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The Law Commission, commercial and common law team

ILLEGALITY IN CONTRACT

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1 INTRODUCTION

- 0.1. In 1999 the Law Commission published a consultation paper (CP 154) entitled "Illegal transactions: the effect of illegality on contracts and trusts". The need for reform in this area was highlighted by the House of Lords' decision in *Tinsley v Milligan*,¹ where Lord Goff of Chieveley specifically called for a review by the Law Commission. It has recently been confirmed in *Collier v Collier*,² where facts broadly comparable to those of *Tinsley v Milligan* led to the opposite outcome.³
- 0.2. The central proposal put forward in CP 154 was that, in general, a court dealing with a transaction tainted by illegality should have a discretion whether to enforce it. The discretion would be "structured" by setting out the factors that the court should take into account (such as the seriousness of the illegal purpose, whether refusing to enforce the transaction would tend to deter illegality of that kind, and so on).
- 0.3. CP 154 did not deal with the effect of illegality on a claim in tort; but it was subsequently decided, in the light of the responses to CP 154, that that issue also needed to be addressed. A further consultation paper, "The Illegality Defence in Tort" (CP 160), was therefore published in 2001. Again a structured discretion was proposed.

¹ [1994] 1 AC 340. That case concerned a claim for possession, by the legal owner of a house, against a person who had contributed to the purchase price but had agreed, in order to defraud the Department of Social Security, that her name should not appear on the title. It was held that the defendant could rely on the presumption of resulting trust, because she did not have to rely on the fraud in order to make out her case.

² [2002] EWCA Civ 1095. In this case the claim for possession was against the claimant's father, who had conveyed the property to the claimant in order to defraud the Inland Revenue and other creditors. This time the Court of Appeal held that the defendant could not invoke a resulting trust, because he did have to rely on the fraud in order to make out his case.

- 0.4. On revisiting the issues discussed in CP 154, with the considerable benefit both of hindsight and of the responses to the two consultation papers, we now think it may be necessary to reconsider some of the proposals there advanced.⁴
- 0.5. Many of the responses to CP 154 supported our proposal that the court should be given a discretion whether to enforce a contract tainted by illegality. However, a minority of respondents raised concerns which we take very seriously. There was doubt over the scope of our proposals,⁵ and concern that a much wider range of contracts would fall within the reach of the discretion than would ever be found to be illegal under the present law. For example, an offence committed in the course of performance will seldom render a contract illegal at present, but would engage the court's discretion under our proposals. There was a worry that the discretion, even structured in the way we proposed, would lead to even greater uncertainty than at present.
- 0.6. There was less consensus over the proposals that, if the contract is held to be unenforceable, there should be a discretion whether to allow restitution, and whether to recognise that the contract was effective to transfer property. In part this seems to be because respondents were not always clear exactly what was being proposed.
- 0.7. Meanwhile, our own thinking has also changed somewhat, in the light of a number of factors.
- 0.8. First, we are facing a growing backlog of unimplemented reports. This has led us to explore means of encouraging improvement in the law without the necessity for legislation. For illegality we still think that the best solution would be a statutory discretion; but we have to accept that a Bill on illegal transactions might never be enacted. So we have been wondering about second-best solutions. Are there ways in which the courts – and in particular the House of Lords, should it get the opportunity⁶ – could usefully rationalise and develop the law? Could our report, either as an explicit alternative to legislation or simply in the course of discussing what is required, give a “steer” as to what we (and respondents) think is the “right” direction?
- 0.9. Secondly, the tort paper led us to concentrate more heavily on the *rationale* of the illegality rules. Why is it that a claim is sometimes denied because it somehow involved illegal activity? We think that, even in contract cases, the answer is not always clear.

³ Mance LJ said at [84] that the case highlighted the technicality of some of the English principles governing illegality, and the importance of our project.

⁴ This paper deals only with the issues that arise in relation to illegal contracts; but our suggestions would clearly have implications for the proposals in CP 154 on the law of trusts, and (though probably to a lesser extent) the proposals in CP 160 too.

⁵ Would, for example, every contract induced by fraud be within the discretion?

⁶ “If English law in this area is to be further refashioned judicially after *Tinsley v Milligan*, it seems to me that this should be at the highest level”: *Collier v Collier* [2002] EWCA Civ 1095 at [106], *per* Mance LJ.

- 0.10. Thirdly, as will appear below, we have been wondering whether our original approach was insufficiently radical, in that it still tended to look at the issues as between the claimant and the defendant, without paying sufficient attention to the position of third parties or, in some cases, the State. In particular, we need to consider the implications of the Proceeds of Crime Act 2002.
- 0.11. The approach we have adopted in this paper is to focus first on the *outcomes* we would like to see in different kinds of case, rather than the machinery by which those outcomes might be reached. At the end of the paper we then ask how far our preferred outcomes differ from the present law.
- 0.12. Where they do differ, there is the further question of whether it would be possible to secure the necessary development of the law without legislation. It may be that in some cases our preferred outcome could in fact be reached under the present law, properly understood or re-interpreted at the highest level. In other cases that may be impossible, and some kind of statutory reform would seem necessary. But we do not deal with these further questions in this paper.
- 0.13. This paper also does not consider the issues raised by contracts which are “illegal” although not involving illegality in the criminal sense. Thus we do not discuss contracts which involve the commission of *civil* wrongs; nor contracts which are unenforceable because, though involving no legal wrong, they are contrary to public policy.
- 0.14. Finally, in this paper we do not discuss the question of whether a party who is unable to enforce his *contractual* rights because of illegality should nevertheless be able to rely on *proprietary* rights acquired under the contract.

2 Rationales

- 0.1. In order to decide on the outcomes that are desirable, it is necessary to ask what the aims of a doctrine of illegality should be. Possible rationales for the doctrine were described in CP 154 but did not feature prominently, and respondents said little about them. In CP 160 we raised the issue specifically. In general respondents agreed with our suggestion that punishment is not an appropriate rationale; that the rules will seldom have a deterrent effect; and that the dignity of the courts does not need protection, provided that the rules that the court is asked to apply are sensible. What would make a court look silly is to be asked to apply rules that are clearly contradictory, for example to order something that is illegal.
- 0.2. There was general agreement that an aim of rules on illegality should be to prevent enforcement of the claim (the respondents were obviously primarily concerned with claims in tort) undermining the rule making the act illegal in the first place. Some would perhaps use an alternative formulation that the rules on illegality should positively further the purpose of the rule making the act illegal. However, we put it as we have because, in relation to contract, there was a fairly strong consensus that the starting point should be that the contract should be enforceable despite a taint of illegality.
- 0.3. In CP 160 we suggested that an overarching rationale for the illegality doctrine is that the law should appear consistent. About half the respondents agreed that

this is the best rationale. Others doubted whether it was more than one rationale out of several, or wondered whether it added anything to “furthering the purpose of the rule”. However, a large majority favoured adding it to the list of factors to be taken into account by the court.

