Illegal Contacts and Efficient Deterrence: A Study in Modern Contract Theory

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Illegal Contracts and Efficient Deterrence: A Study in Modern Contract Theory

Juliet P. Kostitsky*

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I. INTRODUCTION

Contract law generally is based on the principle that courts will enforce agreements into which the parties freely entered. If parties comply with contract formalities, the law typically provides relief in the event of a breach. The doctrine of illegal contracts, which allows parties to avoid their obligations when a contract is "illegal," or against public


2. For a discussion of the general characteristics and purposes of a system based on legal formalities that have a "limited substantive content" and that are designed to facilitate private agreements rather than to achieve any particular outcomes, see Kennedy, Form and Substance in Private Law Adjudication, 89 Harv. L. Rev. 1685, 1687-1701 (1976). Such formalities "define in advance a tariff that the private actor must pay if he wishes to behave in a particular way. The lawmaker does not care what choice the actor makes within this structure, but has an interest in the choice being made knowingly and deliberately . . . ." Id. at 1694; see also Feinman, Promissory Estoppel and Judicial Method, 97 Harv. L. Rev. 678, 682 n.21 (1984) (defining formalism); Fuller, Consideration and Form, 41 Colum. L. Rev. 799 (1941) (discussing characteristics of legal formalities and their functions in context of consideration requirement).


4. In one sense an "illegal contract" is a "self-contradictory" term. 6A A. Corbin, Contracts § 1373, at 1 (1962); see also Strong, The Enforceability of Illegal Contracts, 12 Hastings L.J. 347, 347 (1961). This is because illegal contracts are unenforceable by definition. Thus, illegal contracts are not contracts in the strict sense, since they lack one of the essential elements of a true contract: the availability of a remedy for breach. Accordingly, Dean Wade suggested that the term "illegal bargain" replace the term "illegal contract." Wade, Benefits Obtained Under Illegal Transactions—Reasons For and Against Allowing Restitution, 25 Tex. L. Rev. 31, 31 (1946).

In addition to this definitional inconsistency, "illegality" is not a simple concept. 6A A. Corbin, supra, § 1374, at 4. The usual definition of an illegal contract is a contract whose enforcement would contravene a public policy proclaimed by a legislative or judicial body. Id. at 5-6; see also E.A. Farnsworth, supra note 5, § 5.2, at 330-31, § 5.5, at 347 (1982). Obvious violations of public policy include contracts that offend a legislative statute or constitutional provision, whether it be criminal or otherwise. Illegality in the contracts area also extends to activities that may not ordinarily be considered "illegal" because they are not sanctioned by a penalty other than judicial nonenforcement. E.A. Farnsworth, supra note 5, § 5.1, at 327. Sources of contractual illegality include violations of the common law and of community norms. 6A A. Corbin, supra, §§ 1374-1375; see also infra note 5.

The degree of nexus to the illegality that will cause courts to deny relief to the contracting parties varies. The nexus may be quite direct as when the performance given as consideration is offensive to public policy in and of itself. 6A A. Corbin, supra, § 1375, at 2. An example of this type of illegal contract is a promise by A to commit murder in return for a payment by B. The performance given by both parties to this contract is inherently illegal. The performance
policy,\(^5\) is a rare limitation on freedom of contract.\(^5\) promised by \(A\) is unlawful by itself because murder is prohibited by statute, and the promise by \(B\) is inherently wrong because "the promise [of payment] is one that tends to induce the other party to engage in such conduct." E.A. Farnsworth, supra note 3, § 5.1, at 929; see also RESTATEMENT (SECOND) OF CONTRACTS § 192 (1981) ("A promise to commit a tort or to induce the commission of a tort is unenforceable on grounds of public policy."). Other contracts are illegal because the actual agreement violates public policy and thus is unenforceable even though the consideration, either given or promised, is completely legal in and of itself. For example, a contract between two merchants to sell a specified product for $100 may be illegal because it violates statutes prohibiting anticompetitive agreements, even though there is nothing inherently wrong with the individual performances of each merchant selling a product for $100. 6A A. Corbin, supra, § 1373, at 2 (discussing this example). A contract also may be labelled illegal, despite the fact that both the actual agreement and the performances given as consideration are perfectly legal, "by reason of the wrongful purpose of one or both parties in making it." Id. § 1518. at 744. Such is the case when \(A\) rents a hall to \(B\) in return for \(B\)'s payment of rent, but \(B\) enters the agreement with the intent to use the building for a prohibited purpose, such as gambling. As with other types of agreements, the invalidity of the promise which intended to induce an unlawful purpose and the promise which entered into such purpose is complex. It does not follow that \(B\)'s illegal purpose, she is permitted to enforce the contract. id. See RESTATEMENT, supra note 3, § 173, at 2 (1979), infra text accompanying notes 81-89.

Thus, the threshold question of whether a contract is illegal presents difficult legal questions which this Article will not attempt to address. For an extended treatment of the various ways in which contracts may be illegal, see generally Farnsworth, The Analysis of Illegal Contracts, 16 U. TOronto L.J. 267 (1966). It will focus instead on whether, and to what extent, the court will lend its aid to enforce contracts that offend moral values refuse all relief to parties under bargains that harm family relationships or promote gambling. See, e.g., Kyne v. Kyne, 16 Cal. 2d 456, 458, 106 P.2d 620, 621 (1940) (gambling); E.A. Farnsworth, supra note 3, § 5.4, at 341-47 (family). Courts concerned with economic liberty values condemn restrictive covenants, anticompetitive agreements, and property alienation restrictions. E.A. Farnsworth, supra note 3, § 5.2, at 351-39. For a discussion of the antirestriction policy see Korngold, For Unifying Servitudes and Defeasible Fees: Property Law's Functional Equivalents, 66 Tex. L. Rev. 535, 542-43 (1988); see also McMullen v. Hoffman, 174 U.S. 689, 699-70 (1899) (anticompetitive bidding agreement); Richard P. Riia Personnel Servs. Int'l v. Kot, 229 Ga. 314, 317, 191 S.E.2d 79, 81 (1972) (restrictive covenant unenforceable); cases cited infra note 65. Courts also are loath to enforce contracts that harm government, or that corrupt public officials. See, e.g., United States v. Mississippi Valley Co., 364 U.S. 520, 566 (1961) (contract illegal and government could disaffirm because of conflict of interest). Concerns with fiduciary responsibilities have prompted courts to condemn directors' agreements to vote or act in ways that limit their discretion to act in the interests of the corporations' shareholders. See, e.g., Chapin v. Benwood Found., Inc., 402 A.2d 1205, 1211 (Del. Ch. 1979) (succeesion agreement unenforceable because directive to fill vacancies with particular people restricts exercise of best judgment); cases cited in 6A A. Corbin, supra note 4, § 1454; see also E.A. Farnsworth, supra note 3, § 5.2, at 392 n.14.

These policies, of course, are subject to criticism on the ground that it is impossible to establish them as "suprahistorical norms transcending time and space," Gordon, Historicism in Legal Scholarship, 90 YALE L.J. 1017, 1025 (1981), and thus impossible to immunize the chosen policies from criticism. See also Leff, Unspeakeable Ethics, Unnatural Law, 1979 DUKE L.J. 1229, 1240 ("There is no such thing as an unchallengeable evaluative system.")

This Article, however, does not attempt to justify the policies; it accepts the policies as fundamental givens. It focuses instead on how judges apply the nonenforcement doctrine to promote these policies and in this respect parallels the instrumentalism of law and economics.
Courts have claimed that they effectuate these public policy concerns by characterizing illegal contracts as "void" and denying them all legal effect. They have indicated that withholding judicial relief deters illegal

"[Law and economies] is, however, limited. It can work only by presupposing that law, and the significance of law, are to be determined and judged instrumentally, with reference to more or less deliberately chosen purpuses..." Michelman, Reflections on Professional Education, Legal Scholarship, and the Law-and-Economcs Movement, 35 J. LEGAL EDUC. 197, 209 (1983); see also N. Horiwitz, The Transformation of American Law 1780-1866, at 253-66 (1977) (discussing the characteristics of instrumentalism that distinguish it from formalism).

6. The doctrine "touch(es) upon matters of substance related to the public welfare rather than aspects of the bargaining process between the parties." Restatement (Second) of Contracts ch. 8 introductory note (1979) (emphasis added). Withholding enforcement of contracts that violate public policy is one arena in which commentators have proclaimed contract law's public aspects—that "certain state interests are legitimate limitations on individual freedom." Dalton, supra note 1, at 1010. Professor Dalton undoubtedly would consider this open acceptance of public policy limits unusual, given the typical hostility to public intrusions into private contracting. See generally Dalton, supra note 1. But see infra text accompanying notes 34-49, 195-200 (suggesting that once public goals of doctrine are accepted, the doctrine may, at least in some of its applications, be more compatible with autonomy principle than at first appears).

7. The use of the word "void" to describe the consequences of an illegal contract is commonplace but not particularly useful. Professor Farnsworth suggests that because the word is replete with uncertainty as to its meaning, it is "more accurate to say that the agreement or some part of it is unenforceable by one or both parties than to say that it is 'void.'" E.A. Farnsworth, supra note 3, § 5.1, at 297. Its "commonly intended" meaning is the "total absence of legal effect." I. CORBIN, supra note 4, § 7, at 15. The absence of legal effect presumably would mean that nonenforcement remedies such as rescission and restitution (had there been partial performance) would be available to one or both parties though enforcement would be unavailable. Courts attach differing interpretations to the word "void," however, not all of which are equivalent to no legal effect. Thus, not all courts would deny rescission and restitution as well as enforcement.

8. An early case applying the no-effect rule involved a partnership of two highwaymen. In that case one partner sued for an accounting, but once the illegal nature of the venture became apparent, that case was dismissed. Everet v. Williams, Mich. T. 12 Geo. I. 1725 (No. 40), discussed in 9 LAW. Q. REV. 197 (1895).

The Restatement (Second) of Contracts has adopted this no-effect principle by providing generally that neither enforcement nor restitutory remedy is available to parties to illegal contracts. Section 178 addresses the enforcement aspect: "A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms." Restatement (Second) of Contracts § 178(a) (1979). Section 197 addresses the denial of restitutory remedies: "[A] party has no claim in restitution for performance that he has rendered under or in return for a promise that is unenforceable on grounds of public policy..." Id. § 197.

The disinclination to enforce or otherwise lend judicial support to contracts that contravene some public policy seems antithetical to a major tenet of the classical system of contract law: namely, that courts should enforce whatever agreement the parties have consented to without regard to its substantive fairness or other public concerns. See Feinman, Critical Approaches to Contract Law, 30 UCLA L. Rev. 829, 831-52; Metzger & Phillips, The Emergence of Promissory Estoppel as an Independent Theory of Recovery, 35 Rutgers L. Rev. 472, 475-78 (1985) (disinclination to scrutinize contract for fairness is characteristic of classical system).

If the classical view is accepted, the illegal contracts rule, and the judicial interference with private agreement (in the sense-of denial of effect) which accompanies it, seem to constitute exceptions to the general principle of noninterference with the "private ordering." Feinman, supra, at 832. Professor Farnsworth emphasizes this view of the illegality limit as a public, regulatory mechanism when he states: "Occasionally, however, a court will decide that the public interest in freedom of contract is outweighed by some public policy and will refuse to enforce the agreement..." E.A. Farnsworth, supra note 3, § 5.1, at 325-26; see also GA A. COBB, supra note 4, § 1376, at 20 ("[T]he very fact that a chapter on 'legality' of contract must
contracts because parties will shun unenforceable transactions. While the

he written shows that we have never had and shall never have unlimited liberty of contract . . . ."; Winfield, supra note 3, at 82-83 ("[In Coke's Reports, he states a resolution of the court that the law will never make an interpretation to advance private interests and to destroy public good.")

If, however, one accepts the criticism that the autonomy model is an idealized fictional construct that is belied by the recognition that "[contract law] is like legislative action: [both] necessarily involve public policy judgments in imposing legal liability," Feinman, supra, at 834, the public nature of the illegal contracts doctrine would appear to be compatible with contract doctrine rather than an exception to it. See also Dalton, supra note 1, at 1010 (discussion of public nature of contract law); Kennedy, supra note 2, at 1717-22 (same). A recognition of the public aspects of contract law would lead to an expanded view of the judiciary's role. A restricted view, however, including a disinclination to impose public limits on the bargain, see Feinman, supra, at 832; Metzger & Phillips, supra, at 478-79, would follow naturally only if one conceptualizes contract law as a "field of private ordering in which parties [create] their own law by agreement." Feinman, supra, at 831-32 n.10 (citing O.W. Holmes, The Common Law 299-303 (1881)).

But regardless of whether contract law is conceptualized as exclusively private or public in nature, conceptualizing the illegal contracts doctrine as an exceptional public limitation on the freedom of contract may be an overstatement. The illegal contracts rule obviously is "public" in the sense that courts refuse to enforce private agreements, otherwise meeting the formal criteria, which are believed to harm society. Operation of the rule, however, also may be "private" in the sense that courts, in applying the illegal contracts rule, attempt to reproduce market decisions. See infra text accompanying notes 34-49. Assuming that the loss imposed by the nonenforcement rule is a cost of contracting, courts may seek to replicate the risk-allocation structure of that cost which the parties would have agreed to through unencumbered private bargaining—the "would-be" bargain. See Kennedy, Distributive and Paternalist Motives in Contract and Tort Law, with Special References to Compulsory Terms and Unequal Bargaining Power, 41 Minn. L. Rev. 553, 599 (1982); see also infra text accompanying notes 34-49.

For an analysis of one substantive doctrinal area—the duty to perform in good faith—based on the risk allocation that would have occurred, see Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith, 94 Harv. L. Rev. 369, 378-94 (1980). Professor Kronman examines judicial treatment of mistake in contracting from this vantage point of risk allocations. See Kronman, Mistake, Disclosure, Information, and the Law of Contracts, 7 J. Legal Stud. 1, 2-9, 18-27 (1978); see also Calabresi, Transaction Costs, Resource Allocation and Liability Rules—A Comment, 11 J.L. & Econ. 67, 69 (1968) (discussing barriers to optimal resource allocation). Courts should apply the illegal contracts doctrine using some of the same principles—including efficient risk allocation—that they use in deciding ordinary contract questions. Some critics would dispute the ability of courts to determine what risk allocation the parties would have agreed to, arguing that these determinations necessarily involve value choices. See generally Kennedy, supra; see also Halpern, Application of the Doctrine of Commercial Impracticability: Searching for "The Wisdom of Solomon," 135 U. Pa. L. Rev. 1123, 1159-60 (1987) (pointing out "problems created . . . when one must examine each case ex post to make an economic determination of which party had 'control' or which party might have been better able to 'spread' or 'bear' the consequences of the event").


The more plainly parties understand that when they enter into contracts of this nature they place themselves outside the protection of the law, so far as that protection consists in aiding them to enforce such contracts, the less inclined will they be to enter into them. In that way the public secures the benefit of a rigid adherence to the law.

Id. at 670; see also Gellhorn, Contracts and Public Policy, 85 Colum. L. Rev. 679, 680 (1995); Shand, Unblinking the Unruly Horse: Public Policy in the Law of Contract, 30 Cambridge L.J. 144, 152-53 (1972); Wade, supra note 4, at 48.

Courts also offer various other rationales for denying effect to or treating as void otherwise valid contracts. They explain the hands-off policy on the basis of a perceived need to (1) regulate contractual morality and (2) keep the courts pure by denying undeserving litigants judicial access. Shand, supra, at 148; Wade, supra note 4, at 42-44.
courts have not articulated their reasoning clearly, commentators have explained that because nonenforcement will be costly to the parties in terms of wasted resources, they will be careful to avoid proscribed transactions.\footnote{11}

Despite their broad declarations of the "no-effect" rules, the courts vary their treatment of parties to illegal contracts.\footnote{12} Courts sometimes grant a one-sided voidability right, giving one party the option either to affirm or avoid his contractual obligations, but deny any relief to the other party.\footnote{13} Courts also may grant a one-sided enforcement right. Additionally, in cases in which one party has partly performed, courts may grant a one-sided rescission right, plus restitution.\footnote{14} Finally, courts can deny enforcement but

The deterrence rationale assumes that "private parties will in fact respond to the threat of the sanction of nullity by learning to operate the system."\footnote{10} Kennedy, supra note 2, at 1699. This is the same assumption that the classicists made regarding the ability of all contracting parties to comply with the traditional formation rules. It was assumed that parties would be equally able to comply with the requirements of offer and acceptance and consideration, and that a failure to do so would signify a deliberate choice not to have contract law govern. Similarly, if it can be assumed that "parties are responsive to the legal system," id. at 1699-1700, then the contract that violates a public policy should be denied effect, regardless of who is seeking enforcement. This assumption, however, is open to serious question. See Havighurst, Book Review, 61 Yale L. J., 1138, 1145 (1952) ("mere denial of contractual and quasi-contractual remedy rarely has a substantial effect in discouraging illegal conduct."); see also Gordon, supra note 5, at 1026 (realist model "assumes that the rules of appellate doctrine are instantly incorporated in the incentive structures of individuals"); Kennedy, supra note 2, at 1699 ("real as opposed to hypothetical legal actors may be unwilling or unable to [respond to the threat of the sanction of nullity by learning to operate the system]"

The theory of general deterrence provides that if the law allocates a cost of an undesirable activity to the activity, that allocation will "create[] incentives to engage in safer activities." G. Calabresi, THE COSTS OF ACCIDENTS 73 (1970); see also M. Polinsky, AN INTRODUCTION TO LAW AND ECONOMICS 74-75 (1983) (describing how legal rules about what to do when accidents occur would undertake cost-benefit analysis to reach most efficient enforcement system. Paradoxically, skepticism about the deterrence effects of withholding enforcement may help explain the marked variability in case law results, which weakens deterrence; deterrence is dependent upon judicial consistency.

10. See infra text accompanying notes 34-35 (explaining "costs" of illegal contracts).

11. Theoretically, all parties thereby will "invest time and energy in finding out" the judicial consequences of illegality. Strong, supra note 2, at 1698 (discussing this principle as it applies to knowledge of formation rules).

12. See 6A A. Corbin, supra note 4, § 1573, at 2 ("[i]t is with illegal bargains; their legal effect varies with the character of the factors that cause them to be called illegal."). It is understandable, therefore, that "[t]he certainty suggested by the expression of the [no-effect rule] in many respects is illusory." Wade, Restitution of Benefits Acquired Through Illegal Transactions, 95 U. Pa. L. Rev. 261, 262 (1947); see also Gelhorn, supra note 9, at 683. For a thorough discussion of the varied treatment given such contracts in different contexts, see generally Strong, supra note 4; Wade, supra note 4.

