CONTRACTS

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Chapter 5

Unenforceability on Grounds of Public Policy

A. INTRODUCTION

Relation to freedom of contract

§5.1 Public Policy as a Ground for Unenforceability. The principle of freedom of contract rests on the premise that it is in the public interest to accord individuals broad powers to order their affairs through legally enforceable agreements. In general, therefore, parties are free to make such agreements as they wish, and courts will enforce them without passing on their substance.[1] Occasionally, however, a court will decide that this interest in party autonomy is outweighed by some other interest and will refuse to enforce the agreement or some part of it.[2] This chapter is concerned with the rules that guide courts in reaching such decisions.

§5.1 [1]There is a classic statement of this in Printing & Numerical Registering Co. v. Sampson, L.R. 19 Eq. 462 (1875) (Jessel, M.R.: "It must not be forgotten that you are not to extend arbitrarily these rules which say that a given contract is void as being against public policy, because if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice.").

[2]Sternamen v. Metropolitan Life Ins. Co., 62 N.E. 763 (N.Y. 1902) ("The power to contract is not unlimited. While as a general rule there is the utmost freedom of action

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In recent decades, courts have been particularly perplexed by the legal problems raised by persons who, instead of marrying, have simply lived together and made agreements—sometimes known as "living-together agreements"—affecting some aspects of their relationship. Courts traditionally looked with disfavor upon such "cohabitation contracts" because they have regarded them not only as immoral but also as a threat to the institution of marriage.[35] However, there has been a marked change in this attitude, highlighted by a noted California case decided in 1976.

Lee Marvin, a movie actor, and Michelle Marvin, a former entertainer, had lived together for seven years, during which she had taken his name and he had taken title to all property acquired. She sued, alleging a contract in which they had agreed to hold themselves out as husband and wife, and, in return for her rendering services "as a companion, homemaker, housekeeper and cook," she was to "share equally any and all property accumulated as a result of their efforts whether individual or combined." In *Marvin v. Marvin*, the Supreme Court of California held that she had stated "a cause of action for breach of an express contract." The Court noted the "substantial increase in the number of couples living together without marrying" and observed that "many young couples live together without the solemnization of marriage, in order to make sure that they can successfully later undertake marriage." The court concluded that "a contract between nonmarital partners is unenforceable only *to the extent* that it *explicitly* rests upon the immoral and illicit consideration of meretricious sexual services" and that a contract concerning earnings, property, or expenses is not invalid merely because "a man and a woman live together without marriage, and engage in a sexual relationship" or because "the parties may have contemplated the creation or continuation of a nonmarital relationship when they entered into it."[36]

Marvin has not found universal favor. Some courts have denied recovery, balking at spelling out the terms of an implied contract. Thus the New York Court of Appeals concluded that for a court "to attempt through hindsight to sort out the intentions of the parties and affix jural significance to conduct carried out within an essentially private and generally noncontractual relationship runs too great a risk of error.[37] Other courts have allowed recovery but grounded it on status rather than on contract. Thus the Supreme Court of Washington adopted "a general rule requiring a just and equitable distribution of property following a meretricious relationship," looking for

[35]Hewitt v. Hewitt, 394 N.E.2d 1204 (Ill. 1979) ("enhancing the attractiveness of a private arrangement over marriage . . . contravenes the . . . policy of strengthening and preserving the integrity of marriage").

[36]557 P.2d 106, 109, 112, 113, 122, 123 (Cal. 1976).

[37]Morone v. Morone, 413 N.E.2d 1154, 1157 (N.Y. 1980).

guidance to the laws governing the distribution of marital property.[38] But *Marvin* has had a substantial impact in many jurisdictions,[39] an impact that has carried over to claims arising out of contracts between persons of the same sex.[40] It has also carried over to restitutionary claims.[41] Courts have held that the circumstance that the man, at least, is married does not require a different result.[42] Whether courts will go beyond *Marvin* and uphold agreements in which sexual intercourse is at least some part of the agreement remains to be seen.[43] The common requirement that the agreement not be too closely connected with sexual intercourse has prompted some interesting judicial flights of fancy.

The drafting of intimate agreements raises interesting practical problems.

From this discussion of policies developed by the courts, we turn to a discussion of policies derived by courts from legislation.

