Report on Relief Under Legally Defective Contracts: The *Uniform Illegal Contracts Act*

BCLI Report No. 52 **October 2008**

British Columbia Law Institute

1822 East Mall, University of British Columbia, Vancouver, B.C., Canada V6T 1Z1

Voice: (604) 822-0142 Fax: (604) 822-0144 E-mail: bcli@bcli.org
WWW: http://www.bcli.org

The British Columbia Law Institute was created in 1997 by incorporation under the Provincial *Society Act*. Its strategic mission is to be a leader in law reform by carrying out:

- the best in scholarly law reform and writing; and
- the best in outreach relating to law reform.

This project was made possible with the sustaining financial support of the Law Foundation of British Columbia and the Ministry of Attorney General for British Columbia. The Institute gratefully acknowledges the support of the Law Foundation and the Ministry of Attorney General for its work.

Library and Archives Canada Cataloguing in Publication

Report on relief under legally defective contracts : the Uniform Illegal Contracts Act.

(BCLI report ; no. 52)
"October 2008"
ISBN 978-1-894278-41-6

1. Contracts—British Columbia.

I. British Columbia Law Institute. II. Series: BCLI report ; no. 52
KEB252.R46 2009 346.71102 C2009-900895-5
KF818.R46 2009

INTRODUCTORY NOTE

Report on
Relief Under Legally Defective Contracts:
The *Uniform Illegal Contracts Act*

The general rule of common law regarding contracts that are "illegal" in the sense of being inconsistent with public policy or statute is that they are wholly unenforceable. This rule seems to have logical appeal at a superficial level. It has often operated to produce unjust windfalls and unrecoverable losses, however. This is because the rule implies that courts must let the chips fall where they may once it appears that a contract is tainted with illegality. The parties cannot be restored to their original position.

The illogical and unjust results that the general rule about illegal contracts can produce, often without any significant reinforcement to public policy or respect for the law, have always been recognized. Many exceptions to the rule grew up as a result. These added considerable technicality to the law and were applied so often that it could seriously be questioned whether the general rule retained its force except in theory. In recent decades Canadian courts have moved away from applying the general rule of unenforceability in a mechanical fashion and have begun to employ a restitutionary approach instead to prevent unjust enrichment of one party at the expense of the other. The area nevertheless remains unsettled. It is unclear what the bounds of the courts' remedial jurisdiction are.

The *Uniform Illegal Contracts Act*, approved by the Uniform Law Conference of Canada in 2004, cuts through the inconsistencies and technicality of the common law regarding illegal contracts and confers clear discretionary powers on the court to arrive at a just solution where difficulties arise from contractual arrangements that somehow contravene legislation or public policy. This report recommends some modifications to the *Uniform Illegal Contracts Act* to adapt it to the legal landscape of British Columbia. The Institute recommends the version of the Act set out in Appendix B of the report for enactment in this province.

Ron Skolrood
Chair,
British Columbia Law Institute

October 2008

Acknowledgments

The Institute acknowledges its gratitude for the very valuable work carried out by the former Law Reform Commission of British Columbia in the area of illegal transactions that to a large extent was the inspiration for the *Uniform Illegal Contracts Act*.

The major contributions of Arthur L. Close, Q.C., the former Executive Director of the British Columbia Law Institute, and those of Prof. Michelle Cumyn, Prof. Mary Ann Waldron, Ms. Lorna Proudfoot, Mr. Ken Downing and Mr. Michel Aucoin to the development of the *Uniform Illegal Contracts Act* under the auspices of the Uniform Law Conference of Canada are gratefully acknowledged.

The Institute also acknowledges the contribution of the following present and former members of the Institute's staff to the preparation of this report: Ms. Carolyn Laws, Mr. Zachary Froese, Mr. Greg Blue and Ms. Elizabeth Pinsent.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

This report deals with implementation of the *Uniform Illegal Contracts Act* (UICA) in British Columbia. The UICA was promulgated by the Uniform Law Conference of Canada in 2004 and was a response to repeated calls for reform of this area of the law in numerous jurisdictions, including British Columbia. Its purpose is to delineate and clarify the remedial powers available to the courts to deal with the consequences of illegal transactions and bring about just results.

Contracts that conflict with a recognized head of public policy or statute in their formation, terms, or performance are classified as "illegal" and are unenforceable at common law. The same rule applies to non-contractual transactions, such as trusts and gifts. This general rule of unenforceability prevents the court from giving relief to either party in a claim arising from the contract or other transaction. Thus, if property has been transferred or a benefit of another kind has been conferred under the contract, but the transferee's side of the bargain has not been performed, the transferee keeps the property or the benefit. The chips fall where they may, even if that leaves one party with a windfall and the other with unrecoverable losses.

Given that this classic approach of non-intervention was applied without regard to the degree of culpability of the parties, its results were often highly unjust. The conventional term "illegal contract" carries a misleading implication of criminality or unlawful intent. Quite often the parties to an illegal contract do not intend to violate the law, but simply run afoul of it inadvertently. A breach of statute may occur in the performance of an otherwise legally impeccable arrangement, or a supervening enactment may prohibit the performance of a contract that was completely legal when it was formed. At common law, however, all these situations attracted the sanction of unenforceability and the parties could not be put back to their starting point.

Due to the propensity of the general rule of unenforceability to produce injustice, a patchwork quilt of exceptions were created by case law. Severance of illegal terms was also allowed where illegality could be cured by simply striking out words ("blue-pencil severance"). While these exceptions and the severance remedy continue to exist, courts in common law Canada have begun to retreat somewhat from the classic stance of non-intervention, without abandoning the general rule of unenforceability of illegal contracts as an element of legal doctrine. Canadian courts also apply the so-called "benevolent rule" of interpretation originating in *St. John Shipping Corporation v. Joseph Rank Ltd.*, under which a contract will only be held unenforceable for inconsistency with a statute if this result was the clear legislative intent and the purpose of the enactment cannot be served otherwise.

The two leading cases on illegal contracts in common law Canada at the present time

are *Still v. M.N.R.* in the Federal Court of Appeal and *New Solutions Financial Corporation v. Transport North American Express Inc.* in the Supreme Court of Canada. These decisions point in a common direction towards a flexible approach to contractual illegality in which courts would have a wide range of remedial discretion. This would still include the ability to deny relief as a sanction against deliberate violation of law or bad faith on the part of one or both parties.

It could take decades, however, before the boundaries of the remedial jurisdiction to which the *Still* and *New Solutions* cases point are mapped out through the process of litigation. Implementing the UICA in British Columbia now would provide certainty, clarity, and efficiency. In keeping with earlier law reform recommendations in Canada, the UICA does not attempt to codify or restate the principles of contractual illegality. Instead, it cuts through the incoherence and technicality of the present substantive law and arms courts with an extensive framework of discretionary remedial powers for disentangling the wreckage of transactions tainted with illegality and imposing a pragmatic and fair solution.

The remedial powers conferred by the UICA comprise orders for

- restitution
- compensation
- apportionment of losses
- damages from a party at fault
- declaratory relief
- vesting property, or directing its assignment or transfer
- severance of illegal terms

They also include the power to effect "notional severance." This new remedy emerging from the *New Solutions* decision allows the court to read down or limit the effect of a term in an illegal contract. It is a practical approach if the illegality arises from the breadth or scope of that term, such as excessive duration of a restrictive covenant in restraint of trade or (as in *New Solutions*) an interest rate in excess of the lawful ceiling.

The UICA sets out specific factors the court must consider in deciding whether to grant or refuse relief under the Act. These include the consequences of denying relief, the intent, knowledge and conduct of the parties, and the public interest.

The central recommendation of the report is that the UICA be implemented in British Columbia with minor amendments. The most noticeable amendment is a change in the terminology from "illegal contract" to "legally defective contract." This change is recommended in order to eliminate the automatic but often inaccurate implication

of unlawful intent in the common law term "illegal contract." This and the other recommended changes are reflected in the amended version of the UICA that appears in Appendix B.

Enactment in British Columbia of the version of the UICA appearing in Appendix B of the report would be a significant step forward in simplifying a confused and disorderly area of the law.

I. INTRODUCTION

A. General

This report deals with matters associated with implementation of the *Uniform Illegal Contracts Act* (UICA) in British Columbia. This uniform Act was developed by the Uniform Law Conference of Canada (ULCC) to rationalize the grant or refusal of restitutionary and other remedies where contracts and non-contractual transactions are not enforceable directly because they are contrary to public policy. Such a contract or other transaction is said to be "illegal." In this context, illegality does not necessarily imply criminality or illicit purpose. The parties may have had no intention of violating any element of the law, and may have been unaware of any legal flaw in their dealings.

The subject of illegality in contract has plagued common law judges for more than two centuries, and has attracted considerable attention from law reform bodies in the last four decades. This is because in many cases there is a serious tension between avoiding the appearance of giving effect to an arrangement or dealing that is somehow in conflict with law or public policy and avoiding a distastefully unjust or illogical result for the parties involved.

There is a general rule that a contract or transaction contravening a judicially recognized head of public policy or a statute is unenforceable.[1] The rule is still nominally acknowledged, often implicitly, though it has been seriously eroded. When strictly applied, the general rule (as it will be referred to in this report) has the effect of letting gains or losses fall where they may, no matter how unfair or illogical the result. The injustice it can produce has always been recognized.[2] The result was a proliferation of exceptions created by the courts to prevent absurdly unjust results. These are described in the next chapter. Collectively, they are neither coherent nor logically compelling, and only added technicality to the law. As the former Law Reform Commission of British Columbia noted, the general rule concerning contractual illegality and its exceptions did not reduce litigation relating to contracts classified as illegal, but merely made the litigation more complex.[3]

The growth of regulatory legislation in the twentieth century greatly increased the

1. *Holman v. Johnson* (1775), 1 Cowp. 341 at 343, 98 E.R. 1120 at 1121; *Bank of Toronto v. Perkins* (1883), 8 S.C.R. 603.

2. In *Holman v. Johnson*, *ibid.*, Lord Mansfield said the rule is "contrary to the real justice, as between him [the defendant] and the plaintiff… ."

3. Law Reform Commission of British Columbia, *Report on Illegal Transactions*, LRC 69 (Vancouver: The Commission, 1983) at 52.

scope for some aspect of a transaction to run afoul of a legislative scheme, whether or not the legislation in question actually purported to prohibit the transaction in question. The general rule came to be applied in its rigorous classical form less often in the second half of the century, but the doctrinal gymnastics necessary to circumvent it create uncertainty as to what principles really are being applied in the present day to problems of illegality arising from contractual dealings.

B. Law Reform Activity

Well before the Uniform Law Conference of Canada embarked on the work leading to the UICA, widespread dissatisfaction with the state of the law on illegal contracts had been reflected in law reform activity within the Commonwealth. The New Zealand *Illegal Contracts Act 1970* was a significant innovation, substituting a statutory scheme of discretionary relief for all common law exceptions to the general rule of illegality. The Law Reform Committee of South Australia recommended a similar scheme in 1977, but would have made statutory remedies additional to the common law exceptions to the general rule.[4]

In 1983 the Law Reform Commission of British Columbia issued an exhaustive report on illegal contracts.[5] This report followed consultation and consideration of extensive responses to a detailed working paper.[6] The Commission also recommended legislative reform. The report has not been implemented to date. The Ontario Law Reform Commission devoted a chapter on illegal contracts in its 1987 report on the reform of contract law. Its recommendations have not been implemented either.

In 1998, the British Columbia Law Institute incorporated the 1983 recommendations of the Law Reform Commission on illegal contracts, together with other unimplemented reforms, into a proposed *Contract Law Reform Act*,[7] which remains unimplemented as well but influenced subsequent efforts of the Uniform Law Conference of Canada.

More recently, the Law Reform Committee of the Singapore Academy of Law[8] pro-

4. Law Reform Committee of South Australia, *37th Report Relating to the Doctrines of Frustration and Illegality in the Law of Contract*, (Adelaide: The Committee,1977).

5. *Supra*, note 3.

6. Law Reform Commission of British Columbia, *Illegal Contracts* , Working Paper No. 38 (Vancouver: The Commission,1982).

7. British Columbia Law Institute, *Proposals for a Contract Law Reform Act* (Vancouver: The Institute, 1998).

8. Law Reform Committee of the Singapore Academy of Law, *Relief from Unenforceability of Illegal*

posed a draft bill on illegal contracts and trusts, drawing on both the New Zealand statute and the work of the British Columbia law reform bodies. Re-enactment of the New Zealand legislation was urged in Fiji in 2007.[9]

The English Law Commission issued a consultation paper on illegal transactions in 1999, recommending what it described as a "structured" statutory judicial discretion to grant relief to parties seeking restitution or compensation based on illegal contracts and trusts.[10] The Law Commission intends to publish a final report in 2008.[11]

C. Developments in Canadian Law

From the 1970's onward, a less dogmatic approach toward problems of contractual illegality was developing in Canada, especially in the Ontario courts. The Law Reform Commission of British Columbia acknowledged this in its 1983 report, but concluded that the pace of judicial reform would be too slow and uneven to be a complete answer to the confusion and inconsistency in the law, and recommended legislative reform instead. Between 1983 and 1998, when the Institute published its *Proposals for a Contract Law Reform Act*, the situation had not changed appreciably. Decisions in which the classic general rule was being applied rigidly coincided in Canadian courts with those exemplifying a more flexible approach. Since the late 1990's, however, there have been significant pronouncements by Canadian appellate courts, including the Supreme Court of Canada, in favour of greater flexibility.