0.4. We are reasonably confident, therefore, that the majority of respondents accept one or other of these two rationales as very important, even if not as the main rationales, for the illegality doctrine in tort. There was also a considerable measure of agreement that it would be desirable to have a uniform approach across contract, trusts and tort, though it was pointed out that the detailed considerations may differ according to the context. In particular, those who contemplate entering into illegal *contracts* may perhaps be more influenced by the existence of illegality rules than are those who risk being injured while committing a crime. But we doubt that this is a major consideration in practice. Even if the law is capable of exercising such an influence, we think it questionable whether the illegality defence does in fact discourage illegality to any substantial extent.⁷

0.5. Therefore we approach our quest for “desirable outcomes” in contract cases on the basis that the aim of illegality rules should not be to punish, or to protect the dignity of the court; and with a scepticism as to their deterrent effect. What is important is to avoid undermining the rule that makes the act illegal in the first place (or, for those attracted by the consistency formulation, to ensure that the court is not asked to apply inconsistent rules).

3 Statute and common law

0.1. Illegality may bar a claim arising out of a contract *either*

(1) because the illegality brings the case within the terms of a statute which, on its true construction, has the effect of barring such a claim, *or*

(2) because the case falls within some general principle under which certain kinds of claim are barred if they arise out of contracts which are tainted by illegality in certain ways. A principle of this latter kind may apply even if the prohibition infringed is statutory.

0.2. Under the policy proposed in CP 154, the proposed discretion would not be available where a statute *expressly* states whether a contract in breach of the statute is or is not enforceable. It *would* be available where the statute is silent on this question, so that, under the present law, the court has to look for an *implied* legislative intention.

0.3. We are now persuaded by a point made in the SPTL’s response: namely that, where it is possible to discern a legislative intention one way or the other, the principle of parliamentary sovereignty leaves no room for a discretion to override that intention. If, on its true construction, a statute says that a claim is barred because of illegality, or that a claimant is entitled to succeed in spite of illegality, we now think that that must be the end of the matter – whether the legislative

⁷ See, eg, para 68 below.

intention is express or implied. All our other conclusions are subject to this one. In other words, we are concerned *only* with whether there should be any principles of the kind referred to in paragraph 20(2) above, and if so what the content of those principles should be.

- 0.4. This does not mean that our proposals could have no application to statutory illegality. They could apply, *except* in so far as the statute expressly or impliedly provides otherwise. It is of course possible that, if the rules were made more flexible, the courts might become less willing to construe statutes as impliedly determining the matter either way. But our proposals do not assume that that would be the case.

4 “Illegal contracts” or unenforceable obligations?

- 0.1. It is traditional to approach questions of illegality in the law of contract by asking first whether the contract is illegal, and, if so, whether this prevents the claimant from enforcing it. We find this approach confusing and unhelpful.⁸ Instead, we prefer to go straight to the question of whether the claimant is barred from enforcing the particular *obligation* that she seeks to enforce. For this purpose we find it helpful to distinguish between those obligations that are inherently illegal, in the sense that they cannot be performed without committing an offence, and those that are themselves lawful but should arguably be unenforceable because of some associated illegality.

5 ENFORCEMENT OF OBLIGATIONS THAT INVOLVE CRIMINAL OFFENCES

- 0.1. Should a contracting party be able to enforce an obligation which is illegal, in the sense that it cannot be performed without committing an offence?

6 Specific enforcement

- 0.1. Clearly no order should be made which would have the effect of directly compelling a party to commit a criminal offence, even a minor one. Thus a court should not order specific performance if compliance with the order would mean committing an offence. Nor should it give judgment for the contract price in the rare case where payment of the price would itself be an offence.

7 Damages

- 0.1. Where the claim is for damages for breach of the illegal obligation, however, we think a more flexible approach is justified. It is less obviously inconsistent for the court to treat the non-performance of an obligation as a breach of contract and award damages for it, even though the performance of the obligation would have involved the commission of an offence, than it would be for the court actually to

⁸ Cf A Tettenborn, *An Introduction to the Law of Obligations* (1984) p 176:

Traditionally, it is said that certain kinds of contract are “illegal”, whether as being entered into for an immoral purpose, or as being prohibited by statute, or as being illegal at common law. If, it is said, a contract comes into this category, it is (subject to exceptions) “void” and nobody is bound by it to do anything. Great energy is then spent determining what contracts are thus “illegal”. In fact this approach is misguided; illegality affects not contracts as such, but obligations arising under them.

order the defendant to perform such an obligation, and thus to commit an offence, in the case before it.

0.2. Whether damages can properly be awarded in a particular case will depend on a number of variables. Chief among these, we believe, is the *seriousness* of the offence that would have been committed. At a number of points in this paper we suggest that there should be one outcome where the illegality is serious and a different outcome where it is not. This does not necessarily imply that there should be a rule which draws a sharp distinction between the two.⁹ A better approach, we think, would be the one proposed in CP 154, namely to give the court a discretion while directing the court, in exercising that discretion, to take particular account of the seriousness of the illegality. Obviously there is a spectrum between (say) murder at one end and purely regulatory offences, punishable with a small fine, at the other. Our intention in this paper is merely to suggest that, at the ends of the spectrum, different outcomes may be called for. How one deals with the cases in the middle of the spectrum is a secondary issue.

0.3. In any event, the line might be drawn at different points of the spectrum for different purposes. In particular, the illegality might be serious enough to render the contract unenforceable, but not serious enough to preclude restitution as well.

8 SERIOUS OFFENCES

0.1. We suggest that a court should never award damages for the breach of an obligation whose performance would have inevitably involved the commission of a serious offence. It is immaterial for this purpose

- (1) whether the illegality was apparent on the face of the contract, or was merely inevitable in the circumstances in which the background was made (and, in the latter case, whether P was or was not aware of the circumstances making it inevitable¹⁰); and
- (2) whether P seeks damages for loss of expectation, or only for the fact that, because of D's breach, P is worse off than if the contract had not been made.

In any of these cases, the imposition of liability for failing to perform such an obligation would undermine the rule creating the offence, and thus impair the internal consistency of the law.

9 *Innocent claimant*

0.1. We suggest that a seriously illegal obligation should be unenforceable even by a claimant who, at the time when the contract was made, had no way of knowing that the obligation was illegal – for example, where it is a serious offence to do a

⁹ It would of course be possible to do this in a fairly crude way, by enacting different rules for (say) indictable and summary offences, or for offences which are and are not punishable with imprisonment.

¹⁰ But see also para 31 below.

particular thing without a licence, and P agrees to pay D to do that thing, mistakenly believing that D has a licence.

- 0.2. However, in these circumstances we think it may sometimes be acceptable to let P claim on a *collateral* contract, on the basis (if the facts justify it) that D implicitly promised to ensure that the obligations he was undertaking could lawfully be performed and would therefore be enforceable.¹¹ But we think the damages for breach of such a contract should *not* be assessed in such a way as to put P in the position he would have been in if the main contract had been *enforceable*, because this would be tantamount to enforcing the main contract, and would therefore be inconsistent with our view that the main contract ought not to be enforceable.¹² In our view the damages should seek only to compensate P for the loss he has sustained through being induced to enter a contract which he cannot enforce,¹³ and should therefore be assessed in such a way as to protect his “negative interest” by restoring him to the position he would have been in if the main contract had not been made.
- 0.3. In *Re Mahmoud and Ispahani*,¹⁴ for example, P sought damages for D’s non-acceptance of linseed oil which, unknown to P, D was not licensed to buy. Under our scheme (even assuming that D could be taken to have implicitly warranted that he had a licence), P would be entitled to damages only if the oil left in his hands was worth less than what he had paid for it – *not* for the fact that it was worth less than D had agreed to pay. In effect, this would be equivalent to a remedy in tort.¹⁵
- 0.4. To repeat: damages would in any event be unavailable if to award them would be incompatible with the apparent intention of the legislature. *Re Mahmoud and Ispahani* itself was decided on the basis that the contract was rendered unenforceable by statute, so it was immaterial whether the outcome was fair. Even under our scheme, if the court construed the statute as precluding *any* award of damages (even on a negative interest basis) then that would be the end

¹¹ Cf *Strongman (1945) Ltd v Sincock* [1955] 2 QB 525 – though in that case it was the *plaintiffs’* obligations, not the defendant’s, which (thanks to the defendant, and unknown to the plaintiffs) could not be performed without illegality. See also *Archbalds (Freightage) Ltd v S Spangle Ltd* [1961] 1 QB 374, 392, where Devlin LJ suggests that the defendants might have been regarded as giving an implied warranty that the van used to carry the plaintiffs’ goods would be licensed to do so.