C. POLICIES DERIVED FROM LEGISLATION

Increasing role of legislation

§5.5 Judicial Derivation of Policies from Legislation. Although many important public policies were first recognized by judges, the declaration of public policy has become increasingly the province of legislators. Legislators are usually more responsive to the public than are judges and have facilities for factual investigations that judges do not. For example, bargains tending to encourage litigation and improperly to influence legislators and other government officials have come under extensive legislative control.[1] Thus legislation supplements or replaces the common law

[38]Connell v. Francisco, 898 P.2d 831, 834-835 (Wash. 1995).

[39]Watts v. Watts, 405 N.W.2d 303 (Wis. 1987) ("public policy does not necessarily preclude an unmarried cohabitant from asserting a contract claim against the other party . . . so long as the claim exists independently of the sexual relationship").

[40]Whorton v. Dillingham, 248 Cal. Rptr. 405 (Ct. App. 1988) (*Marvin* extended to homosexual male plaintiff).

[41]Watts v. Watts, *supra* note 39 ("unmarried cohabitants may raise claims based on unjust enrichment following the termination of their relationships where one of the parties attempts to retain an unreasonable amount of the property acquired through the efforts of both"). On restitutionary claims by married and unmarried cohabitants, *see* the discussion of intimate relationships in §2.20 *supra*.

[42]*Marvin* is an example (male defendant was married, but female plaintiff, "being unmarried could neither be convicted of adulterous cohabitation nor of aiding and abetting defendant's violation").

[43]For a case that goes beyond *Marvin*, *see* Whorton v. Dillingham, *supra* note 40 (as distinguished from *Marvin*, "here the parties' sexual relationship was an express rather than implied, part of the consideration" and issue is "whether the sexual component . . . is severable").

§5.5 [1]*See* the discussion of the great variety of policies in §5.2 *supra*.

of maintenance and champerty in many states,[2] and penal laws condemn bribery and corrupt influence, perjury and other falsification in official matters, and obstruction of government operation.[3] Older laws prohibiting usury have been supplemented by newer ones dealing with consumer transaction[4] and older laws prohibiting gambling have been subjected to more modern exceptions.[5]

Function of court

When legislators make conduct a crime, however, they seldom deal explicitly with the enforceability of contracts involving that conduct.[6] The legislation, even with the usual aids to its interpretation, commonly serves only to indicate a policy that the legislature regarded as significant. It is for the court to balance that policy against the policy favoring respect for party autonomy and determine whether unenforceability should be added to the sanctions provided by the legislature.

Agreement or conduct prohibited

If a statute expressly prohibits making the agreement or engaging in the agreed conduct, courts have often assumed that the agreement is unenforceable. This was the traditional judicial response to agreements made on Sunday in violation of statutes prohibiting the transaction of business on Sunday[7] and to agreements requiring performance on Sunday in violation of statutes prohibiting doing work on Sunday.[8] However, this response is not inevitable. A court may conclude that the sanction explicitly provided by the legislature is adequate to further the statute's underlying policy, without the additional sanction of unenforceability.[9]

[2] *See, e.g.*, Mass. Ann. Laws ch. 221 §§43-44B (attorneys prohibited from soliciting business); N.Y. Jud. Law §474-a (contingent fees regulated in actions for medical malpractice).

[3] *See, e.g.*, Model Penal Code §§240-243. As to statutes regulating lobbying, *see* footnote to the discussion of the great variety of policies in §5.2 *supra*.

[4] *See, e.g.*, Uniform Consumer Credit Code §§2.201, 2.202, 2.401.

[5] *See, e.g.*, N.J. Stat. Ann. §5:12 (authorizing casino gambling in Atlantic City); N.Y. Rac. Pari-Mut. Wag. & Breed. Law §§518-532 (authorizing off-track pari-mutuel betting). As to the common law on gambling, *see* the discussion of the great variety of policies in §5.2 *supra*.

[6] Common exceptions are gambling and usury laws, which often provide that proscribed contracts are "void." *See, e.g.*, N.Y. Gen. Oblig. Law §§5-411 (gambling), 5-511 (usury). *Cf.* Carnival Leisure Indus. v. Aubin, 53 F.3d 716 (5th Cir. 1995) ("there is a continued strong policy in Texas against enforcement of gambling debts" and no "Texas court has ever allowed an action for [promissory] fraud to be maintained against a gambling debtor").

[7] Sauls v. Stone, 241 So. 2d 836 (Ala. 1970) (agreement made on Sunday for sale of business held unenforceable).

[8] Ewing v. Halsey, 272 P. 187 (Kan. 1928) (agreement by "Halsey's Flying Circus" to put on performance on Sunday was unenforceable, and Halsey was not liable for damages when he failed to appear).

