

**RELIEF FROM UNENFORCEABILITY  
OF ILLEGAL CONTRACTS AND  
TRUSTS**

LAW REFORM COMMITTEE  
5 JULY 2002

# RELIEF FROM UNENFORCEABILITY OF ILLEGAL CONTRACTS AND TRUSTS

## INTRODUCTION

1.0 This report by the Law Reform Committee considers and makes recommendations to reform the law relating to relief from the **unenforceability** of illegal contracts and trusts. A draft bill, entitled '**Illegal Transactions (Relief) Act 2002**', accompanies the **report**.<sup>1</sup>

1.1 At the outset, we should explain the scope of the **subject** matter of reform. We are concerned with contracts and trusts which are illegal as well as contracts and trusts which are contrary to public policy. Contracts and trusts which are contrary to public policy are not strictly illegal but as they engage the same issues of unenforceability, it is convenient to treat them as similar or analogous to illegal contracts and **trusts**.<sup>2</sup> For that reason, we include them. In this **respect**, absolute gifts which are illegal or contrary to public policy stand on the same or on a similar footing as illegal trusts or trusts contrary to public policy. As such, they are within the compass of the proposed reform, although we have not found it necessary to refer to them explicitly in this report. We have also included certain aspects of the law of restitution within our proposals for reform as they significantly affect the extent of the effects of an illegal contract.

1.2 The law as to illegal contracts and trusts is complex. While the courts recognise that the unjust enrichment of a defendant who successfully pleads illegality as a defence is tolerated not for the **defendant's** sake, but for the sake of "**the** general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the **plaintiff**",<sup>3</sup> they have felt it necessary to minimise the occasions on which holding that a contract or a trust is illegal will lead to the unjust enrichment of a defendant who is as blameworthy as the plaintiff. The judicial approach has been pragmatic, although relying on arguments with strict walls of compartments and firm lines of demarcation. Complex rules have been devised to do real justice between the parties, despite the presence of illegality. As complexity has mounted, the need for reform has become more pressing.

## STATUTORY ILLEGALITY

2.0 We first review very briefly the categories of illegal contracts and trusts. Contracts and trusts which are illegal because they are prohibited by statute are of two kinds, namely expressly prohibited contracts and trusts and impliedly prohibited contract and **trust**.<sup>4</sup> Identifying express **prohibition**<sup>5</sup> is seldom difficult. Implied prohibition, in **contrast**, often requires a fairly intricate exercise in statutory construction; since recourse must be had to the purposes of the statute alleged to prohibit the contract or trust in question, and the disproportion, if any, between the criminal penalty imposed for violation of the prohibition and the value of the contractual or trust benefit that would be lost if the contract was held to be **prohibited**.<sup>6</sup>

2.1 A contract prohibited by statute was formerly thought to be unenforceable by both parties to the contract. We note, however, **that**, in an important **development**, the courts have been moving away from an all or nothing approach in which a contract prohibited by statute is seen as unenforceable by both parties. In recent cases involving statutes enacted for the protection of the public, the courts have decided that the contract which was **statutorily** prohibited was only unenforceable by the guilty **party**.<sup>7</sup> They were able to find that Parliament could not have intended to produce the hardship or injustice which would ensue by holding the contract unenforceable by the innocent **party**.<sup>8</sup>

## COMMON LAW ILLEGALITY

3.0 Contracts which are illegal at common law fall into diverse **categories**.<sup>9</sup> A contract may be illegal because the parties share a common intention to commit a crime, prohibited act or other wrongdoing such as a tort or breach of **trust**.<sup>10</sup> However, a contract is not unenforceable merely because one party commits an illegality in performing his **contract**,<sup>11</sup> unless the other party suing on it incited the commission of the illegal performance or actively participated in the illegal **performance**.<sup>12</sup> A contract may be illegal because of its illegal object or purpose. Thus, a contract for the

smuggling of contraband in contravention of the Customs and Excise Act is illegal because the purposes are **illegal**;<sup>13</sup> likewise, a contract the object of which is to commit a common law **wrong**.<sup>14</sup> A contract may also be illegal because the consideration for it is **illegal**.<sup>15</sup> Thus, a contract for the deposit of the proceeds of a crime is illegal because the consideration is illegal; likewise a contract to assign a licence when the assignment is prohibited by **law**.<sup>16</sup>

3.1 Contracts which are illegal at common law share a common feature which distinguishes them from **statutorily** prohibited contracts. In the case of **statutorily** prohibited contracts, intent of the parties is immaterial and a contract prohibited by statute is unenforceable notwithstanding the parties did not intend to break the **law**.<sup>17</sup> However, **in** the case of contracts illegal at common law, ignorance of the law or of the circumstances surrounding the making of a contract often materially affects **enforceability**. For instance, an innocent party may enforce a contract illegal on account of illegal consideration, although the guilty party may not. Again, an innocent party who has been misled as to the illegal object of the contract may enforce it, although the guilty party may not.

3.2 It is necessary to add that a contract is also unenforceable if a person seeking to enforce it must rely on an illegality in order to prove his claim: *ex turpi causa non oritur action*.<sup>18</sup> The courts consider that such a contract is tainted by illegality. For this purpose, it does not matter that the contract is otherwise lawful. The courts will not assist in enforcing a contract notwithstanding it is otherwise lawful if the plaintiff cannot sustain his claim without relying on or having to prove his illegal conduct or another illegal contract. This is the reason why the courts will refuse to enforce a guarantee securing the performance of an illegal **contract**<sup>19</sup> or an insurance contract when the claim has to be made by relying on another contract which is **illegal**.<sup>20</sup> For convenience, we shall call this the '**reliance principle**'.<sup>21</sup> The reliance principle has the important consequence that it does not matter that a party has made an illegal contract if the party is suing to recover property which has passed to him. If though pursuant to an illegal contract, title has **passed**,<sup>22</sup> a claim that the property has passed may be made without relying on the illegal contract since reliance can be placed on the passing of title **alone**.<sup>23</sup>

## ILLEGAL TRUSTS

4.0 There is also a diversity of illegal trusts. A trust may be illegal because it is established for an illegal purpose, as where a trust is established in order to conceal moneys obtained from criminal activities; or for an illegal consideration, as where a trust is established in consideration of the commission of an offence; or because it obliges the trustees or the beneficiaries to commit an illegality. The reliance principle is also relevant. It leads to the result that no assistance will be given to the **plaintiff** if he has to prove his illegal purpose in order to maintain his claim under a resulting **trust**.<sup>24</sup> We note that a trust which is alleged to be illegal may not fail in entirety. Whether it does depends very much on the circumstances. For instance, where there is an illegal provision which can be severed from the **trust**, without defeating the purpose of the settlor in creating the trust, the remainder of the trust will be valid. An instance of this would be where a settlor creates a trust giving the beneficiary an equitable interest subject to several conditions, some of which are illegal and void. If the void conditions are severable, the remaining trust will be **valid**.<sup>25</sup>

4.1 It may be useful to add that where an illegal trust is **void**,<sup>26</sup> the trustees hold the trust property on resulting trust for the settlor. Distributions out of the trust funds are also void and, if in the hands of the recipient, may be recovered by the settlor who does not have to rely on an illegality in making his **claim**, subject perhaps to the defence of bona fide purchaser without **notice**.<sup>27</sup>

## CONTRACTS AND TRUSTS AGAINST PUBLIC POLICY

5.0 Contracts against public policy are particularly difficult to classify but fortunately any classification is purely expository and didactic. It is common to classify such contracts broadly in terms of the particular public interest to be protected or fostered. Thus, a contract is unenforceable when its object is harmful to the administration of **justice**;<sup>28</sup> or **jeopardizes** the public safety; or is contrary to good morals (such as a contract for **prostitution**<sup>29</sup>); or when its object is to **defraud** the **revenue**;<sup>30</sup> or corrupt the public life (such as a contract to corrupt, or use influence

unfairly,<sup>31</sup> or to buy honours<sup>32</sup>), or impair or damage familial relationships.<sup>33</sup> A contract for the purposes of furthering or inducing conduct which is inimical to public policy or may operate to its detriment is equally unenforceable.<sup>34</sup>

5.1 A similar classification as applies to contracts which are against public policy may be adopted for trusts which are against public policy. Thus, a trust which is harmful to the administration of justice or a trust which is contrary to good morals is void.<sup>35</sup>

5.2 The difficulties encountered in cases where contracts and trusts were held to be against public policy are too well documented to require any elucidation. The fact that “[n]otions of public policy change with the passage of time” (*per* Sir Richard Scott V-C)<sup>36</sup> and difficulties in estimating the strength of the tendency to further or induce conduct contrary to public policy (where the contract or trust is not on its face contrary to public policy) are a few of them.

