

Illegal Contracts – a case for review

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Introduction

- [1] At common law illegal contracts have posed great conceptual and practical difficulties to the Courts. That is painfully obvious in case of remedies denied to the innocent or otherwise deserving parties. The common law has taken the approach of 'all or nothing', ie either the contract is legal or it is illegal and if it is illegal no remedy is available [excepting to innocent third parties acting in good faith for value]. In New Zealand the common law was modified by the Illegal Contracts Act 1970.
- [2] The purpose of this paper is to review some of the decisions of the Fiji Courts to show that time has now come for similar legislation in Fiji, especially if one is to harness the harsh and unfair consequences on the innocent and the less guilty parties to an illegal contract. The need for law change is heightened by steady increase in foreign investors, many of whom do not appreciate the harsh consequences of non compliance, and some of whom have learnt the hard way by losing their investment.
- [3] Those innocent and less guilty parties are, in a sense, consumers too who deserve a better deal. On that basis the topic of this paper is relevant to the theme of the session, Empowering Consumers.

Illegality

- [4] There are a number of different ways in which a statute may indicate that a contract which is entered into in contravention of its provisions will be illegal *at its inception*:

- (i) where the statute specifically states that the contract made in contravention of it shall be illegal;
 - (ii) where the statute prohibits the making of certain kinds of contracts and any agreement made in contravention of it will, generally, be held to be illegal even though the statute does not explicitly so provide;
 - (iii) where the statute impliedly, rather than explicitly, prohibits the making of certain contracts, either by the creation of an offence prohibiting the agreement itself or the conduct relevant to it although nothing is said about the effect of breach on any such contract;
 - (iv) where the statute states that any contract made in contravention of its provision will be null and void or void or unlawful and void. In any of these cases it will be a matter of interpretation whether the contract is also illegal, and generally they are.
- [5] Additionally, few statutes provide express guidance as to the consequences of *illegality during performance* of the contract. The Courts are normally required to determine whether a contract has become illegal during performance by looking to the purpose of the statute in question and considering whether the purpose would be frustrated by giving effect to contracts which has been performed in a manner forbidden by the statute. The Court may take into account the effect on third parties in deciding whether the object of a statute requires a contract in breach of the statute to be illegal.

Fiji Legislation

- [6] Civil lawyers practicing in Fiji, whether they are conveyancers or litigators, invariably come across legislation which renders contracts illegal for non compliance, or breach, of such legislation.
- [7] Statutes most commonly encountered are:
- (i) Native Land Trust Act (Cap.134), s.12
 - (ii) State Lands Act (Cap. 132), s.13

- (iii) Subdivision of Lands Act (Cap.140), s. 5
- [8] In recent time other legislation has gained notoriety:
- (i) Land Sales Act (Cap. 137), s. 6
 - (ii) Exchange Control Act (Cap. 211), ss. 10 & 11
 - (ii) Companies Act (Cap.247), s.58
- [9] Though the Exchange Control Act (Cap. 211) contains provision for validation of contracts made in breach of the Act (s. 20(2)) legislation modeled on the New Zealand Act would provide additional and varied remedies to deserving parties.
- [10] Among the newer legislation yet to be considered by the Fiji Courts are the Consumer Credit Act and the Employment Relations Act. The latter is likely to raise issues of restraint of trade, which is also dealt with by the Illegal Contracts Act 1970, NZ (s.8).

Fiji Cases

- [11] There are many cases on illegal contracts, reported and unreported, deserving consideration in this paper because of the injustice inflicted on the innocent and the less guilty. However I have selected a few as sample.