[9] Town Planning & Engrg. Assocs. v. Amesbury Specialty Co., 342 N.W.2d 706 (Mass. 1976) (Kaplan, J.: "Our cases warn against the sentimental fallacy of piling on sanctions unthinkingly once an illegality is found."). The problem in this case is discussed in §5.6 *infra*. *See* Restatement Second §180, which states circumstances under which a promisee who is "excusably ignorant of facts or of legislation of a minor character" may enforce a promise that would otherwise be unenforceable.

Malum prohibitum or *malum in se*

In deciding such cases, courts have sometimes attempted to distinguish cases in which the proscribed conduct is merely *malum prohibitum* ("wrong because prohibited") from those in which it is *malum in se* ("wrong in itself").[10] Jeremy Bentham wisely deprecated this distinction, "which being so shrewd and sounding so pretty, and being in Latin, has no sort of an occasion to have any meaning to it: accordingly it has none."[11] There is no simple substitute for the balancing process that a court must undertake in these cases.

Factors in court's decision

The Supreme Court of Indiana has listed five factors to be considered by a court engaged in this process:

> (i) the nature of the subject matter of the contract . . . ; (ii) the strength of the public policy underlying the statute . . . ; (iii) the likelihood that refusal to enforce the bargain or term will further that policy . . . ; (iv) how serious or deserved would be the forfeiture suffered by the party attempting to enforce the bargain . . . ; and (v) the parties' relative bargaining power and freedom to contract. . . .[12]

A court may be aided by the history and purpose of the legislation for, even if the legislature did not deal explicitly with the question of unenforceability, it may be helpful to search for the "intention of the legislature" on the matter.[13] A disparity between a relatively modest criminal sanction and a much greater forfeiture that will result if enforcement is refused may suggest that the policy in question is not substantial enough to justify the refusal.[14] Furthermore, the court may look beyond the particular statutory provision to the entire legislative scheme. If it finds, for example, that

[10] Gardner v. Reed, 42 So. 2d 206 (Miss. 1949) (making contract for sale of fertilizer without complying with statutory requirements, such as registration as dealer and payment of inspection fees, "was not malum in se but merely malum prohibitum"). *But see* Anabas Export v. Alper Indus., 603 F. Supp. 1275 (S.D.N.Y. 1985) ("exception . . . is limited primarily to revenue and licensing statutes").

[11] J. Bentham, Comment on the Commentaries 80 (C. Everett ed. 1928).

[12] Fresh Cut v. Fazli, 650 N.E.2d 1126, 1130 (Ind. 1995).

[13] Gates v. Rivers Constr. Co., 515 P.2d 1020 (Alaska 1973) (where "the predecessor to the present statute expressly made such contracts void and of no effect . . . , repeal of the former section coupled with the new enactment evinces an intent on the part of Congress that such contracts are no longer to be 'void and of no effect' ").

[14] DeCato Bros. v. Westinghouse Credit Corp., 129 N.H. 504, 529 A.2d 952 (1987) (lender's violation of statute requiring disclosure of interest, punishable as misdemeanor, was "not so repugnant as to entitle [borrower] to . . . the free use of a large amount of money").

similar statutes in the same field contain explicit provisions making comparable agreements unenforceable, it may infer from the absence of such a provision in the statute at hand that the additional sanction of unenforceability is inappropriate.[15]

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It has been said that "the defense of illegality . . . is not automatic but requires . . . a comparison of the pros and cons of enforcement" and a consideration of "the reciprocal dangers of overdeterrence and underdeterrence."[16] Sometimes refusal to enforce the agreement will not further the policy that occasioned enactment of the statute.[17] In some situations it may even frustrate it. For example, if the legislation was enacted to protect a class of persons to which the claimant belongs in a situation like that before the court, refusal to enforce the agreement is usually inappropriate.[18] Furthermore, refusal to enforce the agreement may frustrate the policy of the statute, though it was not enacted to protect persons such as the claimant. For example, federal immigration and nationality laws prohibit aliens to enter into employment agreements except in prescribed circumstances, and it has been held that an alien cannot recover earnings under an agreement made in violation of these laws.[19] However, a more enlightened court held that the alien can recover, recognizing that the purpose of legislation, "safeguarding of American labor from unwanted competition, . . . would not be furthered by permitting employers knowingly to employ excludable aliens and then, with impunity, to refuse to pay them for their services [and that] to so hold could well have the opposite effect from the one intended."[20]

Legislation in broad sense

The term *legislation* is used here in the broadest sense, to include not only statutes and constitutions[21] but also local ordinances and administrative regulations[22] and even codes of professional conduct.[23] A court should be alert, however, to the possibility that a minor ordinance or regulation may not indicate a sufficiently significant or broad interest to outweigh the interest in enforcement of the agreement.