## RESTITUTION UNDER ILLEGAL CONTRACT

6.0 We turn briefly to consider relevant aspects of the law of restitution. The law of restitution has an important impact on illegal contracts because, where it is applicable, it serves to reverse the unjust enrichment that may otherwise result from refusing to enforce an illegal contract. Restitution under an illegal contract may be entertained if there is total failure of consideration *and* the plaintiff is not guilty of illegal conduct;<sup>37</sup> but *in pari delicto potior est conditio defendentis*. Thus, an innocent party who has bought goods from an enemy alien and paid the price for them may recover his payment made under the illegal contract on the ground of total failure of consideration if the defendant does not deliver the goods when delivery is due.<sup>38</sup> A guilty plaintiff, however, is *in pari delicto* with the defendant and may not recover payment made under the illegal contract.<sup>39</sup> In other well-defined cases (they may be seen as involving parties who are *non in pari delicto*), restitution may be entertained if the party seeking restitution of benefits conferred under an illegal contract is within a class of protected persons;<sup>40</sup> or if he is the victim of a mistake or fraud perpetrated<sup>41</sup> or duress or undue influence exerted<sup>42</sup> by the other contracting party. (In fact, it seems

that with respect to mistake, it will be enough to show that the plaintiff was labouring under an honest and reasonable mistake of his own **doing**.<sup>43</sup>) In all these instances, the important fact is that the plaintiff seeking restitution has to establish the ingredients of the **restitutionary** claim on its own **terms**.<sup>44</sup> For this **reason**, even if the plaintiff is innocent of an illegality, he cannot recover payment made under the contract if the contract has been partially executed by the **defendant**, for there would not then have been a total failure of consideration. However, in order to encourage withdrawal from an illegal purpose which has not been substantially carried out, the courts will permit a guilty party to bring a claim in restitution upon proof that he has withdrawn from his illegal **purpose**.<sup>45</sup> Thus, a guilty party who has deposited a bond with the defendant as security for an illegal loan to be made by the defendant may recover back his bond if he withdraws from his illegal purpose before it is carried out; but if the illegal loan has in fact been made at the time when he purports to repudiate the contract, it will be too late for him to withdraw and for the court to assist him in recovering his **bond**.<sup>46</sup> It is also possible to obtain restitution of benefits conferred under an illegal contract where to refuse it would be prejudicial to the public **interest**.<sup>47</sup>

6.1 An important limitation on the restitutionary claim should be mentioned. A restitutionary claim in respect of an illegal contract must be compatible with the public interest to be protected by the **prohibition**.<sup>48</sup> Notwithstanding there is total failure of consideration and the plaintiff is not guilty of illegal conduct, recognition of the claim in restitution must be refused if it would be tantamount to violating the public interest to be protected.

## **SHORTCOMINGS OF PRESENT LAW**

7.0 The various rules we have briefly mentioned have been applied so as to afford consequential relief to a plaintiff who is party to an illegal contract or trust where refusal to enforce the contract or trust seems unduly harsh, perhaps because the unjust enrichment is great **and/or** the contravention of policy is trivial. For instance, in some cases, the courts were able to avoid holding the contract illegal by construing the pertinent statutory prohibition narrowly. In other cases, they were able to enforce the

contract at the behest of an innocent party by construing the pertinent statutory prohibition as contemplating the protection of persons such as the innocent party. In some cases of contracts alleged to be tainted by illegality, they were able to disregard the illegality by holding that the claimant did not need to rely on the illegality in asserting his claim and thus afforded him relief.

7.1 The result is that the judgments handed down are sometimes not easily reconcilable with others. For instance, there are cases involving unlicensed manufacturers or service providers in which the courts have held their contracts unenforceable by both **parties**.<sup>49</sup> But in other cases, their contracts are unenforceable only by the guilty manufacturer or service **provider**.<sup>50</sup>

7.2 The reliance principle has attracted particularly severe criticisms. Take the case of a hire purchase agreement that is illegal. The **plaintiff** finance company sues to recover the hired property after the defendant hirer commits a **repudiatory** breach of the illegal contract. According to the decision in *Bowmakers Ltd v Barnet Instruments Ltd*<sup>51</sup> such finance company may recover its property despite the illegality because its claim is based on its title to the property and it does not have to rely on an illegal contract to prove its claim. The trouble is that, in the above-mentioned case, without proving the illegal contract and its repudiation, it could not there be shown that the defendant's right to retain and use the property had determined, entitling the plaintiff to recover the property. The decision therefore rested on somewhat unsatisfactory **reasoning**.<sup>52</sup>

7.3 Recently, the reliance principle was applied in the case of *Tinsley v Milligan*.<sup>53</sup> A property was purchased by the plaintiff and the defendant with funds belonging to them jointly but was transferred to the sole name of the plaintiff. The purpose of the transfer in one name only was to defraud the Department of Social Security. After the purchase, both plaintiff and defendant lived in the property. Subsequently, the defendant repented of the **frauds** and disclosed them to the Department of Social Security. The parties quarrelled and the plaintiff moved out of the property. Later, the plaintiff instituted proceedings against the defendant seeking possession of the property and asserting sole ownership of the property while the defendant

counterclaimed for an order for sale and a declaration that the **plaintiff** held the property in trust for both of them in equal shares. The judge at first instance dismissed the **plaintiff's** claim and allowed the defendant's counterclaim. The plaintiff appealed and the Court of Appeal dismissed the appeal on the ground that, in the circumstances of the case, public conscience would not be affronted if the defendant's counterclaim were allowed to succeed. The plaintiff then appealed to the House of Lords. The appeal was also dismissed. The House held that the defendant in seeking to recover her interest in the property needed only to show that the funds for the purchase of the property came from both of them jointly, thus giving rise to a resulting trust in her favour. The counterclaim did not need to rely on proof of the true purpose of the trust which was to defraud the Department of Social Security.

7.4 Contrasted with this is the case of *Palaniappa Chettiar v Arunasalam Chettiar*<sup>54</sup> where the property was purchased with the funds provided by the father but was transferred to his son as the absolute owner. The sole purpose of doing so was to defraud the relevant authority. Subsequently, the father sought to recover the property from the son, who resisted the claim. The claim failed. The Privy Council held that upon the transfer of the property by the father to the son, a presumption of advancement arose in favour of the son. In seeking to recover the property from the son, the father had to rebut that presumption and in so doing, he had to show that his true intent was not to benefit his son but to defraud the relevant authority. Since he had to rely on an illegality, the court would not assist him in enforcing the resulting trust.

7.5 A case somewhat similar to *Palaniappa Chettiar v Arunasalam Chettiar* arose in Australia where the High Court adopted a different approach. In that case, namely *Nelson v Nelson*,<sup>55</sup> a mother purchased a property with her own funds and the property was transferred to her son and daughter. The purpose of the arrangement was to enable the mother to purchase another property with the benefit of a subsidy under the Defence Service Homes Act 1918 (Cth). She would not be entitled to such subsidy if she owned another property. She did purchase another property and received the subsidy, after making a false declaration that she did not own or have any financial interest in another property. The first property was subsequently sold and the mother

and son sought a declaration that the proceeds of sale were held in trust for the mother, while the daughter sought a declaration that she had a beneficial interest in the sale proceeds. In contradistinction to the decision of the House of Lords in *Tinsley v Milligan*, the Australian High Court, by a majority, rejected the 'all or nothing approach' exemplified by the reliance principle. Instead of considering whether the mother needed to rely on an illegality in asserting her interest in the property transferred to her son and daughter, the majority considered whether the policy or importance of the public interest to be protected was of an overriding nature before which considerations of hardship must yield. The policy contravened was not of such overriding nature and the mother's claim was therefore allowed on terms. This has been termed the policy **solution**.<sup>56</sup>

7.6 Our law at present is a little uncertain. The reliance principle as applied in *Tinsley v Milligan* has been accepted by our Court of Appeal in *Shi Fang v Koh Pee Huat*.<sup>57</sup> However, some ten years ago, in *Suntoso Jacob v Kong Miao Ming*<sup>58</sup>, the Court of Appeal applied the reliance principle in a manner inconsistent with that applied in *Tinsley v Milligan*. The plaintiff had created a trust over certain shares in order to practise a deception on the relevant authority and subsequently sought to recover the shares from the trustee relying on an automatic resulting trust. The Court of Appeal held that in seeking to recover the shares he had to rely on the trust and in so doing "the illegal purpose of the transfer that gave rise to the trust **emerged**."<sup>59</sup> It is doubtful if *Suntoso* would today be decided as it then was.

7.7 As to **restitutionary** relief, just as the reliance principle is deficient in its application because it takes no account of the seriousness of the illegality involved, so the *par delictum* rule may operate harshly because it assumes that all illegality is equally serious. Suppose the plaintiff has sold rubber to a firm of rubber dealers and the sale is prohibited because rubber dealers must be licensed but the firm is not licensed. If the plaintiff who was aware of the illegality sues to recover back the rubber delivered to the firm, the *par delictum* rule will bar his claim. But it may be that, on the particular facts, the firm was unlicensed only because of an inadvertent omission to renew its license and that it would have been granted a fresh licence had it not neglected to renew its expired licence. Under those circumstances, the

contravention of policy is not serious but the *par delictum* rule **will** nevertheless bar recovery by the plaintiff.