¹² As in *Strongman (1945) Ltd v Sincock* [1955] 2 QB 525.

¹³ Cf the German doctrine of *culpa in contrahendo*.

¹⁴ [1921] 2 KB 716.

¹⁵ In *Re Mahmoud and Ispahani* itself, Bankes and Scrutton LJJ expressly left open the possibility that P might have a remedy in deceit: [1921] 2 KB 716, 726 and 730. But the remedy we propose would not depend on proof of fraud.

We have considered whether the availability of *any* remedy, even one limited to P’s negative interest, might in certain circumstances undermine the prohibition by encouraging D to perform the contract rather than have to pay compensation. But our present view is that, if the measure of damages were limited as we suggest, no such incentive could arise. If, for example, the market price of the oil had fallen, a refusal to accept the oil would render D liable to compensate P for that fall; but, by the same token, acceptance would leave him with oil that was worth less than he had paid for it. He would be no worse off by rejecting than by accepting.

of the matter. All we are saying is that there should be no *general* principle precluding such an award.

10 MINOR OFFENCES

- 0.1. The main justification for not enforcing obligations to commit criminal offences is that the law should strive for consistency. It stultifies itself if, while prohibiting certain conduct, it nevertheless treats a failure to engage in such conduct as a legal wrong for which damages are recoverable.
- 0.2. However, the consistency argument has to be weighed against other considerations which militate in favour of enforcing contracts, such as (a) the importance of avoiding injustice in individual cases, and, perhaps more important, (b) the public interest in maintaining the principle of *pacta sunt servanda*. Where the illegality is serious, these considerations must clearly take second place. Where the illegality is comparatively minor, however (*and* the question is not whether D should be directly compelled to commit the offence in question but whether, having failed to commit it, he should pay damages for that failure), we think they may become more pressing than the consistency argument.
- 0.3. A further argument for allowing such obligations to be enforced is the need for consistency with the converse situation, where a party whose *own* obligations are illegal seeks to enforce the intrinsically lawful obligations of the other party. Suppose A contracts with B to do something which involves the commission of a minor offence, and duly does it. Should A be able to sue for the agreed price? We think she should.¹⁶ But it would seem inconsistent for the law to give A a right to the price, thus creating an incentive to perform and thereby commit the offence, while denying B the right to damages if A does *not* perform. Consistency dictates either that both obligations should be enforceable or that neither should be; and we think it should be both.
- 0.4. We therefore think it may be justifiable to award damages for breach of an obligation even though the performance of the obligation would have involved the commission of a minor offence.
- 0.5. This is particularly so where the offence is incidental, rather than central, to the obligation P seeks to enforce – for example, where specific goods are sold in packaging which is illegal in some minor way. But it may be so even if the illegality is central to the obligation in question – eg where it is an offence, but only a minor regulatory offence, to sell the goods at all.

11 ENFORCEMENT OF OBLIGATIONS THAT ARE NOT THEMSELVES ILLEGAL

- 0.1. Somewhat different considerations may arise where the obligation that P seeks to enforce is in itself lawful, in the sense that D could perform it without committing an offence, *but* D argues that it should not be enforced because of some associated illegality. The illegality may arise in various ways:

¹⁶ See para 43 below.

- (1) At the time of making the contract, P may have intended (or may have known that D intended) that the contract should be performed in a way which would involve an offence.
- (2) P may in fact have committed an offence in the course of performing the contract.
- (3) D may have committed an offence in the course of performing the contract, with P's agreement or acquiescence.
- (4) Some of the *other* obligations undertaken by D may be illegal.
- (5) P may have entered into the contract for an illegal purpose, or in the knowledge that D was doing so.
- (6) Even if none of the above applies, the making of the contract may itself be an offence.

While it may seem more natural to take case (1) first, it is easier to explain our thinking if we deal with it after cases (2) and (3).

12 P has performed illegally

- 0.1. Suppose P, having performed her own obligations under the contract, seeks to enforce those of D. D points out that P committed an offence in the course of her performance. Should this be a defence to P's claim?
- 0.2. We suggest that the crucial factor should again be the seriousness of the offence involved. It would be unacceptable for an obligation of D's to become enforceable as the result of a serious offence on P's part, because this would mean allowing P to benefit from her own serious wrong.¹⁷ If the contract actually *required* P to commit a serious offence, in the sense that it was impossible for P to perform without committing it, there is the further consideration that D would not have been able to enforce that obligation; and the law would be creating the wrong incentives if it allowed P to rely, for the purpose of enforcing D's obligations, on P's own performance of an obligation which, in order to discourage P from performing it, the law would not have allowed D to enforce. But we think the outcome should be the same where P has in fact committed a serious offence in the course of performance, even if she could have discharged her obligations without doing so.
- 0.3. Conversely, where P is obliged to commit a *minor* offence in order to trigger D's obligation, we have suggested that P should be able to enforce D's obligation if D could have enforced P's (and vice versa); and that it would be better for both obligations to be enforceable than neither.¹⁸ And we think this should be so not

¹⁷ It is assumed here that D's obligation is conditional on P performing (or being ready and willing to perform) her own obligations. There is the further possibility that D's obligation might be *independent* of P's, in the sense that (illegality aside) P could enforce D's obligation without performing (or being ready and willing to perform) her own; but this situation is unlikely to arise.

¹⁸ See para 37 above.

only where P *could* have discharged her obligations without committing the offence, but equally where she could not.¹⁹

- 0.4. Where P has in fact illegally satisfied a condition precedent to D's obligation, but was not contractually obliged to satisfy that condition at all (for example where P has insured against an event which she then brings about by her own illegal act), we again suggest that P should be able to enforce D's obligation if the illegality is minor, but not if it is serious.

13 D has performed illegally, and P is implicated

- 0.1. In the previous case, where it is P who has performed illegally, the argument against allowing P to enforce D's counter-obligations is that this would enable P to profit from his own offence. The objectionable feature of P's claim is that it is *by means of* the illegality that he has earned the right which he seeks to enforce.²⁰ Somewhat analogous considerations apply, we believe, where it is D who has performed illegally, but P is implicated in that illegal performance by having agreed to it or acquiesced in it. In this case the illegality may have little or nothing to do with P's claim; and, if so, we do not think it should be a defence. The closeness of the connection should be crucial.
- 0.2. For example, if D has contracted to carry P's goods and has damaged them through failing to take reasonable care as required by the contract, P should not be barred from recovering *merely* because he knew that the mode of performance chosen by D was illegal, or even seriously illegal, but only if the failure to take reasonable care was *closely connected* with a seriously illegal mode of performance. Thus we think it is right that P should not recover on the facts of *Ashmore Benson Pease & Co Ltd v A V Dawson Ltd*,²¹ where P let D carry P's goods on a vehicle which could not safely or lawfully carry goods of that kind, and the goods were damaged when the vehicle overturned. It would be inconsistent to let P sue when his complaint is inextricably tied up with an illegality to which he was party. If the negligence were unconnected with the illegality, on the other hand – for example, if the goods were stolen while the vehicle was left unattended²² – we think the illegality ought not to affect the claim.