[15]As to the significance in connection with licensing statutes, *see* the discussion of a regulatory or other purpose in §5.6 *infra*.

[16]Northern Ind. Pub. Serv. Co. v. Carbon County Coal Co., 799 F.2d 265, 273 (7th Cir. 1986).

[17]Miller v. Radikopf, 228 N.W.2d 386 (Mich. 1975) (statute prohibiting lottery did not make agreement to split winnings from Irish Sweepstakes unenforceable because "nonenforcement . . . might tend to discourage people from agreeing to split their legal winnings [but] would not tend to discourage people from buying or selling Irish Sweepstakes tickets").

[18]*See* the discussion of when the agreement may be enforceable by the other party in §5.6 *infra*.

[19]Short v. Bullion-Beck & Champion Mining Co., 57 P. 720 (Utah 1899) (employee could not recover for services rendered under contract in violation of statute prohibiting work in mill for more than eight hours a day).

[20]Gates v. Rivers Constr. Co., *supra* note 13, at 1022.

[21]Wm. R. Clarke Corp. v. Safeco Ins. Co., 938 P.2d 372 (Cal. 1997) ("pay-*if*-paid" provision that applied regardless of reason for nonpayment was unenforceable as contrary to policy underlying state constitutional right to mechanic's lien).

Change in legislation

In general, the relevant legislation is that in effect at the time the agreement was made.[24] Therefore, courts have usually held that if a promise is unenforceable on grounds of public policy when made, it does not become enforceable if the legislature later changes the law, unless the legislature manifests an intent to validate such promises.[25] This is a questionable rule if the reason for the change is a dissatisfaction with the underlying policy. Many courts have adhered to it, however, even where the promisor ratified or made a new promise after the change.[26] This is in contrast to their general willingness to recognize a ratification or new promise in other types of cases.[27] For example, if a promise to pay a debt is unenforceable because the rate of interest is usurious, a new promise to pay the debt with no more than the legal rate of interest "purges" the usury and is enforceable.[28] In the converse situation, in which the promise is enforceable when made but the performance is subsequently prohibited by law, the promisor may be excused from performing on the ground of impracticability.[29] But if the promisor nonetheless performs, courts have not generally allowed recovery under the contract.[30]

[22]Lund v. Bruflat, 292 P. 112 (Wash. 1930) (city ordinance requiring licensing of plumbers).

[23]Matter of Cooperman, 633 N.E.2d 1069 (N.Y. 1994) (lawyer's nonrefundable retainer fee agreement violated Code of Professional Responsibility).

[24]Although the relevant law is ordinarily also that of the place where the conduct occurred, *see* Lewkowicz v. El Paso Apparel Corp., 625 S.W.2d 301 (Tex. 1981) ("contract made in consideration of compounding a criminal offense is void because it is in contravention of the [Texas] Penal Code and public policy" and fact that conduct occurred in Mexico was "no less abhorrent than had it been committed in Texas").

[25]Interinsurance Exch. v. Ohio Cas. Ins. Co., 373 P.2d 640 (Cal. 1962) (provision excluding permissive users from automobile insurance policy did not become enforceable on change in statute that prohibited such provisions).

[26]Handy v. St. Paul Globe Publishing Co., 42 N.W. 872 (Minn. 1889) (agreement to publish newspaper on Sunday was "incapable of being ratified," even after amendment of law to except newspapers).

[27]Central Labor Council v. Young, 240 P. 919 (Wash. 1925) (new promise to pay over sums collected in performing agreement to sell tickets to illegal lottery was enforceable).

[28]Whittemore Homes v. Fleishman, 12 Cal. Rptr. 235 (Ct. App. 1961) (abandonment of original agreement and "execution of a new obligation for the amount of the original debt . . . bearing only legal interest purges the original usury"). *See* Restatement Second §86 cmt. *h* ("promise to pay the original debt with interest that is not usurious in substitution for the usurious interest is enforceable").

[29]*See* the discussions of supervening illegality in §9.5 and of examples of a basic assumption in §9.6 *infra*.

[30]Tocci v. Lembo, 92 N.E.2d 254 (Mass. 1950) (contractor barred from recovery for work done after construction was prohibited).

In the next section we take up situations in which it is clear that refusal of enforcement will further the policy underlying the relevant legislation, but it is questionable whether refusal is justified in view of the forfeiture that would result.