Sections 12, Native Land Trust Act;

Section 13, State Lands Act

- [12] A good starting point is **Chalmers v Pardoe**¹. In that case P, who was the lessee of native land made an arrangement with his friend and solicitor, C, whereby C could build on part of the land provided C got consent of Native Land Trust Board under s.12. C erected six buildings on part of the land but did not get the Board's consent. Subsequently P & C fell out and C claimed an equitable charge on the land for the cost of the six buildings. The Privy Council held that equity would, apart from the statutory prohibition, have intervened and prevented P from obtaining the

¹ [1963] 3 All ER 552 (PC)

- buildings erected by C for nothing but as the arrangement coupled with erection of the dwellings constituted a dealing under s.12 and therefore unlawful, the Court was precluded from lending its aid to C.
- [13] Similar agreements or family arrangements made between mother and son or between brothers or between extended family members have all been declared illegal and no relief has been granted to the innocent or the less guilty party. In some cases these people had lived on the land for many years or had expended their life savings to build homes on the land: **Phalad v Sukhraj** ²; **Jai Kissun Singh v Sumitra** ³; **Ram Narain v Ram Kisun** ⁴; **Sadhu v Subramani** ⁵; **Baburam v Udhan** ⁶ .
- [14] The Courts have also refused to uphold contracts where consents have been subsequently granted, on the ground that such consent could not revive that which was by law a nullity. For that reason the Courts have also refused to disturb the common law rule that the loss must lie where it falls, even in the face of the guilty party gaining a windfall: **Chalmers v Pardoe**; **Jai Kissun Singh v Sumitra** .
- [15] Tenancy agreements and subleases too have been held to be illegal and unenforceable where consents have been obtained late. In several cases tenants have had to vacate their business premises of many years without being compensated for their fixtures and fittings or for other improvement made to the premises. In one pending case the tenant vacated a large commercial premises mid term and has raised illegality to defend a claim for breach of contract: **Juman Sai v Harry Atchson** ⁷, **Westmall Limited v Cul (Fiji) Limited** ⁸ .

Section 6, Land Sales Act

- [16] Section 6(1) provides:

² 24 FLR 170

³ 16 FLR 165

⁴ 15 FLR 1

⁵ 1980 FLR 132

⁶ 1973 FJCA Vol. 73 p 40

⁷ 7 FLR 71

⁸ Lautoka HC, 175/01, pending

"No non-resident or any person acting as his agent shall without the prior consent in writing of the Minister responsible for land matters make any contract to purchase or to take on lease any land.

Provided that nothing contained in this subsection shall operate to require such consent or prevent a non-resident from making any such contract if the land together with any other land in Fiji of such non-resident does not exceed in the aggregate an area of one acre."

- [17] This section was considered by the Supreme Court in **Gonzales v Akhtar & Ors**⁹. In that case Ignacio Gonzalez ("G") was an American citizen who came to Fiji in early 1985 to set up a hotel business. G decided to buy 12 acres beach front freehold land near Sigatoka. He engaged a solicitor in Nadi for the transaction. The solicitor who acted for both the vendor and the purchaser drew up the Sale & Purchase Agreement dated 25 September 1985. The Agreement was not made subject to the consent of the Minister under s.6. At the hearing the solicitor testified that he was unaware of the Land Sales Act and that was the reason for the omission of the consent clause in the Agreement. In July 1990 G became aware of s. 6 and he himself made an application to the Minister. The Minister granted his consent in October 1990. But between 1985 and October 1990 G had taken possession and performed some of his obligations under the 1985 Agreement including making of roads, obtaining rezoning for hotel use; preparing building plans and had carried out other improvements on the land. He had also paid off the purchase price. The Supreme Court held that the 1985 agreement was illegal and unenforceable for breach of s.6. G lost his entire investment exceeding \$400,000.00
- [18] The Supreme Court rejected an argument that the contract was impliedly subject to consent under s.6. The Court was not moved by G's (and his solicitor's) lack of knowledge of the legislation or by the fact that consent was subsequently granted. The Supreme Court however left open the status of a contract expressly made subject to the prior consent under s.6.