13. It is common in the area of securities law for courts or legislatures to grant voidability rights to parties that justifiably lack knowledge of the wrongdoing. E.A. Farnsworth, supra note 3, § 5.9, at 364 n.7; see, e.g., 15 U.S.C. § 77l (1982) (authorizing rescission to innocent buyers of securities sold not in compliance with registration provisions); see also infra note 66 (right of rescission discussed in detail).

14. If a court finds that the agreement is unenforceable on public policy grounds, the general rule also precludes a restitutionary recovery. "If a party is barred on [illegality] from enforcing the other party's promise, he is usually also barred from getting restitution for any performance that he has rendered in return for the unenforceable promise." E.A. Farnsworth, supra note 3, § 5.9, at 365. Numerous exceptions, however, permit claims for restitution: when denial will result in "disproportionate forfeiture," the parties are not of equal guilt, or one party is "excessively ignorant." RESTATEMENT (SECOND) OF CONTRACTS §§ 197-199 (1979).
grant rescission to both parties. Commentators have detailed the various qualifications to the no-effect rule without offering a comprehensive theory to explain why the exceptions exist and how they interrelate.

This Article offers a unified theory that explains why courts, despite

15. Sometimes it is relatively easy to determine what legal effect, if any, a court is giving to a contract. In other cases, however, the posture of the lawsuit may produce an outcome but leave many unanswered questions. Thus, if A sues B, the court does not always tell you what it would do in a suit by B, thus leaving unclear which of the options, discussed supra text accompanying notes 13-15, the court would adopt.

16. See supra note 12.

17. This Article thus seeks a functional explanation for the various exceptions. Functional theories assume certain predetermined goals and attempt to explain the legal rules and their exceptions in terms of their ability to achieve those goals. In assessing the functional usefulness of the rules, this Article focuses on the “operational effects,” L. Kalman, Legal Realism at Yale 1927-1960, at 10 (1986), on various participants in contractual transactions. See also Hansmann, The Current State of Law-and-Economics Scholarship, 53 J. LEGAL EDUC. 217, 231 (1983) (discussing need for empirical showing of sensitivity of contract behavior to legal rules). For another example looking at functionalism with regard to legal rules, see Shand, supra note 9, at 156 (criticizing unrealistic assumptions regarding deterrence: “In cases where the eventual injury is unintended the deterrent effect may be slight.”). In examining the likely effect of the various forms of judicial relief, this Article adopts the law and economics approach of determining how the formulation of alternate legal rules will affect the real world. “That is, economics leads the analyst to consider the ways in which the world will actually be different if one legal rule rather than another is adopted.” Id. at 226. This Article uses the term “functionalism” differently than Professor Feinman. He describes functionalism as premised “on a belief that legal development is controlled by social conditions.” Feinman, The Meaning of Reliance: A Historical Perspective, 1984 Wis. L. Rev. 1373, 1377 (1984) [hereinafter Feinman, Meaning]. For an example of functional scholarship similar to that described by Professor Feinman, see Metzger & Phillips, supra note 8, at 505 (discussing development of promissory estoppel and modern social context). Although this Article agrees that social conditions, including the average characteristics of parties, may affect how principles are applied, it disagrees with Feinman’s and Metzger & Phillips’s claim that the laws’ responses to social context necessarily entail an embrace of collectivistic over private values. Instead, this Article seeks to accommodate certain core principles of private contract law with the realities of human behavior without concluding that there is a conflict between social and private goals. This is characteristic of what Professor Feinman denominates neoclassical theory, Feinman, Book Review, 39 Stan. L. Rev. 1537, 1538 (1987) [hereinafter Feinman, Book Review] (reviewing H. Cozens, The Law of Contract (1986)).

Professor Michelman would classify this effort as explanatory theory since it attempts to find (1) a “descriptive law that can order the data, organize them into an elegant, trenchant, parsimonious macropattern, and impart to them an ‘implicit logic’; and (2) a hypothetical causal model that can account for the patterning so far observed and predict the forms of its extensions . . . .” Michelman, Norms and Normativity in the Economic Theory of Law, 62 MINN. L. REV. 1015, 1035 (1978). But see Gordon, Unfreezing Legal Reality: Critical Approaches to Law, 15 Fla. St. U.L. Rev. 195, 199 (1987) (questioning “seemingly technocratic apparatus of rational justification—suggesting that the miscellany of social practices we have been brought into in this historical moment is much more than a contingent miscellany”).

18. In assuming that a coherent framework can be found, this Article entertains the “chief aim” of “mainstream legal scholarship”: “that of rationalizing the real, of showing that the law-making and law-applying activities that go on in our society make sense and may be rationally related to some coherent conceptual ordering scheme.” Gordon, supra note 5, at 1018. Of course, many scholars dispute the possibility of achieving conceptual ordering schemes because of the essentially contradictory goals that we are pursuing: altruism and individualism. See, e.g., Feinman, supra note 8, at 857; Kennedy, supra note 2, at 1685; Mensch, Freedom of Contract as Ideology (Book Review), 35 St. L. Rev. 753, 758 (1981). In the illegal contracts area, although it appears that we are committed to the contradictory goals of deterrence and punishment, the manner in which they are administered often reveals a certain implicit coherence of efficient deterrence. This Article, however, goes farther than merely "rational-
the compelling argument for deterrence, should not apply the no-effect rule uniformly and why they should vary the type of relief according to the factual setting. It posits that a graduated relief structure will maximize \textit{efficient} deterrence—allocating the risk of nonenforcement to the cheapest cost avoider, rather than to both parties in all instances. An efficient deterrence scheme will preserve limited personal, judicial, and societal resources without burdening legitimate transactions. Efficient deterrence theory\textsuperscript{20} can guide the courts to the proper remedy in differing factual contexts. Importantly, because efficient deterrence may mirror private choices, it also establishes the illegal contracts doctrine as consistent with, rather than an exception to, traditional freedom of contract notions (referred to here as the autonomy principle).\textsuperscript{21}

This discussion of illegal contracts joins the current debate about the public vs. private nature of contract law. Some scholars portray many contract doctrines as reflecting expanding incursions of collectivistic and paternalistic notions which have begun to undermine\textsuperscript{22} the essentially private world\textsuperscript{23} of traditional contract law. Other scholars rebut that thesis, suggesting that even "modern" doctrines such as promissory estoppel, perceived to reflect substantive fairness concerns,\textsuperscript{25} dovetail with a regime of private autonomy.\textsuperscript{26} The efficient deterrence theory suggests that the illegal contracts doctrine is founded upon a private autonomy basis previously unrecognized because of the exclusive emphasis placed on the doctrine's public policy aspects.\textsuperscript{27}
Section I describes the efficient deterrence theory and explores the policy and societal goals that support it. It also posits that, given certain assumptions about human behavior, the efficient deterrence theory is compatible with the autonomy principle rather than an exceptional public policy limit on private agreement. Section II documents the impact of certain factual predictors on case outcome and reconceptualizes them in terms of an efficient deterrence theory. Section III reexamines several doctrinal exceptions to the no-effect rule: the antiforfeiture, the protected class, and the collateralness doctrines. It asserts that the doctrinal exceptions fail to account persuasively for the case law outcomes and then suggests that the doctrines can be better explained in terms of efficient deterrence. Section IV reexamines the efficient deterrence theory and relates it to the principle of contract freedom.

II. EFFICIENT DETERRENCE: SOCIAL POLICIES AND PRIVATE AUTONOMY

Efficient deterrence theory seeks to minimize the costs resulting from the nonenforcement of contracts. When an illegal contract is not enforced, parties lose the economic resources that they allocated to an activity calculated to maximize their respective self-interests. It also is costly to society because resources spent to enter or even perform a contract that is of no effect could have been productively utilized elsewhere in the economy.

Parties to an illegal contract who recognize the risk and cost of nonenforcement may explicitly allocate the cost among themselves to reduce that cost. Absent such an explicit bargain, the courts must make that determination. When applying the illegal contracts doctrine they not diminish the importance of public regulatory intervention in the definition of the policies. Moreover, in some cases, for reasons to be explored later in this Article, even the application of the doctrine seems rooted in public, not private, goals. See infra text accompanying notes 195-200.

28. See infra text accompanying notes 34-49.
30. See infra text accompanying notes 194-200.
31. See infra text accompanying notes 50-156.
32. See infra text accompanying notes 157-93.
33. See infra text accompanying notes 194-200.
34. An important premise is that society is composed of value maximizing individuals. This assumption, of course, is subject to criticism on several grounds. "Individuals serve only as 'channels or locations where what is of value is to be found.' Similarly, wealth maximization is not egalitarian. It does not value persons, only productivity, just as utilitarianism values, not persons, but only pleasure." Kornhauser, A Guide to the Perplexed Claims of Efficiency in the Law, 8 HOFSTRA L. Rev. 591, 600 (1980). Professors Kennedy and Michelman criticize the model of human behavior because of the "weak, highly plausible factual judgment that people tend most of the time to act as though they had goals and were trying to achieve them—i.e., that people are rational maximizers of satisfactions." Kennedy & Michelman, Are Property and Contract Efficient?, 8 HOFSTRA L. Rev. 711, 713-14 (1980).
35. Cf. Coase, The Problem of Social Cost, 3 J. Law & Econ. 1, 33 (1960) (resources should be allocated to uses that produce maximum social gain).
should allocate the loss to the cheapest cost avoider—the “superior risk” bearer\textsuperscript{37}—if one exists. A superior risk bearer is the party to whom rational, value maximizing parties would allocate a risk to reduce the cost of that risk.\textsuperscript{38} If it appears that neither party could avoid the cost more cheaply than the other party, the courts should leave the parties where they are by withholding all judicial aid. The courts should not incur the costs of loss shifting if the loss falls on a party who is at least as deterrable as the other party. The courts should identify the cheapest cost avoider by hypothesizing how two contracting parties would allocate a future risk of nonenforcement, assuming that each party would try to “minimize the joint costs” of that risk.\textsuperscript{39} In doing this the courts should consider factors such as relative status, knowledge, degree of participation, and potential benefit from the illegality.\textsuperscript{40} Unfortunately, the cases often do not reach the correct results or fail to articulate an adequate theoretical basis.

The allocation of the cost to the party in the best position to be deterred at the least cost pursuant to efficient deterrence theory will produce several societal benefits. It will reduce the transaction costs of negotiating to opt out of legal rules such as broad nonenforcement rules, which may be inefficient as discussed above.\textsuperscript{41} Moreover, it often will penalize persons whose characteristics make them professionals with respect to the transaction, thus forcing them out of business.\textsuperscript{42} Additionally, allocation of loss to the cheapest cost avoider will promote the development of a rule recognizing the varying abilities of parties to respond to the deterrent effect of certain directives. It thereby will apply scarce judicial

\textsuperscript{37} Kronman, supra note 8, at 4 (identifying superior risk bearer as one who can “minimize the joint costs” of an error); see also Goetz & Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 YALE L.J. 1261, 1285 (1980) (“The least-cost bearer of any risk will presumably agree to absorb the risks of regretted promises in exchange for an enhanced return promise.”).

\textsuperscript{38} Kronman, supra note 8, at 4; see also infra note 39.

\textsuperscript{39} Kronman, supra note 8, at 4. Professor Halpern discusses this concept of risk allocation in another context of impracticability. See Halpern, supra note 8, at 1160.

The efficiency analysis, whether in terms of ‘superior risk bearer’ or ‘least-cost bearer,’ or more general efficiency criteria, is a determination as to how two supposedly risk averse parties would have allocated the risk of disruptive events had they been required specifically to do so and had their goal been an efficient, least-cost, present transaction. What is involved is a complicated set of trade-offs relating to how much each party would have been willing to pay to have the other assume the risk.

\textit{Id.} (footnotes omitted). Professor Halpern criticizes this ex post determination, stating that “[s]uch an analysis would seem to amount to little more than conjecture when used to determine how the parties would have handled the risk of the disruptive event had they been aware of it.” \textit{Id.} at 1161.

\textsuperscript{40} For a discussion of the significance of the parties’ relative knowledge, see infra text accompanying notes 81-104. For examples of the kinds of constraints that may interfere with the voluntariness of a party’s actions, see infra notes 105-27. For a discussion of the participation factor, see infra notes 135-44. See infra text accompanying notes 145-56 for a discussion of the benefit factor, the incentive to commit violations, and the relative deterrent effect on the parties.

\textsuperscript{41} See Kronman, supra note 8, at 4-5 (by imposing risk on “better information-gatherer . . . an efficiency-minded court reduces the transaction costs of the contracting process itself”); Posner & Rosenfield, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, 6 J. LEGAL STUD. 83, 89 (1977) (explaining that adoption of efficient rules will save transaction costs of parties having to negotiate efficient outcomes to replace inefficient rules).
resources to people most likely to adjust their behavior to take account of
the directive and will reduce the resources needed to achieve the desired
level of deterrence. It also will prevent overdeterrence of legitimate
transactions, which may occur if the loss is allocated on a random basis to
the nonsuperior risk bearer. This misallocation may require some parties to
undertake expensive search costs to discover if, for example, their coun-
terpart to a contract contemplates illegal transactions.43

When one applies the efficient deterrence theory to the illegal
contracts cases, the doctrine of illegal contracts emerges as compatible with
the autonomy principle in most contexts, rather than as an extraordinary
interference with private agreement. Although the doctrine of illegal
contracts adopts substantive goals at the outset,44 and thus apparently is
unlike the purely "facilitative"45 rules of offer and acceptance designed in
theory to promote private exchanges,46 the efficient deterrence doctrine in
fact maximizes private welfare. Efficient deterrence theory posits that
courts decide whether to grant or deny relief by calculating how different
classes of persons will respond to the application of the no-effect rule and
at what cost. The courts' decisions would reflect how the contracting parties
would have allocated the risks of loss through private negotiation.

Thus, when there are no market imperfections47 between the parties,
the courts should adopt a "leave-the-parties-where-they-are" approach for
illegal contracts. Nonintervention then could be rationalized in terms of the
autonomy principle because the parties' failure to bargain represents a
deliberate decision that each should bear the loss equally.48 Judicial
intervention would upset this allocation.49 On the other hand, if market
imperfections exist because one party lacks knowledge of the illegality,
there is a disparity in status or access to counsel, or the parties have an
ongoing or fiduciary relationship, the parties are unlikely to bargain

43. See infra text accompanying notes 81-89; see also infra text accompanying notes 187-93
(discussing Kansa City case).
44. Professor Kennedy therefore would classify the illegal contract doctrine as a "legal
institution[] . . . whose purpose is to prevent people from engaging in particular activities
because those activities are morally wrong or otherwise flatly undesirable." Kennedy, supra
note 2, at 1691.
45. Gordon, supra note 5, at 1025.
46. For a discussion of the ongoing battle between advocates of contract law's public policy
responsibilities and proponents of contract law's autonomy foundations, see supra note 8.
47. By "market imperfections" this Article refers to certain persuasive barriers to
contracting which prevent an explicit allocation of the risk of nonenforcement of the contract.
These persuasive barriers to contracting are discussed in the context of promissory estoppel in
Kositsky, supra note 1, at 940-49.
48. Professor Farnsworth would dispute the contention equating an absence of provisions
governing future contingencies with deliberate risk-taking with regard to such events. "In
contrast to the . . . fiction, which assumes that the parties have expectations concerning all
possible situations, is the likelihood that they give their "limited attention" only to a limited
number of situations . . . ." Farnsworth, Disputes Over Omission in Contracts, 68 CORNELL L. REV.
860, 869-70 (1968), cited in Halpern, supra note 8, at 1156 n.137.
49. This conclusion presumes that parties want to allocate such risks and wish to do so in
an "efficient" manner. But see supra note 34. The pitfalls of an attempt to divine such a
would-be bargain are explored by Professor Halpern, supra note 8, at 1160-61; see also
("The efficiency formulation is only of limited help . . . because parties do not always allocate
risks efficiently."). cited in Halpern, supra note 8, at 1161 n.159.
explicitly to allocate the loss to the cheapest cost avoider. One party may not know of the risk to be allocated, or misperceived trust may interfere with explicit bargaining over possible disruptive contingencies. In these cases, courts should intervene by permitting enforcement, rescission, or restitut

ional recovery. Courts should deny any relief, however, when it is the cheapest cost avoider seeking it. This would promote efficient deterrence because it would raise the risks and costs of contracting for the cheapest cost avoider by subjecting her to liability but denying her the right to rescission or enforcement. Allocating the costs in that fashion achieves the allocation by the parties themselves presumably would have reached in unrestricted negotiation, and so facilitates private welfare maximization.

III. STRUGGLING TO MAKE SENSE OF THE FACTUAL EXCEPTIONS: IS THERE A PATTERN OF EFFICIENT DETERRENCE?

The various factual exceptions to the no-effect rule elucidate best the concept of efficient deterrence and loss reallocation. Courts recognize some of these exceptions explicitly, while in other cases the factors implicitly affect outcome. Thus, despite illegality, a plaintiff may be able to recover depending on (1) the relative status of the parties, (2) the relative knowledge of the parties, (3) the voluntariness of the parties' conduct, (4) the degree of the parties' participation, and (5) the relative benefit to the defendant and to the plaintiff from the wrongdoing. Scholars have made no attempt to account for these exceptions in a comprehensive theory. Instead, they have regarded each exception as a sui generis separate phenomenon. An efficient deterrence theory helps unify the disparate factual exceptions in the cases.

50. Many of the exceptions can be rationalized as criteria that determine whether the parties are of equal guilt. See, e.g., Gabaldon, Uneven Hands and Self-Inflicted Wounds: The Significance of Plaintiff Conduct in Actions for Misrepresentation Under Rule 10b-5, 71 Miss. L. Rev. 317, 344 (1998) (explaining that excusable ignorance and fraud exceptions "simply appear to reflect the requirement of equal fault"); see also E.A. Farnsworth, supra note 3, § 5.9, at 365 ("An exception is . . . made in favor of a claimant not equally in the wrong with the party from whom he seeks restitution.").

51. See infra text accompanying notes 58-80.

52. See infra text accompanying notes 81-104.

53. For examples of the kind of constraints that may interfere with the voluntariness of a party's actions, see infra text accompanying notes 105-27.

54. See infra text accompanying notes 133-44.

55. For a discussion of the benefit factor, the incentive to commit violations, and the relative deterrent effect on the parties, see infra text accompanying notes 145-56.

