932).
It is evident that the presumption of intent to perform the contract in a legal manner is dependent on the degree of relative fault between the parties. It is only available to a party seeking to enforce its terms who did not participate in or cooperate with the illegal performance. The presumption in turn will allow the remedies usually associated with an action upon a legal contract. It is another demonstration of determining the relief available by the degree of relative fault, by such rules as pari delicto or justifiable ignorance. The public interest must have been considered, if at all, in the formulation of such rules. The result is that the weight of public interest becomes "frozen" in them. While different rules may be available for varying degrees of relative fault, the notion of public interest will be preconceived in each of them. The degree of relative fault in each case may, by determining the applicable rule, ultimately determine the relief available.

**Separate Treatment of Public Interest Factor**

Consideration of the public interest, only at the stage of the formulation of the rule, overlooks the reality that the extent to which the public interest is involved will vary in each case just as the degree of relative fault between the parties. Other courts have weighed the public interest separately in each case to determine what remedies would be available in any event, and then granted the remedy from among these, if any, which would be appropriate to do justice between the parties. This seems to be the approach in the "accounting of proceeds" cases, which often extend greater relief than would be available under the fixed rules of relative fault.

It will be recalled that in *Holt v. Morgan*, the refusal of the court to enforce an agreement in violation of a statute was based solely on the degree of protection which the court determined the legislature intended for the public interest. Rather than making this policy the measure of pari delicto, the court simply held that the rule was inapplicable where the policy precluded enforcement of the transaction, whatever the degree of relative fault between the parties.

The distinct and primary emphasis upon public interest involved in the particular case is also evident in the recent decision in *Black Point Aggregates, Inc. v. Niles Sand and Gravel Co.*. The plaintiff had obtained a permit to issue stock, conditioned upon escrow of the share certificates. No transfer by the stockholders could be made with-

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out the written consent of the Commissioner. Plaintiff corporation, in financial difficulties, entered certain agreements during this time with the defendant whereby the property of the former was leased in return for "rentals" to be paid by defendant. Plaintiff also agreed to deposit in escrow stock certificates representing at least 80 per cent of its outstanding capital stock, such certificates to be "duly endorsed in blank by the owners thereof." The shareholders were to receive from the "rentals" and certain "royalties," a total sum representing 120 per cent of the par value of the outstanding shares. Plaintiff sought to determine the legality of these agreements. The court held that they clearly contemplated a stock transfer in violation of the Corporate Securities Act.\textsuperscript{113} Although, as between the parties, it appeared defendants had dictated the terms to the plaintiff corporation which was in financial straits, and to permit them to assert the invalidity of the agreements would, in a sense, permit them to rely on their own wrong as a defense, enforcement nonetheless would be denied. The court said: "However, questions of public policy far beyond the equities of the immediate parties are involved. To enforce the agreements here involved 'would be to open the door to all the illegal practices condemned by the Corporate Securities Act."\textsuperscript{114}

**Conclusion**

Corbin points out that the factors in this area "... occur in numberless combinations, making easy generalizations unsafe, however frequently they may be repeated. The specific combination found in each case must be weighed in the light of prevailing mores and judicial experience."\textsuperscript{115}

In general terms, the factors can be grouped as follows:

- **The Remedies**: Remedies of specific performance and compensatory damages constitute enforcement of the contract. Specific restoration or payment of the reasonable value of consideration given are not regarded as enforcement, although any relief must be predicated upon proof of the contract, and its breach.\textsuperscript{116} Enforcement is usually limited to the executed features of the contract. Remedies of specific performance or damages for anticipatory breach are rare.

- **The Degrees of Fault**: The cases have considered the following degrees of relative fault:
  1) The party seeking relief is in equal or greater legal fault with

\textsuperscript{113} Cal. Corp. Code §§ 25000-26103.
\textsuperscript{114} Supra note 112, at —, 10 Cal. Rptr. at 765 (1961).
\textsuperscript{115} 6 Corbin, op. cit. supra note 1, § 1534, at 1057-58.
\textsuperscript{116} Id. § 1535, at 1060.
respect to the factors which make the contract illegal. (In pari delicto.)

2) Although both parties are blameworthy, the fault of one is only slight compared to that of the other. (Not in pari delicto.)

3) The party seeking to enforce the contract did not participate in or cooperate with the other's unlawful performance and the contract itself manifests no intent or purpose that it is to be performed in an illegal manner. (Presumption of intent to perform in a legal manner, and the contract will not be declared void even if it was in fact performed in an illegal manner.)

4) One party is justifiably ignorant, and the other party is not, of facts or minor regulations relating to a particular business which make the bargain illegal. (Justifiable ignorance.)

- The Public Interest: The degree to which the interest of the public must be protected, unless fixed expressly by statute or by the original formulation of a rule of relative fault, will vary in degree with the circumstances in each case.

It should, in the final analysis, be the measure of the relief available, if any, between parties who stand in various degrees of relative fault between themselves.