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## RESTITUTION - EFFECT OF ILLEGALITY - RIGHT OF PERSON NOT A PARTY TO THE ILLEGAL TRANSACTION TO INVOKE DEFENSE OF ILLEGALITY

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RESTITUTION — EFFECT OF ILLEGALITY — RIGHT OF PERSON NOT A PARTY TO THE ILLEGAL TRANSACTION TO INVOKE DEFENSE OF ILLEGALITY — In an action for conversion of stock, plaintiff alleged that her intestate was the actual owner of the capital stock of a brewing corporation. Intestate had in fact furnished the consideration for the stock, but it was issued in the name of one Vogel as his dummy and agent. After the death of intestate, the defendant, with knowledge of plaintiff's interest, acquired the stock from Vogel by means

of a pretended purchase and converted it to his own use. As a defense to the conversion action, defendant interposed a plea of illegality, alleging that the capital stock was issued to Vogel as part of a fraudulent scheme to conceal the fact that the intestate was the true owner. The purpose of the scheme was to induce the federal and state liquor authorities to issue permits for the operation of the brewery. Plaintiff's motion to strike out this defense was granted at special term. The appellate division denied the motion.<sup>1</sup> *Held*, that the defense is sufficient in law. "The transactions of plaintiff's intestate . . . were so far against the public good as to disable the plaintiff from invoking the aid of the court in her endeavor to disengage herself (as administratrix) from the unlawfulness of the conduct of her intestate."<sup>2</sup> *Flegenheimer v. Brogan*, 284 N. Y. 268, 30 N. E. (2d) 591 (1940).

Neither courts of law nor courts of equity will affirmatively enforce any obligation which arises out of an illegal agreement or transaction.<sup>3</sup> Deterrence, not retribution, is the primary policy back of the doctrine.<sup>4</sup> Also, money or property transferred pursuant to an illegal transaction cannot be recovered in an action for restitution, at least where the parties are *in pari delicto*.<sup>5</sup> To mitigate the harshness that might result from a strict adherence to the latter rule, there are several corollaries which may offer relief in an appropriate situation. Where the illegality is collateral to and remote from the asserted right, restitution will be allowed.<sup>6</sup> Plaintiff can recover benefits conferred if he can establish his cause of action independent of the illegality.<sup>7</sup> But in such case plaintiff may not rely on the valid part of a partially illegal transaction, for the defendant is free to interpose the illegal phase of the transaction by way of defense.<sup>8</sup> It is

<sup>1</sup> *Flegenheimer v. Brogan*, 259 App. Div. 347, 19 N. Y. S. (2d) 343 (1940).

<sup>2</sup> Principal case, 30 N. E. (2d) 591 at 593.

<sup>3</sup> 12 AM. JUR. 713 (1938); 13 C. J. 492 (1917). The classic statement of the doctrine is that made by Lord Mansfield in *Holman v. Johnson*, 1 Cowp. 341, 98 Eng. Rep. 1120 (1775).

<sup>4</sup> 5 WILLISTON, CONTRACTS, rev. ed., § 1630 (1937); *McManus v. Fulton*, 85 Mont. 170, 278 P. 126 (1929); *Hope v. Linden Park Blood Horse Assn.*, 58 N. J. L. 627, 34 A. 1070 (1896). Cf. *Greenberg v. Evening Post Assn.*, 91 Conn. 371, 99 A. 1037 (1917).

Several other policy reasons have been advanced: that it deservedly punishes the plaintiff, that it saves courts from the indignity of having to deal with disputes between lawbreakers, and that suits between other litigants will be expedited. WOODWARD, QUASI CONTRACTS, § 135 (1913).

<sup>5</sup> WOODWARD, QUASI CONTRACTS, § 135 (1913).

<sup>6</sup> "The rule, according to the great weight of authority, is to the effect that a contract in itself is not rendered unenforceable by the mere fact that one of the parties thereto has knowledge of an intended purpose of the other party thereto, by means of the contract or subject-matter thereof, to violate some law or public policy of some state. . . ." Annotation, 53 A. L. R. 1364 at 1366 (1928).

<sup>7</sup> *Electrova Co. v. Spring Garden Ins. Co.*, 156 N. C. 232, 72 S. E. 306 (1911); *First & City Nat. Bank v. McCrossin*, (C. C. A. 5th, 1916) 230 F. 983; *Orsi v. Orsi*, 125 Conn. 66, 3 A. (2d) 306 (1938); 2 CONTRACTS RESTATEMENT, § 597 (1932).