56. Efficient deterrence theory also may help explain other factual exceptions not examined in this Article. One such exception is the doctrinal exception for substantial compliance in contracts for professional services made illegal because the party subject to a licensing requirement fails to obtain the requisite license. Ordinarily, the cases will arise in the following posture. The service professional will complete a job and sue for the unpaid contract amount. The recipient of the services will also sue, alleging that the contract is illegal because of the plaintiff's failure to obtain a license and that it therefore is unenforceable and void. In some cases the contractor who brings an action still may be able to recover despite her unlicensed status if the violation is a mere technicality, as when she is licensed at the outset of the contract and has little difficulty procuring a renewal. See, e.g., Latipac, Inc. v. Superior Court of Martin County, 49 Cal. Rptr. 676, 411 P.2d 564 (1966). In such cases, the denial of recovery might lead to overcautious behavior in the license renewal procedure because even
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thereby reallocate a loss, courts should decide whether that party, and others in its position, will be effectively deterred from engaging in the illegal conduct in the future and, if so, at what cost.57

A. The Relative Status of the Parties

Courts should favor the party with inferior status.58 The term "status

those parties who take the license requirement seriously, but inadvertently allow the license to lapse, will be penalized with the same force, by loss of a contract recovery, as if they had deliberately flouted the law and been unable to meet the substantive requirements for the license. To avoid that overdeterrence, the law permits recovery based on the substantial compliance doctrine.

57. In its focus on the effect that the formulation of legal rules is likely to have on parties, given their behavioral characteristics, this Article follows the lead of law and economics scholars who have explored what effect the formulation of a liability rule is likely to have on parties given their particular characteristics, including the characteristic of rational maximizing utility. See generally Kitch, supra note 29, at 188 (Professor Kitch posits in identifying the "strong regularity of human social behavior," law and economics has given us tools "to analyze responses to laws.").

Perceptions about how parties are likely to respond to legal rules, given their characteristics, also have affected the formulation and application of legal rules in the context of promissory estoppel. See generally Barnett, supra note 1, at 310-17; Farber & Matheson, supra note 26, at 929-30; Kosstritsky, supra note 1. The attempt to combine doctrinal analysis with "the realities of commercial practice," Feinman, Book Review, supra note 17, at 1538, including the realities of "how real-world actors are likely to respond" to certain rules, Kosstritsky, supra note 1, at 964, has been described as neoclassical theory. Feinman, Book Review, supra note 17, at 1538-39. Despite the shared element of assent in (1) neoclassical and (2) law and economics scholarship of a concern with behavioral characteristics, Professor Feinman would distinguish these schools in terms of the relative importance of doctrinal categories in their respective systems. The neoclassicists still find that "the formulation of principle and doctrine ... can be significant." Id. at 1539. The law and economics scholars, however, attempt to "provide a substitute for classicism" that "ignore[s] traditional doctrinal categories in favor of some metaprinciple that governs many cases ... ." Id.

58. Status disparity here is meant to refer to parties "of a statically different order" and is not meant to refer to a disparity "which is the product of a particular contingency." Ellingshaus, In Defense of Unconscionability, 78 YALE L.J. 757, 767 (1969). A disparity resulting from a contingency refers to a case in which a party of seemingly lower status obtains a temporary nonrecurrent advantage. Of course, even disparities that are the product of a "particular contingency," such as extremely necessitous financial circumstances, may affect the court's attitude toward judicial relief.

Status is a persuasive predictor of case outcome not only in the illegal contracts area, but also in other doctrinal developments in contract law. Status has figured prominently in the development and application of unconscionability and other avoidance doctrines, the close connectedness doctrine in commercial paper, and the law of actionable nondisclosure. In each of these areas, courts regularly have manipulated the result according to the relative status of the parties. The greater the disparity in status between the parties, the more likely it is that the court will grant relief to the party with inferior status, whether it is in the form of enforcement or avoidance. Alternatively, if the parties appear to be on a relatively equal footing, it is less likely that either party will be afforded relief. See, e.g., Jones v. Approved Bancredit Corp., 256 A.2d 739 (Del. 1969) (emphasizing importance of disparity in status of parties in denying lender holder in due course status); Zapatha v. Dairy Mart, 381 Mass. 284, 294, 408 N.E.2d 1370, 1377 (1980) (refusing to find franchise contract unconscionable in view of franchisee's "business experience and education"), cited in E. Murphy & R. Speidel, supra note 3, at 74-79; Ollerman v. O'Rourke Co., 94 Wis. 2d 17, 288 N.W.2d 95 (1980) (emphasizing plaintiff's noneexpert status in deciding whether nondisclosure was actionable fraud).

Equating status disparity with disparities in sophistication and knowledge has prompted the development of disclosure obligations of brokers to their clients under the aegis of the shingle theory. See, e.g., Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943) (failure to
"disparity" is used here to denote some disparity in professional stature, as when one party is an expert in the transaction, better educated, or financially better off than the other party. A difference in professional stature often creates a disparity because other differences, such as dispro-


A variety of status disparities also have prompted courts to grant restitutionary and damage recoveries as well as avoidance relief to the party with inferior status. *See*, e.g., Beynon v. Garden Grove Medical Group, 100 Cal. App. 3d 698, 705, 161 Cal. Rpr. 146, 150 (1980) (allowing employee to avoid clause violating public policy because "there was no evidence that the agreement was negotiated by parties having a parity of bargaining strength"); Parsky Funeral Home, Inc. v. Shapiro, 83 Misc. 2d 566, 570-71, 372 N.Y.S.2d 288, 295-94 (1975) (granting consumer avoidance rights when funeral establishment breached statute by failing to disclose price information to consumer, but denying funeral establishment contractual and noncontractual recovery); Perlmut h v. Scappy and Peck, Inc., 73 Misc. 2d 927, 931, 343 N.Y.S.2d 40, 44-45 (1973) (granting consumer punitive damages due to defendant body shop's charges exceeding statutorily authorized amounts); Best v. Arthur Murray Town & Country Dance Club, 60 Misc. 2d 660, 662, 303 N.Y.S.2d 546, 549 (1969) (granting consumer restitutionary recovery against dance company when contract violated statute, even though statute silent on question of restitutionary recovery). In the *Parsky*, *Perlmut h*, and *Best* cases, the losing party violated a statute. In *Parsky* the funeral establishment failed to furnish the written estimate required by statute, noncompliance with which could lead to (1) license revocations and/or (2) criminal fines, 83 Misc. 2d at 569, 372 N.Y.S.2d at 292. In *Best*, the statute prescribed the requisites for contracts "for instruction in physical or social skills" to be enforceable, 60 Misc. 2d at 681, 303 N.Y.S.2d at 548. In *Perlmut h* the ordinance (1) set maximums for storage charges of disabled vehicles, (2) prescribed forms for repair estimates, and (3) banned fees for estimates to which the owner had not assented. 73 Misc. 2d at 929, 343 N.Y.S.2d at 43. In each case, however, the statute did not resolve whether the statutory violator should be subject to the particular contractual or noncontractual relief sought by the winning party. As Professor Gelhorn explains, the court must decide: "Should the courts then refuse to lend their process to actions upon contracts which, if executed, would violate the statute, or should they hold that the penal sanction had been deemed sufficient by the legislature as a punishment for one who acted contrary to the law?" Gelhorn, *supra* note 9, at 681. In determining the type of relief that it should provide to claimants, the court is influenced by the relative position of the parties. It could be argued that the above cases are not explicable in terms of status. Rather, since the legislature has made only the defendant's conduct criminal or the subject of other sanctions, it only makes sense to permit the "innocent party" to recover in contract or off the contract. Under this view, the courts do not manipulate outcome according to status but merely give effect to the legislature's statutory scheme.

The absence of a legislative decision on contract relief, however, still necessitates a judicial decision. Moreover, in other contexts in which the legislature prohibits conduct by only one party, a court may deny relief to the party who has not violated the statute if the court finds the nonviolator to be an active, knowing participant. *See*, e.g., Serzysko v. Chase Manhattan Bank, 250 F. Supp. 74, 83-84, 89-90 (S.D.N.Y. 1968) (denying damage recovery to sophisticated investor who misled broker about purpose of loans, despite fact that statute prohibited broker's, but not investor's, conduct and despite fact investor deemed to be part of statutorily protected class). The question of who is to police illegal extensions of credit now has been resolved explicitly by a statute making it illegal to extend or receive illegal credit. The significance of that statutory change is discussed in Stern v. Merrill Lynch, Pierce, Fenner & Smith, 603 F.2d 1073, 1080 (4th Cir. 1979). *See also infra* text accompanying notes 172-85. These cases involving statutory violators show that courts still make independent decisions that are dictated in part by their calculations about how to maximize efficient deterrence.
portionate knowledge, expertise, or bargaining power, will accompany it. Some courts articulate the status factor as a rationale for granting relief, while others come to results that reveal it as an implicit concern.

_Gates v. River Construction Co._ illustrates the circumstances under which a plaintiff with inferior status prevails against a defendant with superior status, despite the fact that both are parties to an illegal contract. The claimant in _Gates_ was an employee who sued his employer for unpaid wages. The purpose of the employment contract was to induce an alien to enter the United States without the requisite governmental approval, in violation of a federal statute.

The defendant moved to dismiss on the grounds of illegality. The trial court granted the motion, citing the violation of public policy. The Supreme Court of Washington reversed and remanded, concluding that the contract should be enforced. Although the court did not explicitly ground its conclusion on status, the court emphasized that the employer, who knowingly participated in the scheme, should not be permitted to profit at the employee's expense. _Gates_ is consistent with results in other

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59. See, e.g., cases cited infra note 65.
60. See infra text accompanying notes 108-19 (discussing _Lockman v. Cobb_).
62. The statute involved was 8 U.S.C. § 1182(a)(14) (1954) which provided: "(T)he following classes of aliens shall be ineligible to receive visas and shall be excluded from admission into the United States: . . . (14) Aliens seeking to enter the United States, for the purpose of performing skilled or unskilled labor, unless the Secretary of Labor has determined and certified to the Secretary of State and to the Attorney General that they are not of such a class that the employment of the alien would not "adversely affect the wages and working conditions" of similarly situated workers in the United States.
64. Id. The court was unwilling to permit such enrichment based in part on its interpretation of the congressional intent reflected in the legislative history. Because the prior statute regulating aliens had made such contracts for employment "utterly void," and not merely unenforceable, while the current statute at issue in _Gates_ omitted the voidness provision, the court surmised that "Congress determined that the exclusion of certain aliens from admission to the United States was a more satisfactory sanction than rendering their contracts void and thus unjustifiably enriching employers of such alien laborers." _Id._ at 1023. Thus, because of the emphasis on statutory interpretation, _Gates_ might be perceived as weak support for the operative effect of status. Yet the repeal itself arguably was ambiguous and the court cited no legislative history to support its interpretation. Although Congress substituted a seemingly less harsh provision without the voidness language, the newer statute did not specifically address the effect, if any, such contracts were then to have and whether they intended to make employment contracts of illegal aliens enforceable by both employer and employee and thus benefit both parties. Despite this potential ambiguity, the court chose to construe the statute in such a way that afforded unilateral relief to the employee and made the meaning of the repeal appear unambiguous.

The statute under which the _Gates_ case arose is now superseded by the Immigration Reform and Control Act of 1986, Pub. L. No. 99-603, 100 Stat. 3262 (codified at 8 U.S.C. § 1324a) (Supp. IV 1986). IRC. IRC makes it unlawful for a person or other entity to hire, or to recruit or refer for a fee, for employment in the United States an . . . alien knowing that the alien is an unauthorized alien." 8 U.S.C. § 1324a(1)(A) (Supp. IV 1986). One district court recently has interpreted that statute to deny an alien the right to sue for minimum wages otherwise guaranteed workers under the Fair Labor Standards Act (FLSA). See Patel v. Sunami Corp., 660 F. Supp. 1528, 1535 (N.D. Ala. 1987) (FLSA does not provide protection to illegal aliens). The _Patel_ district court decision was reversed on appeal by an 11th Circuit Court of Appeals sensitive to the economic incentive that denial of the FLSA claim would have on employers to hire illegal aliens. 846 F.2d 698, 704 (1988). The district court might have
cases in which courts treat employees favorably in illegal contract actions against employers.\(^65\)

\(^65\) Gates illustrates the general proposition that in illegal contracts cases, employees are likely to prevail on claims for unpaid wages, either in contract, under federal statute, or on quantum meruit, against their employers. See, e.g., Patel v. Sumani Corp., 846 F.2d 700 (11th Cir. 1988) (employee permitted to prevail on wage claim despite employment contract's violation of I.R.C.); Trumbo v. Bank of Berkeley, 77 Cal. App. 2d 704, 713, 176 P.2d 376, 381 (1947) (employee entitled to reasonable value of services even though contract of employment illegally limited directors' hiring discretion); Nizamuddowlah v. Bengal Cabaret, Inc., 92 Misc. 2d 220, 223, 399 N.Y.S.2d 854, 857 (Sup. Ct. 1977) (even though employee was co-conspirator in scheme to circumvent immigration laws he was entitled to payment since employer was "main perpetrator" of same scheme to circumvent immigration laws); aff'd, 415 N.Y.S.2d 685, 686 (App. Div. 1979); Dzodzi v. Jacoby, 178 Misc. 851, 854, 36 N.Y.S.2d 672, 673 (Sup. Ct. 1939) (granting alien recovery for services rendered pursuant to contract entered into after illegal immigration, because statute rendered void only contracts entered into before immigration). But see Wise v. Radiis, 74 Cal. App. 705, 778, 242 P. 90, 95 (1925) (denying unlicensed real estate broker partial commission from licensed partner since broker's failure to comply with licensing statute rendered promise to share unenforceable); Restatement (Second) of Contracts § 181 (1979) (discussing effect of failure to comply with licensing statute; recovery denied when purpose is regulatory and policy outweighs "interest in . . . enforcement"). The different result in the unlicensed broker cases is explainable in terms of deterrence. It may be that courts and legislatures are reluctant to permit brokers to recover because it is cheaper to put the cost of nonenforcement on the broker; she is likely to be more knowledgeable about (1) whether she is licensed and (2) the consequences of the statutory violation. But see infra note 152 (suggesting reasons to permit recovery for unlicensed contractors).

Courts also give employees preferential treatment against employers in the context of "illegal" restrictive covenants. See Restatement (Second) of Contracts § 188 comment g (1979) ("post-employment restraints are scrutinized with particular care because they are often the product of unequal bargaining power"); see also E.A. Farnsworth, Cases and Materials on Contracts 446-48 (1988). Thus, courts are likely to construe strictly such covenants and deny enforcement by the employer, permitting the employee to avoid the obligation. See, e.g., White v. Fletcher/Mayo/Associates, 251 Ga. 203, 207-08, 303 S.E.2d 746, 750-51 (1983) (refusing to redraft non-competition covenant because vice president was employee without bargaining power); Redmond v. Royal Ford Inc., 241 Ga. 711, 712, 251 S.E.2d 569, 580 (1979) (finding improper inhibition against employee for violation of restrictive covenant prohibiting competition for 50 miles over 5 years and noting stringent treatment given to such covenants in employment context); Howard Schultz & Associates of the Southwest, Inc. v. Bronner, 239 Ga. 181, 188, 236 S.E.2d 265, 270 (1977) (denying employer injunction to enforce unreasonable covenant not to compete); Rina Personnel Servs. Int'l, Inc. v. Kot, 229 Ga. 314, 317-18, 191 S.E.2d 79, 81 (1972) (refusing to enforce or sever unreasonable territorial covenant restricting competition by employee); Kern Mfg. Corp. v. Sant, 182 Ga. App. 135, 136, 141-42, 355 S.E.2d 437, 442, 444-45 (1987) (denying employer right to enforce and refusing to "blue pencil" overly broad territorial restrictions in noncompetition covenant, but permitting employee to recover damages under contract if proved on remand); H & R Block, Inc. v. Lovelace, 208 Kan. 530, 544-46, 479 P.2d 205, 211-12 (1972) (denying franchisor right to enforce unreasonable restrictive covenant and citing inequality in status and bargaining power between employee and employer); Smith, Batchelder & Rugg v. Foster, 119 N.H. 679, 685-86, 406 A.2d 1310, 1314 (1979) (denying employer right to enforce unreasonable restrictive covenant or to obtain reformation of it, in part because employees who executed covenant after employment given little opportunity to understand covenant); Peat, Marwick, Mitchell & Co. v. Sharp, 385 S.W.2d 905, 910 (Tex. Civ. App. 1979) (allowing withdrawing partner to recover profits under partnership agreement even though partnership's covenant not to compete unreasonable, against public policy, thus unenforceable).

In contrast to the strict standards used when the restrictive covenant is between the employee and the employer, courts apply a more lenient standard in judging restrictive covenants in the context of what they regard as an arms-length sale of business. See, e.g., Wells
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The pattern of results in nonemployee cases also reflects the impact of status upon courts' decisions. This is evident in a number of contexts. For example, courts regularly grant relief to purchasers against sellers in cases of securities law violations, borrowers against banks and other lenders in

v. Wells, 400 N.E.2d 1817, 1920 (Mass. 1980) (different, more lenient standard applicable to noncompetition covenant in buyer-seller context; see also Blake, Employee Agreements. Not to Compete, 73 Harv. L. Rev. 625, 647-48 (1960)). From this perspective, courts treat the issue of potentially "illegal" covenants differently in different contexts depending on the relative status of the parties. Courts often justify this differentiated treatment on the bargaining power factor; they afford employee noncompetition covenants less deference since they are less likely to be freely negotiated than such covenants made in the context of an arms-length transaction. E.A. Farnsworth, supra note 3, § 5.3, at 338. Thus, courts are more likely to blue pencil the sale of business contracts.

Heightened scrutiny in the employee context could be rationalized in terms of distributive and paternalistic motives. See Kennedy, supra note 2, at 1717-22. Courts strike down noncompetition clauses to protect employees and thereby equalize the balance of power between employers and employees. It is also possible, however, to rationalize the variegated application of the noncompetition policy of enforcement in efficient deterrence terms.

Arguably, in the sale of business context, the noncompetition covenant is the subject of open and knowledgeable bargaining. See Blake, supra, at 647-48 (by implication). For that reason, and assuming the price is fair, the purchaser has no particular reason to suspect a resource misallocation. Thus, it would often be costly to deter resource misallocation in the sale of business context. On the other hand, when the employee agrees to a noncompetition covenant, the employer may have reason to suspect, based on the persuasive impediments to hard bargaining and the salary negotiated, that the employee has given up a disproportionate amount in the noncompetition clause in return for the agreed-upon wage. She may be getting nothing extra for the noncompetition clause beyond what she ordinarily would receive for performing those services. Id. at 647. Thus, it may be more efficient to deter the employer who suspects a resource misallocation than to deter the employee from entering such covenants.