⁹ [2004] FJSC 2

[19] That question arose in **Port Denerau Marina Ltd v Tokomaru Ltd**¹⁰. In that case the respondent (Tokomaru) and a trustee for the appellant (PDML) had in 1999 entered into an agreement for the sale and purchase of a marina business on Denarau Island, and associated assets, as a going concern. Pursuant to the agreement, Tokomaru, as the prospective lessee from the Crown in respect of two parcels of land, was to sublease those areas to PDML; by definition, the assets to be sold included the subleases. Both parties were non-residents. The agreement expressly provided:

“The purchaser and the vendor are only obliged to proceed to Completion if the following conditions are satisfied or waived:

- (a) all Authorisations necessary for:-
 - (i) the parties to sign and complete this Agreement;
and
 - (ii) the Purchaser to own, operate and conduct the Business and enter into the Sub-Leases as Sub-Lessee.

As soon as practicable after execution of this Agreement, the Vendor shall:-

- (a) use its best endeavors to obtain all Authorisation to enter into the Leases and the Marina Channel Licence;
- (b) use its best endeavors to enter into and validly execute the Leases and the Marina Channel Licence with the Crown;
- (c) upon the valid execution of the Leases and Marina Channel Licence by the Crown and the obtaining of all necessary Authorisations, to use its best endeavors to attend to registration of the Leases and if possible the Marina Channel Licence, with the Titles Office.”

¹⁰ [2006] FJCA 27; ABU0026U.2005S (6 December 2006)

In proceedings commenced by Tokomaru in 2004, the High Court decided as a preliminary point that the Sale Agreement dated 8 September 1999 made between [Tokomaru] as vendor and [PDML] as purchaser was void ab initio for illegality pursuant to Section 6 of the Land Sales Act. PDML appealed to the Court of Appeal.

[20] The Court of Appeal said:

“We conclude the contract before us is distinguishable from those in issue in *Hunter v Apgar*, *Sakashita* and *Gonzales*. It is sufficiently plain that the obligation to grant the subleases did not arise unless and until satisfaction of the condition that the Minister of Lands consented to the grant. The Minister had the opportunity to consider the proposed subleasing "right at the outset". The agreement did not infringe s.6(1)”

[21] The Court observed, obiter:

“Where an agreement breached section 6(1), to leave a purchaser or lessee in the appellant’s position in possession, thus circumventing the prohibition, would be contrary to the spirit and purpose of the section. Cumulatively these considerations have led us to conclude section 6(1) must be construed as if it provided that agreements in breach were ineffective to pass any interest”.

Illegal Contracts Act 1970, (NZ)

[22] The Illegal Contracts Act 1970 was prompted by the decision in **Carey v Hastie**¹¹. In that case the Court of Appeal confirmed the decision of Speight J. (on appeal from lower Court) that C, a builder, who carried out carpentry alterations and plumbing and electrical work without a required permit could not recover under the contract for such work because it was illegal to commence work without first obtaining the permit.

[23] An illegal contract, for the purposes of the Act, means:

¹¹ [1968] NZLR 276

“any contract governed by New Zealand law 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”.

[24] Section 7 of the Act is relevant for our purposes. Sub section (1) gives the Court powers, either in the course of any proceedings or on application made for the purpose, to grant relief 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, otherwise howsoever as the Court in its discretion thinks just.

[25] An application may be made by:

- (a) Any person to whom the Court may grant relief pursuant to section 7(1); or
- (b) Any other person where it is material for the person to know whether relief will be granted under that subsection.

[26] In considering whether to grant relief, and the nature and extent of such relief, the Court is to 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 be in the public interest.

[27] The Court can make an order under section 7(1) 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.

[28] The Court may by any order made under section 7(1) 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.

[29] Any order made under section 7 (1), or any provision of any such order, may be made upon and subject to such terms and conditions as the Court thinks fits.