The UICA provides a discretionary remedial scheme, substantially in keeping with the current direction of judicial thinking in Canada and the work of law reform bodies in Canada and elsewhere, that would rationalize an area of the law that still remains in a state of flux and uncertainty. This report is concerned with developing a version of the UICA appropriate for enactment in British Columbia.

Contracts and Trusts (Singapore: Academy of Law, 2002)

9. B.C. Patel, *Illegal Contracts – A Case for Review*. Office of the Attorney-General, Government of Fiji, online: http://www.ag.gov.fj/docs/Speakers/EConsumers/BCPatel.pdf.

10. Law Commission of England and Wales, Consultation Paper No. 54: *Illegal transactions: the effect of illegality on contracts and trusts* (London: H.M. Stationery Office, 1999). A paper presented by the Commission's Commercial and Common Law Team in 2002 discussing subsequent work in progress appeared to herald a change in the direction of reliance on influencing incremental change in the common law: *Illegality in contract*, paper presented at the SPTL Society of Legal Scholars, 2002 Conference, De Montfort University, Leicester.

11. Law Commission of England and Wales, Annual Report, *Tenth Programme of Law Reform* (London: The Stationery Office, 2008) at 25.

D. Terminology

The traditional use of the term "illegal" in a comprehensive sense to describe contracts and non-contractual transactions that are inconsistent in some way with a common law head of public policy or a statute is as inaccurate as it is unfortunate. It is a misleadingly emotive term, carrying a stigma of criminality or unlawful purpose that is often absent. In many, if not most, cases of illegality in the contractual context, the breach of positive law or public policy tainting an agreement or transaction is inadvertent. Nevertheless, it is the term used throughout case law and legal literature concerning this category of unenforceable contracts and transactions, and it is also the term used in the UICA. Not to use it in discussing the principles and authorities in this confused area or in referring to provisions of the UICA would lead to greater confusion. For this reason, we follow the conventional use of the terms "illegal contract" and "illegal transaction" in the body of this report.

A more neutral and accurate term should be devised for use in remedial legislation, however. The version of the UICA in Appendix B that we recommend for enactment in British Columbia employs the term "*legally defective contract*." This term is not totally ideal from the standpoint of accuracy either, as some contracts and other transactions may be legally impeccable at their formation and fully capable of being performed legally, but may come within the scope of the UICA due to some supervening illegality. "Legally defective contract" is more accurate than "illegal," however, because not all contracts and other transactions that the UICA would cover are entered into for an illegal purpose or call for something to be performed that cannot be done legally. The term "legally defective" also avoids the connotation of criminality or illicit purpose. We think it is a reasonable substitute for the misleading conventional term "illegal."

For reasons of brevity, the term "contract" is used in this report to refer to both contracts and other transactions, such as gratuitous transfers of property, that are subject to the same rules of illegality as contracts, unless the context requires distinguishing between contractual and non-contractual transactions.

E. Structure of Report

Chapter II provides a brief overview of the existing law of contractual illegality. Chapter III explains the genesis of the UICA, reviews its provisions, and analyzes their interaction with existing British Columbia legislation. Chapter IV presents conclusions and recommendations.

Appendix A sets out the text of the UICA, and Appendix B contains the modified version of the UICA that we recommend for enactment in British Columbia.

II. OVERVIEW OF THE CURRENT LAW OF ILLEGAL CONTRACTS AND TRANSACTIONS

A. General

This chapter is not intended as an exhaustive review of the law of illegal contracts and non-contractual transactions like that in the 1983 *Report on Illegal Transactions* of the former Law Reform Commission of British Columbia. It is intended only as a summary of the law as it presently stands to provide the background to the development of the UICA. In order to come to an understanding of the present state of the law of illegal contracts and other transactions, which has been undergoing considerable evolution in the past two or three decades in Canada towards more flexibility in remediating the wreckage from illegal arrangements, it is first necessary to grasp the "classic" first principles surrounding contractual illegality. These continue to form the theoretical underpinning of the law, even though they are now being applied much less rigidly than in the past. In the discussion below, the unsettled and transitional state of the present law should become evident as the "classic" model of illegality is repeatedly contrasted with the more flexible modern approach that is increasingly being used by Canadian courts.[12]

B. General Rule of Unenforceability of An Illegal Contract or Transaction

A contract that does not comply with public policy is said to be "illegal" and will not be given legal effect. This general rule still lies at the root of the law of contractual illegality although, as will be seen from later portions of this report, its application and effects are gradually being rethought by Canadian courts. In its classic form, it has two aspects. One is that a court will not allow a claim that must be founded on an illegal contract. Stated another way, this means an illegal contract is not enforceable by action.[13]

The second aspect is that the court will not assist a party whose claim is founded on an illegal contract.[14] As a result, the court will not hold the parties to the bargain

12. The terms "classical model" and "modern approach" were employed by Robertson, J.A., writing on behalf of the Federal Court of Appeal in the influential case *Still v. M.N.R.*, [1998] 1 F.C. 549 (C.A.).

13. *Holman v. Johnson*, *supra* note 1 at 1121. This principle is expressed by the commonly cited Latin maxims *ex turpi causa non oritur actio* and *ex dolo malo non oritur actio*.

14. *Ibid.* The aspect of the general rule that requires a court to abstain from giving relief to a party whose claim is based on an illegal contract is expressed by the maxim *in pari delicto potior est conditio defendentis* (in equal fault, the defendant prevails).

they made,[15] nor grant a remedy for breach of the agreement.[16] Similarly, the court will not order restitution of property that has been transferred or of a benefit conferred under the illegal contract.[17] This may result in the defendant getting something for nothing, because the defendant cannot be compelled to perform its side of the illegal arrangement.

In the classic application of the general rule of illegality, therefore, the court's stance is one of non-intervention: the court will let the chips fall where they may, though the result may be unjust windfalls and losses.[18] This is what is actually meant when a contract is said to be unenforceable by reason of illegality. Neither party gets help from the courts under the classic model of contractual illegality, subject to the exceptions discussed below.

Among the most graphic examples of the rigid application of the general rule of unenforceability is the Ontario case *Kingshott v. Brunskill*.[19] A farmer sold a quantity of ungraded apples to another farmer, whose main business included the grading of apples and marketing them to the public. Ontario legislation made it an offence to sell ungraded apples. The buyer refused to pay the full value of the apples at the agreed price on the ground that the sale to him was illegal, and the seller sued. Despite the fact that the buyer was able to grade the apples and then re-sell them at a profit, and the seller had never intended to sell the apples to the public before they were graded, the unpaid seller's claim for the price of the apples was dismissed on the basis that the first sale was prohibited.

Unenforceability is not the same thing as voidness or nullity. A void contract is wholly inoperative. Under an unenforceable contract, what is done under the contract remains done, but performance of the rest is not compellable. Thus, a transferee of property under an unenforceable contract would keep the title even though the transfer should not have taken place. The court would not compel a transfer back.[20] The terms "void," "null and void," "unlawful" and various other formulas denoting lack of legal effect have been used interchangeably with "unenforceable" in legislation and by the courts, however, resulting in considerable confusion sur-

15. *Zimmermann v. Letkeman*, [1978] 1 S.C.R. 1097.

16. *Antoine Guertin Ltee v. Chamberland Co. Ltd.*, [1971] S.C.R. 385.

17. *Elford v. Elford* (1927), 64 S.C.R. 385.

18. *Holman v. Johnson*, *supra*, note 1; *Bank of Toronto v. Perkins*, *supra*, note 1.

19. [1953] O.W.N. 133 (C.A.).

20. *Elford v. Elford*, *supra*, note 17.

rounding this point.[21]

C. Applicability of General Rule to Transactions Other Than Contracts

The general rule of illegality applies not only to contracts, i.e. agreements intended to create mutually binding legal obligations in which there has been an offer, acceptance and consideration, but also to trusts,[22] gifts,[23] and other arrangements intended to have legal effect.

For example, in a case where land was transferred in order to defraud the transferor's creditors, the transferor tried to recover the property on the basis of a resulting trust in his favour. A resulting trust normally arises by operation of law where property is transferred gratuitously between unrelated parties, and under normal circumstances a court could enforce it by compelling a retransfer. The Supreme Court of Canada held that no resulting trust arose because the transfer was tainted by the transferor's fraudulent intent, and the transferee therefore could keep the land.[24]

D. Two Branches of Illegality

1. General

For the purpose of the general rule that a contract that is non-compliant with public policy is unenforceable, public policy may be found either in the common law or in statutes.

2. Non-Compliance with Public Policy at Common Law

A court may find a contract illegal if it conflicts with elements of public policy considered to be incorporated into the common law. In making this determination, the court may draw on decided cases and generally recognized social values and conventions, as the court perceives them. It may also take note of policy embodied in statutes, but in contrast to statutory illegality discussed below, the basis for holding

21. *Supra*, note 3 at 39-41. In the two most significant recent decisions in Canada on the subject of contractual illegality, *Still v. M.N.R.*, *supra*, note 12 and *New Solutions Financial Corporation v. Transport North American Express Inc.*, [2004] 1 S.C.R. 249 the effect of illegality is described in some portions of the judgments as rendering a contract unenforceable and in others as making it "void *ab initio*."

22. *Goodfriend v. Goodfriend*, [1972] S.C.R. 640; *In re Great Berlin Steamboat Company* (1884), 26 Ch.D. 616 (C.A.).

23. *Jackson v. Jackson* (1961), 26 D.L.R. (2d) 686 (B.C.S.C.).

24. *Scheuerman v. Scheuerman* (1916), 52 S.C.R. 625.

a contract illegal would not be the specific terms of the statutes themselves, but the court's opinion of the policy values underlying them.

Some examples of contracts that have been fairly consistently held to be illegal for inconsistency with public policy are:

- agreements in restraint of trade[25]
- agreements to commit a tort[26]
- agreements to oust the jurisdiction of the courts[27]
- agreements for extramarital cohabitation[28]

The common law categories of public policy are not closed. They can evolve. A decision to recognize a new head of public policy may be based either on evidence or judicial notice of a new social convention.[29] Heads of public policy may also be abandoned as social standards change. For example, gambling is no longer considered contrary to public policy, and a gambling-related loan contract may be enforced here.[30]

3. Statutory Illegality

(a) General

The second form of contractual illegality is where a contract runs counter to a statute. The statute may prohibit the formation or performance of the contract expressly or impliedly, or the contract may simply be inconsistent with the purpose or

25. *Stephens v. Gulf Oil Canada Ltd.* (1975), 11 O.R. (2d) 129 (C.A.); leave to appeal refused [1976] S.C.R. xi; *Ross v. Jones* (1995), 14 B.C.L.R. (3d) 301 (C.A.). An agreement between a vendor and purchaser of a business or between an employer and former employee are treated somewhat differently than other contracts violating public policy at common law. They will be upheld if the geographical scope and duration of a covenant not to compete is no more than is reasonable to protect the legitimate interests of the vendor or the employer and is not detrimental to the public interest: *Elsley v. J.G. Collins Insurance Agencies Ltd.*, [1978] 2 S.C.R. 916 at 923.

26. *Wanderers' Hockey Club v. Johnson* (1913), 14 D.L.R. 42 (B.C.S.C.) (inducing a breach of contract).

27. *Czarnikow v. Roth, Schmidt & Co.*, [1922] 2 K.B. 478 (C.A.).

28. *Prokop v. Kohut* (1965), 54 D.L.R. (2d) 717 (B.C.S.C.).

29. *Supra*, note 3 at 21.