7.8 The cases we have instanced sufficiently show the complexity in the law relating to illegal contracts and trusts. While there is considerable flexibility in the approach adopted by the courts in dealing with illegal contracts and trusts, the courts cannot engage in an exercise of balancing the interests of the parties involved and considering the factors for and against enforcing such contracts or granting **restitutionary** reliefs. They have no jurisdiction or power to do so.

## **PROPOSALS FOR REFORM**

8.0 We now make our recommendations for reform on the law relating to illegal contracts and trusts.

8.1 Our view is that nothing in the proposed reform should affect the determination of whether a contract or trust is illegal. In granting appropriate relief in situations where a contract or trust is affected by illegality, the courts presently have no jurisdiction to declare that the contract or trust is legal when it is illegal. In our opinion, the courts should continue to have no power or discretion other than to grant relief in appropriate **cases**.<sup>60</sup> To empower the courts to do otherwise would create too much uncertainty and provoke unnecessary litigation.

8.2 Retention of the existing law will also ensure the preservation of existing flexibility in the law. For instance, we note that there is probably a great deal of flexibility in the way an illegal trust is defined and in cases where voiding a trust is disproportionate to the strength of the public interest to be protected, there is sufficient flexibility to hold the trust valid, or valid but unenforceable by a plaintiff who needs to rely on an illegality in proving his interest. This flexibility will be available to accommodate cases where it would be right that the innocent beneficiaries and not the settlor should obtain the intended interests.

8.3 However, while we do not favour alterations to the law relating to when a contract or trust is illegal, we recommend that the courts and arbitrators exercising their proper jurisdiction should be empowered to afford relief in their discretion in respect of an illegal contract or trust, having regard to all the circumstances and in particular, such considerations as: (i) the seriousness of the illegality involved; (ii) the knowledge and intention of the party seeking to enforce the contract, seeking to recover benefits conferred under it, or seeking the recognition of legal or equitable rights under it; (iii) whether denying the claim would deter the illegality; (iv) whether denying the claim would further the purpose of the rule which renders the contract illegal; and (v) whether denying relief would be proportionate to the illegality involved. In making this recommendation, we have considered several reform options and briefly describe them below.

8.4 There are at least three options as to how to define the scope of a statutory discretion to give relief in respect of an illegal contract or trust.

### **The Israeli Solution**

8.5 The Israeli Contracts (General Part) Law 1973 provides an example of what may be termed the partial solution. The illegal contract is declared to be void (and not merely unenforceable) but there is a duty to make restitution for **benefits** received and if partly executed, the court may "require the other party to fulfil the whole or part of the corresponding obligation." **Enforceability** of an illegal contract may be granted in the court's discretion. The courts are left free to decide which factors matter and which do not.

8.6 We think that the Israeli solution goes too far in making restitution a matter of duty. This ignores the possibility that in some cases restitution should be denied for the sake of the public interest to be protected. It should be noted that the Israeli Act provides a pretty wide scope of relief since the illegal contract is made void as opposed to being merely unenforceable. A void contract will not pass title and will not permit a claim based on title which has passed. In dealing with an illegal **contract**, the courts in Israel will therefore have to consider whether and how to protect third

parties who have dealt in good faith with a party to an illegal contract and who allege that they have good title.

### **The New Zealand Illegal Contracts Act 1970<sup>61</sup>**

8.7 The New Zealand Act renders an illegal contract of no effect and empowers the court to grant to the contracting parties and anyone else affected "such relief by way of restitution, compensation, variation of the contract, validation of the contract in whole or part or for any particular purpose or otherwise howsoever as the Court in its discretion thinks just." The important and distinctive characteristics of the Act are a fuller range of discretionary relief (not restricted to mitigating the defence of illegality) and a relatively unstructured discretion.

8.8 One of its attractive points is that the New Zealand Act has not, despite the absence of a structured **discretion**, provoked a floodgate of litigation. It has inspired both the British Columbia and Ontario proposals for reform and appears to have worked particularly well in avoiding the hardship occasioned by implied prohibition.

8.9 We note that section 6 of the New Zealand Illegal Contracts Act 1970 changes the common law as to the passing of property under an illegal contract. At common law, title may pass under an illegal **contract**.<sup>62</sup> The adoption of section 6 would be inappropriate in light of our recommendation against making alterations to the existing **law**.<sup>63</sup> Under our proposals, the present law continues to determine the question of title. If legal title has passed under an illegal contract to one of the parties and he delivers the property to a third party, that third party will obtain a good title in accordance with the present law. As a result, knowledge on the part of the third party that there was an illegal contract before his own dealing will be **immaterial**.<sup>64</sup>

### **The English Proposals**

8.10 Following strong judicial calls for **reform**, the English Law Commission recently produced a consultation **paper**<sup>65</sup> in which it tentatively indicated its preference for a discretionary relief with two prominent characteristics, namely a

structured discretion and restricted relief so that the courts may only mitigate the defence of illegality but not (say) vary the contract in question or make compensation orders in favour of a party to the contract. The Law Commission provisionally proposed that when exercising its discretion to afford relief, a court should consider: (i) the seriousness of the illegality involved; (ii) the knowledge and intention of the party seeking to enforce the contract, seeking to recover benefits conferred under **it**, or seeking the recognition of legal or equitable rights under it; (iii) whether denying the claim would deter the illegality; (iv) whether denying the claim would further the purpose of the rule which renders the contract illegal; and (v) whether denying relief would be proportionate to the illegality **involved**.<sup>66</sup>

**8.11** Unlike the older Israeli and New Zealand reforms, the English proposals take in illegal trusts *and gifts* as well. We think that as illegal trusts *and gifts* raise the same or similar issues as illegal contracts, they are amenable to the same or similar **reform**. There are, however, three important differences between our recommendations and the English Law Commission proposals. First, whereas the English Law Commission proposals involve abrogation of the reliance principle, we have recommended retaining the existing law. Second, we have recommended that the court's power to grant relief should not be restricted to but should go beyond mitigating the defence of illegality. Third, the English Law Commission suggests that while the statutory discretion to afford relief in respect of an illegal contract or trust or gift should be exercised having regard to all the circumstances, the consideration of certain factors should be made obligatory; but we have not found it necessary to stipulate an obligatory list of considerations to be taken into account when granting relief. In order to provide comprehensive guidance on how the discretion to grant relief should be exercised, our proposed draft bill spells out very fully the relevant considerations which bear on the exercise of that discretion.

<sup>1</sup> See Appendix I.

<sup>2</sup> We distinguish contracts which are **statutorily** invalid (void, voidable, unenforceable) but which do not involve prohibited conduct. We are aware that there are numerous anomalous cases in which the courts have treated some such contracts as being illegal. See footnote 3. See also *Estate of Tuan Sheikh Abdulrahman, deceased (1919)* 2 FMSLR 204. To that **extent**, the contracts will be within the scope of our proposed reform. Wagering contracts are declared unenforceable under the Civil Law Act and many commentators treat them as separate from illegal contracts, even though the act of gaming in certain circumstances is prohibited. It may be that although not illegal in the sense of prohibition they are contrary to the policy of the statute: see *Ralli v Angullia (1917)* 15SSLR 33.

<sup>3</sup> *Holman v Johnson (1775)* 1 Cowp 341 at 343.

<sup>4</sup> We note that an expressly or impliedly prohibited trust is rare. More commonly, the statute will merely render the trust void without making the creation of the trust an offence and it may be that some of these trusts are regarded as illegal: see *infra* n 6. If so, they will fall within the scope of our reform.

<sup>5</sup> See *Mohamed v Alaga & Co [1998]* 2 All ER 720; *Re Mahmoud and Ispahani [1921]* 2 KB 716. A difficulty often glossed over is whether the conduct of contracting must attract a criminal penalty before the contract is properly regarded as expressly prohibited (this difficulty also exists with respect to implied prohibition). There are some views that the conduct of contracting must be made a criminal act: see eg Ong Hock Sim FJ (dissenting) in *Ng Siew San v Menaka [1973]* 1 MLJ 50 *affd* [1973] 2 MLJ 154. But the majority of courts do not require the presence of a penal provision to justify holding a contract to be prohibited. A contract may be held to be prohibited even though the statute merely provides that it shall be void. Thus, a grant of rights made non-transferable and void if assigned was treated as illegal in *Tan Hock Bing v Abu Samah [1968]* 1 MLJ 221.

<sup>6</sup> *St John Shipping Corp v Joseph Rank Ltd [1957]* 1 QB 267. See also *Phoenix General Insurance Co of Greece SA v Halvanon Insurance Co Ltd [1988]* QB 216 at 273. Note that a contract may be impliedly prohibited as performed: see *St John Shipping Corp v Joseph Rank Ltd [1957]* 1 QB 267; although the distinction with contracts illegal in **inception** is not always clear or even made: see *Archbalds (Freightage) Ltd v S Spangle Ltd [1961]* 1 QB 374 and Law Commission Consultation Paper No 154 at 83.