66. See, e.g., Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 43 (1940) (permitting innocent purchaser to enforce stock option agreement against corporation even though unregistered securities violated Securities Act of 1933; no-effect conclusion would thwart investor protection goals); General Life of Mo. Inv. Co. v. Samburger, 546 F.2d 774, 777, 782, 784 (8th Cir. 1976) (denying corporate issuer, who violated securities laws by failing to register public offering, right to enforce stock subscription involving the unregistered stock against innocent purchaser not otherwise "having access to the kind of information which registration would disclose"); Smith v. Turner, 238 Cal. App. 2d 141, 145, 149, 47 Cal. Rptr. 582, 585, 587 (1965) (granting plaintiff-purchasers recovery of payments made to more experienced sellers in violation of statute prohibiting collection prior to incorporation; "plaintiffs . . . not men of financial or business experience," thus parties "not upon an equal basis"); Kneeland v. Emerton, 280 Mass. 371, 378, 183 N.E. 155, 159 (1932) (because plaintiff purchaser within protected class, entitled to recover price or rescission); Loewenstein v. Midwestern Inv. Co., 181 Neb. 547, 554, 149 N.W.2d 512, 516 (1967) (permitting plaintiff-farmer-buyer to recover against defendant corporation in illegal sale of treasury stock). In some of these cases in which courts allow damages or restitutionary recovery, the statute specifically empowers the purchaser to rescind or recover damages. In other cases, the statute simply proscribes conduct of which the party raising the in pari delicto defense is guilty. In one sense these securities cases considered together may not appear to stand for any proposition other than the following: First, if the statute permits the purchaser to recover and the party seeking recovery belongs to the class sought to be protected by the legislation, the court has no choice but to grant the recovery authorized by statute. Second, if the statute proscribes certain conduct of which one party is guilty and the other innocent (such as the crime of selling unregistered securities), it makes sense to permit the nonviolator (purchaser) to recover from the violator (seller) because we do not want to penalize nonculpable behavior. However, even in situations in which the statute permits recovery by purchasers, courts still may deny recovery if they are in pari delicto. See, e.g., Pinter v. Dahl, 108 S. Ct. 2063, 2072-75 (1988) (recognizing that certain conduct by purchasers might bar rescission action); Malamphy v. Real-Tex Enter., Inc., 527 F.2d 978, 980 (4th Cir. 1975); L. Loss, supra note 38, at 1196 n.94.
cases of interest rate violations, clients against attorneys in cases of unpermitted fee arrangements, and insured parties against insurance companies in cases of illegal premiums or other illegal agreements.

In the class of cases in which the party raising the in pari delicto defense is a violator of a statute, the court still must decide whether a nonviolator may recover in contract if the statute is silent on that question. In deciding that question, the court makes independent judgments, which can be explained in terms of efficient deterrence. See, e.g., Smith v. Turner, 238 Cal. App. 2d 141, 152, 47 Cal. Rptr. 582, 589 (1965) ("effective deterrence is best realized by enforcing the [purchaser's] claim") (quoting Lewis & Queen v. N.M. Ball Sons, 48 Cal. 2d 141, 151, 308 P.2d 713, 719 (1957)). While it is conceivable that the court could decide that the best way to protect investors would be to deny them all recovery and thus provide the incentive to investigate the illegality and avoid such transactions in the future, the decision to grant recovery to the purchaser demonstrates that courts prefer to impose the losses of illegal contracts on those with superior status because they regard that result as consistent with efficient deterrence. For a discussion of the circumstances warranting a denial of the rescission right ordinarily available to purchasers, see Brief for SEC at 8-18, Dahl v. Pinter, 787 F.2d 965, reh'g denied en banc (5th Cir. 1986), vacated, 108 S. Ct. 2063 (1988).

67. Browning v. Morris, 98 Eng. Rep. 1364 (1778); see also cases cited in Ryan v. Motor Credit Co., 130 N.J. Eq. 531, 545-46, 23 A.2d 607, 616-17 (Ch. 1941), aff'd, 132 N.J. Eq. 398, 28 A.2d 181 (1942). Usury cases generally permit the borrower to recover the illegal interest paid. Sometimes recovery of the principal and legal interest is allowed but the lender usually is entitled to keep the legal interest and to repayment of the principal. 6A A. CORBIN, supra note 4, at § 1507. One could argue that merely awarding the usury victim recovery of the illegal interest may not be consistent with efficient deterrence. Since the lender will engage in multiple illegal transactions and is knowledgeable about the illegality, he is the cheapest cost avoider. If the most that he can ever be required to give up is the illegal interest in cases that actually are brought, the lender may continue to charge illegal amounts, secure in the expectation that he will forfeit only a small portion of the illegal interest paid on an ad hoc basis. When that is considered in light of the total illegal interest recoverable over the multiple transactions, deterrence may require the imposition of a larger penalty.

68. Wade, supra note 12, at 278 ("If the defendant is an attorney, for example, courts often refuse to let him rely upon the maxim."); see, e.g., Berman v. Coakley, 243 Mass. 349, 355, 137 N.E. 667, 671 (1923) (denying in pari delicto defense to attorney who induced plaintiff to make payment by threatening that without payment indictment would follow, and permitting plaintiff-client to recover extorted funds); Kukla v. Perry, 361 Mich. 311, 321, 329-30, 105 N.W.2d 176, 181, 185 (1960) (requiring attorney, who extorted illegal mortgage covenant under which plaintiff defaulted, to cancel notes and mortgages and to account for amounts received); Field & Sons, Inc. v. Pechnner, Dorfman, Wolfie, Rounick & Cabot, 312 Pa. Super. 125, 142-43, 458 A.2d 545, 554-55 (1983) (clients who engaged in criminal conduct with advice of their counsel to defeat unionization drive permitted to recover legal fees paid to counsel); Peyton v. Margiotti, 398 Pa. 86, 95, 156 A.2d 865, 869 (1959) (permitting client to recover money given to attorney "despite the essential invalidity" of agreement under which client agreed to pay lawyer a fee contingent on the lawyer's successfully obtaining release of client's relative). But see Cort v. Fleisher, 93 Ill. App. 3d 517, 532, 417 N.E.2d 764, 775 (1981) (denying attorney recovery or enforcement against ex-law firm, with which he entered into unpermitted employment and fee arrangements to which client had not consented, because this would deprive clients of right to choose counsel). The emphasis on the attorney's status in the denial of recovery has sometimes been explained in terms of the need to maintain the reputation of the profession, see Wade, supra note 12, at 278, and in terms of a fiduciary relationship.

69. See, e.g., Homestead Supplies, Inc. v. Executive Life Ins. Co., 81 Cal. App. 3d 978, 991, 993, 147 Cal. Rptr. 22, 29 (1978) (granting insured declaratory judgment on recovery of annual premium and rejecting insurer's defense that because premium was illegal and represented rebate premium and rate discrimination in direct contravention of statute, the
short, if the parties have disparate status, the courts should grant relief to the party with inferior status and deny relief to the party with superior status.

The impact of status is reflected in the Supreme Court's recent decision of Bateman Eichler, Hill Richards, Inc. v. Berner. In Bateman Eichler the Court confronted an issue on which lower federal courts had split: "Whether the common law in pari delicto defense bars a private damages action under the federal securities laws against corporate insiders and

agreement should be unenforceable); Denver Fire Ins. Co. v. McClelland, 9 Colo. 11, 26, 9 P. 771, 779-80 (1885) (allowing policy holder to enforce insurance contract even though ultra vires for the insurance company to issue it); Williams v. Continental Life & Accident Co., 100 Idaho 71, 74, 599 P.2d 708, 711 (1979) (granting insured recovery on policies against insurer despite fact that policies violate statutory dollar limitation; insured allowed to "reasonably and justly rely upon the superior knowledge and expertise of the insurer for full compliance with the law"); Bowman v. Preferred Risk Ins. Co., 348 Mich. 531, 547, 83 N.W.2d 434, 437 (1957) (plaintiff allowed to recover against insurance company on policy despite fact plaintiff caused accident while illegally moving parked car); Kellogg v. German Am. Ins. Co., 133 Mo. App. 391, 403, 113 S.W. 663, 667 (1908) (granting insured recovery on fire insurance despite insured's participation in selling liquor on insured premises); Buck v. Mountain States Inv. Corp., 76 N.M. 261, 266, 414 P.2d 491, 495 (1966) (reforming insurance policy to conform to insured's oral understanding despite contention that policy illegal); Douglass v. Mutual Benefit Health & Accident Ass'n, 42 N.M. 190, 213, 76 P.2d 453, 467 (1938) (granting insured recovery on policy against insurer even though policy issued in violation of statute); Messersmith v. American Fidelity Co., 292 N.Y. 161, 166, 183 N.E. 432, 435 (1931) (granting insured recovery on insurance policies even though insured gave permission to minor to drive in violation of statute).

The cases described above involve two categories of cases. In some cases the insurers violated statutory provisions that prohibited the payment of rebates, required the form of the insurance contract to conform to certain requirements, required the agent issuing the policy to be licensed, or limited the issuance of contracts to those within the insurer's corporate powers. In other cases the insured, rather than the insurer, had violated a statute that was unrelated to the contract of insurance.

In the first category, there is often no legislative determination as to what effect, if any, should be given to contracts issued in violation of the statute. In deciding that the violator should be estopped from raising the illegality defense, the courts emphasize the "premium for dishonest dealing" which might result should the court bar recovery to the innocent party. Denver Fire Ins. Co., 9 Colo. at 29, 9 P. at 775. In emphasizing the inducement to the defendant to violate the statute that might result should he be permitted to use his own wrongdoing as a defense, the courts ignore another potential inducement to violations by insurers. If insureds are, for example, permitted to recover rebates, though they otherwise are prohibited by statute, perhaps they will be induced to seek out insurers who are illegally offering them, resulting in a greater number of illegal rebates. Denying insureds recovery of the illegal rebates could provide a deterrence to their entering into prohibited rebate agreements. The courts' failure to analyze these consequences from this alternative rule of enforceability reflects a determination that the costs of deterring insureds, including the additional costs of educating insureds to the illegalities, outweigh the incremental deterrence that will be achieved.

In the second category of cases, enforcement of the insurance contract by a law violator arguably will induce more wanton violations of the law. The theory is that law violators who know that their ordinary contracts will not be affected will be induced to commit more crimes than if courts treat law violators as pariahs, entitled to no judicial aid of any kind. The disinclination to adopt this approach may reflect an underlying concern with efficient deterrence. It would be costly to deter violations such as the moving of the parked car, Bowman, 348 Mich. 531, 83 N.W.2d 434, on the basis of the no-effect rule because it would be difficult to persuade people to weigh those costs regarding contract enforcement at the time of the violation. The contract rules simply would seem too remote to be properly internalized. See also infra text accompanying notes 186-93.
broker-dealers who fraudulently induce investors to purchase securities by misrepresenting that they are conveying material nonpublic information about the issuer." 71

In cases such as Bateman Eichler, both the tipper, who furnishes the false information, and the tippee, who trades on the information, are guilty of securities law violations. 72 When a tippee sues a broker-dealer on 10b-5 grounds, the tipper usually asserts an in pari delicto defense, arguing that the tippee's guilt bars recovery. The availability of that defense has varied among jurisdictions. 73 In Bateman Eichler the Court generally held the in pari delicto defense to be unavailable in suits by tippees against tippers.

In rejecting the availability of the defense, the Bateman Eichler Court stressed the goal of efficient deterrence and concluded that because of disparities in access to counsel, susceptibility to sanctions, and the parties' positions in the chain of violations, imposition of costs on the tipper class was likely to be the best way to reach that goal. 74 Thus, the Court "demonstrated greater concern for the maximum deterrence of insider trading than for punishing each and every culpable actor." 75

The disparate treatment that courts afford claimants based on their status is consistent with an efficient deterrence theory. Both Bateman Eichler and Gates demonstrate the impact of the status factor on the outcome of a claim made under an illegal contract. When the plaintiff and defendant have a marked disparity in status, the disadvantaged plaintiff should prevail, despite his participation in an illegal contract. When there is a parity in status, as when the parties are co-adventurers, a plaintiff should lose upon a defense of contract illegality. If one accepts that differential knowledge of the applicable rules of law accompanies status disparities, 76 then it is more economically efficient to place the risk of loss on the party with superior status. Thus, the party who is likely to be more aware of the consequences of illegality than her contract partner, and therefore more

71. Id. at 301. Compare Moholt v. Dean Witter Reynolds, Inc., 478 F. Supp. 451, 453 (D.D.C. 1979) (denying summary judgment on tippers' in pari delicto defense to tippees' claim of fraudulent misrepresentation in stock purchases, noting "greater threat . . . to the integrity of the regulatory framework" posed by brokers) and Nathanson v. Weis, Voisin, Cannon, Inc., 325 F. Supp. 50, 57 (S.D.N.Y. 1971) (tipper not permitted to rely on in pari delicto defense to defeat tippees' claim because "broker-dealer presents a greater potential threat to undermining the statutory protection intended for the public investor") with Tarasi v. Pittsburgh Nat'l Bank, 555 F.2d 1152, 1164 (3d Cir. 1977) (in pari delicto precludes tippee's recovery from tipper), cert. denied, 434 U.S. 965 (1977) and Kuehnert v. Texstar Corp., 412 F.2d 700, 705 (5th Cir. 1969) (deterrence benefit from allowing tippees to sue tippers overshadowed by "enforceable warranty" created if in pari delicto defense rejected).

72. Bateman Eichler, 472 U.S. at 311-12.


76. See Kostritsky, supra note 1, at 918.
likely to consider those consequences when formulating her behavior, will be denied judicial aid. Moreover, even if the parties share equal knowledge of the illegality (as in Gates\textsuperscript{77}) it still may be more efficient to put the loss on the employer rather than employee. The law will reach the "source" of the wrongdoing and thus nip the illegality at the outset.\textsuperscript{78} By fashioning a rule under which the professional wrongdoer always loses, courts might drive many of them out of business.\textsuperscript{79} If fewer wrongdoers remain professionals, there will be fewer participants in the wrongdoing. Moreover, assuming that professional wrongdoers will engage in multiple wrong acts, loss shifting to the professional will conserve judicial resources. Focusing deterrence on this party obviates the need for applying judicial resources to the myriad victims of professional wrongdoing. On the other hand, if the parties appear to be on an equal footing, especially if they are coconspirators, they are equally deterrable and so the court should leave the parties where they are.\textsuperscript{80}

B. The Relative Knowledge of the Illegality and/or of Facts Giving Rise to the Illegality\textsuperscript{81}

1. Party Ignorant of Facts Giving Rise to Illegality

A party's relative degree of knowledge of the underlying illegality also should affect her ability to recover. If the party seeking relief is "excusably ignorant" of the facts giving rise to the illegality or is unaware of the illegal nature of the transaction itself, then the court should grant relief—in whatever form it is sought—to that party.\textsuperscript{82} For instance, courts have
The importance of relative knowledge and sophistication of the parties in another context can be seen in the early cases concerned with violations of the federal securities laws' margin requirements. 15 U.S.C. § 78g (1982 & Supp. IV 1986). As originally enacted, the law prohibited bankers and brokers from extending credit for the purchase of securities except in accordance with regulations prescribed by the Federal Reserve Board. Id. Regulations T (for brokers and dealers) and Q (for banks) “prescribe minimum margin requirements referred to as maximum loan values which have been varied from time to time.” Serzysko v. Chase Manhattan Bank, 290 F. Supp. 74, 77 (S.D.N.Y. 1968). The issue that arises under these regulations is whether an investor has an implied private cause of action when the broker or bank lends in excess of the margin requirement and if so, under what circumstances the investor can be considered as in pari delicto with the broker. In Serzysko the plaintiff investor sued to recover for losses sustained when the bank extended credit in violation of the margin requirements and then sold the collateral at a loss to satisfy margin calls. The plaintiff's theory of loss was that if the bank had required the loans to be collateralized properly, in accordance with the statute, the plaintiff would own the collateral, which had been sold at a loss but which had appreciated in value by the time of the trial. After holding that the investor had an implied cause of action, the court nevertheless rejected the plaintiff's claim, citing the plaintiff's knowledge, sophistication, and fraudulent misleading of the banker as to the purpose of the loans that resulted in the statutory violations. The court found that “to allow the plaintiff to recover in this action would be to encourage rather than discourage deception on the part of investor-borrowers with resulting prejudice to the observance of the margin requirements of the Act.” Id. at 89-90. Although the Serzysko court did not discuss the results of the case in efficiency terms, because the plaintiff knew of the illegality of the loans and intentionally misrepresented the purpose to induce the defendant to loan money, there is reason to think that permitting him to recover would encourage further violations. In addition, there is no particular reason to think that the defendant broker is a cheaper cost avoider or more deterrable as a source of the wrongdoing. See Moscarelli v. Stamm, 288 F. Supp. 453, 459 (E.D.N.Y. 1968) (court unwilling to concede that Congress intended to protect all investors regardless of their participation in the margin violation). These cases generally emphasized that “recovery should be denied to the sophisticated trader on the ground that he is an accomplice in the violation” and because “denying him a remedy would serve as a greater deterrent to future violations.” Comment, Securities Exchange Act of 1934—Civil Remedies Based Upon Illegal Extension of Credit in Violation of Regulation T, 61 M.I.L. REV. 940, 954 (1963). But see Pearlstein v. Scudder & German, 429 F.2d 1136, 1141-42 (2d Cir. 1970) (even knowledgeable investors could prevail against brokers under Reg. T, citing the fact that statutory prohibition was directed solely at brokers). Even Pearlstein, however, can be rationalized in terms of efficient deterrence. In explaining its conclusion that even knowledgeable investors could recover, the court said: “In our view the danger of permitting a windfall to an unscrupulous investor is outweighed by the salutary policing effect which the threat of private suits for compensatory damages can have upon brokers and dealers . . . .” Pearlstein, 429 F.2d at 1141.

Since Pearlstein, 15 U.S.C. § 78g has been amended, making it illegal not only for brokers
awarded relief based on justifiable ignorance of the facts in cases involving the breach of a promise to marry made by a person who is already married. In these cases, a promisee, ignorant of the fact that the promisor is already married, may recover damages even if the promisor's married status renders the contract illegal.83

Disparity in knowledge of the transaction's illegality explicitly influenced a decision to grant rescission to the party lacking knowledge in National Bank v. Petrie.84 In Petrie, the plaintiff had purchased bonds from a national bank. When the plaintiff attempted to set aside the transaction on the grounds of fraudulent misrepresentation and recover the money from the bank on a rescission theory,85 the bank defended on the ground that the contract was illegal and "void" because the bank lacked the authority to sell the bonds.86

The United States Supreme Court rejected the defense, explaining:

The complaint, to be sure alleges that the bank was acting unlawfully in selling the bond, but it does not appear that Petrie [the plaintiff] knew the fact, and it would be a strong thing to charge him with notice or a duty to make inquiries as to how the bank was conducting its business. . . .87

Granting relief in such cases is consistent with a theory of efficient deterrence. In this context, the court seems to be saying that although it could make the plaintiff a parallel enforcer of the bank's corporate behavior, doing so would be a "strong" thing to do. "Strong" may mean

and banks to lend if not in accord with the margin requirements, but also not customers to accept such loans. See 15 U.S.C. § 78g(f) (1982), or also Stern v. Merrill Lynch, Pierce, Fenner & Smith, 603 F.2d 1073, 1080 (4th Cir. 1979) ("investor equally responsible with the broker for observance of the margin requirements"); Pearlstein v. Scudder & German, 527 F.2d 1141, 1145 n.3 (2d Cir. 1975) (discussing effect of the addition of § 78g(f) in extending responsibility for policing violations to investors).