30. *G.N.L.V. Corporation v. Wan*, (11 September 1991) Vancouver C914422 (B.C.S.C.). See also *Boardwalk Regency Corporation v. Maalouf* (1992), 6 O.R. (3d) 737 (C.A.).

policy of the enactment. A court will not enforce a contract that would bring about the very result the legislature intended to avoid by passing the statute. In contrast to illegality at common law, the court does not form its own view as to what is established public policy when it is alleged that a contract is illegal by virtue of a statute. The public policy to be upheld is that expressed in the legislation.[31]

A statute may expressly prohibit an agreement to do or refrain from doing something or declare that such an agreement is void, null and void, unlawful, invalid, of no effect, or employ some other formula to indicate lack of legal effect.[32] An example is the *Human Tissue Gift Act*, which prohibits the sale or any dealing with human tissues except for listed purposes.[33] The provincial *Railway Act* prohibits railway companies from agreeing to charge preferential or discriminatory freight rates.[34] When a statute expressly prohibits an agreement, the agreement is unenforceable, whether or not the statute so states.[35]

A statute may also prohibit or invalidate agreements impliedly. If a contract or other transaction undermines the policy of a statute by bringing about a result that the statute was intended to prevent, it may be held illegal.[36] For example, section 73(1) of the *Land Title Act*[37] prohibits subdivision of land for the purpose of transfer or leasing for a term of more than 3 years without compliance with Part 7 of the Act, which includes prior approval by an approving officer. Section 73(1) is silent as to the effect on a lease of part of a parcel of land longer than three years if the lessor does not obtain the approval required by Part 7. In *International Paper Industries Ltd. v. Top Line Industries Inc.,* the British Columbia Court of Appeal held that such a lease was wholly unenforceable, not giving rise even to a licence to occupy. The ten-

31. Waddams, *The Law of Contracts*, 5th ed. (Toronto: Canada Law Book Inc., 2005) at 395.

32. *Neider v. Carda of Peace River District*, [1972] S.C.R. 658. (*Lord's Day Act*, R.S.C. 1952, c. 171, s. 4 prohibiting the sale of real estate on a Sunday*); Nova Scotia Union of Public Employees v. Halifax Regional School Board* (2001), 195 N.S.R. (2d) 97 (S.C.) (Public Sector Compensation (1994-1997) Act, S.N.S. 1994, c. 11 freezing public sector pay raises and declaring in s. 12 any term in contravention to be without force and effect).

33. R.S.B.C. 1996, c. 211, ss. 10, 11.

34. R.S.B.C. 1996, c. 395, s. 204(7).

35. *Bank of Toronto v. Perkins*, *supra* note 1 at 610 and 613; *Neider v. Carda of Peace River District*, *supra*, note 32; *Sukovieff v. Beliveau* (1967), 61 D.L.R. (2d) 714 (B.C.S.C.).

36. *Supra*, note 3 at 12. See *Montreal Trust Co. v. Abitibi Power & Paper Co.*, [1937] 4 D.L.R. 369 at 373; *Prince Albert Properties and Land Sales Ltd. v. Kushneryk*, [1955] 5 D.L.R. 458 at 465 (Sask. C.A.).

37. R.S.B.C. 1996, c. 250.

ant was unable to exercise rights under a renewal clause.[38] In a subsequent decision, the Court of Appeal held the landlord had no claim for occupation rent against the tenant for the period between the trial and the judgment in appeal declaring the lease illegal.[39]

A penal or regulatory statute that prohibits certain conduct and creates an offence may be interpreted to impliedly prohibit contracts that contemplate commission of the offence, or enforcement of the contract if the offence is committed in the course of performing them.[40] The classic principle was expressed in *Cope v. Rowlands* in 1836:[41]

> [W]here the contract which the plaintiff seeks to enforce, be it express or implied, is expressly or by implication forbidden by the common or statute law, no court will lend its assistance to give it effect. It is equally clear that a contract is void if prohibited by a statute, though the statute inflicts a penalty only, because such a penalty implies a prohibition… .

Contracts for work to be performed in breach of licensing requirements have frequently been held illegal, preventing one or both parties from recovering damages for their breach or the value of work done under them.[42]

(b) The Increasingly Influential "Benevolent Rule" of Interpretation

The proliferation of regulatory statutes in modern times has led to a retreat from the earlier, mechanical application of the sanction of unenforceability whenever the formation, substance, or performance of a contract is somehow associated with a breach of statute. The modern approach is not to find a contract or other transac-

38. (1996), 20 B.C.L.R. (3d) 41 (C.A.). See British Columbia Law Institute, *Report on Leases of Unsubdivided Land and the Top Line Case*, Report No. 38 (Vancouver: The Institute, 2005). The *Top Line* decision has now been reversed by the enactment of s. 73.1 of the *Land Title Act*, *supra*, note 37.

39. *Top Line Industries Ltd. v. International Paper Industries Ltd.*, [2000] 3 W.W.R. 496 (B.C.C.A.).

40. *Burgess v. Zimmerli* (1914), 19 B.C.R. 428 (breach of Act prohibiting delivery of services by unlicensed practitioner preventing recovery of fees). Further examples are provided by the many cases decided under the now-repealed *Lord's Day Act,* R.S.C. 1970, c. L-13, which made it an offence to sell personal or real property or offer it for sale on a Sunday, subject to the exceptions in the Act. Contracts of purchase and sale of real property entered into on a Sunday were regularly held illegal and unenforceable before the Act was finally declared unconstitutional and repealed. See, e.g. *Neider v. Carda of Peace River District*, *supra*, note 32; *McDonald v. Fellows*, [1979] 6 W.W.R. 544 (Alta. C.A.).

41. (1836), 2 M.& W. 149 at 157, 150 E.R. 707 at 710.

42. *Kocotis v. D'Angelo*, [1958] O.R. 104 (C.A.); *Burgess v. Zimmerli*, *supra*, note 40;

tion to be impliedly prohibited by the statute unless there is a clear implication that the legislature intended this result.

This "benevolent rule" of interpretation derives from the English case *St. John Shipping Corporation v. Joseph Rank Ltd.*[43] A ship carrying grain from the U.S. to Britain became overloaded when the ship took on additional fuel after leaving port, but arrived safely at its destination. The overloading was in violation of British marine safety legislation that imposed a fine designed to confiscate the extra freight that would be earned by the overloading. There was nothing in the contract of carriage that required the carrier to overload the ship. The master of the ship was convicted and fined after arrival in Britain. The holder of the bill of lading for the cargo withheld the unpaid portion of the freight on the ground that the shipowner had performed the contract of carriage illegally and was accordingly disentitled to recover any freight.

The English court held that the test in all cases where a contract is alleged to be illegal because of a breach of statute is whether the statute actually prohibits the contract. This requires a careful examination of the purpose and policy of the enactment. The court concluded that the enactment in question did not require that otherwise legal contracts of carriage be held unenforceable for illegality in order to further its policy. Thus, the cargo owner could not set up the illegality of the carrier's performance in order to resist the carrier's claim for freight.

Strictly speaking, the benevolent rule as enunciated in *St. John Shipping* applies in relation to breaches of statute committed in the course of performance of a contract, because the facts of *St. John Shipping* raised an issue of illegal performance rather than illegality touching the formation and subject-matter of the contract. The benevolent rule has been invoked outside the context of performance, however, and the court that decided *St. John Shipping* expressed the test of statutory illegality in broader terms:[44]

> [B]ut whether it is the terms of the contract or the performance of it that is called in question, the test is just the same: is the contract, as made or as performed, a contract that is prohibited by the statute?

The benevolent rule from the *St. John Shipping* case has been followed numerous times in Canada.[45] It is important to note, however, that the benevolent rule does

43. [1957] 1 Q.B. 267.

44. Per Devlin, J. in *St. John Shipping Corporation v. Joseph Rank Ltd.*, *ibid.* at 284.

45. E.g., *Sidmay v. Wehttam Investments Ltd.*, [1967] 1 O.R. 508 (C.A.); *Still v. M.N.R.*, *supra*, note 12;

not displace the general one that contracts and non-contractual transactions that are expressly or impliedly prohibited by statute are illegal and therefore unenforceable. This principle remains the fundamental proposition underlying the analysis of statutory illegality. The benevolent rule requires only that the policy and purpose of the statute be analyzed to determine if it cannot be served except by refusing to enforce agreements and transactions that are inconsistent with the statute in some aspect of their formation, subject-matter, or performance. A British Columbia court has stated in reference to *St. John Shipping*:[46]

> [T]he words of caution of Devlin, J. suggest the court should go slow in implying that there is a statutory prohibition in respect of a commercial contract entered into by parties unwitting of the breach, however, it does not go so far as to suggest a discretionary application of the rule [that contracts prohibited by statute are unenforceable]… .

D. Exceptions to the General Rule of Unenforceability of Illegal Contracts

1. General

The general rule that contracts violating public policy are unenforceable is subject to several judge-made exceptions. These exceptions were developed to allow relief of some nature, such as recovery of property transferred, amounts paid, or the value of benefits conferred, despite some taint of illegality. The purpose of granting relief where it would otherwise be precluded is to prevent unjust or untoward consequences like a huge discrepancy, of the kind seen in *Kingshott v. Brunskill*, between the level of illegality on the part of the plaintiff and the loss that would result from denying relief.

The exceptions described in this Section D predate the modern approach to illegality that was spearheaded by the *St. John Shipping* case, which explains much of their technicality. They have added greatly to the complexity of the law of illegal contracts, a point eloquently made in the 1983 report of the Law Reform Commission of British Columbia.[47] They have been applied so frequently, however, as to seriously undermine the force of the general rule.

2. Where the Parties Are Not Equally At Fault

If the parties are equally at fault (*in pari delicto*) the court will not assist either of

Dodge v. Eisenman (1985), 68 B.C.L.R. 327 at 327 (C.A.).

46. Per Grist, J. in *Layton Brison Outfitting and Trailriding Ltd. v. R&R Ginsent Enterprises Ltd.* (29 April 1997) Vancouver C960326 (B.C.S.C.) at para. 18.

47. *Supra*, note 3 at 52.

them under the classic model of illegality. If the party claiming relief was unaware of the illegality or was less to blame for some other reason such as duress or fraud, however, relief may be possible.

In the British Columbia Court of Appeal decision *Burgess v. Zimmerli*, for example, a dentist sued to recover the unpaid balance of fees for services provided by an unlicensed dentist working in his office in contravention of provincial legislation. The patient defended the claim on the basis that the contract for professional services was illegal, and counterclaimed for the partial payment he had made on account of the fees. The dentist's claim was dismissed on grounds of illegality, but the patient's counterclaim was allowed because the patient had not known the dentist who provided the services was unlicensed.[48]

3. Where a Party Resiles Before the Contract is Substantially Performed (*Locus Poenitentiae*)

If a party withdraws from an illegal contract before performing it, that party may recover property transferred or the value of a benefit conferred under the contract on the other party.[49] This is known as a *locus poenitentiae* (a place to repent).

If the contract is substantially performed when the claim for relief is made, however, the *locus poenitentiae* is lost.[50] In one case, a party to a contract for the construction of a brothel thought better of it and sued to recover his deposit. The other party had already cleared the land and ordered materials. It was held that the contract had been performed to an extent that the *locus poenitentiae* had been lost. While the plaintiff apparently recovered his moral compass to the extent that his soul may have been out of danger, his deposit proved unrecoverable.[51]

What amounts to substantial performance for the purpose of this exception can be problematical. In *Ouston v. Zurowski*, the British Columbia Court of Appeal allowed

48. Other examples of the not *in pari delicto* exception: in *Neider v. Carda of Peace River District Ltd.*, *supra*, note 32, the institutional transferee of property under an illegal transfer made on a Sunday could not rely on its own illegality to retain the property. The transferor, who was not a businessperson and presumably less to blame, got the property back. In *Kiriri Cotton Co. Ltd. v. Dewani*, [1960] A.C. 192 (P.C.) (Uganda), the payor of illegal "key money" was able to recover it from the sublessor, who extracted it illegally. While the payor obtained the sublet by an illegal payment, the sublessor was considered more at fault because the prohibitory enactment was for the payor's protection.

49. *Zimmermann v. Letkema*n, [1978] 1 S.C.R. 1097; *Ouston v. Zurowski* (1985), 63 B.C.L.R. 89 (C.A.).

50. *Zimmermann v. Letkeman*, *ibid.*; *McDonald v. Fellows*, [1979] 6 W.W.R. 544 (Alta. S.C., App. Div.).

51. *Perkins v. Jones* (1905), 1 W.L.R. 41 (N.W.T.S.C.).

investors who had paid into an illegal pyramid scheme to recover their money, even though they had performed their obligations at least in part before repudiating the contract by attempting to recruit others into the scheme.[52] While they had been initially unaware of the illegality of the scheme, they had performed their obligations at least to this extent. By contrast, in the Alberta case *Lefaivre v. Green*, investors in a pyramid scheme who had started to recruit others were held to be barred from recovering their investment because the scheme had proceeded too far.[53] While the plaintiffs in *Lefaivre v. Green* were found to have reason to suspect the scheme was illegal, this should not have had any bearing on whether the contract had been substantially performed. [54]

4. Where the Parties Act Under a Mistake of Fact

If the parties are under a mistake of fact that prevents them from appreciating the illegality of their contract, the court will grant a remedy to prevent loss. The classic case illustrating this exception was one involving insurance on a cargo of goods being shipped from Russia to England. Neither party was aware when the policy was taken out that a state of war existed between England and Russia, which made the shipment and insurance on it illegal. The plaintiff was able to sue successfully for return of the insurance premiums.[55]

There is no corresponding exception where parties act under a mistake of law, even if they act in good faith. The usual principles of illegality operate, even though the parties are unaware their arrangement violates the law.[56]

5. Where the Illegal Contract Does Not Have to Be Pleaded

If a party to an illegal contract is in a position to base a claim for relief independent of the contract, such that the claim can be pleaded without reference to the illegal contract, that party may obtain relief.[57]

---

52. *Supra*, note 49.