<sup>7</sup> *Phoenix General Insurance Co of Greece SA v Halvanon Insurance Co Ltd [1988]* QB 216 applied in *Foo Kee Boo v Ho Lee Investments (Pte) Ltd [1988]* 3 MLJ 128. See the anticipation of this in *Beca (Malaysia) Sdn Bhd v Tan Choong Kuang [1986]* 1 MLJ 390. Cf *Re Mahmoud and Ispahani [1921]* 2 KB 716.

<sup>8</sup> See *Hughes v Asset Management plc [1995]* 3 All ER 669. *Rasih Munusamy v Lim Tan & Sons Sdn Bhd [1985]* 2 MLJ 291; *Tokyo Investments Pte Ltd v Tan Chor Thing [1993]* 3 SLR 170. Cf A Phang Cheshire, Fifoot & Furmston's *Law of Contract - Singapore and Malaysian Edition* who confines class protection reasoning to **restitutionary** remedies.

<sup>9</sup> The broad distinction is explained lucidly in *St John Shipping Corp v Joseph Rank Ltd [1957]* 1 QB 267 at 283. A case of statutory illegality involves prohibition of the contract in question whereas a case of common law illegality involves the prohibition of an act (not necessarily a contract). "In a [case of common law illegality] you have only to look and see what acts the statute prohibits; it does not matter whether or not it prohibits a **contract**; if a contract is deliberately made to do a prohibited **act**, that contract will be unenforceable."

<sup>10</sup> *Foster v Driscoll [1929]* 1 KB 470.

<sup>11</sup> *Laurence v Lexcourt Holding Ltd [1978]* 1 WLR 1128.

<sup>12</sup> *Ashmore Benson Pease & Co Ltd v Dawson Ltd [1973]* 1 WLR 828. Note that knowledge that the defendant intended to break the law when performing the contract is not participation unless perhaps that knowledge was acquired at the outset when the contract was concluded. See also *Fielding & Platt Ltd v Najjar [1969]* 1 WLR 357 where there was neither incitement nor participation and *Patriot Pte Ltd v Lam Hong Commercial Co [1980]* 1 MLJ 135 where there was participation. It does not appear that the epithet 'active' adds anything of further significance.

<sup>13</sup> See and cf *Foster v Driscoll [1929]* 1 KB 470.

<sup>14</sup> *Brawn Jenkinson & Co Ltd v Percy Dalton (London) Ltd [1957]* 2 QB 621. A contract to break another contract is probably illegal at common law: see the observations in *British Homophone Ltd v Kunz and Crystallite Gramophone Record Manufacturing Co Ltd (1935)* 152 LT 589 at 592.

<sup>15</sup> See *Wood v Barker (1865)* LR 1 Eq 139.

<sup>16</sup> *Tan Hock Bing v Abu Samah [1968]* 1 MLJ 221. See also *Leong Poh Chin v Chin Thin Sin [1959]* MLJ 246.

<sup>17</sup> *Ahmad bin Udoh v Ng Aik Chong* [1969] 2 MLJ 116 at 117; *Datuk Ong Kee Hui v Sinyiam Anak Mutit* [1983] 1 MLJ 36 at 41, reversing [1982] 1 MLJ 36.

<sup>18</sup> A party may not found an action on an illegal cause. And the associated maxim, *ex dolo malo non oritur actio*. See *Bowmakers Ltd v Barnet Instruments Ltd* [1945] KB 65. In *Palaniappa Chettiar v Arunasalam Chettiar* [1962] MLJ 143 a father who had transferred his land to his son for an illegal or fraudulent purpose could not get the land back on the ground that no court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act.

<sup>19</sup> See *Lougher v Molyneux* [1916] 1 KB 718.

<sup>20</sup> *Euro-Diam Ltd v Bathurst* [1990] 1 QB 1 applied in *Overseas Union Bank Ltd v Chua Kay Kok* [1993] 1 SLR 686.

<sup>21</sup> Some commentators take the view that the reliance principle is separate from the notion of tainting by a linked contract. There is support for this view in *Fisher v Bridges* (1854) 3 El & Bl 643. Cf *Spector v Ageda* [1973] Ch 30. And cf *Euro-Diam Ltd v Bathurst* [1990] 1 QB 1.

<sup>22</sup> See *Belvoir Finance Co Ltd v Stapleton* [1971] 1 QB 210; *Singh v AH* [1960] AC 167. Note that Treitel *The Law of Contract* (9 ed, 1995) at 458 explains the first case cited as establishing a proposition valid as between purchaser and third party. It appears that there must be at least some act such as delivery of possession before title can pass under an illegal contract. An executory illegal contract may well not effectively pass title to property or if it passes title, but the vendor has yet to deliver the property, the purchaser will have no assistance from the court to enforce his property.

<sup>23</sup> *Singh v Ali* [1960] AC 167 applied in *Lim Kim Hock v Lee Ah Kong* [1981] 2 MLJ 206; *Daniel s/o D William v Luhah Wan* [1990] 2 MLJ 48.

<sup>24</sup> See *Tinsley v Milligan* [1994] 1 AC 340.

<sup>25</sup> See *Re Elliott* [1952] Ch 217. See and cf *Re Raven* [1915] 1 Ch 673.

<sup>26</sup> In some textbooks, and especially in the older cases, an illegal contract is said to be void ab initio; but the best view is that it is merely unenforceable. If an illegal contract was void, it could not support an action for inducement of breach of contract Nor would it support a defence against a holder in due course. Cf *Mogul SS Co v McGregor Gow & Co* [1892] AC 25 at 39. Note that in the Malaysian Contracts Act 1960, the term 'void' is probably used synonymously with 'unenforceable'.

<sup>27</sup> The trustee holding on resulting trust for the settlor has a duty to recover the property from the third party transferee. The settlor arguably may assert his equitable interest against the third party recipient, joining the trustee as defendant. The express trust being void, the trustee could not give good title to the third party.

<sup>28</sup> Note that in Singapore a champertous retainer has been regarded as being a contract prohibited by the Legal Profession Act as opposed to being a contract contrary to public policy. See *Estate of Tuan Sheikh Abdulrahman, deceased* (1919) 2 FMSLR 204. Generally, however, champertous contracts are contracts against public policy. See *Khan Kam Chee v Wan Yat Realty Sdn Bhd* [1985] 1 MLJ 42.

<sup>29</sup> Or in aid of prostitution: see *Pearce v Brooks* (1886) LR 1 Exch 213.

<sup>30</sup> *Miller v Karlinski* (1945) 62 TLR 85; *Alexander v Rayson* [1936] 1 KB 169.

<sup>31</sup> See *Lemenda Trading Co Ltd v African Middle-East Petroleum Co Ltd* [1988] QB 448.

<sup>32</sup> *Parkinson v College of Ambulance Ltd and Harrison* [1925] 2 KB 1.

<sup>33</sup> *Tan Kai Mee v Lim Soei Jin* [1981] 1 MLJ 271; *W v H* [1987] 2 MLJ 235 at 240; *Hyman v Hyman* [1929] AC 601 at 626.

<sup>34</sup> A contract to indemnify another against the consequences of his committing a tort is not against public policy unless it tends to induce the commission of the tort.

<sup>35</sup> See *Re Edgar* (1939) 83 SJ 154 (trust to discourage beneficiary from undertaking public office); *Thornton v Howe* (1862) 31 Beav 14; *Re Hyde* [1932] 1 Ch 95 (*inter vivos* trust for future illegitimate children).

<sup>36</sup> *Bevan Ashford v Geoffeandle (Contractors) Ltd* [1998] 3 WLR 172 at 181. See also *Thai Trading Co v Taylor* [1998] QB 781.

<sup>37</sup> *Parkinson v College of Ambulance Ltd and Harrison* [1925] 2 KB 1.

<sup>38</sup> *CiBerg v Sadler and Moore* [1937] 2 KB 158.

<sup>39</sup> *Abdul Shukor v Hood Mohamed* [1968] 1 MLJ 258.

<sup>40</sup> *Kiriri Cotton Co Ltd v Dewani* [1960] AC 192.

<sup>41</sup> *Hughes v Liverpool Victoria Friendly Society* [1916] 2 KB 482.

<sup>42</sup> *Smith v Cuff* (1817) 6 M & S 160.

<sup>43</sup> *Oom v Bruce* (1810) 12 East 225. But not if he is the victim of his own negligence.

<sup>44</sup> *Taylor v Bhail* [1996] CLC 377.

<sup>45</sup> *Tribe v Tribe* [1995] 4 All ER 336; *Taylor v Bowers* (1876) 1 QBD 291; *Kearley v Thompson* (1890) 24 QBD 742.

<sup>46</sup> *CF Bigos v Bousted* [1951] 1 All ER 92.

<sup>47</sup> *The Vauxhall Bridge Co v The Earl Spencer* (1821) Jac 64 at 67. See also *Gehres v Ater* 73 NE 2d 513 (1947).

<sup>48</sup> *Mohamed v Alaga & Co* [1998] 2 All ER 720. See also Lord Goff in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] 2 WLR 802 at 813.