14 Illegal performance was intended

- 0.1. Having considered the position where the contract has in fact been illegally performed, we now turn back to the case where one or both parties *intended* that it should be illegally performed. At the time of contracting, P may have intended (or may have known that D intended) that the contract should be performed in such a way that, had it been performed in accordance with those intentions, P

¹⁹ Of course, it may be that, on the true construction of the contract, P's illegal performance is insufficient to discharge her obligations, because it was implicit that she should perform lawfully. But it is arguable that this is not necessarily the case, because if illegal performance by P will not reflect badly on D then it may be immaterial to D whether or not P's performance is lawful.

²⁰ This is so only if D's obligation is conditional on P's performance: see n 17 above.

²¹ [1973] 1 WLR 828.

²² Cf *Archbolds (Freightage) Ltd v S Spanglett Ltd* [1961] 1 QB 374.

would, under the principles we propose, have been unable to enforce D's obligations; but those intentions may not in fact have been carried out.

- 0.2. For example, suppose P agrees to transport D's goods, intending to use a vehicle which is so unsuitable that it will create a serious hazard to other road users. If P did use such a vehicle it would (let us assume) be such a serious offence that, under the principles we have proposed, P would not be entitled to payment. Should P's claim equally be barred by the mere *intention* to perform illegally, even if in fact she changes her mind and uses a vehicle which is entirely suitable? Should an unfulfilled intention have the same effect as it would have if it were fulfilled?
- 0.3. We see no reason to make the enforceability of the contract hinge on intentions that do not materialise, and we do not think the claim should be barred by the intention alone. The argument for making the outcome turn on the existence of such an intention would seem to be based on the idea that there is a sharp distinction between those contracts that are tainted with illegality *ab initio* and those that are not. But, as we have said, we find this distinction of limited value.
- 0.4. Similarly, where P has in fact performed illegally, but the offence committed is too minor to render D's obligations unenforceable, we do not think it should make any difference that P intended to commit that offence all along. Thus, where a shipowner has earned the freight by fractionally overloading the vessel, we think it should be immaterial whether he decided to do so before or after the contract was made.

15 D's other obligations are illegal

- 0.1. Suppose the obligation that P seeks to enforce is itself lawful, but one or more of D's *other* obligations are illegal and unenforceable under the criteria we have proposed (for example because the illegality is serious). Should this render *all* of D's obligations unenforceable? In principle the question should be whether enforcement of the lawful obligations would undermine the rules that would be infringed by performance of the illegal ones. And this would again seem to depend on the proximity of the connection between the illegality and the claim in question – that is, between the illegal obligations and the lawful ones that P seeks to enforce. If they are inextricably connected, it may be impossible to enforce the lawful ones without encouraging the performance of the illegal ones too. If they are sufficiently independent to be severable, we think P should be allowed to enforce the lawful ones.

16 The contract was made for an illegal purpose

- 0.1. What if the contract is intrinsically lawful but one party intends to use it (or the other's performance of it) for an illegal purpose? For example, P agrees to buy from D materials which P intends to use in the commission of a crime. In principle we think that the answer should depend primarily on the seriousness of the intended crime and, where the illegal purpose is not P's but D's, on P's knowledge of that purpose. We therefore suggest that D's obligation should be unenforceable

- (1) if P has a seriously illegal purpose (whether or not D knew of this purpose when the contract was made, or even at the time of the alleged breach), or
- (2) if D has a seriously illegal purpose *and* P knew this when the contract was made;

but *not* merely because either party's purpose is illegal in a minor way.

17 The making of the contract was itself criminal

- 0.1. Finally it is possible that, although *further* illegality is not required or intended and does not in fact occur, it may be an offence to make the contract in the first place. It is often said that a contract must be illegal (i.e. unenforceable) if it is illegal (i.e. an offence) to make it. Where (as will usually be the case) it is a statute that forbids the making of the contract, the effect of the statute may indeed be to render the contract unenforceable; but there is no reason in principle why a statute, on its true construction, should not forbid the making of a contract without rendering it unenforceable if it is made.²³ Subject to any contrary legislative intention, we suggest that the contract should again be enforceable unless the offence committed by making it is a serious one. We see no need for a *general* principle that a contract cannot be enforceable if it is an offence to make it.

18 RESTITUTION

- 0.1. Where P has conferred a benefit on D under a contract, but (under the criteria we propose) cannot enforce D's obligations under the contract because of illegality, should P be entitled to restitution? In some cases the answer is clearly yes, for example where P has changed his mind and withdrawn from the transaction before D has a chance to perform. In other cases the answer is less clear.
- 0.2. The argument for granting restitution in these circumstances is the same as in any other case where restitution is sought: namely that if it is not granted then D will be unjustly enriched. This outcome is undesirable in any event. It is doubly undesirable where it means that D is able to retain a benefit which he has obtained *through illegality*, because that outcome is contrary to the principle that a person should not be allowed to benefit from his own wrong. But the element of illegality cuts both ways: it may be just as unsatisfactory that P, a party to the illegality, should obtain restitution as that D should be unjustly enriched. In some cases the best solution may be that *neither* party should succeed. And that solution appears to be achievable, at least in certain circumstances, under recent legislation.

²³ "It is often said that a contract expressly or impliedly prohibited by statute is void and unenforceable. That statement is true as a general rule, but for complete accuracy it needs qualification, because it is possible for a statute in terms to prohibit a contract and yet to provide, expressly or impliedly, that the contract will be valid and enforceable." *Yango Pastoral Company Pty Ltd v First Chicago Australia Ltd* (1978) 139 CLR 410, 413, *per* Gibbs ACJ.

19 The Proceeds of Crime Act 2002

- 0.1. The Proceeds of Crime Act (POCA) received Royal Assent on 24 July 2002. Its aim is to strengthen the existing provisions by which the proceeds of crime may be confiscated. The Act establishes the Assets Recovery Agency (ARA), which will have responsibility for pursuing confiscation claims. Part 2 of the Act consolidates the existing criminal confiscation regimes, which deal with drug and non-drug offences respectively. In addition, however, Part 5 establishes a new *civil* confiscation regime, which will enable the state to confiscate property obtained through illegal conduct even if no-one has been convicted in respect of that conduct. It is these latter provisions that seem to have the most impact on our proposals.
- 0.2. The powers to confiscate property without the need for criminal proceedings are wide. The ARA may apply in the High Court for the recovery of property which “is, or represents, property obtained through unlawful conduct”.²⁴ Conduct is “unlawful” if it is criminal.²⁵ In order to confiscate property the court must be satisfied, on the civil standard of proof, either that “any matters alleged to constitute unlawful conduct have occurred” or that “any person intended to use any cash in unlawful conduct”.²⁶
- 0.3. Section 242(1) provides:
- (1) A person obtains property through unlawful conduct (whether his own conduct or another’s) if he obtains property by or in return for the conduct.
 - (2) In deciding whether any property was obtained through unlawful conduct –
 - (a) it is immaterial whether or not any money, goods or services were provided in order to put the person in question in a position to carry out the conduct,
 - (b) it is not necessary to show that the conduct was of a particular kind if it is shown that the property was obtained through conduct of one of a number of kinds, each of which would have been unlawful conduct.
- 0.4. Property obtained through unlawful conduct is “recoverable property”.²⁷ Recoverable property may be followed into the hands of a person who has obtained it on a “disposal” by the person who obtained it through unlawful conduct.²⁸ There is a disposal of property where a person makes a payment to another (whatever form the payment takes²⁹), and where property passes under

²⁴ POCA, s 240(1)(a).