The generally greater willingness to grant recovery to the party ignorant of the illegality also can help explain, in efficiency terms, the results of cases permitting recovery against attorneys. If one assumes that the attorney is likely to have greater knowledge of the illegality and that this knowledge is a central feature of the average attorney-client relationship, then one also can assume that on average it will be more efficient to deter the attorney from engaging in the prohibited conduct. Although it would be possible to deter the client as well, it would be necessary for the client to undertake search costs regarding the illegality. In addition to the knowledge disparity, another characteristic of the attorney-client relationship may be a reservoir of trust by the client in the attorney. The client may naturally assume that the attorney will undertake responsibility for all the requisite legal formalities. This trust also may constitute a persuasive barrier to explicit allocation of the risk of nonenforcement. Kostritsky, supra note 1, at 937-38 (exploring impact of trust on hard bargaining); see also infra text accompanying note 196. If such trust is a central feature of the attorney-client relation, then it may be more efficient to make the attorney the primary monitor of compliance. If the law sanctions the client, it will be expensive to break down that trust in a way that makes the client realize that he must monitor the attorney's activities. Moreover, the information gathering necessary to give the client the knowledge to judge the legality of the fee or other arrangement will require additional costs.

83. See Ashley v. Dalton, 119 Miss. 672, 699, 81 So. 488, 488-89 (1919) (cited in E.A. Farnsworth, supra note 3, § 5.7, at 358).
84. 189 U.S. 429 (1903).
85. Id.
87. Petrie, 189 U.S. at 424.
harsh in terms of the costs involved in making the plaintiff such an enforcer. From a strictly theoretical standpoint, denying relief to ignorant parties will induce them and others to employ costly searches to determine the legality of future transactions before entering them. The promisee of the promise to marry will investigate the promisee's true status, the bond purchaser will explore the bank's corporate powers, and both will adjust their behavior accordingly. Yet even if the system did operate in this perfect, theoretical manner, information gathering would be expensive for society. Thus, it is costly to deter illegal contract formation by placing the loss on unknowing parties. Because in each case one party already knows about the illegality of the agreement or of the facts causing it, the court can deter that party and obviate expensive searches. The court, therefore, can further efficient deterrence by regularly denying the knowledgeable party relief and by granting recovery to the less knowledgeable party—the person in the best position to avoid the illegality can do so at the least cost.

2. Plaintiff Has Parity of Knowledge of the Illegality with Defendant

When the parties' knowledge of the underlying illegality appears equal, the courts should reject or restrict both parties' claims for judicial relief. This should be the case in both enforcement and rescission actions. For example, in *Woodward v. Jacobs* the court, in denying relief to both claimants, relied on the fact that both parties were aware of the illegality. In *Woodward*, a contractor agreed to build a unit for the owner for $40,000. The contractor, however, walked off the job after the $40,000 had been paid, despite the fact that the job was not complete. The owner then hired a substitute contractor to complete the job. The contractor sued for unpaid bills and the owner counterclaimed for damages.

In denying recovery on both the claim and counterclaim, the court approved the trial court's conclusion that "the contract was illegal and that

88. See *supra* note 9.

90. Professor Kronman is similarly concerned with the differential ability of parties to avoid a cost, such as the cost of a mistake, or, in this context, the cost of nonenforcement. In analyzing why the law chooses to allocate the risk of mistake to the party who is already aware of it, he explores the greater costs engendered by putting the risk of a mistake on a party who must, in order to avoid a mistake, "acquire[e] the necessary expertise himself." *Kronman, supra* note 8, at 6.

90. *See, e.g.,* Danebo Lumber Co. v. Koutry-Brennan-Vana Co., 182 F.2d 489, 490, 495 (9th Cir. 1950) (denying party rescission since he had been told about the scheme to cover up the conspiracy), *cert. denied*, 340 U.S. 830 (1950); *Woodward v. Jacobs*, 541 P.2d 691, 692 (Colo. Ct. App. 1975) (denying both parties relief when "[t]here is evidence in the record that the parties were aware that . . . a triplex would be illegal"); *Hendrix v. McKee*, 281 Or. 123, 135, 575 P.2d 134, 141 (1978) (denying recovery on employment contract when plaintiff "knew that the defendant was conducting an illegal gambling operation"); *Tucker v. Binenstock*, 310 Pa. 254, 262, 163 A. 247, 249-50 (1933) (denying accounting when partner's 'direct knowledge' of illegal liquor sales was clear); *Schare v. Thiede*, 58 Wis. 2d 489, 494, 206 N.W.2d 129, 131-32 (1973) ("While they denied that they knew that the arrangement was illegal, all parties to the contract recognized that the agreement was a subterfuge to cover the fact that both . . . were operating the tavern without a proper license.").

91. 541 P.2d 691 (Colo. 1973).

92. *Id.* at 692.
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it had been entered into by the parties with knowledge of its illegality."\textsuperscript{93} The appellate court found "ample support in the record for the court's finding that both parties were knowing, active participants in a plan of action which violated public policy."\textsuperscript{94}

\textit{McCauley v. Michael}\textsuperscript{95} is another case in which the parties' knowledge of the illegality affected the relief granted. In \textit{McCauley} the plaintiff tendered $500 to the defendant's agent to purchase 1,000 shares of corporate stock. Minnesota blue sky regulations required that promotional shares of the type sold to the defendant be escrowed and prohibited the sale of these securities without the Blue Sky Commissioner's consent.\textsuperscript{96} The contract to sell shares to the plaintiff out of escrow and without the Commissioner's consent violated these rules and was therefore illegal.

When the defendant refused to deliver the shares, plaintiff brought suit seeking conversion damages or specific performance in the form of delivery of the stock. A primary question on appeal was whether the purchaser could enforce the stock purchase contract even though the contract was illegal.\textsuperscript{97} The trial court found the agreement to be illegal and unenforceable but permitted the purchaser to recover the $500. The appellate court affirmed that conclusion, denying enforcement but permitting rescission. In concluding that enforcement was not available,\textsuperscript{98} the court focused on the plaintiff's status as a broker-dealer, on his general sophistication, and on his specific knowledge of the purchase contract's illegality. "[H]e fully understood that escrowed shares cannot be transferred by any means."\textsuperscript{99} The court concluded that "McCauley's knowledge and experience generally as a licensed broker-dealer, and his specific knowledge of this particular transaction, will not allow him to enforce the stock contract . . . ."\textsuperscript{100}

Denying enforcement to claimants knowledgeable about the underlying illegality is consistent with the promotion of efficient deterrence. If one assumes that both parties are knowledgeable about the illegality and there are no constraints operative against either party,\textsuperscript{101} then it further can be assumed that the parties will be able to take account of the no-effect rule in deciding whether to enter similar transactions in the future. The fact that both parties will have an equal chance of being the plaintiff who faces the nonenforcement rule further enhances this deterrent effect since either party may breach the agreement and either party may be the victim of the breach.\textsuperscript{102} Thus, the enforcement rule will maximize deterrence as both

\textsuperscript{93} Id.

\textsuperscript{94} Id.

\textsuperscript{95} 256 N.W.2d 491 (Minn. 1977).

\textsuperscript{96} Id. at 494.

\textsuperscript{97} Id. at 495 (although trial court originally found that plaintiff was unaware of illegality, it subsequently amended its finding to conclude that plaintiff had knowledge).

\textsuperscript{98} Id. at 496. Under a strict application of the efficient deterrence doctrine, the court should have denied plaintiff all relief, including rescission.

\textsuperscript{99} Id.

\textsuperscript{100} Id. at 496-97.

\textsuperscript{101} See infra notes 128-32.

\textsuperscript{102} Thus, the "system" of illegal contract deterrence is based on the randomness of loss occurrences. Presumably, the costs associated with random losses are thought to be high
parties will be likely to consider the chance that they, as victims of breach, may not be permitted to recover, and both will adjust their behavior accordingly.

With knowledgeable parties, the nonenforcement rule is not only a strong deterrent, but is also the most efficient deterrent. Social costs are incurred when courts award relief and shift losses from one party to another. When the parties are equally deterrable, shifting the loss from one party to another will not increase the overall deterrent effect. Thus, it would be inefficient for courts to generate the social expense of loss shifting by enforcing the contract.

If loss shifting is generally not efficient when the parties are equally knowledgeable about the illegality, then one must ask how, if at all, the McCauley court's grant of restitutionary recovery to the purchaser promotes efficient deterrence. Arguably, it would promote deterrence even more to deny the plaintiff the $500 downpayment because otherwise the purchaser's entry into the illegal transaction becomes risk free. If one focuses on the role that the parties played in the transaction, however, it may make economic sense to grant restitutionary recovery. In McCauley, had the court denied the plaintiff purchaser recovery of the $500, then the putative seller would have been able to keep the $500 without delivering any of the shares that were the subject of the illegal agreement. Denying restitution would affirmatively tempt sellers in similar positions to commit violations, effectively involving many potential future purchasers. The purchaser that is permitted to recover the $500 has less positive incentive to commit violations than the seller who receives a windfall benefit.

C. The "Voluntariness" of the Illegal Actions

A third factor that should affect the outcome of cases is the voluntariness of the parties' actions. If circumstances indicate the presence of fraud, duress, or other overreaching by one party, the courts should grant judicial relief to the party who has been victimized by this conduct despite his participation in an illegal contract. On the other hand, if the facts indicate that no constraints operate against either party and the claimant is a voluntary and active participant in the illegality, the courts should not grant a judicial remedy to either party.107

enough to act as a powerful deterrent. This deterrence system operates on different assumptions as to how legal rules should be applied than those underlying a system based on formalities. See supra note 2. In the case of formalities, it is important to design a system with predictability that parties can follow, secure in the expectation that if they follow its directives, enforcement will be available.

103. See Coase, supra note 35, at 15.
104. See infra text accompanying notes 145-56; see also infra note 118.
105. See Kennedy, supra note 8, at 582; see generally Wade, supra note 12, at 272-82.
107. See infra text accompanying notes 128-32.
1. Defect in Bargaining Process: Fraud, Duress, or Other Overreaching

Traditionally, courts grant relief more readily when defects in the bargaining process render the "voluntariness" of the illegal agreement suspect.108 Lockman v. Cobb109 illustrates the type of overreaching that will prompt a court to permit the victim to recover. In Lockman, the plaintiff (Cobb) sued to recover money paid to the defendants as a wager on an illegal foot race. The facts indicated that the plaintiff, who knew nothing about racing or betting, was fraudulently induced to enter a wager agreement by the defendants, who were professional gamblers. The defendants conspired and set up an elaborate scheme in which they told Cobb that he was needed to bet their money for them at a club for millionaires and that "he was not to hazard any money of his own."110 As part of the scheme, the runner on whom Cobb bet fell during the race and a new race was scheduled. In this subsequent race, Cobb was persuaded to bet his own money, assured by the defendants that the race was fixed in his favor and that he would get back all of his money. Cobb was told that the race took place, even though it had not, and that he had lost.

At trial, the court ordered a judgment in favor of the plaintiff and awarded damages for the amount requested. The Supreme Court of Arkansas affirmed, emphasizing that the plaintiff was robbed of his money by fraud and deceit:

[I]t was a conspiracy by the defendants to defraud the plaintiff and to steal his money; to obtain by deceit and falsehood the money of plaintiff by inducing him to believe that a foot race was to be run and that they were actually wagering their money, one against the other, upon it; and to induce him to believe he was betting upon a foot race.111

A court's willingness to set aside such contracts or to grant avoidance rights to a party that has been the victim of fraud or other overreaching can be rationalized in many ways.112 Legal theorists explain the law permitting avoidance for fraud and duress victims in terms of (1) the assent principle,113 (2) welfare maximization,114 and (3) substantive fairness.
principles.\textsuperscript{115} If a dominant party employs duress to overcome a person's will, assent theorists find no reason to enforce the obligation because it lacks the key element of voluntariness requisite to contract obligation. Some contemporary scholars justify avoidance rights on the basis that contracts induced by fraud do not maximize welfare. The victims of fraud lack the information necessary to decide which transactions are value maximizing and thus cannot allocate their resources to their highest valued uses.\textsuperscript{116} Critical legal studies scholars explain avoidance premised on duress as evidence of paternalistic fairness principles that traditional scholars seek to deny and suppress.\textsuperscript{117}

The basis for an approach permitting fraud or duress victims to escape the normal operation of the no-effect rule by granting relief can, however, be reconceptualized in efficient deterrence terms. If one of the two parties to a contract is peculiarly vulnerable to being duped by others, as in \textit{Lockman}, then it is not likely that the additional sanction of refusing judicial aid would deter that person from entering such a contract in the future. There are several reasons why this is so. First, if the fraudulent party misleads the party seeking relief as to the steps being taken to comply with the law, the misled party is not likely to take any further steps toward compliance and it would be inefficient to sanction him. Second, even if a party knows of the illegality and is defrauded on some other matter such as the sureness of the potential profits, as in \textit{Lockman}, a court still may decide that it is more efficient to deter the defrauder than the victim of the fraud. Parties who have been victims of fraud schemes may, as a general matter, share certain vulnerabilities that make them susceptible to the persuasive powers of others. Victims with these less sophisticated characteristics might consistently overvalue the potential benefits of the deal and discount the risks of nonenforceability, and thus fail to respond to the deterrent effect of potential voidness. Alternatively, persons having these vulnerabilities may have such substantial self-interested motivations to ignore the law that a judicial sanction may be ineffective against them. If the courts nonetheless deny relief to the fraud victim, it is not likely that the denial will result in efficient deterrence. The constrained party would continue to enter into illegal contracts because of his unsophisticated characteristics. When a defect in the bargaining process exists, therefore, the cheapest and most effective way to deter illegal contract formation is to impose the loss upon the defrauder.

\textit{But see} Dalton, \textit{ supra} note 1, at 1025. Professor Dalton describes the approach based on determining the genuineness of assent as "unworkable" because "we cannot directly know or ascertain the subjective intent of the disfavored party." \textit{Id.; see also} Dawson, Economic Duress—An Essay in Perspective, 45 Mich. L. Rev. 253, 266 (1947); Gordon, \textit{ supra} note 17, at 211.

\textsuperscript{114} R. Coffey, Information Failures: Nature, Significance, Prevention and Rectification 4 (Sept. 12, 1985) (unpublished manuscript) (copy on file at Iowa Law Review) ("information failure in securities transactions may . . . allocate total wealth between consumption and investment in a manner that is inconsistent with the real range of investment-consumption opportunities available").

\textsuperscript{115} Dalton, \textit{ supra} note 1, at 1024 (describing duress as a "public" doctrine "to police the limits of 'fair' bargain").

\textsuperscript{116} R. Posner, \textit{ supra} note 19, at 81-82.

\textsuperscript{117} See generally \textit{supra} note 115.
ILLEGAL CONTRACTS AND EFFICIENT DETERRENCE

Last, because the defendant fraud perpetrators in *Lockman* were professionals and the plaintiffs were nonprofessionals, imposing the loss on the former is likely to promote efficient deterrence for another reason. If the courts consistently impose the loss on the professional wrongdoers, they will deter a party with incentive to engage in multiple illegal transactions. Courts can thus achieve greater deterrence at a lower cost. Of course, it is possible to argue that the defrauder would be the more difficult party to deter because the fraudulent party might be willing to take extraordinary risks, including the risk of nonenforcement, to achieve those profits. Even if one admits the difficulty of deterring the defrauder, the risk of multiple violations by such parties might justify, in efficiency terms, the costs associated with shifting losses to that party. Moreover, the size of the expected gains by the defrauder might indicate a willingness by that party to assume whatever risks might accrue from the transaction, including the risk of nonenforcement.

2. Economic Leverage

Courts also appropriately depart from the no-effect rule—through intervention—on the basis of (1) economic coercion exercised against, or (2) lack of bargaining power by, the party seeking relief. *Karpinski v. Collins* illustrates the influence of the coercion factor. In *Karpinski*, the plaintiff sought recovery of rebates which he alleged he had been coerced into paying in order to obtain a Grade A milk contract. The defendant

118. Professor Wade pointed out the importance of this distinction in determining outcome. *Wade, supra* note 12, at 277-78 ("plaintiff is greatly aided if he can show that the defendant is engaged in transactions of this sort as a kind of business"). Professor Wade explains this distinction in terms of a kind of moral distaste for professional profiteering. *Id.*

One court recognizing the importance of professional status for maximization of deterrence is *Watts v. Malatesta*, 262 N.Y. 80, 82, 186 N.E. 210, 211 (1933) ("Curb the professional with his constant offer of temptation . . . and you have to a large extent controlled the evil."). *Id.*

119. *See supra* note 118.

120. *See, e.g.*, Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134, 145 (1968) (White, J., concurring) ("When those with market power and leverage persuade, coerce, or influence others to cooperate in an illegal combination to their damage, allowing recovery to the latter is wholly consistent with the purpose of § 4, since it will deter those most likely to be responsible for organizing forbidden schemes."); *Greene v. General Foods Corp.*, 517 F.2d 635, 646 (5th Cir. 1975) (denying defendant—a small businessman, to participate in an antitrust violation—*in pari delicto* defense because of "disproportionate bargaining power"); *cert. denied*, 424 U.S. 942 (1976); *see also CVD, Inc. v. Raytheon Co.*, 769 F.2d 842, 856 (1st Cir. 1985) (*in pari delicto* defense inappropriate against party "overwhelmed by a party in a superior bargaining position"); *American Motor Inns v. Holiday Inns*, 521 F.2d 1250, 1255 (3d Cir. 1975) (denying defendant *in pari delicto* defense because plaintiff franchisee was subject to dictatorial control of defendant).

Although courts readily cite coercion as a factor militating in favor of recovery, the difficulty of establishing when coercion exists is readily apparent. *See generally A. Wertheimer, COERCION* (1987).