<sup>8</sup> *Rainer v. Western Union Tel. Co.*, (Mo. App. 1936) 91 S. W. (2d) 202.

also generally said that the defense of illegality is available only as between the parties to the illegal transaction, and a third person may not invoke it.<sup>9</sup> That a mere unqualified statement of these rules is misleading, if not inaccurate, is clearly apparent from the decisions. For instance, there are many cases where technically no reference to an illegal transaction is necessary to establish a cause of action, yet no recovery is permitted.<sup>10</sup> Cases involving third parties raise special problems. It seems clear the assignee of a party to an illegal transaction cannot recover property parted with by his assignor pursuant to the illegal agreement.<sup>11</sup> More difficulty is encountered in cases where the third person is the defendant, and seeks to defend on grounds of illegality. The general rule is as stated above—the defense is not available to third persons. It has been frequently asserted, however, that the defense is available to any one in legal privity with a party to the transaction.<sup>12</sup> But what constitutes “privity” in this regard is not clear. It would seem that a bona fide pledgee for value is not in legal privity.<sup>13</sup> When a third party is defendant in an action founded on an illegal agreement to which he was not a party, he is allowed to assert the defense of illegality, despite the general rule that the defense is not available to third parties.<sup>14</sup> Typically, cases wherein effect was given to the general rule have been those where defendant is in possession of the fruits of an illegal transaction to which he was not a party, as where he is a stakeholder.<sup>15</sup> However, in most, if not all, of these cases the same result might have been reached on the basis of the rule that plaintiff need not rely on the illegality to establish his claim.<sup>16</sup> It is apparent that these various rules and their limitations are by no means mutually exclusive and that they present anything but a coherent picture. Certainly, as both dissenting opinions point out, defendant was not a party to the illegal act, and plaintiff’s action for conversion could have been established without refer-

<sup>9</sup> *Bohn Mfg. Co. v. Hollis*, 54 Minn. 223, 55 N. W. 1119 (1893); 12 AM. JUR. 720 (1938). See annotation in 50 A. L. R. 293 (1927).

<sup>10</sup> Technically speaking, in every case where goods are sold with the express intent that they be used for an illegal purpose, the vendor could sue for the value of the goods without in any way relying on the illegal purpose. Yet that recovery in many sale of goods cases is and should be denied is clear. A notable example is where the intended purpose is to commit a heinous crime. 53 A. L. R. 1364 at 1375 (1938). Obviously the degree of moral turpitude is an important factor. The mere fact that plaintiff is able to set up a cause of action without reference to, or aid from, the illegality is not determinative. However, it is a useful rule where fairness requires restitution.

<sup>11</sup> *Benson v. Bawden*, 149 Mich. 584, 113 N. W. 20 (1907).

<sup>12</sup> *Ellsworth v. Mitchell*, 31 Me. 247 (1850); 13 C. J. 508 (1917).

<sup>13</sup> *Pelosi v. Bugbee*, 217 Mass. 579, 105 N. E. 222 (1914). The court spoke of defendant as being an independent wrongdoer. Chief reliance was placed on the fact that the suit was not on the illegal contract, but was for conversion. See also *Hipple v. Rice*, 28 Pa. St. 406 (1857).

“Privity” in this regard would certainly include privity in representation, but beyond that it is none too clear. As to successive mortgages of the same property, see *Ellsworth v. Mitchell*, 31 Me. 247 (1850).

<sup>14</sup> 12 AM. JUR. 716-717 (1938).

<sup>15</sup> The cases are annotated in 50 A. L. R. 293 (1927).

<sup>16</sup> E.g., *Roselle v. Beckemeir*, 134 Mo. 380, 35 S. W. 1132 (1896).

ence to the illegality. But however one may differ from the actual result, still the approach taken by the majority is sound and realistic. The various limitations on the general doctrine of nonenforceability must be made subservient to the accomplishment of the main purpose. Sound administration of the law requires that persons not only be punished for, but that they be discouraged from, participating in illegal transactions. A proper disposition of each case should embrace a consideration and appraisal of several factors: the extent of forfeiture involved, the degree of culpability and moral turpitude with which the party seeking relief is chargeable, and the general public policy to be effectuated.<sup>17</sup>

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<sup>17</sup> 2 CONTRACTS RESTATEMENT, § 600 (1932). *Ryan v. KVL, Inc.*, 198 Wash. 459, 88 P. (2d) 836 (1939).