²⁵ POCA, s 241(1). Conduct abroad is “unlawful” if it is criminal in the country in which it occurs *and* would be criminal if it occurred in the UK: s 241(2).

²⁶ POCA, s 241(3).

²⁷ POCA, s 304(1).

²⁸ POCA, s 304(3).

²⁹ POCA, s 314(2). These words may be intended to forestall the argument that succeeded in *R v Preddy* [1996] AC 815, viz that, where funds are transferred from one bank account to another, the property thus created in the second account is not the same property that

a will or intestacy or by operation of law.³⁰ Recoverable property may also be followed into property which, on a disposal of the original recoverable property, is obtained in place of it.³¹

0.5. However, property ceases to be recoverable in a number of circumstances, for example where it is disposed of to a person who obtains it in good faith, for value, and without notice that it was recoverable.³² In particular, section 308(3) provides that property ceases to be recoverable if

- (a) in pursuance of a judgment in civil proceedings (whether in the United Kingdom or elsewhere), the defendant makes a payment to the claimant or the claimant otherwise obtains property from the defendant,
- (b) the claimant's claim is based on the defendant's unlawful conduct, and
- (c) apart from this subsection, the sum received, or the property obtained, by the claimant would be recoverable property ...

0.6. Where the ARA thinks that a person holds recoverable property, in advance of starting proceedings for a recovery order it may apply to the High Court for an interim receiving order – that is, an order for the detention, custody or preservation of the property, and the appointment of an interim receiver.³³ Any court in which proceedings are pending in respect of any property may stay those proceedings if an interim receiving order has been applied for or made in respect of the property.³⁴

0.7. What is the effect of these provisions in relation to illegal contracts? Our interpretation is as follows.

0.8. First, where D has been paid to commit an offence and still has the money paid (or property which he has bought with that money), it can clearly be confiscated from him. He obtained the money “through” his own unlawful conduct because he obtained it “in return for” that conduct.³⁵ It is immaterial that it was paid in advance of that conduct. It is also immaterial whether D did in fact commit the offence, because, even if he did not, he still obtained the money “in return for” committing it.

0.9. The same would apply if D had obtained property other than money, as long as he still had the property or its proceeds. If he had only received *services*, however, there would be no recoverable property. It would not be possible to

previously existed in the first: it is different property of the same value. But for the purposes of POCA this seems to be immaterial.

³⁰ POCA, s 314(3).

³¹ POCA, s 305.

³² POCA, s 308(1).

³³ POCA, s 246.

³⁴ POCA, s 253(2).

³⁵ It might equally be said that he obtained it “by” his unlawful conduct in *agreeing* to commit the offence, because that agreement would itself amount to the offence of conspiracy.

confiscate the value of the services, even though they were obtained through unlawful conduct.³⁶

- 0.10. Suppose now that P, having paid money to D under an illegal contract, has secured restitution of that money, and still has it (or property which she bought with it). Can the money (or other property) be confiscated from P? Arguably yes: the money originally paid to D was recoverable in D's hands, and, though D has been compelled to "dispose of" it by satisfying the judgment in P's favour, it can be followed into P's hands because, being party to the illegality, she has notice that the money is recoverable. The exception under section 308(3) does not seem to apply, because P's claim for restitution is not "based on the defendant's unlawful conduct": it is based on the fact that P has conferred a benefit on D and that D will be unjustly enriched if he is not made to pay for it.³⁷
- 0.11. Even if this reasoning is correct, however, it will only work if the money paid by P to D can be traced into the money returned by D to P. The fact that they are identical amounts is not enough. *A fortiori* this reasoning will not work where the benefit originally conferred on D was not property but valuable services, even though P's restitutionary claim results in her obtaining money representing the value of those services.

20 Arguments against awarding restitution

- 0.1. As we have said, the argument *for* granting restitution in illegality cases is clear, namely the avoidance of unjust enrichment. The arguments for a general rule *against* awarding restitution need closer examination, against the background of the new confiscation provisions.

21 A DISINCENTIVE TO ENTER INTO ILLEGAL CONTRACTS

- 0.1. It is said that by denying restitution to those who make illegal contracts the law discourages people from entering into such contracts in the first place. But in fact it only discourages those parties who might wish to *claim* restitution (because they would be conferring a benefit on the other party before receiving the other party's counter-performance). By the same token it *encourages* people to enter into illegal contracts under which they would *receive* a benefit before having to perform. There is no reason to assume that the disincentive on one side is more powerful than the incentive on the other. It is true of course that if one party is unwilling to contract at all then the contract will not be made, however much the other party wants to make it. But if the contract is particularly attractive to one party, this will affect the price that that party will accept, and this adjustment of the price may be sufficient to render the contract acceptable to the other party too – despite the disincentive created by the rule against restitution. Introducing a

³⁶ For the purposes of the *criminal* confiscation provisions, a person who obtains a "pecuniary advantage" as a result of or in connection with conduct is taken to obtain, as a result of or in connection with that conduct, a sum of money equal to the value of the pecuniary advantage: POCA, s 76(5). But there seems to be no such provision in relation to civil confiscation.

³⁷ If P was entitled to recover on the ground that she had *withdrawn* from the illegal contract, her claim would arguably be based on the illegality, because if the contract had not been illegal she would not have been entitled to withdraw and claim restitution. But would it be based on *D's unlawful conduct*, as distinct from the fact that the contract is illegal?

right to restitution would not increase the incidence of such bargains, but only the price at which they are struck.

22 NO INCENTIVE TO PERFORM ILLEGAL CONTRACTS

0.1. A somewhat stronger argument, we believe, is that, if there is a right to restitution, a person who has *already* entered into an illegal contract, and received a benefit under it, may have an incentive to carry it out rather than have to make restitution. For example, if P has paid D to commit an offence, D may think it more profitable to commit the offence than to have to repay the money. If P had no right to restitution, D would have the additional option of keeping the money *without* committing the offence, which might be the most appealing option of all.

0.2. However, we think that the extra incentive thus created is likely to be marginal at best. In the first place, if D is not deterred from illegality by the penal sanctions available on conviction, the absence of liability in restitution is hardly likely to turn the scales. Even if P does have a right to restitution, he may prefer to waive it rather than publicly disclose her wrongdoing, and the incentive created by the existence of the right will be diluted by that possibility.

0.3. But in any event this argument seems to be undermined by the new confiscation provisions. Where D has been paid by P to do something which would involve an offence, he can no longer count on being able to keep the money *whatever he does*: even if he performs as agreed, he stands to lose the money to the ARA, and this prospect may be no more appealing than that of having to return the money to P. Thus D may not in fact have any incentive to perform, even if a right to restitution is introduced.