Discretionary jurisdiction of Court very wide

[30] The Courts have generally been reluctant to find that the jurisdiction to grant relief has been excluded. Privative clauses have been held to have only limited effect: **Edwards v O'Connor**¹². It has also been held that jurisdiction is not lost where a statute expressly prohibits validation of an illegal contract but is silent as to other forms of relief: **Re AIC Merchant Finance Ltd**¹³. In that case the Court of Appeal was dealing with an application for relief by persons who had deposited moneys with a finance house, where there was at the relevant time no valid prospectus to enable them to rank as secured creditors. *The Securities Act 1978 provided that its provisions were to have effect notwithstanding anything to the contrary in any enactment.* The Court of Appeal held that the statutory priority of the Securities Act provision meant that validation of the contracts was not possible. However, other forms of reliefs could be granted, if appropriate. In the result, the receiver was ordered to treat the unsecured creditors as if there had been a valid security; an order which had an effect indistinguishable from validation.

¹² [1989] 3 NZLR 448

¹³ [1990] 2 NZLR 385 (CA)

[31] In **Philips v Foster**¹⁴ Cooke P considered as obiter that transaction which was otherwise perfectly legal but which was intended to be concealed from the Commissioner of Island Revenue could be validated under s 7 of the Act. He stated that the dictum of Quilliam J in *Barsdell v Kerr*¹⁵ that it would be wrong in principle to apply the Act to validate a contract which was illegal from the outset as being contrary to public policy, went to far. He considered the jurisdiction in the Act was wide enough to cover such a case and that the legislature intended the discretionary jurisdiction of the Court to extend to all kinds of illegal contracts, including both contract made illegal at common law and those made illegal by statute and subordinate legislation.

[32] Cooke P was echoing the views of the Court of Appeal in the earlier case of **Harding v Coburn**¹⁶:

“the power to validate under the Illegal Contracts Act can only arise when by statute, expressly or impliedly, or by the principles of common law or equity, a contract has first been made invalid. Far from being inconsistent with a power to validate, a state of invalidity is a condition precedent thereto. Only then is such a power needed. So too as to the omnibus authorization of relief, “otherwise however”: any relief must be relief from some burden, and the fact that a burden has been imposed in plain terms is not inconsistent with a discretion to lift it”

The Judicial Committee of the Privy Council expressly approved this statement in **Ross v Henderson**¹⁷.

[33] Deliberate illegality by one party is no bar to relief being given to the other party: **Hurrell v Townsend**¹⁸. Likewise Courts will be slow to refuse relief to a deserving party where the other party has only pleaded illegality

¹⁴ [1990] 3 NZLR 263

¹⁵ [1979] 2 NZLR 731

¹⁶ [1976] 2 NZLR 577, 584

¹⁷ [1977] 2 NZLR 458

¹⁸ [1982] 1 NZLR 537

because of a change of heart as to the value of the bargain: **France v Hight**¹⁹.

- [34] If relief is to be available, its form is essentially considered on the basis of fairness as between the parties. Cases show that s.7 is not to be used to increase the penalties applicable to a party who breaches a statute: **Broadlands Rentals Ltd v RD Bull Ltd**²⁰.
- [35] Relief in various form has been granted by the Courts for breach of statutory provisions, eg for breach of s.25 Land Settlement Promotion and Land Acquisition Act 1952: **Harding v Coburn** *supra*, **France v Hight** *supra*, **Hurrell v Townsend** *supra*; s.37 Securities Act: **Re AIC Merchant Finance Ltd**²¹; s.62 Companies Act: **Catley v Herbert**²²; s. 41(2) Fisheries Act: **Edwards v O'Connor**²³, **Mercurius Ventures Ltd v Waitakere City Council**²⁴; Hire Purchase Act 1971 and the Hire Purchase and Credit Sales Stabilisation Regulations 1957: **National Westminster Finance New Zealand Ltd v South Pacific Rent-a- Car Ltd**²⁵.
- [36] Relief, however, has been refused in several cases on the grounds of public interest eg where deliberate attempt has been made to avoid the regulations: **R D Bull Ltd v Broadlands Rentals Ltd** *supra* or where the contract was made so as not to disclose a crime: **Mall Finance & Investment Co v Slater**²⁶.