121. *See Beynon v. Garden Grove Medical Group*, 100 Cal. App. 3d 698, 705, 161 Cal. Rptr. 146, 150 (1980) (granting weaker party avoidance rights because "no evidence that the agreement was negotiated by parties having a parity of bargaining strength"); *see also William J. Davis, Inc. v. Slade*, 271 A.2d 412, 415 (D.C. 1970) (rejecting *in pari delicto* defense because of "great disparity in bargaining position" between landlord and low income tenant).

122. 252 Cal. App. 2d 711, 60 Cal. Rptr. 846 (1967).
creamery defended, citing the illegality of the rebates. In rejecting the defense and in affirming the trial court judgment awarding the plaintiff restitution of all amounts paid to the defendants, the appeals court relied on the economic coercion factor. It found that because the "plaintiff was a small dairyman whose economic survival was dependent upon his ability to obtain a Grade A milk contract in a locality where such contracts were extremely scarce," "he was therefore peculiarly vulnerable to the exertion of economic coercion by a person such as the defendant ... ."

Assuming that the defendant does exercise financial pressure on the plaintiff, saying in effect "deal with me on these terms or there is no deal at all," withholding or denying legal effect to illegal contracts will promote efficient deterrence. Those who are susceptible to and accede to financial pressure because they avidly want what the other has to offer (as Karpinski wanted the Grade A contract) may be substantially motivated to ignore all risks associated with the achievement of that goal, including the risk of nonenforcement. In these cases the court may decline to apply the no-effect rule because it may conclude that those susceptible to economic pressure will fail to give adequate weight to the nonenforcement cost and consistently will choose to incur the risk of nonenforceability to promote their own sense of self-interest. Even if the Karpinski scenario is conceptualized differently, a court still may find it inefficient to apply the no-effect rule against the farmer. If the farmer lacks alternatives to the dairy by which to get a Grade A contract and the dairy thereby has sufficient market power to "force" the farmer to accept the terms of illegal rebates, one may argue that the farmer has not truly "assented" to the agreement. It is arguable that under these circumstances the parties' failure to assign expressly the risk of nonenforcement does not represent a recognition that the aggregate interests of the dairy and the farmer will be served by leaving the loss where it falls, but rather the coercive imposition of that allocation by the dairy on the farmer.

Regardless of how Karpinski is conceptualized, either as a deliberate assumption of the risk of enforcement to maximize private interest or as forced acquiescence in an equal allocation of the risk of nonenforcement, the court should conclude that the "coerced" party will be a poor candidate.

123. The amounts paid to the defendants included $6,500 loaned by the plaintiffs to the defendants and $4,177.22 in rebates. Id. at 714, 60 Cal. Rptr. at 848.
124. Id.
125. Id.
126. Since this is the choice that confronts parties in most financial transactions, see Dalzell, supra note 108, at 298, conservative theorists argue that parties subject to these choices should not be considered coerced and should not be granted avoidance rights. See Epstein, Unconscionability: A Critical Reappraisal, 18 J.L. & Econ. 293, 297 (1975). Under Epstein's view, Karpinski was arguably not coerced because he was put to the same choice that others are put to: forgo either his entitlement (his money in the form of rebates) or a Grade A contract (his desire).
127. As Professor Dalzell has pointed out, even in cases in which the offeree is presented with two very unpalatable alternatives from which to choose, the offeree may make a perfectly rational and deliberate choice of the most desirable (least offensive) alternative. Dalzell, supra note 108, at 238. On the basis of the above contention Professor Dalzell would probably dispute that the choices made, even in the fraud context, are any less consensual than would ordinarily be the case.
for the deterrence sanction. The "weaker" party will either ignore the sanction in self-interest or fail to allocate the risk because of an inability to bargain over any term.

Demonstrating a plausible basis for why it may be difficult to deter the victim of the overreaching does not explain why it would be more efficient to deter the coercing party. For instance, in *Karpinski* it may be argued that the dairy is susceptible to the same substantial incentives to ignore the law and is thus an equally weak candidate for deterrence. If the profits from the illegal rebates are large and the risk of farmers' lawsuits is small, then arguably both categories of parties are weak candidates for the deterrence sanction. If that were the case, then neither party would be a superior risk bearer of the cost of nonenforcement and shifting the loss from the farmer to the dairy would seem to achieve no efficiency gains. However, if the dairy's position as an entity likely to engage in extortion of illegal rebates from all farmers is taken into account, it may make economic sense to force the dairy to disgorge the illegal rebates. Otherwise, if the court left the parties where it found them, the dairy would be able to retain the illegal rebates. That result would send a message to individual farmers to refrain from paying these rebates. Farmers would realize that no matter what the agreement with the dairy, they would never get restitution of the illegal rebates and so would be more reluctant to pay them in the first place. That result, however, would be a costly means of achieving deterrence. Individual farmers would have to be educated to the costs of nonenforcement. Deterrence of farmers might be difficult because farmers, when presented with the alternatives of paying illegal rebates or losing the contract altogether, would always opt for the illegal rebate. The incremental costs of the rebate always would be less than the costs of losing the contract. If sufficient deterrence can be applied to the dairy to force it to cease accepting the bribes, then the practices may cease altogether and it will not be necessary to worry about deterring a large number of individual farmers.

Another reason why it may be more efficient to deter the dairy, or comparably situated parties, is that doing so might achieve the result that the parties would have reached in private negotiation, had the risks about the illegal rebates been allocated explicitly. Since the profits from the multiple illegal rebate deals would be large, the dairy presumably would be willing to take more risks, including the risk that the illegal rebates would be returned to the customer, in order to secure those profits.

In every case in which the parties both stand to profit from the illegality, as in *Karpinski*, the question that needs to be asked is how the loss from entering into an illegal transaction should be allocated and why. If the dairy is permitted to retain the illegal rebates, it will be given an incentive to engage in multiple illegal transactions, secure in the knowledge that farmers will never be able to recover the rebates because the "illegality" would defeat their claims. If, however, the farmer is given a right to rescind and to recover the rebates in every case, relegating the dairy to no more than a legal amount in every case, that might act as a potential deterrent to collecting the illegalities initially. On the other hand, the farmer who has no desire to pay illegal rebates, and would prefer not to if given the choice, should be allowed to recover the illegal rebate. Restitution of those amounts will encourage farmers to sue on the illegal contracts, thus bringing the
illegality to light and providing the only possible deterrent to the dairy’s illegal practices.

3. No Constraints Operative Against Either Plaintiff or Defendant

If no apparent constraints operate against either party and both parties appear to conspire actively and voluntarily to participate in the wrongdoing, neither party should secure judicial relief.\(^{129}\) *Ryan v. Motor Credit Co.*\(^{129}\) illustrates this contention. In *Ryan* the plaintiff, a used car dealer with ten years’ experience, purchased automobiles from the defendant on credit. A state statute, which governed the extension of credit between the parties, prohibited any individual from owing more than $300 to a lender.\(^{130}\) To avoid this dollar limitation, the plaintiff and defendant conspired to create a dummy loan scheme in which the plaintiff received loan proceeds from loans made to fictitious persons. When the dealer defaulted on his loan obligations, the lender brought a replevin action to recover the unsold cars. The plaintiff and defendant each sought various forms of relief. The plaintiff (dealer) sought a one-sided voidability right under which he could avoid his obligations on the promissory notes and recover monies already paid to the defendant. He also sought a hands-off policy, which would preclude the lender from succeeding in its replevin action. The lender sought to enforce a guarantee agreement, which would protect him in the event of a shortfall upon foreclosure. The court denied relief to both parties, dismissing the complaint and the counterclaim\(^{131}\) and denying the defendant the right to recover the deficiency remaining after the repossessed automobiles were sold.

In deciding that the plaintiff was not entitled to relief because he was *in pari delicto* with the defendant, the court emphasized that the plaintiff “had previously operated a used car business . . . and had borrowed moneys from small loan companies there.”\(^{132}\) In fact, the plaintiff had ten years’ experience as a used car dealer and the defendant was a lender. There were thus no significant, apparent disparities in status as when one party is dependent on the other. Moreover, there was no evidence of coercion or other overreaching by one party against the other. Both parties appeared to be equal participants in the scheme. Hence, the court applied a “leave-the-parties-where-they-are” approach, denying avoidance and restitution rights to the plaintiff and enforcement rights to the defendant.

In a situation of equality, as in *Ryan*, the parties are equally deterrable. Because no clear benefit results when the loss is shifted from one equally deterrable party to another, it is more cost efficient to leave the parties where they are. It could be asserted that *Ryan* is an appropriate case in which to apply the fountainhead argument against the dealer. Since the

\(^{128}\) See cases cited infra note 80.

\(^{129}\) 130 N.J. Eq. 581, 28 A.2d 607 (1941), aff’d, 132 N.J. Eq. 398, 28 A.2d 81 (1942).

\(^{130}\) The purpose of the statute was to make available up to $300 in credit to borrowers who otherwise could not secure credit. Any further borrowings were subject to the ordinary interest rate cap of 6% (Small Loan Act, ch. 62, Pub. L. No. 1932) (current version at N.J. Stat. Ann. § 17:10-2 (West 1984)).

\(^{131}\) *Ryan*, 130 N.J. Eq. at 563, 28 A.2d at 625.

\(^{132}\) *Id.* at 558, 28 A.2d at 622.
dealer will engage in many potential violations, deterring the dealer arguably would prevent many more future violations more efficiently than deterring the individual borrower. In Ryan, however, the borrower actively conspired with the defendant in order to benefit his business interests, a result that likely would accrue in every illegal loan in which he participates, thus indicating that the borrower is likely to engage in multiple future violations. A rule directed at deterrence of both dealer and borrower, therefore, makes economic sense.

D. The Degree of Claimant's Participation in the Wrongdoing: 133
Claimant Knowledgeable About, But Not an Active Participant in, the Illegality: Relief Granted

Even if the claimant knows of the underlying illegality, she still should recover if the defendant is the active wrongdoer and the claimant only a passive participant. 134 Ordinarily, a no-relief rule promotes efficient deter-

133. See Strong, supra note 4, at 376 (discussing importance of participation factor).
134. The Restatement (Second) of Contracts recognizes the possibility of recovery even when the promisee has knowledge “of some improper use that the promisor intends to make of what he obtains unless the promisee (a) acted for the purpose of furthering the improper use, or (b) knew of the use and the use involves grave social harm.” Restatement (Second) of Contracts § 182 (1979). See, e.g., Graves v. Johnson, 179 Mass. 53, 57, 60 N.E. 383, 385 (1901) (“Seemingly the plaintiffs did not act in aid of the defendant’s intent beyond selling him the goods [liquor].”); cases cited in E.A. Farnsworth, supra note 3, at § 5.6 n.26; see also cases cited infra note 138. One other efficiency concern that may be lurking behind the active/passive distinction is a concern that a rule deterring the less active party may lead to overdeterrence and thus be inefficient for that reason. Golberg v. Sanglier, 96 Wash. 2d 874, 639 P.2d 1347 (1982), may illustrate this point. In Golberg, the defendant applied for a Cadillac dealership, agreeing in return to furnish $100,000 in unencumbered funds. Since the defendant did not actually have the cash, he recruited three other partners to join him in the venture, each contributing $33,000. Because Cadillac required unencumbered funds, the defendant franchisee misrepresented the source of funds to be a family gift and the partnership agreed to participate in concealing the true source of funds. Id. at 881, 639 P.2d at 1352. After the partnership was formed, the defendant franchisee began to negotiate to sell the company and solicited one of the three other partners to participate in a scheme to divert the remaining partners of the stock without revealing the ongoing negotiations for the sale to a third party. Id. at 877-78, 639 P.2d at 1350. The partner in collusion with the franchisee convinced the plaintiffs to sell their stock by false statements as to the mismanagement of the company. Id.
When the plaintiffs realized the deception, they sued for damages based on the profits that could have been realized had they not been fraudulently induced into selling their stock. The defendants argued that the plaintiffs were precluded from recovering because they had participated in a violation of the Washington securities laws by concealing from the franchisor the true source of the funds. Id. at 876-79, 639 P.2d at 1349-50.

The court permitted the suit, citing as its rationale the exception to the nonenforcement rule which arises when the parties are not in pari delicto. Id. at 882-88, 639 P.2d at 1352-56. The result also is explainable in terms of the less extensive participation by the plaintiffs. A concern with efficient deterrence also may explain the result. First, the petitioners alleged that they believed the transaction to be legal and thus would be difficult to deter. Second, the alleged fraud on the franchisor was a relatively harmless error since the partnership had agreed not to recover profits until the franchisor was paid off. Thus, the violation was merely a technical one and penalizing the investors for their participation in the nonmaterial violation might act to deter future investors from future deals. The punishment (denial of remedy) thus would be disproportionate to the offense and therefore might result in overcaution. Moreover, the court clearly found the more active wrongdoer and opportunist to be the franchisee. By permitting the likely repeat offender to prevail, the court would deprive itself of the opportunity to deter
rence when the parties are equally knowledgeable about the illegality. This principle, however, will not apply in cases in which one of the equally knowledgeable parties plays a more active role in the wrongdoing than the other knowledgeable party.

_Holman v. Johnson_\(^{135}\) illustrates the impact that differential participation in the illegal scheme may have on the outcome of a case in which the parties have equal knowledge of the illegality. In _Holman_, the plaintiff agreed to sell tea to the defendant, who intended to smuggle it into England. When the defendant refused to pay for the goods delivered, the plaintiff brought an action for the agreed price. Since the contract was made and completed in Dunkirk where the sale was legal, the court was faced with the question of whether the plaintiff's cause of action transgressed the laws of England. The court found the plaintiff guilty of no offense,\(^{136}\) concluding that the plaintiff's knowledge of the illegal purpose was insufficient to render the contract unenforceable. The court distinguished the case of "a bargain which is to be paid in case the vendee should succeed in landing the goods"\(^{137}\) from the facts of the case before it on the ground that the plaintiff was indifferent to the outcome of the smuggling operation and approached the transaction as he would any legitimate sale of goods.

How does the plaintiff's "concern in the transaction" and degree of participation in the illegality relate to the goal of efficient deterrence?\(^{138}\) If a court wishes to maximize efficient deterrence and is faced with the choice of leaving the parties where they are or intervening to grant relief, it should intervene on behalf of the wrongdoer that is clearly less active. First, imposing the loss on a passive, though knowledgeable, participant may lead to overdeterrence of even legitimate transactions. Even if the seller in the fountainhead of crime and thus be inefficient in its administration of sanctions.


136. The court stressed that because the sale of the tea occurred in Dunkirk, where such a sale was legal, it alone did not constitute an unlawful offense. _Id._ at 1120-22.

137. _Id._ at 1121.

138. Other courts have echoed the view that the degree of participation in the wrongdoing is a relevant factor in resolving questions of relief. *See*, e.g., California Pac. Bank v. Small Business Admin., 557 F.2d 218, 219-20 (9th Cir. 1977) (parties _in pari delicto_ when bank masterminded scheme to evade federal law requiring assumption of 10% of risk and SBA failed to exercise requisite oversight); Severance v. Knight-Counihan Co., 29 Cal. 2d 561, 569, 177 P.2d 4, 8-9 (1947) (denying recovery when both parties took role in agreement to defraud creditors); Woodward v. Jacobs, 541 F.2d 691, 692 (Colo. 1973) (denying relief when both parties "active participants"); State v. AAMCO Automatic Transmissions, 295 Minn. 342, 348, 199 N.W.2d 444, 448 (1972) (denying relief to party whose participation was "both knowing and willing"); International Aircraft Sales v. Betancourt, 582 S.W.2d 632, 635 (Tex. 1979) ("if vendor in any way aids the vendee in his unlawful design to violate the law, such participation will render void the contract of sale and will bar recovery"); Blossom Farm Prods. v. Kasson Cheese Co., 133 Wis. 2d 386, 392, 395 N.W.2d 619, 622 (1986) (denying claim for contract price because of plaintiff's "knowledgeable involvement in [defendant's] improper conduct"); _see also_ Pinter v. Dahl, 108 S. Ct. 2063, 2074 (1988) (plaintiff purchaser's suit "should not be barred where his promotional efforts are incidental to his role as investor"); Comment, _Antritrust: Limiting In Pari Delicto as a Defense to Treble Damage Actions_, 53 MINN. L. REV. 827, 828 (1969) (in _pari delicto_ denies recovery to an "active participant in an illegal or morally delinquent scheme"). The impact of the participation factor also is illustrated by cases in which less extensive participation in the wrongdoing by one party may persuade a court that judicial recovery for that party should be available.
Holman knew of the defendant's intended illegal purpose, the defendant still could change his mind and use the goods for a legal purpose. If one adopts a rule that prohibits potential sellers from entering into transactions with any purchaser who initially has an illicit purpose, then even perfectly legal transactions (those in which the defendant changes the intended use to a legal one) will be deterred.

Second, it also may be more efficient to deter the more active participant because the court may thereby reach the source of the wrong. Because it is likely that each active wrongdoer will engage in more than one illegal transaction, imposing the disincentive on this party will cast a wider net of deterrence.

Finally, in cases in which the passive party has no particular interest in the illegal aspect of the transaction—she stands to gain no more from the illegal transaction than from an ordinary transaction—while the active wrongdoer stands to profit by the extraordinary gains associated with an illegal transaction, the active party's incentive to enter into such illegal transactions will be greater. Because the expected gain will be great, there is a greater incentive for active parties to engage in multiple illegal future transactions. It is more important, therefore, to deter the active party and stifle this additional incentive. It is less important to deter the passive party because, when given the choice, such a party is not inclined to choose an illegal transaction because the profit obtained from each transaction (legal or illegal) will be identical.

Another case in which the degree of participation affected the outcome of the case is Greene v. Brooks. In Greene the parties entered into a partnership of a supper club, in which each partner was to have responsibility for different facets of the business. The defendant was to make all decisions regarding the bar. When the plaintiff partners sued for an accounting, the defendant used the illegality defense, alleging that the license had been illegally issued in the defendant's name only. The court rejected the defense and allowed the plaintiffs to recover despite the "technical" illegality. Although the Greene court rationalized the outcome in terms of the greater fault of the defendant, the decision also is explicable in terms of relative participation and efficient deterrence. Since

139. The importance of deterring the source of the wrongdoing has prompted courts to impose liability on corporate insiders and broker-dealers in the securities law context. As one court explained.

The true insider or the broker-dealer is at the fountainhead of the confidential information . . . . If the prophylactic purpose of the law is to restrict the use of all material inside information until it is made available to the investing public, then the most effective means of carrying out this policy is to nip in the bud the source of the information, the tipper, by discouraging him from "making the initial disclosure which is the first step in the chain of dissemination."

140. This may not be true in every instance, and if the less active wrongdoers stood to gain extraordinary profits, their incentives to enter illegal transactions would be greater.