53. [2002] A.J. No. 362 (Prov. Ct.).

54. Waldron, "Remedies in Case of Illegality: Twenty Years and Where Are We?", para. 48. Paper presented to Uniform Law Conference of Canada Civil Law Section, 2003, online: Uniform Law Conference of Canada, http://www.ulcc.ca/en/poam2/Illegal_Contracts_En_pdf.

55. *Oom v. Bruce* (1810), 12 East 25, 104 E.R. 87 (K.B.).

56. *Waugh v. Morris* (1873), L.R. 8 Q.B. 202 at 208.

57. *Elford v. Elford*, *supra*, note 17; *Tinsley v. Milligan*, [1994] 3 A.C. 340 (H.L.).

In the British Columbia case *Faraguna v. Storoz*,[58] the parties were equally at fault in preparing two sets of documents for a sale of land. One set showed a fictitious understated price to reduce the property purchase tax payable. There was an agreement for sale separate from the transfer documentation, however. The vendors were able to recover the amount owing under the agreement for sale because in pleading their claim they did not have to rely on the fraudulent transfer documents.

In the English case *Shelley v. Paddock*, the exception worked in favour of an innocent party.[59] A purchaser of land was able to recover the price of land from foreign vendors who had defrauded him, despite the fact that he had paid the purchase price in violation of U.K. exchange controls. This was because the purchaser based the claim on the tort of deceit, not on the sale transaction that involved a statutory violation.

If the taint of illegality arises on the facts as they are proved, however, it is sometimes held that the court cannot ignore it and must dismiss the claim even if the illegal arrangement has not been pleaded.[60]

The extreme technicality and artificiality of this exception was heavily criticized by the former Law Reform Commission, which pointed out that it was fortuitous in its application and could require the court to ignore the fact that both parties are rogues, or even to favour a rogue who engages in careful pleading over a blameless party.[61]

6. Where the Plaintiff Is a Member of a Class Protected by the Statute

If a statute was enacted to protect a member of a class of which the plaintiff is a member, the plaintiff may recover benefits conferred on another in breach of the statute where the refusal of relief would defeat the purpose the statute was to serve.[62]

---

58. [1993] B.C.J. No. 2114 (S.C.).

59. [1979] Q.B. 120.

60. *Menard v. Genereux* (1982), 39 O.R. (2d) 55 (H.C.); *Berne Developments Ltd. v. Haviland* (1983), 40 O.R. (2d) 238 at 248 (H.C.).

61. *Supra*, note 3 at 33. The Supreme Court of Canada ignored the fact both parties were rogues in *Elford v. Elford*, *supra*, note 17, where a husband and wife colluded to defraud the husband's creditors by transferring the husband's property to the wife. When the wife refused to reconvey, the husband used a power of attorney he held from the wife to transfer the property back to mself. The wife successfully sued the husband on the basis of the husband's fraudulent use of the power of attorney, which was independent of the original fraudulent conveyance.

62. *Burgess v. Zimmerli,* supra, note 40; *Nash v. Halifax Building Society*, [1979] Ch. 584. Another case likely decided on this basis is *D'Amore v. McDonald* (1973), 32 D.L.R. (3d) 543 (Ont. H.C.),

In *Re Ontario Securities Commission and British Canadian Commodity Options Ltd.*, the plaintiff had bought securities from an unlicensed trader. The plaintiff was able to have the purchase transaction rescinded and recover amounts paid under it, because the licensing requirement was for the protection of investors.[63]

E. Severance of Illegal Terms (Under the Classical Model of Illegality)

If illegality arises only from particular terms in a contract, courts traditionally sever the offending terms and uphold the rest of the contract if

(a) what is left retains "the core of the agreement,"[64] or in other words, is self-contained and workable;

(b) it would be reasonable to impute to the parties an intention to adhere to the arrangement without the severed terms;

(c) the offending terms could be severed by simply striking out words, rather than amending or adjusting them.[65]

The last-mentioned requirement for severance is known as the "blue pencil" test.[66]

Written contracts frequently contain a severance clause whereby the parties agree that if any term is found illegal or void, it will be severable and the balance of the contract should remain in force. Where such a clause is present, the court does not need to determine if the balance of the contract remains a workable arrangement.

F. Recent Evolution of the Doctrine of Illegality in Canadian Case Law

1. General

So far we have been describing the principles of the historical or "classical" model of contractual illegality, which continue to be the doctrinal foundation for resolving cases in which illegality of contractual arrangements and other transactions is alleged, even though they are being gradually displaced by newer judicial thinking. In

aff'd (1973), 40 D.L.R. (3d) 354 (Ont. C.A.).

63. (1979), 93 D.L.R. (3d) 208 (Ont. H.C.).

64. Per Arbour, J. for the majority of the Supreme Court of Canada in *New Solutions Financial Corporation v. Transport North American Express Inc.*, [2004]1 S.C.R. 249 at para. 27.

65. *Supra,* note 3 at 77.

66. Per Younger, L.J. in *Attwood v. Lamont*, [1920] 3 K.B. 571 at 593 (C.A.).

order to accurately describe the current state of Canadian common law on the subject, it is necessary to examine how the classical model is being modified.

2. Chipping Away at Doctrinal Rigidity in Ontario

In the late 1960's and 1970's, the rigid traditional rule that courts would not assist parties to an illegal contract apart from recognized exceptions began to be eroded slightly in the Ontario courts. In 1967, the Ontario Court of Appeal hinted strongly in *Sidmay v. Wehttam Investments Ltd.* that restitutional remedies should be available, or contractual obligations enforced, in cases of statutory illegality if the protective purposes of a statutory prohibition would be defeated by letting the chips fall where they may once an agreement is found illegal under it.[67] In other words, someone should not be left unjustly enriched while the class intended to be protected would be correspondingly deprived. These comments were not binding in subsequent Ontario cases, because the court made no finding of illegality in the case in question.

The comments by the Ontario Court of Appeal in *Sidmay* formed the basis for the decision in another Ontario case decided ten years later, however. In *Royal Bank of Canada v. Grobman* it was alleged that a second mortgage to the bank for an amount exceeding the 75% loan to value ratio permitted under the *Bank Act*[68] as it then stood was illegal, and therefore the bank had no claim to funds standing in place of the mortgage.[69] The court stated that modern judicial thinking was no longer characterized by a "knee-jerk reflexive reaction to a plea of illegality" and would weigh the following factors:[70]

> (a) the serious consequences of invalidation of the contract or other transaction;
>
> (b) the social utility of those consequences; and
>
> (c) the class of persons for whose protection the prohibition in question was enacted.

The court found that the purpose of the maximum loan to value ceiling in the *Bank Act* was for the protection of depositors and shareholders, and it would be inconsis-

67. [1967] 1 O.R. 508 (C.A.), aff'd on other grounds [1968] S.C.R. 828.

68. R.S.C. 1970, c. B-1, s. 75(3). The comparable provision is now S.C. 1991, c. 46, s. 418(1).

69. (1977), 18 O.R. (2d) 636 (H.C.).

70. *Ibid*., at 653.

tent with that purpose to treat the mortgage as unenforceable. In holding that the bank was entitled to the funds, the court expressly gave effect to the remarks of the Ontario Court of Appeal in *Sidmay*.

An Ontario court took a bold step further in the 1983 case *Berne Development Ltd. v. Haviland*.[71] A lender and a borrower colluded to deceive a first mortgagee as to the size of the borrower's equity in the mortgaged property by concealing the fact that a second mortgage was being granted. This purpose was evidently not achieved, in that no third party was actually deceived. Later, the lender attempted to enforce its second mortgage against the homeowner. The court acknowledged, as a first principle, that the mortgage was tainted by the joint illegal purpose of the lender and borrower and therefore unenforceable as being against public policy. It also acknowledged that the case did not fit within any recognized exception to the general rule of unenforceability of illegal contracts that would allow for an order for the return of money paid under such a contract. If the court applied the classic principle of non-intervention and left the parties as they were, however, the borrower would be unjustly enriched despite being equally at fault. Declaring it was now recognized that there needed to be a balance between upholding public policy and preventing unjust enrichment, the court held that the parties should be restored to their original positions by giving judgment to the lender for the principal amount of the second mortgage, without interest, and ordering the lender to discharge the mortgage upon payment.

It is significant for the evolution of the doctrine of illegality that *Sidmay* and *Royal Bank of Canada v. Grobman* were cases of statutory illegality, while *Berne Development Ltd. v. Haviland* involved illegality at common law, involving a contract entered into for the purpose of committing the tort of deceit.

3. Persistence of the Classical Model in 1980's and 1990's

At the same time as the Ontario courts were taking some departures, Canadian courts clung on other occasions to the rigid classical model of non-intervention to aid a party to an illegal contract, unless the case fit within one of the recognized exceptions. The general rule of contractual illegality and its effect were restated by the Supreme Court of Canada in *Zimmermann v. Letkeman*[72] in 1978 without mention of

71. (1983), 40 O.R. (2d) 238 (H.C.).

72. *Supra*, note 15. In *Zimmermann v. Letkeman*, however, it could not be said that the general rule and the classical model of its application worked any injustice. The case involved a claim for specific performance by the purchaser of real estate under an agreement of purchase and sale tainted by a common intent on the part of the vendor and purchaser to defraud a prospective mortgage lender by stating a fictitious inflated price. The vendor resiled and returned the pur-

any concurrent developments in the direction of allowing restitutionary remedies in appropriate cases. Decisions in lower courts predominantly gave effect to the general rule of non-intervention, with relief to restore the parties to their original position being available only under the traditionally recognized exceptions to the rule.[73] This situated persisted well into the 1990's, when the *Top Line* decision discussed above was rendered. It was against this background of inconsistency in approach that the Law Reform Commission of British Columbia and the British Columbia Law Institute proposed legislative reform in 1983 and 1998, respectively, believing that judicial reform in the area of illegal contracts would be too slow and discontinuous.[74]

4. Momentum Builds for a New Approach: *Still v. M.N.R.* and *New Solutions*

(a) Enunciation of a "Modern Approach" in Still v. M.N.R.

The 1997 decision of the Federal Court of Appeal in *Still v. M.N.R.*[75] provided a significant impetus towards a new way of approaching remediation in situations of statutory illegality. The case concerned an immigrant who had taken employment in Canada in good faith on the assumption that she did not require a work authorization to do so pending the passage of an order in council giving her permanent resident status. She had misinterpreted ambiguous wording in an official document she had been given. After being granted permanent resident status, she was laid off and applied for unemployment insurance benefits. These were denied on the basis that her employment contract had been illegal.

The Federal Court of Appeal found that Still's employment contract was indeed in breach of section 18(1) of the *Immigration Regulations, 1978,*[76] which prohibited

---

chaser's deposit. The Supreme Court held the action had been properly dismissed at trial as being brought on an illegal contract.

73. E.g., *Menard v. Genereux,* supra, note 60 (court considering itself bound to refuse relief unless a recognized exception applies); *Williams v. Fleetwood Holdings Ltd.* (1973), 41 D.L.R. (3d) 636 (Sask. C.A.) (fraudulent collusive mortgage unenforceable by mortgagee, but the court will not order it to be expunged from the title as the mortgagors and mortgagee were *in pari delicto*); *McDonald v. Fellows*, [1979] 6 W.W.R. 544 (Alta. C.A.) (contract of purchase and sale illegal because entered into on a Sunday in contravention of the *Lord's Day Act*, R.S.C. 1970, c. L-13, s. 4, purchaser able to recover deposit under *locus poenitentiae* exception); *Faraguna v. Storoz*, *supra*, note 58 (parties *in pari delicto* but petitioners able to recover balances owing under an independent agreement not in itself illegal); *Ouston v. Zurowski*, *supra*, note 49 (*locus poenitentiae* exception applying to allow recovery of amounts paid under illegal pyramid scheme).

74. *Supra*, notes 3 and 7.

75. [1998] 1 F.C. 549 (C.A.).

76. S.O.R./78-172, as am. by S.O.R./89-90, s. 1.

persons other than citizens and permanent residents from engaging or continuing in employment in Canada without a valid employment authorization. That did not end the matter of Still's entitlement to unemployment insurance benefits, however. Drawing on *Royal Bank of Canada v. Grobman*, the Federal Court of Appeal distinguished what it referred to as the "classical model" of illegality from the modern approach:[77]

> Under the classical model, the purpose of the statute was only relevant when determining whether the prohibition was for the sole purpose of raising revenue. Today, the purpose and object of a statutory prohibition is relevant when deciding whether the contract is or is not enforceable.