23 RESTITUTION TANTAMOUNT TO ENFORCEMENT

0.1. It is said that it would be inconsistent to refuse to enforce a contract on grounds of illegality, while granting a restitutionary remedy which for practical purposes amounts to enforcement of the contract. We accept that this is a good argument for not granting a restitutionary remedy which does have that effect. But it does not follow that restitution should not be granted *at all* – only that the *measure* of restitution should not (unlike a quantum meruit or quantum valebat) include any profit element. We think this objection can in principle be met by restricting the right to restitution in this way.

24 DIGNITY OF THE COURT

0.1. It is said that granting *any* remedy in respect of an illegal transaction is offensive to the dignity of the court. But this is clearly an exaggeration: courts often have to get involved in the most unsavoury transactions. Whether the dignity of the court is offended depends not on the situation that the court is asked to deal with, but on what it is that the court is asked to do about it. We accept of course that the court should not have to value a benefit where the nature of the benefit is such that it would be offensive for the court to have to do so. But where this difficulty does not arise (for example because P has simply paid money) we do not think the illegality of the underlying transaction is in itself a good reason for denying restitution.

25 PUNISHMENT

- 0.1. Finally, it may be said that a willing party to an illegal contract simply does not *deserve* restitution.

The defendant is enriched at the expense of the plaintiff – but his enrichment is not unjust. It is the price which the plaintiff must pay for having entered into an illegal transaction in the first place.³⁸

- 0.1. In effect, this amounts to treating the denial of restitution as a form of punishment. But it is punishment of an arbitrary kind, unrelated to the gravity of P's conduct. The appropriate way to punish P for criminal misconduct is via criminal proceedings; and the way to ensure that P does not retain the proceeds of such misconduct is by taking proceedings under POCA to confiscate any money she recovers by way of restitution. If P is not caught by the confiscation provisions, or if the ARA chooses not to invoke them, we see no reason why the law of contract should intervene so as to ensure that P never gets restitution at all.

- 0.2. The law of contract is a doubly inappropriate weapon for this purpose because the only way in which it can punish P is by rewarding D, who may be equally at fault. Admittedly it may now be possible to rectify that drawback by denying restitution *but* confiscating the proceeds from D under POCA. But it seems wrong that the law of contract should require one wrongdoer to be punished by rewarding the other, even if there is machinery for depriving the other of the reward. The best outcome may involve confiscation; but the law of contract, being unable to achieve that outcome, should in our view be aiming for the *next* best outcome. Reversing D's unjust enrichment seems to us to be a *better* outcome than punishing P by rewarding D – even if confiscation is actually a better outcome than either.

26 Our conclusion

- 0.1. We think that the arguments against granting restitution are, in general, outweighed by the arguments in favour, provided that the measure of restitution excludes any profit element. This conclusion is reinforced by the fact that the proceeds of the illegality will in future be liable to confiscation in any event, so that D will stand to lose them anyway.

- 0.2. We therefore suggest that, in general, a party who cannot enforce a contract because it is illegal should nevertheless be entitled to restitution in respect of any benefits that he or she has conferred on the other party.³⁹ The measure of restitution should be (a) the value of the benefit conferred on D, (b) the cost to P of conferring it, or (c) the contract price – whichever is the lowest. Where P sells

³⁸ *Taylor v Bhail* [1996] CLC 377, 383, *per* Millett LJ. He went on to express “some satisfaction” at the conclusion that P was not entitled to any payment for the work he had done under a contract which he had secured by agreeing to provide an inflated estimate, thus enabling D to defraud D's insurers.

³⁹ Cf the Israeli legislation, which creates a presumption in favour of restitution, subject to a power (a) to refuse restitution or (b) to allow enforcement in certain circumstances: CP 154, paras 7.46 and 7.86.

goods which cannot lawfully be sold, for example, restitution might be based on the cost of the goods to P rather than their street value.⁴⁰

27 A free-standing right to restitution?

- 0.1. CP 154 did not propose that there should be a general discretion to award restitution in respect of benefits conferred under an illegal contract. The proposal was that “the court should have a discretion whether or not to allow a plaintiff *who, applying the standard law on restitution, has a claim for restitution to recover benefits conferred under an illegal contract ...* That is, we do not provisionally recommend that the fact that the defendant, as a result of the unenforceability of the contract, would otherwise retain a benefit, is in itself sufficient to justify a restitutionary claim.”⁴¹ In effect, the court would have a discretion whether to allow the illegality to act as a bar to a restitutionary claim to which there would otherwise be no defence. With the exception of the case where P withdraws from the contract before the illegal purpose is carried out, the court would *not* have a discretion to grant restitution in circumstances where, but for the illegality, there would have been no right to restitution.
- 0.2. In what circumstances would a party who has conferred a benefit under a contract, but could not enforce the other party’s contractual obligations, *not* have a right to restitution under the general law? We have identified three possible cases.
- 0.3. First, where P has paid *money* to D, she may be unable to recover it back if D has partially performed: the failure of consideration is not total. What if the contract is illegal? The approach adopted by CP 154 was that there would be a discretion to allow P’s claim for restitution, despite the illegality, provided that, but for the illegality, that claim would have succeeded. But, the paper argued,⁴² the law was moving towards the abandonment of the requirement of total failure; therefore P would be entitled to restitution under the general law, and her claim would be barred *only* by the illegality; therefore, under the proposals, the court would have a discretion to allow the claim. Unfortunately this prophecy has so far remained unfulfilled, and, subject to certain exceptions,⁴³ total failure seems still to be required.⁴⁴ It would follow that, under the CP 154 proposal, the court would have no discretion to award restitution.

⁴⁰ We recognise that it might sometimes be hard to separate the cost of conferring a benefit from the profit element in the contract price. For example, if P works for £50 per hour, what should D be liable to pay by way of restitution for one hour’s services? To award £50 would infringe our principle that P’s profit is not recoverable; to award less might leave P out of pocket if the demand for his services exceeded the supply (ie he had other customers who would have paid him £50 for that same hour).

⁴¹ Para 7.20 and n 42 (italics supplied). The paper goes on to contrast this proposal with the approach adopted under the Israeli Contracts (General Part) Law 1973, which, subject to the court’s discretion to order otherwise if it deems it just, imposes the same duty of mutual restitution under an illegal contract as upon rescission.

⁴² Para 7.59, citing *Goss v Chilcott* [1996] AC 788.

⁴³ eg where it is possible to apportion the contract price, as in *Dawood (Ebrahim) v Heath (Est 1927) Ltd* [1961] 2 Lloyd’s Rep 512.

⁴⁴ *Stoczni Gdanska SA v Latvian Shipping Co* [1998] 1 WLR 574.

- 0.4. Secondly, the conventional view is that, where P has completed or substantially completed her contractual performance, her only remedy is to sue for the contract price: she cannot then terminate the contract and claim restitution in respect of her performance.⁴⁵ This view has been challenged as illogical and anomalous,⁴⁶ but the point remains unclear. If the conventional view prevails, the proposal in CP 154 would mean that a party who completes her contractual performance, but is not allowed to sue for the price because the contract is illegal, would not be able to ask for restitution either.
- 0.5. Thirdly, suppose P has paid D in advance and in full. D has performed substantially but not completely. P cannot recover damages for the breach, because the obligation that D has not performed is illegal; and she cannot get restitution because D has substantially performed. Here too the CP 154 proposal would mean that there was no discretion to award restitution.
- 0.6. We do not think that the availability of restitution under an illegal contract ought to hinge on what the law of restitution would have to say about the case if the contract were *not* illegal. Subject to certain exceptions, we now think that a party who confers a benefit under a contract, but cannot enforce the other party's contractual obligations because of illegality, should have a right to restitution on those facts alone. In other words we think that the unenforceability of D's obligations on grounds of illegality should *in itself* make it unjust for D to retain benefits provided by P under the contract without making restitution.⁴⁷

28 Exceptions to the right to restitution

- 0.1. In what circumstances should restitution be denied, by way of exception to our general principle?