142. Id. at 169, 45 Cal. Rptr. at 104.

143. Id.
the defendant had control of the bar, it was more efficient to direct the sanction against him. Otherwise, if the defendant were allowed to defeat the accounting action, future parties in the plaintiffs' position will be required to take on an oversight role of the other partners' activities, which will involve significant costs. The courts should direct the sanction at the party who actively sought to keep the copartner's name off the license and thus target the deterrence at those considering whether to engage in this type of behavior in the future.144

E. The Benefit to the Defendant and Claimant from Wrongdoing145

The windfall factor also should affect a court's assessment of which party is in the best position to be deterred. If nonenforcement produces a windfall gain which, because of the likely sequence of the parties' performances, regularly accrues to one party rather than the other, the recipient of the windfall gain will have a strong incentive to commit the violation and rely on the no-effect rule as a defense to liability.146 If the other party does not stand to gain a similar windfall from the no-effect rule, he will have less incentive to enter illegal contracts. When the incentives to violate the law or public policy are unequal, it makes economic sense to apply the relief rules in a manner that will remove the stronger incentive.147

1. Differential Benefits

The Gates148 case, which involved the employment of an illegal alien, illustrates differential incentives to commit violations. If one assumes that employers regularly pay their employees for services already rendered,149 the employer and the employee would have different incentives to enter an illegal contract. The employer will have a positive incentive to hire persons in violation of the immigration laws because he will regularly secure a windfall. Moreover, because of his superior position and status, he is more likely to know of the no-effect rule and thus be able to exploit it to his advantage. He is likely to perceive that he can obtain services and subsequently use the no-effect rule as a defense if the alien sues for wages. Imposition of a no-recovery rule in such contexts will provide a strong

144. This case also may be explained in terms of differential incentives to commit illegibilities. See infra text accompanying notes 148-56.
145. For a discussion of the benefit factor, see Wade, supra note 4, at 48-51, 52-53.
146. Wade, supra note 4, at 55 ("To a defrauder, the knowledge that the law will permit him to keep ill-gotten gains will be an incentive to induce another to participate in an illegal contract.").
147. In cases in which one party regularly benefits more than the other, courts should allocate the risk of loss to the party receiving these greater benefits because, had the parties negotiated privately, this party would have been more likely to assume the risk of nonenforcement, speculating that the benefits would outweigh the costs.
148. See supra note 61.
149. Of course, one might wonder why the workers do not stop working or demand daily payment to avoid the potential risks of nonpayment when the employer retains the right to pay at the end of a period. It may be that the worker lacks the information about the risks of nonpayment which might, if known, affect the worker's willingness to assume the risks of periodic payment and the concomitant risk of nonpayment.
incentive to employers to commit future violations to reduce the cost of doing business. Allowing the alien to recover simply will permit the employer to break even by paying for services received. In neither instance will the employer incur a loss. The illegal worker, on the other hand, will not have the same positive incentive to enter these agreements because he will not obtain a windfall profit from working in violation of the immigration laws. If the employer pays him, either voluntarily or by judicial decision, the employee simply will break even, receiving compensation for work already completed. If, however, the court invokes the nonenforcement rule, the alien will suffer a net loss. In neither instance will the alien secure a windfall as the employer does when the contract is not enforced. Thus, one explanation for the result in *Gates* and similar cases\(^{150}\) is that the courts are concerned with deterring illegal behavior as effectively as possible. It makes economic sense to deter the employer and others who, because of the likely sequence of the parties' performance, stand to gain a windfall from the no-effect rule. Parties who will receive windfalls regularly are likely to enter into multiple illegal transactions which will be advantageous to them.\(^{151}\) Thus, deterring those with greater incentive to commit illegalities is more efficient because it may help to prevent many future violations.\(^{152}\)

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150. See *supra* note 65.

151. Courts and commentators have voiced a concern with the adverse impact on deterrence that a windfall benefit might have. See, e.g., *Gellhorn*, *supra* note 9, at 689. Professor Gellhorn treats a case involving a claim for overtime wages by an employee who worked in excess of the statutorily permitted maximum of eight hours a day. In discussing the state court decision finding the employee guilty of violating the statute and denying him a claim for the overtime, *Gellhorn* states that "If the decision affected the policy of limiting work-hours, it could affect it only adversely, since the employer was assured immunity against the necessity of paying wages for any over-time services." *Id.*

152. The likelihood of future and recurrent windfalls is likely to arise in the context of unlicensed contractors and professionals. In these cases an unlicensed professional such as an architect performs services: when she sues to recover her fee, the owner refuses to pay, citing the illegality in the failure to obtain a license. E.g., *Wilson v. Kealakekua Ranch*, 57 Haw. 124, 125, 551 P.2d 525, 526 (1976). Sometimes the courts deny the professional all recovery. See, e.g., *Douglas v. Smulski*, 20 Conn. Supp. 226, 229, 131 A.2d 225, 226 (1957) (because plaintiff was not licensed as an architect, he could not recover for the value of architectural services rendered). In other cases, the court may allow recovery citing such factors as substantial compliance with the licensing requirements, see, e.g., *Latipac, Inc. v. Superior Court of Marin County*, 49 Cal. Rptr. 676, 680-81, 411 P.2d 564, 568-69 (1966) (plaintiff contractor substantially complied with licensing requirement by holding valid license at time of contracting and by renewing it just after performance), the absence of harm to the public from permitting the recovery, see, e.g., *Vitek, Inc. v. Alvarado Ice Palace*, 34 Cal. App. 3d 586, 594-95, 110 Cal. Rptr. 86, 92 (1973) (contractor who received valid license one day after contract was signed did not undermine "statutory purposes of public protection"), or the mere revenue raising purpose of the statute. See 6A A. Corbin, *supra* note 4, § 1527.

Application of efficient deterrence theory and the differential benefit factor suggests explanatory reasons why recovery should be readily allowed in such cases. If the owner is allowed to escape payment for services rendered even when the violation of the licensing statute is merely technical or there is no harm to the public because the professional is duly qualified, owners will have an incentive to hire unlicensed professionals. It still is possible, however, to rationalize the no-effect rule for unlicensed professionals in terms of efficient deterrence. The contractor is the party most likely to know whether she is licensed and is in the best position to effect compliance at the least cost. In view of this factor, denial of recovery still may be appropriate.
A potential counterargument to a scheme of loss allocation directed at the party who benefits most regularly from nonenforcement is that it may be easier to deter the party who does not have an extraordinary stake. Thus, courts could achieve a greater likelihood of success if they directed the losses of the illegal venture against the party with the lesser stake. The indifferent party would more readily give up the illegality because it means little to her. However, the very factors that cause one of the parties to expect a greater potential benefit from the illegality also make that party a likely "repeat offender." Therefore, it may be more efficient to deter him for that reason.

2. Equal Benefit from Wrongdoing; Fortuity of Loss

In contrast to the cases in which differential incentives propel the party who stands to secure a windfall to violate the law, courts should take a different approach in cases involving conspiracies in which there is neither a regular or identifiable sequence of performance, and thus no party regularly securing a windfall, nor market imperfections in the form of informational disparities. In these cases the courts should apply the no-effect rule when either party seeks judicial relief of any kind. For example, in Russell v. Soldinger both parties actively conspired to suppress the bidding on a parcel of land at a probate sale. The parties agreed not to bid against each other, with the bidder to take title jointly with the party who dropped out of the bidding process. The defendant-bidder then refused to convey a proportionate interest in the legal title to the plaintiff who had dropped out of the bidding in accordance with the agreement. The plaintiff sued for a declaration of a constructive trust and filed a motion demanding a title transfer, or the alternative of monetary damages. The trial court granted a nonsuit to the defendants.

On appeal the court affirmed the judgment for the defendants, finding the agreement void and unenforceable. Although the court did not discuss the case in terms of the benefit factor and its effect on deterrence, application of the no-effect rule is consistent with the judicial goal of efficiently maximizing deterrence. Thus, in Russell it is difficult to identify a class of persons or conspirators in advance who will be more likely to gain a windfall, even though an individual party may later secure a windfall on an ad hoc basis. Nothing in the facts indicates one class of persons will routinely bear the initial loss and thus be forced to seek judicial intervention just to break even while the other party will regularly receive the initial benefit and then a windfall profit upon the imposition of the


155. Id. at 640, 131 Cal. Rptr. at 149.

156. Id. at 642, 131 Cal. Rptr. at 150.
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no-effect rule. Instead, each party has an equal chance of suffering from the other party's breach by nonperformance. Because it is fortuitous as to which party initially will bear the loss, neither party has a greater incentive than the other to commit the illegality. In this situation, the court should apply the no-effect rule and leave the parties in the same position in which they exist. Shifting the loss will not enhance deterrence, and thus there is no reason to generate the costs of such loss shifting. The pattern of fortuitous losses will provide the same level of deterrence as would judicial intervention.

IV. **Doctrinal Exceptions Reexamined: Do Their Applications Reflect a Unified Theory of Efficient Deterrence?**

Apart from the factual variants to the no-effect rule as described above, courts also have developed several doctrinal exceptions to the illegality rule.157 These doctrines are applied differently in different factual contexts.158 When viewed individually, like the factual variants, each appears to be an unrelated exception rather than part of a comprehensive judicial approach to the treatment of illegal contracts. The doctrinal distinctions themselves seem unable to predict case outcome. Efficient deterrence theory, however, as embodied in the factors explored in Section II, provides an explanation for the variability in the applications of the doctrinal exceptions. Courts should articulate and apply effective deterrence theory as their rule of decision rather than continuing to rely on imperfect doctrinal categories.

157. Professor Gellhorn describes many of these doctrines used by courts to differentiate enforceable contracts from those to be denied effect. [Courts have undertaken to differentiate their decisions according to whether the contracts in question related to *mala prohibita* or *mala in se*—"that acute distinction between *mala in se* and *mala prohibita*, which being so tenuous and sounding so pretty, and being in Latin, 1 is no sort of an occasion to have any meaning to it, accordingly it has none." Further distinctions have been made between contracts which contravened statutes designed solely for revenue purposes and, on the other hand, statutes which were intended to be prohibitory or which stated conditions "for the benefit of the public"; but the difficulty of drawing the line between the one type and the other vitiates the effectiveness of the distinction, and in any event it is unrealistic to say that the legislature intended or that it did not intend that contracts should be held invalid in violation of such statutes . . . .] Courts have also spun fine theories concerning "collateral illegality" and "new and independent considerations."

Gellhorn, *supra* note 9, at 683 (footnotes omitted). Professor Gellhorn is critical of many of these doctrines, which are relied on to justify a result of recovery or no recovery, because he does not think that they answer the basic underlying question of all illegal contracts: "Should this particular contract be enforced as being consonant with public policy?" Id. at 683 n.22.

158. Professor Corbin illustrates the difficulty with one of the doctrines—the *mala in se/malum in se prohibuit* distinction—when he states that "the falsity of the distinction, as expressed in the Latin phrases, rests in the assumption, made throughout so many centuries, that right and wrong are absolutes and that a mere human being can draw an absolute and unvarying line between good and evil." 6A A. CORBIN, *supra* note 4, at § 1378.
A. Forfeiture

One doctrinal exception to the no-effect rule cited by commentators is the antiforfeiture principle.\textsuperscript{159} The \textit{Restatement (Second) of Contracts} reflects that principle: “In weighing the interest in the enforcement of a term, account is taken of...any forfeiture that would result if enforcement were denied...”\textsuperscript{160} Furthermore, the \textit{Restatement} reflects solicitude for a party that has partly performed by providing that a party may claim restitution if “denial of restitution would cause disproportionate forfeiture.”\textsuperscript{161} The doctrine suggests that courts consider the avoidance of forfeiture an important goal in fashioning judicial relief.\textsuperscript{162}

The antiforfeiture doctrine, however, appears flimsy and manipulable, since courts are willing to tolerate forfeiture in some instances but not in others. A court is more likely to find “disproportionate” forfeiture in cases demonstrating unequal status or knowledge\textsuperscript{163} and to find tolerable, nonremediable forfeiture when the parties appear to have no apparent disparities of knowledge, status, or degree of participation in the wrongdoing, or when the plaintiff has superior status.\textsuperscript{164} Courts, however, often fail to justify the differential willingness to tolerate forfeiture. Instead, when granting recovery, courts invoke the judicial dislike of forfeiture principle. In other cases, even when the party seeking recovery has conferred a measurable benefit, courts denying relief simply do not discuss the antiforfeiture principle.

Two contrasting cases will help illustrate the differential willingness of courts to tolerate forfeiture. In \textit{Brand v. Elledge}\textsuperscript{165} the plaintiff was a recent widow whom the defendant induced to invest over $11,000 in a tavern. They formed a partnership but when the copartners applied for a joint liquor license, the superintendent advised the plaintiff she did not yet qualify because of her short state residence. As a result, the license was issued in the defendant’s name only. Thereafter, the defendant repeatedly

\textsuperscript{159} See, e.g., E.A. \textit{Farnsworth, supra} note 3, at 364; Wade, \textit{supra} note 4, at 52.  
\textsuperscript{160} \textit{Restatement (Second) of Contracts} § 178 (1979).  
\textsuperscript{161} Id. at § 197.  
\textsuperscript{162} Under the present scheme, however, a court often will ignore even the presence of potential forfeiture if the harm of the illegal contract is particularly grave. See \textit{Restatement (Second) of Contracts} § 197 comment b (1979) (“if the claimant has threatened grave social harm, no forfeiture will be disproportionate”).  
\textsuperscript{163} See, e.g., \textit{Brand v. Elledge}, 89 Ariz. 200, 206, 360 P.2d 213, 218 (1961) (granting recovery to recent widow without business experience against defendant “some years older” and “experienced in business”).  
\textsuperscript{164} See, e.g., Russell v. Soldinger, 59 Cal. App. 3d 653, 641, 131 Cal. Rptr. 145, 150 (1976) (denying recovery to party who conspired with defendant to suppress bidding despite resulting windfall to defendant); Woodward v. Jacobs, 541 P.2d 691, 692 (Colo. Ct. App. 1975) (denying recovery to contractor who conspires with owner to violate zoning regulations despite windfall to owner); Ryan v. Motor Credit Co., 130 N.J. Eq. 531, 534, 23 A.2d 607, 611, 613 (1941) (denying recovery to party who conspired to create loan scheme despite fact that lender received windfall by receiving illegal sums), aff’d, 132 N.J. Eq. 398, 28 A.2d 181 (1942); Parsky Funeral Home, Inc. v. Shapiro, 83 Misc. 2d 566, 570, 372 N.Y.S.2d 288, 293 (1975) (denying recovery to funeral establishment suing for price of services rendered despite windfall to consumer); Sinimar v. Le Roy, 44 Wash. 2d 728, 731, 270 P.2d 800, 802 (1954) (denying relief to coconspirator despite coconspirator’s windfall of $450).  
\textsuperscript{165} 89 Ariz. 200, 360 P.2d 213 (1961).
assured the plaintiff that a formal reissuance of the license was not necessary and urged the plaintiff to trust her.166

When the plaintiff sought an accounting, the defendant alleged the partnership was void because the liquor license was issued in violation of the law requiring all partners to be licensed. The lower court dismissed the action, finding that because the parties were in pari delicto, neither was entitled to relief.167 The appellate court reversed and decided that the plaintiff was nevertheless entitled to an accounting due to a number of factors, including (1) the plaintiff's lack of business experience and (2) the potential forfeiture of her initial investment.168

In other cases, however, the possibility of a forfeiture and consequent windfall to a party does not prompt the court to remedy the forfeiture by granting enforcement or restitution. In Sinnar v. Le Roy169 two parties actively conspired to violate the liquor license laws. The plaintiff paid $450 to the defendant for use in illegally securing a liquor license. When the defendant failed to deliver the license, the plaintiff sued for the return of the $450 but the court refused all relief.170

The results of these cases suggest the deficiencies of the antiforfeiture principle as a comprehensive explanatory theory. The theory fails to distinguish those cases in which a benefit conferred is compensated from those in which it is not. A more reliable explanation for predicting the remediability of forfeiture emerges from the factual guidelines set forth in Section II. These factors in turn help identify which results will promote efficient deterrence. Thus, in Brand, the facts show that differential incentives to commit illegalities existed between the parties. The plaintiff attempted to persuade the defendant to reapply for the license in their joint names but encountered resistance from the defendant; she lacked control over the defendant. Since the plaintiff had attempted to effect compliance and indeed had a vested interest in achieving compliance to assure her rights to the partnership profits, denying her recovery would not advance the goal of deterrence.171 Thus, because of the differing interests in achieving legal compliance, it would not make economic sense to deter those parties who already have an economic interest in compliance. It makes sense, however, to grant the plaintiff her accounting claim. Otherwise, a party with a vested interest in noncompliance (such as a partner who wishes to take all of the profits) will receive a windfall, prompting that party to engage in other illegal joint ventures. Moreover, courts that deny relief in such situations might overdeter and discourage parties from entering
business transactions because even if they take steps to assure legal compliance, they will be denied recovery based on their inability to control the other parties' actions.

On the other hand, it makes no economic sense to differentiate between parties if both are parties to a conspiracy as in Sinnar or Russell. In practical effect, therefore, there is no universal antiforfeiture doctrine. Instead, courts that rely on the concept are in fact applying the factual elements discussed in Section II. The differential use of the forfeiture doctrine, therefore, is best explained by efficient deterrence. Those factual predictors are examined and the results are manipulated to maximize efficient deterrence.

B. Protected Class Doctrine

Another well-recognized exception to the no-effect rule provides that if a party belongs to a class of persons whom the law was intended to protect, "there is no policy against the enforcement of the promise by one who belongs to that class." A court is more likely to permit a party to an illegal bargain to recover if the statutory prohibition is directed at conduct of the party against whom recovery is sought. The usefulness of the protected class doctrine, however, is limited. If its factual applications are considered, it becomes possible to "decode" the doctrine and articulate an underlying efficient deterrence theory which seems to account for variations in the doctrinal applications.