The Federal Court of Appeal stated that it rejected the classical model, first on the grounds that it had long lost its persuasive force and was no longer being applied consistently. *Sidmay* and *Grobman* were described as marking "a new era in the illegality doctrine" while retaining its "quintessential feature," namely the jurisdiction to refuse relief to parties in breach of a statutory prohibition on a principled and non-arbitrary basis. The court went on to say that:[78]

> The second reason for rejecting the classical model is that it fails to account for the reality that today a finding of illegality is dependent, not only on the purpose underlying the statutory prohibition, but also on the remedy being sought and the consequences which flow from a finding that a contract is unenforceable.

The Federal Court of Appeal described the modern approach to statutory illegality that should be applied "in the federal context" as being the following:[79]

> [w]here a contract is expressly or impliedly prohibited by statute, a court *may* refuse to grant relief to a party when, in all of the circumstances of the case, including regard to the objects and purposes of the statutory prohibition, it would be contrary to public policy, reflected in the relief claimed, to do so.

In other words, under the modern approach taken in *Still*, the court is able to determine the consequences of statutory illegality in a given case.[80] Instead of a dogmatically invoked rule of non-intervention, the particular relief claimed is to be withheld only where it would be contrary to public policy to grant it.

77. *Supra*, note 75, per Robertson, J.A. at 573.

78. *Supra*, note 75 at 575.

79. *Supra*, note 75 at 578.

80. *Luzolo v. Canada (M.N.R.)*, [1999] T.C.J. No. 822.

To illustrate the point that a blanket rule of unenforceability unrelated to its consequences is no longer tenable, the Federal Court of Appeal asked several hypothetical questions. Accepting that Still's employment contract was in breach of the immigration regulations, and that the employer might have been justifying in dismissing her on learning she required an employment authorization, would she have been unable to claim unpaid wages for time worked? Would she be disentitled to the protection of provincial labour standards legislation while she was working? If she had been injured on the job, would she be disentitled to workers compensation? The classical model of illegality is unable to deal with these nuances.

The Federal Court of Appeal mentioned a further factor, namely whether the denial of the remedy sought would be a penalty disproportionate to the statutory breach. The *Immigration Regulations, 1978* created an offence only of "knowingly" failing to obtain a work permit, so Still would not have been subject to any quasi-criminal penalty. The denial of benefits in the amount of several thousand dollars would constitute a civil penalty far out of proportion to the breach. Thus Still's good faith was of crucial significance.

In the result, the Federal Court of Appeal found that awarding unemployment insurance benefits to Still, a legal immigrant who had acted in good faith, would not undermine the policy of either the *Immigration Regulations, 1978* or the *Unemployment Insurance Act, 1971*.[81]

Still v. M.N.R. was mentioned with apparent approval by the Supreme Court of Canada in the *New Solutions* case discussed below.[82] Its approach has been followed in numerous subsequent decisions of federal and provincial courts, including courts in British Columbia.[83]

81. S.C. 1970-71-72, c. 48.

82. *New Solutions Financial Corporation v. Transport North American Express Inc.*, [2004] 1 S.C.R. 249, per Arbour, J. for the majority in the Supreme Court at para. 20.

83. Some decisions in which *Still v. M.N.R.*, *supra*, note 75 was followed are: *Johnson v. Lazzarino* (1998), 39 O.R. (3d) 724 (S.C.J.); *Luzolo v. Canada (M.N.R.)*, [1999] T.C.J. No. 822; *Haule v. Canada (M.N.R.)*, [1998] T.C.J. No. 1079; *Agasi v. Wai* (2000), 4 C.L.R. (3d) 101 (Ont. S.C.J.); *Garland v. Canada (M.N.R.)* (2005), 40 C.C.E.L. (3d) 149 (TC.C.); *Lotusland Estates Ltd. v. Ali* (2002), 20 C.L.R. (3d) 307 (B.C.S.C.). *Still* was followed, though distinguished on its facts, in *Mia v. Canada (M.N.R.)*, [2001] T.C.J. No. 199, where it was held that public policy would be furthered by denying unemployment benefits to the plaintiff who, unlike Still, knew or ought to have known he was working in Canada illegally.

(b) Notional Severance: New Solutions

A new tool became available to the courts to deal with some varieties of contractual illegality when the Supreme Court of Canada approved the concept of "notional severance" in 2004 in *New Solutions Financial Corporation v. Transport North American Express Inc.* ("New Solutions").[84] This case involved section 347 of the *Criminal Code*,[85] a provision that has spawned a large body of statutory illegality cases.

Section 347 makes it an offence to enter into an agreement to receive interest at an effective annual rate in excess of 60 per cent, or to receive interest at such a rate. "Interest" for the purpose of section 347 includes any charge or expense for the advancing of credit, regardless of what it is called under the lending agreement. Section 347 is a penal provision that is silent as to the contractual effect of an interest rate over the 60 per cent ceiling.

The commercial lending arrangement in *New Solutions* consisting of several distinct contracts had an effective annual interest rate of 90.9% as a result of various fees and charges that all qualified as interest under section 347 in addition to the basic interest provision stipulating a rate of four per cent per month. The trial judge concluded the offending interest provisions providing were severable, but that he was not bound simply to excise those terms. Instead he granted a declaration that the loan arrangement carried the maximum legal rate of 60 per cent, referring to this process of reading down the interest terms as "notional severance."

On appeal, notional severance was rejected as having no foundation in law. Traditional blue-pencil severance was employed to strike out the clause specifying an interest rate of four per cent per month, leaving the incidental fees and charges in place. This resulted in reducing the effective interest rate to 30.8 per cent.

On further appeal, the majority in the Supreme Court of Canada endorsed the concept of notional severance and restored the trial result. The majority referred to "a broad consensus that the traditional rule that contracts in violation of statutory enactments are void *ab initio* is not the approach courts should necessarily take in cases of statutory illegality involving section 347 of the *Code*."[86]

The difference between the majority and the two dissenting judges was only in relation to whether notional severance was possible, or whether traditional severance

84. [2004] 1 S.C.R. 249.

85. R.S.C. 1985, c. C-46.

86. *Supra*, note 84 at para. 4,

was the only available remedy. Both the majority and the dissenting judges agreed that the illegal interest rate did not make the entire loan agreement unenforceable. The majority declared that there is a "spectrum of available remedies" under section 347 which runs from rendering the entire arrangement unenforceable ("void *ab initio*" in the Supreme Court's terminology, meaning "void from the start") to severing the terms causing the effective interest rate to exceed the legal limit.[87] Where a given case lies along the spectrum and the remedial consequences that result will "hinge on a careful consideration of the specific contractual context and the illegality involved."[88] Predatory loan-sharking agreements and other agreements having a criminal purpose would be held void. At the other end of the spectrum are contracts that are unobjectionable except that they contravene a statute. Severance will often be possible in these cases.

In addition to its approval of notional severance, *New Solutions* is notable for its approval of a four-part test for determining whether offending terms in a contract that breaches section 347 are severable so that the contract should be "partially enforced":[89]

1. Whether the purpose or policy of section 347 would be subverted by severance.

2. Whether the parties entered into the agreement for an illegal purpose or with an evil intention.

3. The relative bargaining positions of the parties and their conduct in reaching the agreement.

4. The potential for the debtor to enjoy an unjustified windfall.

The considerable overlap between these criteria and the considerations for the court set out in *Still* is notable. In particular, the good faith of the parties or lack of it, careful consideration of the purpose of the enactment, and the injustice of a windfall and

87. The use by the Supreme Court of the term "void *ab initio*" as meaning the same thing as "unenforceable" in the sense of the classic model of contractual illegality may be noted. Use of the terms "unenforceable" and "void" as if they were interchangeable is seen throughout the illegality cases.

88. *Supra*, note 84 at para. 6.

89. This four-part test for the availability of severance as a remedy in cases under s. 347 of the *Criminal Code* was originally enunciated in *William E. Thomson and Associates Ltd. v. Carpenter* (1989), 61 D.L.R. (4th) 1 at 8 (Ont. C.A.).

corresponding detriment (which evokes the concept of a disproportionate civil penalty incidental to the statutory prohibition), are prominent in both the *Still* analysis and the Supreme Court's four-part test in *New Solutions* for usury cases under section 347 of the *Criminal Code*.[90]

New Solutions and *Still* may not be entirely congruent. The Supreme Court seems to have proceeded in *New Solutions* from an underlying assumption from the classical model of illegality that a breach of section 347 would automatically result in unenforceability unless the court finds it can sever the offending terms. By contrast, the Federal Court of Appeal said in *Still* that the modern approach "rejects the understanding that simply because a contract is prohibited by statute it is illegal and, therefore, void *ab initio*" and requires the court to determine if the legislative purpose behind the statutory prohibition can only be served by refusing relief.[91]
In laying the groundwork for the conclusion that courts have jurisdiction to apply notional severance, however, the majority judgment in *New Solutions* states that the appropriate approach is "to vest the greatest possible amount of remedial discretion in judges in courts of first instance."[92] This and the other points of convergence between *Still* and *New Solutions*, namely the emphasis on analysis of the purpose of the prohibitory enactment and the retreat from a rigid application of the principle of non-intervention, clearly point in a common direction towards remediation as the rule, rather than the exception, when a contract is found to be in breach of a statute.

It is unclear how far notional severance as a remedy will be applied beyond the context of loans violating section 347 of the *Criminal Code*.[93] The Alberta Court of Appeal has taken the position that notional severance is confined to the context of usurious lending.[94] The British Columbia Court of Appeal, however, has held that notional severance can be applied in cases of covenants in restraint of trade to confine them to reasonable duration and scope.[95] In this respect, the common law on covenants in restraint of trade in British Columbia has finally moved in the direction recommended nearly 25 years ago by the Law Reform Commission.[96]

90. *Supra*, note 85.

91. *Supra*, note 75 at 573.

92. *Supra*, note 84 at para. 40.

93. *Supra*, note 85.

94. *Globex Foreign Exchange Corporation v. Kelcher* (2005), 262 D.L.R. (4th) 752 (Alta. C.A.).

95. *KRG Insurance Brokers (Western) Inc. v. Shafron* (2007), 64 B.C.L.R. (4th) 125 (C.A.), leave to appeal granted 6 March 2008, no. 31981 (S.C.C.); *ACS Public Sector Solutions Inc. v. Arntsen* (2005), 262 D.L.R. (4th) 512 at paras. 58-59 (B.C.C.A.) (*obiter*).

96. See Law Reform Commission of British Columbia, *Report on Covenants in Restraint of Trade* (LRC

G. Where Are We Now?

In British Columbia, as in the rest of common law Canada, the current law as distilled from the recent authorities appears to be that a contract or non-contractual transaction that does not comply with public policy may be, but is not necessarily, unenforceable. This is an important difference from the classical model of contractual illegality, which prescribed unenforceability (or in other words, judicial non-intervention) as the automatic consequence of illegality unless an exception applied. The exceptions recognized by the classical model still exist, namely:

(a) the parties are not equally at fault (*in pari delicto*), and it is the party less at fault who is seeking relief;

(b) the party seeking relief resiled from the contract before it is substantially completed (*locus poenitentiae*);

(c) the party seeking relief is able to make out a claim without having to plead the illegal contract;

(d) the plaintiff is a member of the class the statute is intended to protect.

Where the classically recognized exceptions do not apply, a range of outcomes is possible, at least in regard to statutory illegality. These include unenforceability as a result of the court refusing relief. The court retains the power to refuse relief to parties whose contractual arrangements fail to comply with a statute. In contrast to the way the law formerly stood, however, that power is now to be exercised on "a principled and not arbitrary basis."[97]

The outcome in a particular case of statutory illegality depends on an analysis of the purpose of the statutory provisions in question, and whether their purpose would be defeated by giving the relief sought. Relief may be denied if the party seeking it intentionally contracted in order to further an illegal purpose. The consequences for the parties of a refusal to grant relief should be weighed. Where denial of relief would result in loss amounting to a penalty for one or both parties disproportionate to the seriousness of the breach, this weighs heavily in the balance in favour of granting a remedy.

If the court, in weighing these criteria, finds that the utility of granting relief out-

74, Vancouver: The Commission, 1984) at 56 and 72.

97. *Still v. M.N.R.*, *supra*, note 75 at 575.

weighs the utility of denying it, the court may order restitution of property or benefits transferred under the illegal contract.[98] In some instances, the court has awarded the equivalent of the benefit the party seeking relief would have obtained under the contract, had there been no illegality.[99] As another alternative, if the prerequisites for severance of illegal terms are met, the court may sever them and enforce the rest. In British Columbia, notional severance may be applied in relation to covenants in restraint of trade.

In the specific context of loans that violate section 347 of the *Criminal Code*,[100] the four-part test in *New Solutions* will be applied to determine if the entire loan arrangement should be treated as unenforceable or enforced in part. The "spectrum of remedies" available to the court runs from denying relief altogether, even to the extent of refusing to give the lender judgment for the principal amount in abusive cases of deliberate loansharking, to conventional "blue-pencil" severance, to notional severance.