29 BENEFIT CANNOT PROPERLY BE VALUED

- 0.1. In some circumstances it would be offensive to the court's dignity for the court to have to value the benefit provided (or, perhaps, the cost to P of providing it). In such a case, restitution clearly cannot be granted.⁴⁸ But this exception would not apply *merely* because the provision of the benefit was itself illegal. There would not necessarily be any objection to valuing, say, unlicensed building work. Again this would seem to depend partly on the seriousness of the illegality and partly on whether the illegality is central or incidental.

⁴⁵ Goff and Jones, *The Law of Restitution* (5th ed 1998) pp 530–531.

⁴⁶ A Burrows, *The Law of Restitution* (1993) pp 270–271.

⁴⁷ In effect this is already the case where P has paid D in advance, has received partial performance, but cannot enforce the rest of D's obligations because the contract has been frustrated (eg by supervening illegality): Law Reform (Frustrated Contracts) Act 1943, s 1(2). We would be making a similar change where the reason why P cannot enforce the rest of D's obligations is that they were illegal *ab initio*.

⁴⁸ Cf the Dutch Civil Code. Unusually among civil jurisdictions, Dutch law permits restitution in respect of performance made under an illegal contract; but this is subject to an exception if the performance made "cannot by its nature be reversed and ought not to be valued in money": Art 6:211(2).

30 RESTITUTION STULTIFYING THE PROHIBITING RULE

- 0.1. We accept that it would be wrong to grant restitution if the effect of doing so would be to undermine or stultify the rule prohibiting the conduct in question; but, for the reasons given at paragraph 68 above, we query whether it ever *would* have that effect. While a person contemplating an illegal transaction might be discouraged by the knowledge that he will not be entitled to restitution in respect of any benefits he may confer on the other party, that same knowledge will be an additional incentive to the other party.

31 INDIRECT ENFORCEMENT OF THE CONTRACT

- 0.1. We accept that restitution should not be granted where this would amount to indirect enforcement of the contract – ie, where it would stultify the rule that the contract is unenforceable. But we do not think this is a genuine exception to the right to restitution of the limited kind that we propose: restitution in that sense *cannot* amount to indirect enforcement because it would include no element of lost expectation. In some cases there may be little *practical* difference between enforcing the contract and granting restitution, even in our limited sense;⁴⁹ but they are in principle different remedies.⁵⁰ If restitution would otherwise be available, we think it would be wrong to deny it merely because, on the facts, it would have much the same effect as another, conceptually distinct, remedy which is not available.

32 SERIOUS ILLEGALITY

- 0.1. Should there be an exception in the case of *serious* illegality?⁵¹ Should P be able, for example, to recover an advance payment made to a contract killer who fails to perform? If not, why not?
- 0.2. The obvious and traditional answer is that getting involved in cases of serious illegality would offend the dignity of the court. But we have concluded that this is not a valid argument, *provided* that what the court is actually being asked to do is not itself offensive. There is nothing intrinsically offensive about ordering D to give P his money back: courts do it every day. Why should it make a difference that what D was supposed to do in return for the money was seriously illegal?
- 0.3. Here again we think the answer may lie in POCA. It seems that, if P successfully obtained restitution of the money paid, the money he thus obtained would be recoverable from him by the ARA. If the illegality is so serious that, but for POCA, it would justify denying restitution, it will presumably be serious enough to persuade the ARA to invoke POCA. In other words POCA seems to meet the need that might otherwise have to be met by a rule that restitution is not available in cases of serious illegality.

⁴⁹ eg where P has made D an interest-free loan. Cf *Boissevain v Weil* [1950] AC 327, where restitution was refused on the ground that it would have been tantamount to enforcement.

⁵⁰ *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, departing from the older view that restitution involves the enforcement of an implied contract.

⁵¹ Cf §140 of the Restatement of Restitution, which allows restitution to be denied because of P's wrongful conduct in connection with the transaction on which his claim is based. Relevant factors include the fact that P's conduct involved serious moral turpitude.

33 GENERAL DEFENCES

- 0.1. Clearly the right to restitution might in addition be subject to factors which constitute a defence to a restitutionary claim under general principles, irrespective of illegality. For example, we think it ought to be a defence that D no longer has the benefit that P conferred on him⁵² – which, in an illegality context, may be because it has been confiscated.⁵³

34 HOW DO OUR PROPOSALS COMPARE WITH THE PRESENT LAW?

- 0.1. How much would the present law need to be changed in order to enable our preferred outcomes to be reached?

35 Enforcement of obligations that involve offences

- 0.1. The present law does not explicitly recognise that the enforceability of an illegal obligation may depend on such factors as the seriousness of the illegality, or whether it is central or incidental. But, where the offence is a statutory one, a court may achieve the same outcome by holding that the statute is not intended to invalidate contracts. It may be that the factors we have identified as relevant, both in CP 154 and in this paper, are already being taken into account under the guise of statutory interpretation. If so, what we propose may not in fact be as far from the present law as it might seem. But it would reduce the risk of a court jumping to the conclusion that the contract is automatically unenforceable, without considering these factors at all.
- 0.2. Indeed it is interesting that illegal obligations are sometimes enforced without, apparently, infringing any *common law* rule that they are automatically unenforceable. One might expect the common law to take this line, irrespective of whether the offence that performance of the obligation would involve is a statutory offence or a creature of the common law; yet it does not. Where the offence is statutory, enforcement can perhaps be justified on the basis that the statute, on its true construction, implicitly overrides any such common law rule. Where the offence is itself a matter of common law, this reasoning will not work; query, therefore, whether, under the present law, it would ever be possible to enforce a contract to which the commission of a minor common law offence (such as a technical assault) is central. We think it should be possible; but this is not an issue of great practical importance.
- 0.3. Where one party is taken to have given a collateral warranty that his obligations would not be rendered unenforceable by illegality, the present law seems to allow recovery for loss of expectation, not merely (as we propose) negative interest.⁵⁴ But the outcome presumably depends on the precise content of the collateral warranty. It would be quite possible to infer in such cases that D is assuming *only* the risk of P sustaining loss through entering into the contract at all, and *not* the

⁵² But not merely that D has changed his position.

⁵³ Another possibility is that the property in dispute may be something which cannot lawfully be possessed at all. Where this is the case, it is clearly a good reason for not ordering D to hand the property over. But this would seem to arise in relation to proprietary claims based on P's title, rather than claims for restitution in respect of contractual performance.

⁵⁴ *Strongman (1945) Ltd v Sincock* [1955] 2 QB 525.

risk of P failing to make the profit she expects to make. In other words our preferred outcome could be achieved without actually changing the law.