<sup>49</sup> *Cope v Rowlands* (1836) 2 M & W 149.

<sup>50</sup> *Hughes v Asset Managers plc* [1995] 3 All ER 669.

<sup>51</sup> [1945] KB 65.

<sup>52</sup> Note that the reliance principle is easily misapplied. It should not be applied when a contract is intrinsically illegal but see *Singapore Finance Ltd v Soetanto* [1992] 2 SLR 407.

<sup>53</sup> [1994] 1 AC 340. By a majority.

<sup>54</sup> [1962] MLJ 143, [1962] AC 294.

<sup>55</sup> *Nelson v Nelson* (1995) 184 CLR 538.

<sup>56</sup> By the English Law Commission in their Consultation Paper No 154 (1999).

<sup>57</sup> *Shi Fang v Koh Pee Huat* [1996] 2 SLR 221.

<sup>58</sup> [1986] 2 MLJ 170.

<sup>59</sup> The point is obscure but there is no reason why the reliance principle should not apply to a claim to interests under an express trust. As a claim based on title, it should be a matter of indifference whether the interest is legal or equitable and whether it arises automatically by operation of law or as a result of express intention.

<sup>60</sup> Cf the tentative proposal of the English Law Commission to drop the reliance principle.

<sup>61</sup> See Appendix II.

<sup>62</sup> In *Singh v Ali* [1960] MLJ 52 the Privy Council held that an illegal transaction between the plaintiff and the defendant that was fully executed and carried out was effective to pass the property in the lorry to the plaintiff.

<sup>63</sup> We note that if title passes, it may be transferred to another and the second purchaser would obtain a more secure title than the *bona fide* purchaser without notice under the New Zealand legislation.

<sup>64</sup> Cf *Spector v Ageda* [1973] Ch 30 at 44.

<sup>65</sup> *Illegal Transactions: The Effect of Illegality on Contracts and Trusts* Consultation Paper No 154 (1999).

<sup>66</sup> See Appendix III.

# APPENDIX I

**ILLEGAL TRANSACTIONS (RELIEF) ACT  
2002**

(No. of 2002)

**ARRANGEMENT OF SECTIONS**

Section

1. Short title and commencement
  2. Interpretation
  3. Application of this Act
  4. Determination of illegality
  5. Court may grant relief
  6. Relevant considerations
  7. Act to bind Government
  8. Savings provision
-

A BILL

*intituled*

An Act to afford discretionary relief in circumstances where a contract, trust or disposition of property is affected by illegality.

New Zealand Illegal Contracts Act, preamble

**An Act to reform the law relating to illegal contracts.**

Be it enacted by the President with the advice and consent of the Parliament of Singapore, as follows:

**Short title and commencement**

1. This Act may be cited as the Illegal Transactions (Relief) Act 2002 and shall come into operation on such date as the Minister may, by notification in the *Gazette*, appoint.

## Interpretation

2. In this Act, unless the context otherwise requires —

"court" means the High Court, a district or **magistrate's** court or an arbitral tribunal, exercising its proper jurisdiction;

*[Source: BC's draft CLRA s. 15 and NZ s.2 (modified).]*

British Columbia, draft Contract Law Reform Act, s.15

"court" means a court, tribunal or an arbitral tribunal exercising its proper jurisdiction;

NZ Illegal Contracts Act, s.2

"Court" means the High Court or a District Court that has jurisdiction under section 9 of this Act or a Small Claims Tribunal which has jurisdiction under section 9A of this Act;

*[By amending legislation in 1979, references to the Supreme Court and a Magistrate's Court were substituted with references to the High Court and a District Court respectively.]*

"**illegal** transaction" means a transaction that is —

- (a) illegal at law or in equity;
- (b) unenforceable as being affected by illegality; or
- (c) unenforceable as being contrary to public policy,

but does not include a transaction which infringes the rule against perpetuities or the rule against accumulations;

*[Source: NZ s.3 and EC draft CLRA s.15 (modified)]*

BC LRC:

"illegal transaction" should be defined for the purposes of an Illegal Transaction Act as any transaction which is null, void, illegal, unlawful, invalid, unenforceable, or otherwise ineffective, or in respect of which no action or proceeding may be brought by reason of—

- (a) an enactment or provision in an enactment; or
- (b) a rule of the common law or equity, relating to public policy, governing the formation, existence or performance of the transaction.

[BC LRC separately excludes from the operation of the Act transactions which are unenforceable by reason of limitation, perpetuity, frustration, failure to register, etc. (see BC's draft Act below)]

British Columbia, draft Contract Law Reform Act, s.15

"illegal contract" means a contract that in its formation, existence or performance, is null, **void**, illegal, unlawful, invalid, unenforceable, or otherwise ineffective, or in respect of which no action or proceeding may be brought, by reason of—

- (a) an enactment or provision in an enactment; or
- (b) a rule of equity or common law respecting contracts that are contrary to public policy,

but does not include a contract that —

- (i) is invalid by reason only of a failure to register the contract;
- (ii) is unenforceable by reason only of **effluxion** of time;
- (iii) is unenforceable by reason only of its not being in writing or signed by the party to be **charged**, or that party's agent;
- (iv) is invalid by reason only of the creation or vesting of a right after a specified period;
- (v) is invalid by reason only that it is in restraint of trade; or
- (vi) is avoided by frustration;

New Zealand Illegal Contracts Act s.3.

**3. "Illegal contract" defined** - Subject to section 5 of this **Act**, for the purposes of this Act the term "illegal contract" means any contract that is illegal at law or in equity, whether the illegality arises from the creation or performance of the contract; and includes a contract that contains an illegal provision, whether that provision is **severable** or not.

"transaction" means a **contract**, trust or disposition of property.

[Source: BC draft CLRA s. 15 (*modified*)]

British Columbia, draft Contract Law Reform Act, s.15

"contract" means a contract, trust, transaction, or arrangement or any provision of a contract, trust, transaction, or arrangement and includes a disposition of property and any instrument effecting or evidencing a disposition of property.

**Application of this Act** [Source: BC draft CLRA s. 16 (*modified*)]

3. This Act shall apply in respect of an illegal transaction whether the transaction was entered into before or after the commencement of this Act.

British Columbia, draft Contract Law Reform Act, s.16

**Application**

16. This Part applies in respect of an illegal contract whether or not:

- (a) the contract was entered into before or after this Part comes into force, or
- (b) the provision of the contract that renders it illegal is **severable** by the deletion of words or otherwise,

but does not apply where the enactment by reason of which the contract is illegal provides for relief.

**Determination of illegality** [Source: (*new*)]

4. Nothing in this Act shall abrogate or affect any rule of law (including any rule of construction) relating to whether and in what circumstances a transaction is affected by illegality.

**Court may grant relief** [Source: NZ s. 7 and BC draft CLRA s.19 (*modified*)]

**5.—(1)** Notwithstanding any rule of law to the contrary, but subject to this Act, in any proceedings involving an illegal transaction, the court may grant to any person referred to in subsection (2), one or more of the following reliefs:

- (a) restitution in whole or in part;
- (b) compensation by way of damages or otherwise;

- (c) apportionment of any loss arising from the formation or performance of the transaction, other than loss of profit;
- (d) a declaration;
- (e) an order vesting property in any person (including the State as *bona vacantia*) or directing a person to assign or transfer property to another;
- (f) variation of the transaction, including severance of any illegal part of the transaction;
- (g) enforcement of the transaction in whole or part or for any particular purpose; or
- (h) any other remedy the court could have granted at common law or in equity had the transaction not been an illegal transaction.

(2) Any relief under subsection (1) may be granted to —

- (a) any party to the illegal transaction; or
- (b) any person claiming through or under any such party.

(3) Any relief under subsection (1) may be granted upon and subject to such terms and conditions as the court thinks fit.

NZ Illegal Contracts Act, s.7

**7. Court may grant relief** – (1) Notwithstanding the provisions of section 6 of this Act, but subject to the express provisions of any other enactment, the Court may in the course of any proceedings, or on application made for the purpose, grant to -

- (a) Any party to an illegal contract; or
- (b) Any party to a contract who is disqualified from enforcing it by reason of the commission of an illegal act in the course of its performance; or
- (c) Any person claiming through or under any such party -

Such relief by way of restitution, compensation, variation of the contract, validation of the contract in whole or in part or for any particular purpose, or otherwise howsoever as the Court in its discretion thinks just.

(2) An application under subsection (1) of this section may be made by —

- (a) Any person to whom the Court may grant relief pursuant to subsection (1) of this section; or
- (b) Any other person where it is material for that person to know whether relief will be granted under that subsection.

.....  
**(5) The Court may by any order made under** subsection (1) of this section vest

any property that was the subject of, or the whole or part of the consideration for, an illegal contract in any party to the proceedings or may direct any such party to transfer or assign any such property to any other party to the proceedings.

(6) Any order made under subsection (1) of this section, or any provision of any such order, may be made upon and subject to such terms and conditions as the Court thinks fit.