H. Where Do We Go?

While the classical model of illegality emphasized deterrence, denunciation and maintenance of standards of public policy at the cost of countenancing windfalls and other forms of injustice, the emphasis in recent case law has been on remediation and restoration of the parties to their starting point insofar as it is possible when a contract founders on the rocks of illegality. Courts are now prepared to weigh the social utility of preventing injustice with that of upholding some aspect of public policy. The jurisdiction remains to uphold public policy by denying relief of any kind to parties who have consciously defied the law or acted otherwise in bad faith.

The case law is still characterized by excessive technicality and inconsistency, however. Courts have only begun to delineate the extent of remedial powers that may be available to them. Incremental reform by the process of the common law may take decades before the boundaries of the jurisdiction said to exist in *Still* and *New Solutions* are mapped out. It is over 40 years since Canadian judges first began to chip away at the rigidity of the common law principles of contractual illegality, yet the landscape is still only partly charted. Legislative reform along the lines originally recommended by the Law Reform Commission of British Columbia was intended to give clear discretionary powers to the courts, enabling them to cut through the technicalities and inconsistencies of the doctrine of illegality and craft pragmatic solu-

98. *Berne Development Ltd. v. Haviland* (1983), 40 O.R. (2d) 238 (H.C.).

99. *Lotusland Estates Ltd. v. Ali*; *Johnson v. Lazzarino*, *supra*, note 83.

100. *Supra*, note 85.

tions to prevent unjust or unreasonable outcomes.

The UICA is largely based on the earlier recommendations for legislative reform, and also reflects later developments in Canadian case law. It is appropriate now to examine it in detail.

III. THE *UNIFORM ILLEGAL CONTRACTS ACT*

A. Genesis of the UICA

The impetus for the UICA came from work carried out by the Uniform Law Conference of Canada on section 347 of the *Criminal Code.*[101] Among the recommendations in a report to the 2002 meeting of the ULCC was that the civil consequences of a finding that a stipulated interest rate contravened setion 347 should be ameliorated to prevent unjustified windfalls to borrowers, except in cases where a criminal prosecution takes place.[102]

The research done for the ULCC on section 347 raised broader issues regarding when a contract should be treated as illegal and what the consequences of such a finding should be. In 2003 the ULCC received a broader study on contractual illegality in common law Canada. This study (written before the decision by the Supreme Court of Canada in *New Solutions*[103]) concluded that the Law Reform Commission of British Columbia had been right in thinking that judicial reform would be too slow and uncertain to lead to satisfactory rationalization of the doctrine of illegality, and that the area was not appreciably more settled than it had been in 1983. The study advocated statutory reform along lines similar to those recommended by the Law Reform Commission. It also raised the possibility of bringing contracts void or unenforceable for reasons other than illegality, such as lack of capacity of a party, or lack of written form, into the scope of the legislation.[104]

In 2003, the ULCC decided to prepare uniform legislation that would take into account nullity of contracts under Quebec civil law in addition to common law illegality. [105] The UICA resulted, and was approved in its present form at the 2004 annual meeting of the ULCC.[106]

---

101. *Supra*, note 85.

102. Waldron, "Section 347 of the *Criminal Code*: A Deeply Problematic Law" in Uniform Law Conference of Canada, *Proceedings of the Eighty-fourth Annual Meeting* (Ottawa: The Conference, 2002) 251 at 273.

103. *Supra*, note 85.

104. Waldron, "Remedies in Case of Illegality: Twenty Years and Where Are We?" (2003), online: Uniform Law Conference of Canada, http://www.ulcc.ca/en/poam2/Illegal_Contracts_En.pdf as of 20 August 2008.

105. Uniform Law Conference of Canada, *Proceedings of the Eighty-fifth Annual Meeting* (Ottawa: The Conference, 2003) 63.

106. Uniform Law Conference of Canada, *Proceedings of the Eighty-sixth Annual Meeting* (Ottawa: The Conference, 2004) 75 and 619.

The UICA provides a framework of discretionary remedial powers. It does not attempt to restate the principles of contractual illegality. Instead, the common law principles of illegality are embedded as unstated assumptions in the definitions of "illegal contract" and "defect," discussed below.

The UICA owes much to the draft reform legislation in the 1983 report of the Law Reform Commission of British Columbia[107] and Part 3 of the proposed *Contract Law Reform Act* in the Institute's report of 1998,[108] but it is a distinct reform effort, reflecting an attempt to develop a remedial statute acceptable to both the common and civil law traditions and adaptable for enactment in any province or territory of Canada.

B. Overview of the UICA

1. Application of the UICA

(a) General

The UICA has a very broad scope, applying not only to contracts in the true sense, but to trusts and any kind of agreement, transaction, or arrangement that may be tainted with illegality. This is keeping both with its remedial purpose and the fact that the general rule of illegality described at the beginning of the preceding chapter applies to all types of transactions and not only true contracts. The broad application flows primarily from the compendious extended definition of "contract" in section 1, which serves as drafting shorthand to avoid repetitious wording:

> "contract" includes
>
> (a) an agreement, a trust, a transaction and an arrangement,
>
> (b) any provision of an agreement, a trust, a transaction or an arrangement, including a provision transferring or otherwise disposing of property, and
>
> (c) if the context requires, the instrument recording the contract; ("contrat")

Paragraph (b) of the definition of "contract" facilitates severance and the exercise of remedial powers under the Act with reference to individual terms that give rise to illegality, leaving the remaining terms unaffected. Section 3(1)(b) of the UICA nevertheless makes the Act applicable to the entirety of an agreement.

107. *Supra*, note 3, Appendix E.

108. *Supra*, note 6.

The UICA applies regardless of when a contract was made.[109] Cases in which legal proceedings involving an allegation that a contract is null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective have been commenced before the effective date of the Act are exceptions.[110] The Act does not apply to these. It is not intended to alter the outcomes of proceedings in which the parties have based their claims and defences on the state of the law at the time the proceedings began.

A number of other exclusions from the scope of the UICA are intended to be optional for enacting jurisdictions to include or not, depending on whether other relevant laws exist in those jurisdictions.

2. SECTION 1 - DEFINITIONS

(a) "Contract"

The definition of "contract" and its significance is mentioned in the preceding section of this report.

(b) "court"

> "court" includes a tribunal, and an arbitrator, acting within its proper jurisdiction; ("tribunal")

"Court" is defined so as to remove any doubt as to the jurisdiction of administrative tribunals and arbitrators to apply the UICA in matters coming before them.

(c) "defect"

> "defect", in relation to a contract, means whichever of the following results in the contract becoming an illegal contract:
>
> (a) the formation, existence or performance of the contract does not comply with or is contrary to an enactment;
>
> (b) by virtue of a rule of equity or common law, the contract is contrary to public policy;
>
> (c) a party to the contract lacked status, capacity or power to enter into the contract;
>
> (d) the operation of an enactment, or of a rule of equity or common law, affects the enforceability of the contract other than in the manner contemplated by paragraph (a) or (b); ("vice")

109. Section 3(1)(a).

110. Section 3(2).

This is a key definition describing the grounds that are capable of rendering a contract unenforceable for illegality or lack of formality, or void for lack of capacity, status or authority of a party. Both kinds of illegality, statutory and contravention of public policy at common law, are covered in paragraphs (a) and (b), respectively, of the definition.

The definition of "defect" is linked with the definition of "illegal contract" (discussed below) in a circular manner. The circularity could be eliminated by deleting the words "whichever of the following results in the contract becoming an illegal contract" after "means" in the main clause of the definition and replacing them with the words "one or more of the following". This would still allow the definitions of "defect" and "illegal contract" to operate together. The basis for them to come into play would be a finding that a given contract has one of the attributes listed in the definition of "illegal contract" (i.e., nullity, voidness, voidableness, illegality, unlawfulness, invalidity, unenforceability) or is otherwise ineffective for a reason included in the definition of "defect."

(d) "enactment"

> "enactment" means any primary or subordinate legislation passed by the legislative or executive branch of any level of government in Canada, including any legislation passed by any minister or other official of such a government that is passed in accordance with that persons' authority;

This definition extends to Acts, regulations, and probably also municipal bylaws because of the reference to passage by "any level of government in Canada."

The definition would not cover foreign legislation forming part of the proper law governing a contract with foreign elements or some aspect of it, such as its performance. It is conceivable that relief might be sought in British Columbia under such a contract. If the illegality tainting the contract is a breach of foreign legislation, this would not be a "defect" under the UICA and hence the Act would not apply even in cases where conflict of laws principles would allow a British Columbia court to resort to it in order to provide a remedy. This might be disadvantageous to the parties. To facilitate application of the UICA when the illegality stems from a breach of foreign legislation, the words "or passed by the competent authority in another country, the law of which governs a contract or its performance" could be added to the definition, and the definition divided into two parts for clarity. The definition would then read as follows:

> "enactment" means any primary or subordinate legislation passed by

(a) the legislative or executive branch of any level of government in Canada, including any legislation passed by any minister or other official of such a government that is passed in accordance with that persons' authority, or

(b) the competent authority in another country, the law of which governs a contract or its performance;

(e) "illegal contract"

"illegal contract" means a contract that is null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective as a result of a defect; ("illégal")

The UICA definition of "illegal contract" extends not only to contracts illegal as being contrary to public policy, but also void and voidable contracts and those unenforceable for such reasons as lack of written form.[111] It does so in order to benefit the parties to them in giving access to the remedial scheme of the Act, but the inclusion of different classes of unenforceable or ineffective contracts under a term associated with one class is confusing. This confusion was not present in Part 3 of the *Contract Law Reform Act* or the earlier reform legislation recommended by the Law Reform Commission of British Columbia, because it covered only illegal contracts. For this reason, as well as the reasons mentioned in Chapter I, the Institute favours substituting the term "legally defective contract" in place of "illegal contract" in a version of the UICA enacted in British Columbia. The rest of the definition would remain unchanged.

(e) "performance"

"performance" includes intended performance; ("exécution")

A contract may not have been performed at the time it is challenged for illegality. A contract that the parties, or one or more of them, intend to be performed in an illegal manner is still an illegal contract and attracts the consequences that flow from that characterization, even though its terms might otherwise be unobjectionable and it could be performed in a legal manner.[112] To ensure that contracts in which illegal

111. Certain of these contracts, such as those that would be unenforceable for lack of writing under s. 59 of the *Law and Equity Act*, R.S.B.C. 1996, c. 253, could be excluded from the scope of the UICA by exceptions in s. 3(3) in order to avoid conflict or overlap with other remedial legislation in force.

112. *St. John Shipping Corporation v. Joseph Rank Ltd.*, *supra*, note 43 at 284; *Ashmore, Benson, Pease & Co., Ltd. v. A.V. Dawson Ltd.*, [1973] 1 W.L.R. 828. In both these cases, contracts of carriage were legally formed but illegally performed by overloading. In *St. John Shipping* the statutory prohibition in question did not go to the validity of the contract, and there would have been a windfall

performance is intended are brought under the UICA, the definition of "performance" must include intended performance.

(f) "property"

> "property" means an obligation, power, interest, right or thing, of any type, that is the subject matter of an illegal contract. ("bien")

This definition covers tangible and intangible rights, as well as physical things, that are the subject-matter of an "illegal contract."

3. SECTION 2 – THE BENEVOLENT RULE

Section 2 of the UICA reads:

> 2 Despite the definitions of "defect" and "illegal contract", the fact that the formation, existence or performance of a contract does not comply with or is contrary to an enactment, or that a contract does not comply with a formality required by an enactment, does not render the contract null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective unless that result is clearly required
>
> (a) by the enactment, or
> (b) in order to further the enactment's purpose.

Section 2 represents an attempt to codify the "benevolent rule" of interpretation enunciated in *St. John Shipping Corporation v. Joseph Rank Ltd.*[113] and discussed in Chapter II. A recitation of the benevolent rule in the UICA, expressed to be paramount to the definitions of paragraph (a) of the definition of "defect" and "illegal contract," is necessary to prevent those definitions from being interpreted as abrogating the benevolent rule and reverting to the earlier position that any non-compliance with a statute is sufficient to vitiate a contract, without a purposive analysis of the statute to determine if the object of the Act requires the invalidation of contracts.

It may be noted that section 2 contains two negative premises. First, it refers to the fact that a contract is not in compliance with or is contrary to an enactment. Second, it states that this fact does not render the contract null, void, voidable, etc. except in the cases referred to in paragraphs (a) and (b). Expressed in the negative, the sec-

---

to the shipper if the carrier's claim was dismissed. In *Ashmore*, however, both parties were aware of the illegal overloading and were therefore *in pari delicto*. The court declined to give assistance to the plaintiff shipper under these circumstances.