36 Enforcement of obligations that are not themselves illegal

37 P HAS PERFORMED ILLEGALLY

0.1. The general rule is that illegal performance by P does in itself prevent him from enforcing D's obligations.⁵⁵ This is subject to the two exceptions recognised by Devlin J in *St John Shipping Corp v Joseph Rank Ltd*,⁵⁶ viz:

- (1) where, in order to make out his claim, P is forced to rely on his own illegal act;⁵⁷ and
- (2) where enforcement would infringe the "forfeiture rule", viz that a person cannot be allowed to profit from his own crime.

0.2. The former will rarely apply in a contractual setting, because (as in *St John Shipping* itself) P will usually be able to make out his claim by showing that he has performed, without having to disclose the fact that his performance was illegal.

0.3. The forfeiture rule is also of limited relevance, for two reasons. First, it appears to be confined to *serious* crimes;⁵⁸ and second, it bars *only* the enforcement of rights "directly resulting" from the crime.⁵⁹ In many cases (as in *St John Shipping*) this requirement will not be satisfied, because the illegality is incidental to P's performance, rather than being the very thing that enables P to earn the right to D's performance.

0.4. The present law thus seems broadly similar to what we propose.

38 D HAS PERFORMED ILLEGALLY, AND P IS IMPLICATED

0.1. *Ashmore Benson Pease & Co Ltd v A V Dawson Ltd*⁶⁰ seems to suggest that acquiescence by P in any illegal mode of performance by D automatically bars any claim under the contract. But it is hard to find any other authority for such a rule. While we would not challenge the outcome on the facts of this case, we have suggested that the outcome ought to be different if the illegal performance were wholly unconnected with P's claim;⁶¹ and we think that, in such a case, *Ashmore Benson Pease v A V Dawson* would probably be distinguished anyway.

⁵⁵ *Wetherell v Jones* (1832) 3 B & Ad 221; 110 ER 82; *Coral Leisure Group Ltd v Barnett* [1981] ICR 503.

⁵⁶ [1957] 1 QB 267.

⁵⁷ This seems to be another form of the "reliance principle" confirmed in *Tinsley v Milligan* [1994] 1 AC 340.

⁵⁸ N Enonchong, *Illegal Transactions* (1998) p 236.

⁵⁹ *St John Shipping Corp v Joseph Rank Ltd* [1957] 1 QB 267, 292, *per* Devlin J.

⁶⁰ [1973] 1 WLR 828.

⁶¹ See para 46 above.

39 ILLEGAL PERFORMANCE WAS INTENDED

- 0.1. There are dicta in both *Archbalds (Freightage) Ltd v S Spanglett Ltd*⁶² and *St John Shipping Corp v Joseph Rank Ltd*⁶³ to the effect that a contract cannot be enforced by a party who, at the time of making it, intended to perform it illegally or knew that the other party so intended. But we are not aware of a clear decision to this effect. Moreover, these dicta may be contrasted with one in *Fielding & Platt Ltd v Najjar*, where D's defence was that Ps had been party to D's intention to import the goods illegally, and Lord Denning MR said:

In order for this to be any kind of defence, [D] must show first of all that the contract contained a term that [Ps] were to give a false invoice: so that it could not lawfully be performed. For if it would [sic] be lawfully performed (by giving a correct invoice) [Ps] can certainly sue upon it.⁶⁴

- 0.1. We think it would be open to the courts to hold that, as we have suggested should be the case, an illegal intention at the time of the contract is not in itself crucial.

40 D'S OTHER OBLIGATIONS ARE ILLEGAL

- 0.1. We have suggested that there is no objection in principle to severing D's illegal obligations and enforcing the rest, provided that they are not too inextricably connected for this to be feasible. It has been said that this is not possible in the case of obligations involving criminal offences,⁶⁵ but the question "is still an open one".⁶⁶ In *Taylor v Bhail*,⁶⁷ P, a builder, secured a contract to do work for D by agreeing to inflate the estimate and thus enable D to defraud his insurers. The Court of Appeal held that the illegal aspect of the agreement could not be severed from the agreement to pay for the work actually done. Millett LJ said:

Whether the arrangement between the plaintiff and the defendant comprised a single contract or two separate contracts is, in my judgment, immaterial; they constituted a single, indivisible arrangement tainted by fraud, neither component of which was ancillary or subsidiary to the other, and neither of which is severable so as to leave the other enforceable.

This implies that the illegal aspect of the agreement could have been severed, leaving the rest enforceable, if it had been "ancillary or subsidiary" to the lawful part. This is essentially what we suggest the position ought to be.⁶⁸

⁶² [1961] 1 QB 374, 384 (Pearce LJ), 388 (Devlin LJ).

⁶³ [1957] 1 QB 267.

⁶⁴ [1969] 1 WLR 357, 361.

⁶⁵ *Bennett v Bennett* [1951] 1 KB 249, 254.

⁶⁶ Treitel, *The Law of Contract* (10th ed 1999) p 467.

⁶⁷ [1996] CLC 377.

⁶⁸ See also *Fielding & Platt Ltd v Najjar* [1969] 1 WLR 357, 362, where Lord Denning MR said that, even if it had been a term of the contract that Ps should furnish D with a false invoice, that term could be severed from the rest of the contract. Arguably the illegality was

41 THE CONTRACT WAS MADE FOR AN ILLEGAL PURPOSE

- 0.1. The fact that P made the contract for the purpose of committing an offence, or knew that D was making it for such a purpose and made himself party to that purpose,⁶⁹ seems on the authorities to render the contract automatically unenforceable.⁷⁰ In this case the common law does seem to be less flexible than the approach we would prefer. But it also seems inconsistent with the more flexible approach already taken to contracts which cannot be performed without committing a minor offence. Given that such contracts are sometimes enforceable, one would expect the same to be true, *a fortiori*, of a contract which can be performed without committing any offence but which is made for the purpose of committing a minor offence. Again we think there is room for the common law to develop towards our preferred position.

42 THE MAKING OF THE CONTRACT WAS ITSELF CRIMINAL

- 0.1. It is commonly said that if the making of the contract is criminal then the contract must be illegal and unenforceable; but, as we have said, we query whether this is actually so, as a matter of law. We are not aware of any clear authority for such a rigid rule.

43 Restitution

- 0.1. In relation to restitution, our proposals clearly depart from the present law. At present, broadly speaking, restitution is available only if P is not *in pari delicto* or withdraws before the illegal purpose is carried out. Some authorities⁷¹ suggest that P can withdraw where, though he has not actually thought better of it, the circumstances have changed so that the illegal contract no longer suits his purpose. But there still seems to be no right to restitution where all that has gone wrong is that D has failed to perform.⁷² Under our proposals, there would in general be a right to restitution even in that case.

“ancillary or subsidiary” in that case because, by contrast with *Taylor v Bhail*, Ps’ agreement to provide the false invoice does not seem to have been crucial to their winning of the contract.

⁶⁹ Knowledge alone seems insufficient: *Hodgson v Temple* (1813) 5 Taunt 181; 128 ER 656. But little in the way of participation seems to be required. See CP 154, para 2.27.

⁷⁰ eg *Langton v Hughes* (1813) 1 M & S 593; 105 ER 222.

⁷¹ eg *Tribe v Tribe* [1996] Ch 107.

⁷² *Parkinson v College of Ambulance* [1925] 2 KB 1; *Bigos v Bousted* [1951] 1 All ER 92; Treitel, *The Law of Contract* (10th ed 1999) pp 456–457.