(7) Subject to the express provisions of any other enactment, the Court shall, in respect of any illegal contract, grant relief to any person otherwise than in accordance with the provisions of this Act.

British Columbia, draft Contract Law Reform Act, s. 19

**Remedies**

**19.—(1)** In a proceeding in respect of an illegal contract, or property, the court may, by order, grant one or more of the following remedies:

- a. **Restitution,**
- b. Compensation by way of damages or otherwise,
- c. Apportionment of any loss arising from the formation or performance of the contract, other than loss of **profit,**
- d. a declaration,
- e. an order vesting property in any person or directing a person to assign or transfer property to another,
- f. where the court is satisfied that one or more of the obligations or rights under the contract are reasonable,
  - i a declaration that those obligations constitute an enforceable contract,
  - ii an order that those obligations be discharged in a lawful manner specified by the court, or
  - iii any other remedy the court could have granted under common law or equity **had the contract** not been an illegal contract.

**Relevant considerations**

**6.—(1)** In granting or refusing to grant relief under section 5, the court shall have regard to all relevant circumstances including —

- (a) the public interest;
- (b) the seriousness of the illegality;
- (c) whether denying relief will act as a deterrent;
- (d) whether denying relief will further the purpose of the rule which renders the transaction illegal;

- (e) whether denying relief is proportionate to the illegality involved;
- (f) the circumstances of the formation or performance of the illegal transaction, including the intent, knowledge, conduct and relationship of the parties;
- (g) whether any party to the illegal transaction was, at a material time, acting under a mistake of fact or law;
- (h) the extent to which the illegal transaction has been performed;
- (i) whether the written law which renders the transaction illegal has been substantially complied with;
- (j) whether and to what extent the written law which renders the transaction illegal provides relief; and
- (k) other consequences of denying relief.

*[Source: UK Law Commission, Consultation Paper; BC draft CLRA s.20(1), modified]*

(2) In addition to the matters it shall have regard to under subsection (1), the court shall also have regard to whether or not —

- (a) a party to the transaction has so altered that **party's** position that granting relief would, in the circumstances, be inequitable;
- (b) another proceeding has been commenced in respect of the transaction; and
- (c) a party to the transaction has compromised a claim in respect of the transaction.

*[Source: BC draft CLRA s.20(2), modified]*

UK's 5 factors:

- (a) the seriousness of the illegality;
- (b) the knowledge and intention of the plaintiff;
- (c) whether denying relief will act as a deterrent;
- (d) whether denying relief will further the purpose of the rule which renders the contract illegal; and
- (e) whether denying relief is proportionate to the illegality involved.

NZ's factors (s. 7):

(3) In considering whether to grant relief under subsection (1) of this section the

Court shall have regard to -

- (a) The conduct of the parties;
- (b) **In** the case of a breach of an enactment, the object of the enactment and the gravity of the penalty expressly provided for any breach thereof; and
- (c) Such other matters as it thinks proper;

But shall not grant relief if it considers that to do so would not be in the public interest.

(4) The Court may make an order under subsection (1) of this section notwithstanding that the person granted relief entered into the contract or committed an unlawful act or unlawfully omitted to do an act with knowledge of the facts or law giving rise to the illegality, but the Court shall take such knowledge **into account in exercising** its discretion under that subsection.

British Columbia, draft Contract Law Reform Act s.20

Discretionary Factors

**20.—(1)** In granting or refusing an order under section 19, the court may **consider —**

- (a) the public interest;
- (b) the circumstances of the formation or performance of the illegal contract, including the intent, knowledge, conduct and relationship of the parties;
- (c) if any party to the illegal contract was, at a material time, acting under a mistake of fact or law;
- (d) the extent to which the illegal contract has been performed;
- (e) if the enactment by reason of which the contract is illegal has been substantially complied with;
- (f) The consequences of denying relief; and
- (g) any other factor the court considers relevant.

(2) **In** granting or refusing an order in respect of an illegal contract that was entered into before this Part came into force, the court, in addition to the factors it may consider under subsection (1), must consider whether or not —

- (a) a party to the transaction has so altered that party's position that granting a remedy would, in the circumstances, be inequitable;
- (b) another proceeding has been commenced in respect of the contract; and
- (c) a party to the contract has compromised a claim **in** respect of the contract.

**Act to bind Government** [*Source: NZ s.4 (modified)*]

7. This Act shall bind the Government.

**Savings provision** [*Source: NZ s.11(1), (3)*]

**8.—(1)** Nothing in this Act shall affect the law relating to contracts, or provisions of contracts, which purport to oust the jurisdiction of any court, whether that court is a court within the meaning of this Act or not.

(2) Nothing in this Act shall affect the rights of the parties —

(a) under any judgment given in any court before the commencement of this Act; or

(b) under any judgment given on appeal from any such judgment whether the appeal is filed before or after the commencement of this Act.

### EXPLANATORY STATEMENT

As a general rule, Singapore courts currently decline to grant relief to parties who have either deliberately or unwittingly entered into an "illegal" transaction. An "illegal" transaction in this context is one which infringes some public policy or on the terms or object of any written law and does not necessarily imply some criminal or dishonourable conduct on the part of any party.

The laws that define when a transaction may be characterised as illegal, and the exceptions to the general rule are uncertain and inconsistent. In its *Report on Relief from Unenforceability of Illegal Contracts and Trusts*, the Law Reform Committee of the Singapore Academy of Law recommended that legislation be enacted which gives the court broad and flexible powers to readjust the rights of parties in an illegal contract, trust and disposition of property.

This Bill seeks to implement the recommendations of the Law Reform Committee.

Clause 1 relates to the short title and commencement.

Clause 2 defines certain terms used in the Bill.

Clause 3 sets out the scope of application of the Bill.

Clause 4 makes clear that the general rules at common law and in equity, including rules of construction, relating to the determination of whether a transaction is affected by illegality are preserved.

Clause 5 empowers the court to grant relief in its discretion in respect of an illegal transaction. The range of orders which the court may grant are set out in sub-clause (1).

Clause 6 specifies certain obligatory considerations which the court must take into account in granting or refusing to grant relief.

Clause 7 states that the Bill binds the Government.

Clause 8 is a savings provision. Sub-clause (1) provides that nothing in this Bill shall affect the law relating to contracts, or provisions of contracts, which purport to oust the jurisdiction of any **court**, whether that court is a court within the meaning of this Bill or not.

Sub-clause (2) provides that nothing in this Bill shall affect the rights of parties under any judgment given in any court before the commencement of this Bill, or under any judgment given on appeal from any such judgment, whether the appeal is filed before or after the commencement of this Bill.

#### EXPENDITURE OF PUBLIC MONEY

This Bill will not involve the Government in any extra financial expenditure.

---

T:/illegal contract.WY:/IC(14th draft)

# APPENDIX II



## ANALYSIS

- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li>• Title</li> <li>1. Short Title</li> <li>2. Interpretation</li> <li>3. "Illegal contract" defined</li> <li>4. Act to bind the Crown</li> <li>5. Breach of enactment</li> </ul> | <ul style="list-style-type: none"> <li>6. Illegal contracts to be of no effect</li> <li>7. Court may grant relief</li> <li>8. Restraints of trade</li> <li>9. Jurisdiction of Magistrates' Courts</li> <li>10. Application of Act</li> <li>11. Savings</li> </ul> |
|---|---|

---

1970, No. 129

An Act to reform the law relating to illegal contracts

[1 December 1970]

BE IT ENACTED by the General Assembly of New Zealand in Parliament assembled, and by the authority of the same, as follows:

1. **Short Title**—This Act may be cited as the **Illegal Contracts Act 1970**.

2. **Interpretation**—In this Act, unless the context otherwise requires,—

"Act" means any Act of the General Assembly; and includes any Act of the Parliament of England, of the Parliament of Great Britain, or of the Parliament of the United Kingdom, which is in force in New Zealand:

"Court" means the Supreme Court or a Magistrate's Court that has jurisdiction under section 9 of this Act:

"Enactment" means any provision of any Act, regulations, rules, bylaws, Order in Council, or Proclamation; and includes any provision of any notice,

consent, approval, or direction which is given by any person pursuant to a power conferred by any Act or regulations:

"Property" means land, money, goods, things in action, goodwill, and every valuable thing, whether real or personal, and whether situated in New Zealand or elsewhere; and includes obligations, easements, and every description of estate, interest, and profit, present or future, vested or contingent, arising out of or incident to property.

3. "Illegal contract" **defined**—Subject to section 5 of this Act, for the purposes of this Act the term "illegal contract" means any contract that is illegal at law or in equity, whether the illegality arises from the creation or performance of the contract; and includes a contract which contains an illegal provision, whether that provision is severable or not.

4. Act to bind **the Crown**—This Act shall bind the Crown.

5. Breach of **enactment**—A contract lawfully entered into shall not become illegal or unenforceable by any party by reason of the fact that its performance is in breach of any enactment, unless the enactment expressly so provides or its object clearly so requires.