113. *Supra*, note 43.

ond premise has the appearance of going beyond the actual proposition expressed in *St. John Shipping* and asserting the reverse of the underlying general rule that a contract that is inconsistent with an applicable statute is not enforceable. This general rule is still a fundamental principle underpinning the law of contractual illegality, despite the remedial approaches developed by Canadian courts in recent decades and exemplified by *Still v. M.N.R.*[114] and *New Solutions*.[115] A court will not give effect directly to an agreement if it will lead to a result directly contrary to law or public policy. Under the modern approach, the court may instead relieve against the consequences of the unenforceability of the illegal contract in appropriate cases.

The "benevolent rule" confines the operation of the general rule in the context of statutory illegality to instances when an enactment actually prohibits the agreement expressly or impliedly, rather than simply prohibiting conduct. It requires close examination of the policy and object of the statute in question to determine if they can only be served by the invalidation of agreements. In recent Canadian case law, this examination forms part of the analysis a court must make whenever a contract is challenged on the basis of statutory illegality. The benevolent rule does not purport to displace or reverse the general rule, however.

Converting the second of the two negative premises in section 2 into a positive one would restate the benevolent rule in *St. John Shipping* more clearly. It would also reduce the possibility of confusion regarding the purpose of the UICA. Like the 1983 recommendations of the Law Reform Commission and Part 3 of the *Contract Law Reform Act* proposed by the Institute in 1998, the UICA is not intended to change the common law principles of contractual illegality, but to superimpose a statutory remedial scheme to permit restitution or other relief where appropriate and prevent the unjust results those principles are capable of producing.

Restating the second premise as a positive one also eliminates the need to expressly override the definitions of "defect" and "illegal contract" at the beginning of section 2.

A version of section 2 with the second negative premise converted into a positive one as suggested above, and with the proposed revised wording italicized for emphasis, might read as follows:

> 2 The fact that the formation, existence or performance of a contract does not comply with or is contrary to an enactment, or that a contract does not com-

114. *Supra*, note 75.

115. *Supra*, note 84.

ply with a formality required by an enactment, *renders the contract null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective only if* that result is clearly required

(a) by the enactment, or
(b) in order to further the enactment's purpose.

4. SECTION 3 – EXCLUSIONS FROM APPLICATION OF THE UICA

(a) Section 3(3) - General

Sections 3(1) and 3(2) were discussed earlier in this chapter under the heading "Application of the UICA." Section 3(3) is concerned with exclusion of certain classes of contracts from the scope of the Act. It reads as follows:

(3) Despite subsections (1) and (2) but subject to section 4(2), this Act does not apply to an illegal contract if

(a) the defect is that the formation, existence or performance of the contract does not comply with or is contrary to an enactment and the enactment expressly sets out the relief that may be granted in relation to such a contract,

[**the following are optional]**

[(b) the defect arises through the operation of [limitation statute of enacting province] or legal or equitable doctrines relating to delay,

(c) the defect is that the contract is not in writing or signed or witnessed as provided by an enactment,

(d) the defect is that the contract calls for the creation or vesting of a right and, under the contract, that creation or vesting will occur later than the time at or before which the creation or vesting must occur under an enactment or at common law,

(e) one or more parties to the contract are minors,

(f) the contract is avoided by frustration, or

(g) the defect is that the contract has not been filed or registered as required by an enactment.]

The UICA contemplates that there will be variances between enacting jurisdictions in relation to the matters they may bring under their versions of UICA, depending on what other remedial legislation is already present in each jurisdiction. Paragraphs (b) to (g) of section 3(3) are intended to be either left in or deleted, depending on the legal landscape of each enacting province or territory. The annotations to s. 3(3) state that enacting jurisdictions need to consider the interface between s. 3(3) and

their domestic legislation carefully.[116] Each exclusion listed in section 3(3) is therefore examined in turn here.

(b) Paragraph 3(3)(a) – Enactments Expressly Setting Out Relief

Section 3(3)(a) excludes a contract from the operation of the UICA where the enactment that the contract allegedly contravenes specifically sets out what relief is possible. Examples of such provisions exist in provincial legislation. Section 229 of the British Columbia *Business Corporations Act* [117] confers wide curative powers to deal with the consequences of a breach of the Act. Section 73.1 of the *Land Title Act*[118] provides that a lease of part of a parcel of land that contravenes Part 3 of the Act may be enforced between the original parties. Section 10 of the *Business Practices and Consumer Protection Act*[119] provides specific forms of relief to consumers from consumer transactions involving an unconscionable act or practice. An unconscionable act or practice is an offence under sections 9(1) and 189(1) of the Act if committed by a supplier in relation to a consumer transaction. Section 10(1) provides that the consumer transaction is not binding on the consumer, making it essentially voidable at the consumer's instance. Section 10(2) confers relatively wide powers to reopen and modify an unconscionable mortgage loan.[120]

Paragraph 3(3)(a) of the UICA is designed to prevent confusion as to which remedial scheme should apply in a given case. In keeping with the nature of a statute of general application, it allows the policy of remedial statutes addressing more specific contexts to prevail. The powers contained under the UICA may in some cases be more wide-ranging than the existing remedial provisions. If so, the choice of preserving a narrower remedy under the specific legislation or bringing a category of

116. See the full annotated version of the UICA in Appendix B.

117. S.B.C. 2002, c. 57.

118. *Supra*, note 37.

119. S.B.C. 2004, c. 2.

120. Relief would also be available in the case of unsconscionable consumer transactions apart from s. 10 of the *Business Practices and Consumer Protection Act* under the non-statutory equitable doctrine of unconscionability as it has been developed in case law: see *Harry v. Kreutziger* (1978), 9 B.C.L.R. 166 (C.A.); *Morrison v. Coast Finance Ltd.* (1965), 55 D.L.R. (2d) 710 (B.C.C.A.). Rescission of contracts and restitutionary orders are possible under the exercise of the court's equitable powers. The fact that an unconscionable consumer transaction is also an offence by the supplier under s. 189(1) of the Act likely does not cause the principles of illegality to displace the court's powers under the doctrine of unconscionability, as s. 7 states nothing in Division 2 (Unconscionable Acts or Practices) of the Act limits, restricts, or derogates from the court's jurisdiction. Division 2 contains the prohibition in s. 9(1) against unconscionable acts and practices in respect of a consumer transaction.

contract under the domestic version of the UICA is one for the legislature to make. Paragraph 3(3)(a) is an essential element of the UICA, and should be retained in a domestic version enacted in British Columbia.

(c) Paragraph 3(3)(b) – Limitation Statutes

Paragraph 3(3)(b) excludes unenforceability arising from the lapse of a limitation period or laches (a doctrine preventing enforcement of equitable rights after long delay). The paragraph may appear superfluous at first, as it is obvious that a limitation period should not be overcome by a general remedial Act. In fact, paragraph 3(3)(b) is not superfluous because if it were not present, paragraph (d) of the definition of "defect" would cover cases where a contract that is legal in all respects becomes unenforceable against a party in breach because of the expiration of a limitation period. The contract would then fit within the wording of the definition of "illegal contract" under the UICA. Paragraph 3(3)(b) is necessary to retain in a domestic version of the UICA to prevent the application of the UICA where it is not intended.

(d) Paragraph 3(3)(c) - Lack of Formality

In common law jurisdictions, requirements for written form have been imposed by enactments inspired by the English *Statute of Frauds*[121] as a prerequisite for enforceability of certain kinds of contracts, such as the sale of an interest in land. The doctrine of part performance evolved to relieve against unduly harsh operation of these formal requirements. Under this doctrine, relief could be had despite lack of writing if conduct consistent only with the existence of the contract was proven.

Paragraph 3(3)(c) is present because the ULCC chose to include contracts unenforceable for lack of formality in a common remedial scheme under the UICA with illegal contracts. It also recognized that some jurisdictions have modified their statute of frauds legislation by enacting a version of the doctrine of part performance, and so could dispense with that feature of the UICA. British Columbia is one of those jurisdictions. Section 59(3) of the *Law and Equity Act*[122] allows enforcement of an unwritten contract for the sale of land under certain circumstances, including payment or acceptance of a payment on account of a purchase price. Section 59(5) permits restitution of benefits conferred and payment of compensation for money spent in reliance on the contract, even if the contract is unenforceable.

Paragraph 3(3)(c) should therefore be retained in a domestic version of the UICA in order to avoid conflict or overlap with section 59 of the *Law and Equity Act*.

121. 29 Car. 2, c. 3.

122. R.S.B.C. 1996, c. 253.

(e) Paragraph 3(3)(d) – Remoteness of Vesting

Paragraph 3(3)(d) relates to the common law rules against remoteness of vesting, which render void terms in contracts and instruments that create contingent rights that may vest outside the perpetuity period. Under the so-called "modern rule against perpetuities," this is the duration of a life in being plus 21 years. British Columbia modified the application of the rule against perpetuities and related rules in the *Perpetuity Act*[123] to allow dispositions of property that contemplate remote vesting of interests, or the possibility of it, to be upheld in most cases likely to come forward. In particular, the *Perpetuity Act* extends the perpetuity period to 80 years from the creation of the interest, and provides that contingent interests capable of vesting beyond the perpetuity period are presumed valid until actual events establish that they cannot vest within it.[124]

With the benefit of the *Perpetuity Act*, further remedial legislation is likely unnecessary. Paragraph 3(3)(d) should therefore be retained in a domestic version of the UICA.

(f) Paragraph 3(3)(e) - Contracts by and with Minors

Contracts by and with minors are subject to a special regime under Part 3 of the *Infants Act*. While such contracts are unenforceable against a minor, both parties to the contract may obtain restitutionary relief under section 20 of the *Infants Act* to prevent unjustifiable windfalls and losses. Third parties who have been ordered to make restitution of property may also be compensated. Given these features of Part 3 of the *Infants Act*, the exclusion under paragraph 3(3)(e) of the UICA of contracts in which one or more parties are minors is appropriate.

(g) Paragraph 3(3)(f) – Frustrated Contracts

Paragraph 3(3)(f) excludes frustrated contracts from the UICA. Contracts are said to be frustrated when they become impossible to perform due to supervening events outside the control of the parties. Jurisdictions without frustrated contracts legislation might choose to delete this paragraph in implementing the UICA in order to make its remedial scheme available to restore the parties to a frustrated contract to their starting point. British Columbia has a *Frustrated Contract Act*[125] that allows for

123. R.S.B.C. 1996, c. 358.

124. *Ibid.*, ss. 7 and 9.

125. R.S.B.C. 1996, c. 166.

wide restitutionary relief. Paragraph 3(3)(f) should therefore remain in a domestic version of the UICA.

(h) Paragraph 3(3)(g) – Failure to File or Register a Contract

Examples exist in provincial legislation of requirements to file or register documents evidencing contracts or dispositions of property for regulatory purposes or, as under section 20(1) of the *Land Title Act*,[126] or section 7(7) of the *Manufactured Home Act*, [127] to make them effective against third parties. Section 23(2) of the *Manufactured Home Act*, for example, requires an agreement declaring a manufactured home to be part of the land on which it is situated to be in writing and to be filed in the manufactured home registry in order to have the effect intended.

Where a requirement for filing or registration is imposed, it is generally part of a regulatory scheme under the particular enactment, and the effects of non-compliance are usually specified. It is therefore appropriate to exclude contracts not in compliance with these requirements from the scope of the domestic version of the UICA to avoid interference with these separate regulatory regimes. Paragraph 3(3)(g) should be retained for this reason.

5. Section 4 – Claims for Relief

Section 4 contains important provisions regarding claims for relief under the UICA.

4 (1) Any party to an illegal contract may claim relief under section 5.

(2) Without limiting subsection (1) but subject to subsection (3), if an illegal contract purported to transfer an interest in property to a person, a person who acquires or who purports to have acquired some or all of that interest in property from

(a) the first mentioned person, or

(b) any other person whose right to transfer that interest depends on the first mentioned person having acquired the interest under the illegal contract,

may claim relief under section 5.

(3) Subsection (2) does not apply if

(a) the relief sought by the person claiming relief under subsection (2) is expressly, or by necessary implication, prohibited by an enactment other than this Act, or

126. R.S.B.C. 1996, c. 250.

127. S.B.C. 2003, c. 75.

(b) an enactment, other than this Act, expressly provides for the relief that may be granted in those circumstances to the person claiming relief.

Section 4(1) of the UICA permits any party to an illegal contract to seek relief, including a party who had knowledge of the illegality or who was solely or primarily responsible for it, to claim relief under section 5. This is a significant change from the classic common law position, which would not extend the right to claim relief by way of restitution or otherwise to a party at fault for the illegality. It is in keeping, however, with the remedial purpose of the Act and the manner in which the common law has evolved in Canada in the direction of allowing restitutionary relief to the parties to an illegal contract in a wider range of circumstances. Under section 6(b), however, the knowledge and intent of the parties are still relevant to the exercise of the discretion whether to grant or refuse relief.

Section 4(2) allows subsequent transferees of property that is transferred or purportedly transferred under an illegal contract to apply under the Act for relief. As the annotation to this subsection indicates, section 4(2) may fill in gaps where other legislation provides relief for immediate parties to a transaction, but not to third parties claiming through a party to the illegal contract.