In **R D Bull** Chilwell J refused to grant relief to Broadlands ("B"), who had leased a car to the plaintiff but the whole transaction was illegal as it was in breach of the Hire Purchase and Credit Sales Stabilisation Regulations 1957. His Honour stated that the regulations were specifically promulgated to control the activities of firms such as B. B knew all about the regulations which were substantially self policing and yet adopted an ingenious device to avoid the

¹⁹ [1987] 2 NZLR 38, affirmed [1990] 1NZLR 345 (CA)

²⁰ [1976] 2 NZLR 595

²¹ [1990] 2 NZLR 385 (CA)

²² [1988] 1 NZLR 606

²³ [1989] 3 NZLR 448

²⁴ [1996] 2 NZLR 495

²⁵ [1985] 1 NZLR 646

²⁶ [1976] 2 NZLR 685 (CA)

regulations for its own profit. In such a situation Chilwell J said it would not be in the public interest to grant relief to B. Relief, however, was granted to the plaintiff. The plaintiff had not known the transaction was illegal and while the company knew it could not purchase the vehicle it believed that the plaintiff personally would be able to purchase the vehicle. The Plaintiff was encouraged in that belief by B and he and his company were entitled to rely upon B's advice that the transaction was legal. Relief granted to the plaintiff did however take into account that the Plaintiff had the use of the motor car for 22 months so an amount for the rental of the car was deducted from the sum B was ordered to pay to the plaintiff.

In **Slater** a contract to give an unregistered mortgage in order to avoid prosecution of Slater's de facto husband for misappropriation of money was declared illegal and void. The Court refused to grant relief as to do so would not be in the public interest.

[37] Section 8 of the Act deals with restraints of trade in *any* contract whereby the rights or liberty of one or both of the parties to carry on a business, trade or profession as that party or parties may wish is restricted. It is the effect of a provision imposing restraints on individuals, rather than the form of the provision, that is important. Where any provision of any contract constitutes an unreasonable restraint of trade, the Court may by virtue of s. 8(1):

- (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 deleting 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.

- [38] By s. 8(2) the Court may modify a provision under s.8(1)(b), notwithstanding that the modification cannot be effected by the deletion of words from the provision. The Courts have shown a willingness to take a pragmatic line and rewrite restrictive covenants as necessary to do justice. This may involve a variation of either or both of a geographical restriction or the duration of a restrictive covenant: **Brown v Brown** ²⁷, **Landzeal Group Ltd v Kyne** ²⁸, **Cooney v Welsh** ²⁹. In **Cooney** the Court of Appeal varied a provision forbidding the employee from engaging in legal practice in a specified area by substituting a prohibition on acting for any of the clients of the former employer for the period of the restraint.
- [39] The Courts have also awarded damages under modified provision of restraint of trade: **H & R Block Ltd v Sanott and Another** ³⁰

Illegal Contracts Act for Fiji

- [40] The New Zealand Act is simple and easy to adapt for Fiji's needs. It has the added advantage of case law developed over the past 37 years which will serve as persuasive authority for the Courts in Fiji.
- [41] The only suggestion I would have is to include an express provision requiring every applicant seeking relief to serve his application on the affected head lessor, (ie Native land Trust Board, Director of Lands or the Freehold Owner) and for such head lessor to have a right to be heard before the Court grants relief to any party. In this way the Court will be assisted in its deliberation and at the same time the head lessor's interest will be protected.

Conclusion

- [42] There can be little doubt that legislative intervention is overdue to provide the much needed relief to the innocent and otherwise deserving parties to an illegal contract. The Illegal Contracts Act 1970 (NZ) provides a good model.

²⁷ [1980] NZLR 484

²⁸ [1990] 3 NZLR 574

²⁹ [1993] 1 ERNZ 407

³⁰ [1976] 1 NZLR 213