6. Illegal contracts to be of no **effect**—(1) Notwithstanding any rule of law or equity to the contrary, but subject to the provisions of this Act and of any other enactment, every illegal contract shall be of no effect and no person shall become entitled to any property under a disposition made by or pursuant to any such contract:

Provided that nothing in this section shall invalidate—

- (a) Any disposition of property by a party to an illegal contract for valuable consideration; or
- (b) Any disposition of property made by or through a person who became entitled to the property under a disposition to which paragraph (a) of this proviso applies—

if the person to whom the disposition was made was not a party to the illegal contract and had not at the time of the disposition notice that the property was the subject of, or the whole or part of the consideration for, an illegal contract and otherwise acts in good faith.

(2) In this section the term "disposition" has the meaning assigned to that term by section 2 of the Insolvency Act 1967.

**7. Court may grant relief—**(1) Notwithstanding the provisions of section 6 of this Act, but subject to the express provisions of any other enactment, the Court may in the course of any proceedings, or on application made for the purpose, grant to—

- (a) Any party to an illegal contract; or
- (b) Any party to a contract who is disqualified from enforcing it by reason of the commission of an illegal act in the course of its performance; or
- (c) Any person claiming through or under any such party—

such relief by way of restitution, compensation, variation of the contract, validation of the contract in whole or part or for any particular purpose, or otherwise howsoever as the Court in its discretion thinks just,

(2) An application under subsection (1) of this section may be made by—

- (a) Any person to whom the Court may grant relief pursuant to subsection (1) of this section; or
- (b) Any other person where it is material for that person to know whether relief will be granted under that subsection.

(3) In considering whether to grant relief under subsection (1) of this section the Court shall have regard to—

- (a) The conduct of the parties; and
- (b) In the case of a breach of an enactment, the object of the enactment and the gravity of the penalty expressly provided for any breach thereof; and
- (c) Such other matters as it thinks proper;

but shall not grant relief if it considers that to do so would not be in the public interest.

(4) The Court may make an order under subsection (1) of this section notwithstanding that the person granted relief entered into the contract or committed an unlawful act or unlawfully omitted to do an act with knowledge of the facts or law giving rise to the illegality, but the Court shall take such knowledge into account in exercising its discretion under that subsection.

(5) The Court may by any order made under subsection (1) of this section vest any property that was the subject of, or the whole or part of the consideration for, an illegal contract in any party to the proceedings or may direct any such party to transfer or assign any such property to any other party to the proceedings.

(6) Any order made under subsection (1) of this section, or any provision of any such order, may be made upon and subject to such terms and conditions as the Court thinks fit.

(7) Subject to the express provisions of any other enactment, no Court shall, in respect of any illegal contract, grant relief to any person otherwise than in accordance with the provisions of this Act.

8. Restraints of **trade**—(1) Where any provision of any contract constitutes an unreasonable restraint of trade, the Court may—

- (a) Delete the provision and give effect to the contract as so amended; or
- (b) So modify the provision that at the time the contract was entered into the provision as modified would have been reasonable, and give effect to the contract as so modified; or
- (c) Where the deletion or modification of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand, decline to enforce the contract.

(2) The Court may modify a provision under paragraph (b) of subsection (1) of this section, notwithstanding that the modification cannot be effected by the deletion of words from the provision.

9. Jurisdiction of Magistrates' **Courts**—(1) A Magistrate's Court shall have jurisdiction to exercise any of the powers conferred by any of the provisions of sections 7 and 8 of this Act in any case where—

- (a) The occasion for the exercise of the power arises in the course of any **civil** proceedings (other than an application made for the purposes of subsection (1) of section 7 of this Act) properly before the Court; or
- (b) The value of the consideration for the promise or act of any party to the contract is not more than \$2,000; or
- (c) The parties agree, in accordance with section 37 of the Magistrates' Courts Act 1947, that a Magistrate's Court shall have jurisdiction to hear and determine the application.

(2) For the purposes of section 43 of the Magistrates' Courts Act 1947, an application made to a Magistrate's Court pursuant to subsection (1) of section 7 of this Act shall be deemed to be an action.

10. Application of **Act**—**This** Act shall apply to contracts whether made before or after the commencement of this Act:

Provided that nothing in section 6 of this Act shall apply to contracts made before the commencement of this Act.

**11. Savings**—(1) Except as provided in section 8 of this Act, nothing in **this** Act shall affect the law relating to:

- (a) Contracts, or provisions of contracts, which are in restraint of trade; or
- (b) Contracts, or provisions of contracts, which purport to oust the jurisdiction of any Court, whether that Court is a Court within the meaning of this Act or not.

(2) Nothing in this Act shall affect the right of any person to bring an action for breach of promise of marriage and every such action shall be heard and determined as if this Act had not been passed.

(3) Nothing in this Act shall affect the rights of the parties under any judgment given in any Court before the commencement of this Act, or under any judgment given on appeal from any such judgment, whether the appeal is commenced before or after the commencement of this Act.

---

This Act is administered in the Department of Justice.

---

# APPENDIX III

## 2. STRUCTURING THE DISCRETION

- 7.27 Our provisional proposals above in relation to the illegality defence have involved giving the courts a discretion to apply the public interest. We now need to consider the ingredients of (that is, the factors involved in applying) this discretion. As we have seen, some commentators reject the adoption of a discretionary approach because they believe that it will create uncertainty." But we consider that that uncertainty can be reduced by structuring the discretion: that is, by providing guidance as to the factors that the court should consider when reaching its decision. In this section we consider what we provisionally believe those factors should be.
- 7.28 The aim of the provisionally proposed discretionary approach is to ensure that the courts' decisions reflect the policies that lie behind the illegality rules. In Part VI we identified four such policies: (i) upholding the dignity of the courts; (ii) preventing the plaintiff from profiting from his or her own wrongdoing; (iii) deterring illegality; and (iv) punishment. The relevant factors structuring the discretion should therefore be ones which ensure that those policies are properly reflected in the outcome of the particular case.

### (1) The seriousness of the illegality

- 7.29 A major criticism of the present rules on the effect of illegality is that they take little account of the seriousness of the illegality that is involved. So, for example, it would appear that there is no difference in the rules applied where a party enters into a contract intending to commit murder in its performance, and where a party enters into a contract in the knowledge that he or she will have to commit a parking offence in order to perform it."
- 7.30 On the one hand, the result of such rigidity is that the plaintiff may be required to forfeit his or her usual rights and remedies where the illegality is only slight and where his or her loss may be great. Indeed, the refusal to award civil relief can result in the plaintiff suffering an economic penalty far greater than any applicable criminal sanction. For example, in *St John Shipping Corporation v Joseph Rank Ltd* Devlin J pointed out that had the defendants' arguments in relation to statutory illegality been successful, "[a] shipowner who accidentally overloads by a fraction of an inch will not be able to recover from any of the shippers or consignees a penny of the freight".<sup>54</sup> He was pleased to be able to avoid such a result, yet was apparently prepared to accept that had the shipper *deliberately* contracted to

<sup>52</sup> See para 7.3 n 10 above.

<sup>53</sup> For criticism see, in particular, JD McCamus, "Restitutionary Recovery of Benefits Conferred under Contracts in Conflict with Statutory Policy - the New Golden Rule" (1987) 25 *Osgoode Hall LJ* 787, 821.

<sup>54</sup> [1957] 1 *QB* 267, 281.

overload his ship by a fraction of an inch, he would have forfeited his claim to the whole freight."

7.31 On the other hand, the failure to take account of the seriousness of the illegality may allow the plaintiff to claim to fall within some technical exception to the general non-recovery rules and recover even though his or her behaviour is heinous. As Lord Goff pointed out in his dissenting speech in *Tinsley v Milligan*, a strict application of the majority decision would mean that a plaintiff who had **contributed** towards the purchase price of a house to be used for terrorist activities would be **able to** invoke the assistance of the court in order to establish an equitable interest in the **property**.<sup>56</sup>

7.32 Yet if one looks at the policy issues that we have identified as lying behind the illegality rules, one can see that each bears far greater weight where the illegality involved is particularly serious. The dignity of the court can only be at risk where the conduct **involved** is morally "shocking". In many cases, particularly those involving statutory illegality, this **will** clearly not be the case. As Bingham LJ said in *Saunders v Edwards*: "[I]t is unacceptable that the court should, on the first indication of unlawfulness affecting any aspect of a transaction, draw up its skirts and refuse all assistance to the **plaintiff**, no matter how **serious** his loss nor how disproportionate his loss to the unlawfulness of his **conduct**."<sup>57</sup> The case law has already identified that the principle that the plaintiff may not profit from his or her own wrong is properly of limited **application**,<sup>58</sup> and the justification for pursuing the aims of deterrence and punishment is clearly that much greater where the illegality involved is serious. We therefore provisionally **consider** that in deciding whether or not it would be contrary to the public interest to allow the **plaintiff's** claim the court should consider the seriousness of the illegality involved. This would include considering whether the behaviour has been stigmatised as criminal, what sanctions might be **invoked**, and the manner in which the illegality was committed or intended.