At first this doctrinal exception appears so noncontroversial and "mechanical" that it would not appear to provide any basis for finding implicit judicial logic connecting it to any other doctrine or to efficient deterrence concerns. While the principle of protecting the class that is the object of legislative protection seems simple, the judiciary still must (1) decide how to best protect that class, (2) determine who belongs in that class, and (3) determine what effect, if any, it will give to the contract. Courts do not make these judgments solely on mechanical grounds of whom the legislature protected since such provisions often do not address what effect will be given to a contract when the statute is violated. Even when a statute carves out a protected class for solicitude, courts refuse to protect class members if certain facts are present. In fact, the courts' application of the doctrine often is consistent with the pattern of efficient

172. Restatement (Second) of Contracts § 179 comment e (1979); see also 6A A. Corbin, supra note 4, § 1540 ("If a bargain is illegal, not because a performance promised under it is an illegal performance, but only because the party promising it is forbidden by statute or ordinance to do so, the prohibition is aimed at that party and he is the only wrongdoer."); E.A. Finosworth, supra note 3, § 5.9, at 866.
173. Dalton, supra note 1, at 1009.
174. Wade, supra note 12, at 270.
175. Gellhorn, supra note 9, at 691. Many courts have been unwilling to admit that in deciding what effect, if any, to give to a contract involving some illegality or policy violation, they are exercising independent judgment. "The difficulty has lain in their general unwillingness to accept realistically the proposition that the legislature when adopting a penal statute, has rarely had in mind the problems of contract law that may later arise." Id. at 682.
176. Id. at 682-83.
deterrence already described.\textsuperscript{177}

_Parsky Funeral Home, Inc. v. Shapiro\textsuperscript{178}_ illustrates a situation in which the court relies on the protected class doctrine to deny recovery to a nonprotected class member in his suit against a consumer—a statutory beneficiary. In _Parsky_, the plaintiff was a funeral establishment seeking payment on a contract for funeral services or, alternatively, for a _quantum meruit_ recovery. The defendant moved for summary judgment to dismiss the complaint, arguing the illegality doctrine.\textsuperscript{179}

The issue that the court considered in deciding the summary judgment motion was whether the plaintiff’s failure to comply with a statute requiring disclosure of funeral costs precluded a contractual or quasi-contractual recovery. To resolve that issue, the court considered who constituted the intended statutory beneficiaries of the disclosure regulation. The court found that because the statute was aimed at protecting the public, of which the defendant was a member, it denied the plaintiff any measure of recovery. The court emphasized the inherent inequality in the status and access to information between the funeral establishment and the consumer.\textsuperscript{180}

A different application of the protected class doctrine is illustrated by _Ryan v. Motor Credit Co._\textsuperscript{181} In _Ryan_, the court denied an auto dealer relief when he set up a dummy loan scheme with his lender\textsuperscript{182} despite the fact that he was a member of a class purportedly protected by statute. The plaintiff car dealer in this case was a borrower whom the statutes ostensibly were intended to protect. While the court recognized that borrower status created a presumption that he was entitled to favorable treatment by the court,\textsuperscript{183} the court undertook a careful factual analysis to justify the application of a no-effect rule. In doing so, it began with the proposition that the normal presumption favoring the borrower is founded on assumptions that most borrowers need protection because of their “credulity and susceptibility to oppression by reason of . . . necessitous circumstances.”\textsuperscript{184}

The court then systematically proceeded to show that the prevalent imperfections that ordinarily affect borrowers were not present in the _Ryan_ case.

\begin{itemize}
  \item \textsuperscript{177} See, e.g., _Winston v. Bourgeois, Bennett, Thokey & Hickey_, 432 So. 2d 956, 940 (La. Ct. App. 1983). In _Winston_ the court had to decide whether the noncompetition covenant in a partnership agreement violated a statute prohibiting covenants required by employers. In resolving the statutory interpretation issue, the court engaged in a functional analysis of the relationship of the partner to the partnership to determine if it was equivalent to an employment relationship. While writing in terms of the protected class doctrine, the court actually looked to factors such as the absence of duress and disparity in bargaining power in deciding how to apply the doctrine. _Id._ at 940; see also _Bodily v. Parkmont Village Green Homeowners Ass’n_, 104 Cal. App. 3d 340, 163 Cal. Rptr. 658 (1980) (granting recovery to homeowners as protected parties under statute requiring notification to department of changes in offering of real estate project, and denying recovery to developer, who is most efficient party to sanction, as party in charge of filings).
  \item \textsuperscript{178} 83 Misc. 2d 566, 372 N.Y.S.2d 288 (1975).
  \item \textsuperscript{179} _Id._ at 566, 372 N.Y.S.2d at 290.
  \item \textsuperscript{180} _Id._ at 568-70, 372 N.Y.S.2d at 292.
  \item \textsuperscript{181} 130 N.J. Eq. 531, 23 A.2d 607 (1941)
  \item \textsuperscript{182} _Id._ at 533-38, 563, 23 A.2d at 610-13, 625.
  \item \textsuperscript{183} _Id._ at 556, 23 A.2d at 615-22.
  \item \textsuperscript{184} _Id._ at 558, 23 A.2d at 623.
\end{itemize}
facts. In finding the borrower to be \textit{in pari delicto} with the lender, the court emphasized several factors including the absence of oppression, the conspiratorial nature of the parties' dealings, and the borrower's knowledge of the illegality.\footnote{Id. at 558-60, 23 A.2d at 622-23. Another case in which the protected class doctrine theoretically was available to a claimant who nevertheless was denied relief is \textit{Howard v. Sanby}, 375 S.W.2d 828 (Ky. 1964). In \textit{Howard}, a water commissioner—also an attorney—and a contractor set up a scheme under which the water commissioner would receive illegal kickbacks for steering work to the contractor. When the contractor sued to recover the payments made to the attorney, he won at trial. A state statute arguably empowered the contractor as client to recover, on motion, monies collected by his attorney. \textit{See Ky. Rev. Stat. Ann.} \textsection{} 418.005 (Michie/Bobbs-Merrill 1970). The court, however, refused to consider the kickbacks to be "money collected" so as to allow the client to recover. In reaching that interpretation, the court found that "it is not a matter of [the attorney's] taking undue advantage of his fellow wrongdoer." \textit{Howard}, 375 S.W.2d at 829. Thus, in deciding who was protected by the statute, the court found the relative status of the parties to be a relevant factor.} Thus, although the protected class doctrine theoretically was available, the court's analysis in determining whether recovery should be allowed was factual and based on efficient deterrence factors.

The results of cases in which one of the parties is in a potential class of statutory beneficiaries demonstrate that the presence of the protected status alone is not sufficient to decide what effect, if any, to give to the illegal contract and how to best achieve protection of a statutorily protected class. The deciding factors that seem to predict whether, and in what manner, the potential statutory beneficiary will be protected are the efficient deterrence factors discussed in Section II. Although courts often explain their outcomes in terms of (1) what the legislature intended and (2) the protected class doctrine itself, the differential treatment afforded protected statutory beneficiaries in \textit{Ryan} and \textit{Parsky} suggests a different operative explanation.

If there are market imperfections in terms of knowledge or bargaining power, a court may permit the disadvantaged party to recover. If, however, there are no market imperfections in terms of knowledge or participation, as in \textit{Ryan}, even the fact that the claimant technically is a statutory class member may not be sufficient to justify recovery. Thus, courts manipulate this doctrine, like the others previously discussed, to foster efficient deterrence. In a sense, in deciding which statutory beneficiaries can recover and which cannot, the court is considering efficient deterrence factors which may predict how generalized classes will respond to a recovery/no recovery outcome. If the court granted recovery to the statutorily protected claimants in \textit{Ryan}, the court would be reallocating losses in a case in which both parties have an equal incentive to engage in the illegality and are knowledgeable enough to respond to the directives. That result would be inefficient. However, when the statutory class has inherent or likely traits which impair its ability to be deterred in an effective, efficient manner, courts will reallocate losses.
ILLEGAL CONTRACTS AND EFFICIENT DETERRENCE

C. The Collateralness Principle

Under a third doctrinal gloss on the no-effect rule, the courts grant relief in cases in which the illegality is "remote" but deny relief when the illegality is "inherent" in the transaction. The collateralness doctrine’s usefulness seems limited because courts apply it randomly across a broad spectrum of cases. The doctrine is difficult to apply because no precise rule exists to distinguish between actions that are "collateral" to the illegality and those that are not. The difficulty disappears, however, once it is recognized that the doctrine’s actual application depends upon the factual situation in which the case arises rather than upon any specific "collateralness" rule. These factual distinctions demonstrate that courts achieve results consistent with efficient deterrence.

Kansas City Hydraulic Brick Co. v. National Surety Co. indicates that courts look to the relative positions of the parties and label the illegality as "collateral" or not, depending upon which result will deter future illegal contracts more efficiently. In Kansas City, the defendant was the surety of a general contractor (Atkins) who had completed several streetpaving jobs for Kansas City. The plaintiff was the assignee of a subcontractor who had supplied brick to Atkins and had not been paid for it. When the subcontractor sued for payment, the surety asserted the illegality defense, arguing that the contracts between Atkins and the city had not been competitively bid, as required by statute, and that the plaintiff knew this. The trial court directed a verdict in favor of the defendant, holding that the illegality of the contracts between Atkins and the city also made the contracts between Atkins and the plaintiff unenforceable. On appeal the Eighth Circuit reversed and remanded the case with directions to grant a new trial, holding that the contracts to supply brick were separate and independent of the illegal contracts between Atkins and the city.

Initially, it appears that the no-effect rule would best effectuate the goal of efficient deterrence, despite the fact that the contract sued upon was untainted. Because both parties knew of the illegality, both could be deterred from engaging in future agreements of this type. The court, however, rejected the nonenforcement rule, stating that "knowledge alone would not defeat [the] right of recovery" and that to so hold "would affix to a vendor’s knowledge vitiating results beyond anything required by judicial authority or sound public policy."

The efficient deterrence theory supports this decision. The court may have considered more than the parties’ knowledge of the illegality in determining their relative positions and their ability to be deterred in the

186. See 6A A. Corbin, supra note 4, § 1529; see also RESTATEMENT (SECOND) OF CONTRACTS § 178 comment d (1979) ("A party will not be barred from enforcing a promise because of misconduct that is so remote or collateral that refusal to enforce the promise will not deter such conduct . . . .").
187. 167 F. 496 (8th Cir. 1909).
188. Id. at 501, 503, 510.
189. Id. at 501-02.
190. Id. at 502.
191. Id. at 501.
future. The plaintiff's assignor was not involved directly in the illegal transaction. He had little or no control over the illegal situation and so he would not be in a position effectively to prevent similar deals in the future. Arguably, the imposition of the nonenforcement rule based upon the illegality of the related agreement would provide a form of deterrence only if, in the future, all subcontractors carefully investigate their potential general contractors and refuse to deal with those whose business dealings had any taint of illegality. If the subcontractors operate in this manner, then imposition of the nonenforcement rule possibly would deter illegal behavior by general contractors. This form of deterrence, however, only could be accomplished at a great cost in terms of resources utilized to achieve deterrence. It is unlikely that imposing this burden on the subcontractor, who is not an active participant in the anticompetitive agreement, will have any future deterrent effect on the parties who are considering participating in an illegal bidding procedure. Potential adverse consequences to unrelated third parties (subcontractors) will have little effect on the proscribed contract. 192

Finally, the fact that the no-effect rule gives the defendant, who was directly involved in the illegality, a huge incentive to behave illegally in the future undermines any deterrent that may result from imposition of this rule. The defendant would receive a windfall profit if the court denied the plaintiff recovery because he would reap the benefits of both the illegal deal and the option to avoid his other contractual obligations if it would be to his advantage to do so. The relief that the Kansas City court granted the plaintiff did not provide him with a windfall profit or an incentive to violate the law because the court simply enabled him to collect the amount legally owed and prevented him from taking a loss. This disparate potential for a windfall profit further illustrates that the parties were not on equal footing. Unequal status, as shown by the defendant's direct involvement in the illegality and by the windfall he might obtain, makes it more sensible to impose the loss upon the defendant. Following this analysis, it becomes evident that the court in Kansas City may have rejected the nonenforcement rule not because the illegality was collateral, but because the court analyzed the actual positions of the two parties and realized that because of their relative status, imposition of the nonenforcement rule actually would thwart the purposes for which it was designed. Results in other cases that outwardly rely on the collateralness doctrine also may be explained in terms of efficient deterrence. 193

192. Another instance in which the collateralness of the contract illegality may warrant enforcement is Youngblood v. Bailey, 459 So. 2d 855 (Ala. 1984). In that case, the plaintiff purchased a lottery ticket from an illegal lottery and then resold the ticket to the defendant. When the defendant refused to pay on the ticket, the plaintiff sued. The defense was based on the illegality of the contract. Id. at 857-59.

In Youngblood, even if you conclude that you want to deter the plaintiff from participating in the lottery rather than the lottery owner, it seems odd to do so in the context of resale. It is difficult to imagine how parties' participation in illegal lotteries could be deterred by a rule denying them recovery in the event of a subsequent unrelated transaction. Parties naturally assume that a one-time breach of lottery rules would not invalidate all possible future contracts. Because it would be costly to deter behavior assumed to be within legal norms, it would be inefficient to deter lotteries by regulation of the lottery ticket resale market.

193. Yet another case demonstrating that the collateralness doctrine also can be explained
The observation that efficient deterrence is a plausible justification for the collateralness/inherent illegality distinction becomes even more apparent when one focuses on cases in which courts find the illegality to be inherent rather than collateral. These cases typically involve parties who have each played an active and voluntary role in the illegality. In such cases courts should apply the no-effect rule because both parties are equally deterrable and it is not worth the cost to shift losses.

V. FREEDOM OF CONTRACT AND EFFICIENT DETERRENCE

Advocates on each side of the debate about the private vs. public nature of contracts can justify efficient deterrence. On the one hand, the socially minded advocate can characterize efficient deterrence as furthering a normative social policy agenda of courts\textsuperscript{194} to maximize efficient deterrence, conserve scarce resources for parties most able to respond to deterrence, and yet prevent overdeterrence of desirable contractual activity. On the other hand, the advocate of contractual autonomy might consider efficient deterrence as vindicating the freedom of contract norm.

If one examines closely the situations and manner in which the courts apply the doctrine, underlying autonomy concerns become apparent. Many of the situations in which courts permit recovery involve persuasive barriers that prevent the parties from allocating costs, through negotiation, to the superior risk bearer. Thus, when status disparities exist in the employment context, for example, the employee—the party with inferior status—may lack access to legal counsel and may, therefore, lack knowledge that the transaction is illegal. The parties may have different capacities and resources with which to discover applicable rules of law.\textsuperscript{195} It is difficult to

\textsuperscript{194} See Kornhause, supra note 34, at 607-09 (discussing normative efficiency claims).

\textsuperscript{195} Kostritsky, supra note 1, at 936.
value and allocate a risk of which one is unaware. That barrier may be 
evacurated because parties with superior status often may stand to gain a 
windfall profit from the contract's nonenforcement. They, therefore, have 
a vested interest in maintaining a differential knowledge of the enforce­
ment rules. In such situations, imposition of a risk allocation on the 
cheapest cost avoider is justified because both parties would have chosen 
that allocation to reduce joint costs if each had access to relevant infor­
mation.

In cases in which the parties trust each other due to an ongoing or 
fiduciary relationship, another persuasive barrier prevents the explicit 
allocation of risk. In these situations, parties usually believe that explicit risk 
allocation is unnecessary. Should the risk arise, they believe that they can 
allocate it informally to the superior risk bearer. In such cases, assuming 
that parties generally act "to minimize the joint costs," reallocation to 
effectuate that goal can be viewed as consistent with their private choices.

In other cases, such as Kansas City, market imperfections exist which 
may interfere with the explicit allocation of the nonenforcement risk to the 
cheapest cost avoider. For instance, one contracting party may lack knowl­
edge about the illegality. When the subcontractor in Kansas City entered 
the contract with the general contractor, nothing was likely to alert him to the 
fact that the general contractor previously had engaged in anticompetitive 
activity to secure the contract. Had such information been available, the 
parties presumably would have allocated the risk of loss to the only party 
who knew anything about the illegality, the general contractor. In these 
cases, making an unrelated third party police an illegality would cause 
extraordinary costs and overdeterrence. Intervention in these cases, there­
fore, seems consistent with the deal the parties themselves would have 
reached in the perfect market. Otherwise, the subcontractor would have to 
charge a price the general would not want to pay as compensation for the 
extraordinary search costs associated with discovering hidden illegalities in 
the deal with the city.

In a case like Karpinski, it is difficult to know whether the facts 
demonstrate market imperfections sufficient to interfere with an explicit 
allocation of the risk of nonenforcement. In the court's view the farmer 
lacked the capacity to bargain freely. Consequently, the farmer might have 
hesitated to insist on bargaining to avoid being a troublemaker. That 
general hesitation to bargain may have caused the farmer to be reluctant to 
bargain explicitly over loss allocation; the farmer may fear that to do so 
would jeopardize the deal. If so, then a persuasive barrier prevented 
explicit and complete risk allocation, the absence of which should not be 
considered equivalent to knowing, deliberate risk taking. An alternative 
view would argue that if the dairy lacked monopoly power, the offer of 
a Grade A contract by illegal means was not coercive. Under the second 
view of Karpinski, no market imperfections existed. Both parties were 
substantially motivated to ignore the law and acted affirmatively to promote

196. Kronman, supra note 8, at 4.
197. See supra text accompanying notes 122-26.
198. See Epstein, supra note 126, at 297-98.
their own self-interests. Thus, they well could have chosen to allocate the risk of nonenforcement and their failure to do so represented deliberate risk taking on their part.

In other cases, no apparent market imperfections exist. Both parties know of the illegality and actively conspire to further the illegality. In conspiracies such as in Russell199 or Woodward200 there is no indication that the parties are involved in an ongoing relationship of trust nor are there disparities in knowledge of applicable laws. Thus, nothing interferes with an explicit negotiation over risk allocation. The parties may decide that it is in their economic self-interest to enter the deal despite the risk of nonenforceability. Thus, if given an opportunity, they would reach a bargain in which each party risked the possibility of the no-effect rule to promote its own self-interest. Assuming each party faces equally fortuitous losses, courts in those cases should leave the parties where they are on the theory that both parties are equally superior risk bearers. That rule of nonintervention can also be rationalized as furthering the autonomy goals of contract law. A failure to allocate risk reflects a deliberate conclusion that each should bear the loss equally.

VI. Conclusion

This Article has suggested efficient deterrence as an alternative method of deciding cases involving illegal contracts. In so doing, it has articulated a unified theory that explains many of the myriad exceptions to the no-effect rule currently applicable to illegal contracts. This Article has urged the adoption of the efficient deterrence theory because it will preserve limited personal, judicial, and societal resources. Efficient deterrence will promote a judicial approach that takes into account the varying abilities of people to respond to the doctrine's no-effect rule. The articulation of this theory promotes a reconceptualization of illegal contracts from an explicitly public doctrine into a doctrine compatible with traditional autonomy principles. It also will shed light on the fundamental controversy of modern contract theory between its public vs. private nature.

199. 59 Cal. App. 3d 633, 131 Cal. Rptr. 145 (1976); see supra text accompanying notes 153-56.
200. 541 P.2d 691 (Colo. Ct. App. 1975); see supra text accompanying notes 90-94.