## (2) The knowledge and intention of the plaintiff

7.33 In some **circumstances under** the present law the knowledge and intention of the **plaintiff**<sup>59</sup> is very relevant to the effect of illegality on a contract. For example, at common law a contracting party does not lose his or her right to enforce a contract simply because the other party intends or chooses to perform it in an unlawful manner or for an unlawful purpose. The innocent party may still enforce the contract.<sup>60</sup> However, in at least two circumstances the knowledge and intention of the plaintiff would not seem to be taken into account. First, where

<sup>55</sup> [1957] 1 QB 267, 287-288.

<sup>56</sup> [1994] 1 AC 340, 362.

<sup>57</sup> [1987] 1 WLR 1116, 1134.

<sup>58</sup> See para 6.8 above.

<sup>59</sup> By "plaintiff" we mean to refer to the person who is seeking to rely on what would, **illegality** apart from legal rights and remedies.

<sup>60</sup> See paras 2.24 to 2.31 above.

the contract is held to be **impliedly prohibited by statute**,<sup>61</sup> and **secondly**, though more doubtfully, where the **contract** cannot be performed in accordance with its terms **without** the commission of a legal wrong or conduct otherwise contrary to public policy.<sup>62</sup>

7.34 In claims for restitution we have seen that the *in part delicto* rule does allow some consideration to be given to the guilt or innocence of the plaintiff. Thus illegality can seldom be pleaded as a **successful** defence to claims for the recovery of benefits conferred under contracts **entered** into as a result of duress or mistake. **However**, where both parties are **guilty** (or **even** both innocent), the defendant may shelter behind the illegality in order to resist the **plaintiff's** claim.

7.35 The adoption of the reliance principle in relation to the recognition of property rights created under illegal contracts has reduced the issue of the delictum of the parties to a purely technical and procedural question. Whether or not the plaintiff will be able to recover will turn on fortuitous factors such as how the agreement was **structured** and the **technical** rules of **pleading**.<sup>63</sup>

7.36 But it is our provisional view that the knowledge and intention of the plaintiff must play a central role in deciding whether the policy reasons which lie behind the illegality rules can be relevant to the particular case. Little weight can be given to the argument that it would be an indignity to the court to assist the plaintiff where he or she is wholly unaware of the involvement of illegality. And indeed the courts have recognised that the **principle** that the **plaintiff** should not be allowed to profit from **his** or her own wrongdoing should not be **applied** where the plaintiff does not know that the act is unlawful or is not in any way **culpable**.<sup>64</sup> Although in **limited** cases relief may be refused to an innocent party on the **grounds** that it will deter others or act as a punishment, such action is clearly **harder** to justify than where the plaintiff is aware of and intends the illegality.

7.37 We do not, however, provisionally recommend that, in deciding whether or not it is in the public interest to deny the **plaintiff's** claim, the courts should weigh up the **plaintiff's** "guilt" against that of the defendant. **That** is, we do not suggest that the **courts** should undertake a balancing exercise of the merits and demerits of the parties to the dispute, awarding relief only where the plaintiff is the more **virtuous**.<sup>65</sup> Since the illegality defence acts to deprive the plaintiff of rights or remedies which he or she would otherwise have been able to claim, it should only succeed where the plaintiff's conduct relating to the illegality makes such a result

<sup>61</sup> See para 2.5 above.

<sup>62</sup> See paras 2.20 to 2.23 above.

<sup>63</sup> See para 7.24 above.

<sup>64</sup> *Strongman (1945) Ltd v Sincock* [1955] 2 QB 525, 535, *per Denning LJ* cited at para 6.8 above.

<sup>65</sup> In some cases, of course, the defendant's conduct will be **relevant** in assessing the plaintiff's knowledge and intention - for example, where the defendant has misled the plaintiff as to the legality of the contract.

imperative in order to protect the public interest. The guilt or innocence of the defendant should **have** no bearing."

**(3) Whether denying relief will act as a deterrent**

7.38 We have seen that deterrence is one policy that lies behind the illegality rules, and we provisionally recommend that the potential deterrent effect of their decision is another factor that the courts should take into account when deciding whether or not to allow the plaintiff's claim. The general principle is that refusing to award the plaintiff relief will deter others from entering into or performing under similar illegal contracts. But clearly refusing relief will not act as an appropriate deterrent in all circumstances<sup>67</sup> and the court will need to act on a case-by-case basis. For example, following the decision in *Mohamed v Alaga & Co*,<sup>68</sup> one might argue that unscrupulous solicitors will not be deterred and may even be more likely to enter into contracts to share their fees in breach of the Solicitors' Practice Rules, knowing that any such contract would be unenforceable by the other party even after the performance of work.

**(4) Whether denying relief will further the purpose of the rule which renders the contract illegal**

7.39 We believe that a court should also have in mind the purpose of the rule which renders the contract illegal in the particular case before it. In each case the court should ask whether its decision will further the purpose which the rule promotes. This consideration clearly played a very important role in *Nelson v Nelson*.<sup>69</sup> In particular, McHugh J said that the courts should not refuse to enforce legal or equitable rights simply because they arose out of or were associated with an unlawful purpose unless, *inter alia*, "the imposition of the sanction is necessary, having regard to the terms of the statute, to protect its objects or policies".<sup>70</sup> Indeed Professor Treitel has suggested that this question, whether success or failure of the civil claim would be more likely to promote the purpose of the invalidating rule, should be the decisive issue in all cases.<sup>71</sup>

7.40 This factor must, however, be applied carefully. For although allowing the particular plaintiff before the court to enforce the contract might not defeat the

<sup>66</sup> See *Taylor v Bowers* (1876) 1 QBD 291, 297, per James LJ.

<sup>67</sup> Indeed some commentators argue that the policy of deterrence is just as likely to be achieved by allowing a remedy as by denying it, for if one party to an illegal transaction knew that the other party would be able to obtain restitution of benefits conferred, it would stop him or her entering into the illegal transaction in the first place: G H Treitel, "Contract and Crime" in *Crime, Proof and Punishment: Essays in Memory of Sir Rupert Cross* (1981) p 81 at p 100; G Virgo, "The Effect of Illegality on Claims for Restitution in English Law" in W Swadling (ed), *The Limits of Restitutionary Claims: A Comparative Analysis* (1997) p 141 at pp 183-184. See also, *Tinsley v Milligan* [1994] 1 AC 340, 368, per Lord Lowry.

<sup>68</sup> [1998] 2 All ER 720. See para 2.37 above.

<sup>69</sup> (1995) 184 CLR 538. See para 3.28 above.

<sup>70</sup> (1995) 184 CLR 538, 613.

<sup>71</sup> G H Treitel, "Contract and Crime" in *Crime, Proof and Punishment: Essays in Memory of Sir Rupert Cross* (1981) p 81.

purpose of the rule which rendered the contract **illegal**, the court must keep in mind the principle that like cases should be treated alike, and that allowing the **plaintiff's** claim might open the door to others. So, for example, one might say that the object of the Australian statute in the *Nelson* case - to provide subsidised housing for those in **financial** need - would indeed have been defeated if every person seeking financial assistance were able to hide his or her real assets and make a successful claim.

**(5) Whether denying relief is proportionate to the illegality involved**

7.41 We have explained that we accept that punishment is a legitimate aim of the civil law.<sup>72</sup> However, it is not a policy that can be easily pursued by the present strict illegality rules. The simple refusal of civil relief is generally a very arbitrary and blunt method of meting out punishment, since the penalty is not in any way tailored to fit the illegality involved. And clearly there will be a risk of "double punishment" where the plaintiff has already been convicted of a criminal offence or made to pay damages for a legal wrong in respect of the same conduct.

7.42 Another factor that we therefore provisionally consider that the court should take into account is whether the penal effect of denying the plaintiff relief is proportionate to the illegality involved. If, for example, the illegality is trivial but the value of benefits which the plaintiff has conferred on the defendant is vast, **then** denying a restitutionary claim might be an excessive penalty. Likewise, if a sanction has already been imposed on the plaintiff in respect of his or her unlawful conduct, then the additional **denial** of civil relief might be regarded as unduly harsh. In those cases where criminal or other civil proceedings in respect of the same conduct are likely or have already been commenced but not yet concluded, the court may find it appropriate to use its inherent power to stay proceedings<sup>73</sup> and await the outcome of that other trial before coming to its decision.

7.43 **We ask consultees whether they agree with our provisional view that the proposed discretion should be structured so that the court should be required to take into account specific factors in reaching its decision; and that those factors should be: (1) the seriousness of the illegality involved; (2) the knowledge and intention of the plaintiff; (3) whether denying relief will act as a deterrent; (4) whether denying relief will further the purpose of the rule which renders the contract illegal; and (5) whether denying relief is proportionate to the illegality involved. We also ask consultees whether there are any other factors which they consider the courts should take into account in exercising the discretion. If consultees do not agree with our provisional view, we would ask them to explain why not.**

<sup>72</sup> See para 6.11 above.

<sup>73</sup> The inherent jurisdiction of the court to stay proceedings is preserved under section 49(3) of the Supreme Court Act 1981.