The several references to an "interest in property" in section 4(2) create a tautology, because the definition of "property" in section 1 of the UICA includes an "interest" in a right or thing. The tautology would be eliminated by deleting the words words "interest in" preceding "property" in section 4(2) and referring simply to "property."

Section 4(3) allows other legislation to prevail over section 4(2) if it prohibits relief to a subsequent transferee or expressly provides for specific relief.

6. SECTION 5 – RELIEF

Section 5 is the key provision of the UICA setting out the court's remedial powers.

5 (1) A court may grant relief in relation to an illegal contract in one or more of the following ways:

(a) restitution;

(b) compensation;

(c) apportionment of a loss arising from the formation, existence or performance of the contract;

(d) damages from a party at fault;

(e) a declaration;

(f) an order vesting property in any person or directing a person to assign or transfer property to another person;

(g) if the court is satisfied that
  (i) the contract would be reasonable and lawful if
    (A) one or more provisions of the contract were deleted, or
    (B) the contract as a whole, or one or more of its provisions, were given limited effect only, and
  (ii) the deletion or limitation would not so alter the bargain between the parties that it would be unreasonable to give effect to the contract as modified,

an order that the contract be modified to effect the severance or limitation and that the contract, as modified, be performed in a lawful manner specified by the court;

(h) any other relief the court could have granted under common law or equity had the contract not been an illegal contract.

(2) The amount to which a person is entitled by way of restitution, compensation or apportionment under subsection (1) (a), (b) or (c) must be determined in accordance with the following:
  (a) the amount must not include loss of profits, and

  (b) the amount must be reduced by the fair market value of
    (i) any benefits that remain in the hands of the claimant, and
    (ii) any property that has been returned to the claimant within a reasonable time after the contract is challenged as being null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective, and

  (c) if and to the extent that the claim is for expenditures incurred in performing the contract, other than in performing an obligation under the contract to pay money, the amount must be limited to reasonable expenditures.

(3) A court making an order under this section may include, in that order, any terms and conditions it considers appropriate.

Section 5(1) lists the principal forms of relief that would be sought in order to restore the parties to their original position or obtain compensation for losses.

Section 5(1)(g) addresses severance of unenforceable terms. Sub-paragraph (A) contemplates traditional "blue-pencil" severance involving deletion of terms. Sub-paragraph (B) is intended to address the newer remedy of "notional severance" or reading down of offending terms to render the contract lawful.

Section 5(2) specifies how relief under section 5(1) is to be quantified. Loss of profits is excluded. This is in keeping with the UICA's objective of providing remedial machinery to restore the parties to their position before entering into the illegal ar-

rangement. It would be illogical to award loss of profits as if a claim under the UICA were the same as a claim for breach of a lawful contract that could have been lawfully performed.[128]

Section 5(3) authorizes the court to make relief conditional on the fulfillment of terms it sees fit to impose. In making a restitutionary order, fairness may require imposition of an obligation on the party claiming the relief to disgorge any benefit that party received under the illegal arrangement, or to compensate the other party for expenses or losses incurred as a result of having entered into the arrangement. If tangible property has been transferred under the illegal contract, an order for its return might be made conditional on the reclaiming owner having to compensate the party who previously held it for expenses incurred for its maintenance and preservation while it was in that party's possession.

7. Section 6 – Discretionary Factors

Section 6 sets out factors to guide the court in granting or withholding relief:

> 6 (1) In granting or refusing to grant relief under section 5, a court must consider the following:
>
> (a) the public interest;
>
> (b) the circumstances of the formation, existence or performance of the illegal contract, including the intent, knowledge, conduct and relationship of the parties;
>
> (c) whether a party to the illegal contract was, at a material time, acting under a mistake of fact or law;
>
> (d) the extent to which the illegal contract has been performed;
>
> (e) whether the contract was illegal from the time of its formation or whether the circumstances of its operation led to an illegal result;
>
> (f) if the defect arose out of an enactment, whether the enactment has been substantially complied with;
>
> (g) the consequences of refusing to grant relief;
>
> (h) any other factor the court considers relevant.
>
> (2) In granting or refusing to grant relief in respect of an illegal contract that was entered into before the coming into force of this Act, a court, in addition to the

128. The Law Reform Commission of British Columbia also recommended in its 1983 report that loss of profits be excluded from any apportionment of loss under illegal contracts legislation: *supra*, note 3 at 78-79 for this reason. See also s. 19(1)(c) of the *Contract Law Reform Act* proposed by the British Columbia Law Institute, *supra*, note 6 at 10.

factors set out in subsection (1), must consider whether or not:

(a) a party to the contract has so altered that party's position that granting relief would, in the circumstances, be inequitable,

(b) another proceeding has been commenced in respect of the contract, and

(c) a party to the contract has settled a claim in respect of the contract.

Sections 6(1) and (2) correspond fairly closely to provisions recommended by the Law Reform Commission of British Columbia in the 1983 report and the Institute in the *Contract Law Reform Act* proposed in 1998. They are consistent with the approach taken in *Still v. M.N.R.*[129] and *New Solutions*,[130] the two most influential Canadian decisions dealing with contractual illegality in recent years. The good faith of the parties, or lack of it, remains a significant factor under paragraphs (1)(b), (c) and (e). The relative seriousness of a breach of an enactment under paragraph (1)(f) may be taken into account.

Section 6(2) recognizes that by the time a claim for relief is presented under a contract formed before the effective date of the UICA, matters may have proceeded to a point at which it would be inequitable to interfere with the situation as it then stands. If property has been transferred, for example, the transferee may have incurred binding obligations to a third party, such as a purchaser or mortgagee, in relation to it. The court is then required to consider whether a party's position has been altered to the extent that an order aimed at untangling the relations between the original parties to the illegal contract would lead to greater difficulty and unfairness. Paragraphs (2)(a), (b) and (c) describe circumstances in which the better course may be not to interfere with settled expectations.

129. *Supra*, note 75.

130. *Supra*, note 82.

IV. CONCLUSION AND RECOMMENDATIONS

The UICA is in accord with the direction in which the common law of contractual illegality is evolving in Canada, but would bring a level of certainty that is not now present regarding the scope of the remedial jurisdiction to disentangle the wreckage of a contractual arrangement that is non-compliant with applicable law and arrive at a just and defensible solution. Its concentration on the provision of effective remedies, rather on questions of fault and intent, cuts through the morass of inconsistency and incoherence that characterizes the illegal contract cases. It leaves courts with sufficient discretion to prevent unjust enrichment and also to withhold relief in circumstances where the classical stance of non-intervention is warranted as a sanction and a deterrent.

With the minor modifications we recommend in this report, enactment of the UICA in British Columbia would be a significant step forward in simplifying and clarifying a confused and disorderly area of law. A version of the UICA incorporating the recommended modifications appears in Appendix B.

The Institute therefore makes the following recommendations:

1. The Uniform Illegal Contracts Act *should be enacted in British Columbia with the modifications described in Recommendation 2 .*

2. A version of the Uniform Illegal Contracts Act enacted in British Columbia should contain the following changes:

(a) the words "whichever of the following results in the contract becoming an illegal contract" should be deleted from the main clause of the definition of "defect" and replaced by the words "one or more of the following";

(b) the term "legally defective contract" should replace the term "illegal contract" wherever it appears;

(c) the definition of "enactment" should be amended to read:

> "enactment" means any primary or subordinate legislation passed by
>
> (a) the legislative or executive branch of any level of government in Canada, including any legislation passed by any minister or other official of such a government that is passed in accordance with that persons' authority, or

(b) the competent authority in another country, the law of which governs a contract or its performance;

(d) section 2 should be revised to read:

2 The fact that the formation, existence or performance of a contract does not comply with or is contrary to an enactment, or that a contract does not comply with a formality required by an enactment, renders the contract null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective only if that result is clearly required

(a) by the enactment, or
(b) in order to further the enactment's purpose.

(e) section 4(2) should be revised to read:

(2) Without limiting subsection (1) but subject to subsection (3), if a legally defective contract purported to transfer property to a person, a person who acquires or who purports to have acquired some or all of that property from

(a) the first mentioned person, or

(b) any other person whose right to transfer that property depends on the first mentioned person having acquired the property under the legally defective contract,

may claim relief under section 5.

APPENDIX A

Uniform Illegal Contracts Act

Interpretation

1 In this Act:

"contract" includes
(a) an agreement, a trust, a transaction and an arrangement,
(b) any provision of an agreement, a trust, a transaction or an arrangement, including a provision transferring or otherwise disposing of property, and
(c) if the context requires, the instrument recording the contract; ("contrat")

"court" includes a tribunal, and an arbitrator, acting within its proper jurisdiction;
("tribunal")

"defect", in relation to a contract, means whichever of the following results in the contract becoming an illegal contract:
(a) the formation, existence or performance of the contract does not comply with or is contrary to an enactment;
(b) by virtue of a rule of equity or common law, the contract is contrary to public policy;
(c) a party to the contract lacked status, capacity or power to enter into the contract;
(d) the operation of an enactment, or of a rule of equity or common law, affects the enforceability of the contract other than in the manner contemplated by paragraph (a) or (b); ("vice")

"enactment" means any primary or subordinate legislation passed by the legislative or executive branch of any level of government in Canada, including any legislation passed by any minister or other official of such a government that is passed in accordance with that persons' authority;
("texte")

"illegal contract" means a contract that is null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective as a result of a defect;

("illégal")

"performance" includes intended performance; ("exécution")

Comment: The key definitions in section 1 are "contract," "defect"and "illegal contract". These cast a wide net to bring within the Act as many kinds of transactions as possible that may be vitiated for one reason or another. The repetition of the various synonyms for the concept of the vitiation of a contract is deliberate in the definition of "illegal contract." The purpose is designed to track as many statutory formulations as possible and put beyond doubt the applicability of this Act where these words are used in another enactment. Section 2 adds a gloss to the definitions. Later in the Act, in section 3(3), certain kinds of illegal contracts are excluded from its operation.

The Québec Perspective: The approach that consists in defining a contract as including various legal instruments which are not contracts would not be consistent with civil law methodology. For the Act to be implemented in Québec, its substantive provisions, once redrafted in civilian form, should find their way into the *Civil Code* of Québec, within the existing provisions relating to the nullity of contracts (art. 1416 ff.). The result pursued by the definition of "contract" would then be achieved automatically, since the rules governing nullity of contracts may always be extended by analogy to other juridical acts, without its being necessary to provide an explicit definition to that effect.

The definitions of "defect" and "illegal contract" cover the full range of absolute or relative nullities in Québec law. There are two categories of rules which may bring about the absolute or relative nullity of a contract. The first are those which relate to the procedure of contract formation. The second are those which concern public order, either statutory or based on general moral or social imperatives recognized by the courts.

"property" means an obligation, power, interest, right or thing, of any type, that is the subject matter of an illegal contract. ("bien")

Comment: The term "property" is used in section 4(2). The concern it addresses is where property is purported to be transferred under an illegal contract and the property is then the subject of a further transfer to a person who is not a party to the contract. If this transferee's title is called into question the court can grant relief to the transferee.

Exception

2 Despite the definitions of "defect" and "illegal contract", the fact that the formation, existence or performance of a contract does not comply with or is contrary to an enactment, or that a contract does not comply with a formality required by an enactment, does not render the contract null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective unless that result is clearly required

(a) by the enactment, or

(b) in order to further the enactment's purpose.

Comment: Section 2 creates a benevolent rule of interpretation designed to ensure that contracts are not characterized as illegal owing to the violation of a feature of a statute that is not central to its operation.

The Québec Perspective: The benevolent rule of interpretation is recognised by Québec courts and legal scholars. A codification of the rule in the *Civil Code* of Québec would be desirable.

Application

3 (1) This Act applies to an illegal contract whether or not

(a) subject to subsection (2), the contract was entered into before or after the coming into force of this Act, or

(b) the defect is a provision of the contract and that provision is severable.

Comment: Subject to subsection (2), the Act applies retrospectively to existing contracts. The remedy of severance is provided in section 5(1)(g).

(2) This Act does not apply to an illegal contract that was entered into before the coming into force of this Act if, within a proceeding commenced before the coming into force of this Act, the contract is challenged as being null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective as a result of the defect.

Comment: The Act applies retrospectively to existing contracts except where the illegality is the subject of litigation at the time the Act comes into force.

(3) Despite subsections (1) and (2) but subject to section 4(2), this Act does not apply to an illegal contract if

(a) the defect is that the formation, existence or performance of the contract does not comply with or is contrary to an enactment and the enactment expressly sets out the relief that may be granted in relation to such a contract,

[the following are optional]

[(b) the defect arises through the operation of [limitation statute of enacting province] or legal or equitable doctrines relating to delay,

(c) the defect is that the contract is not in writing or signed or witnessed as provided by an enactment,

(d) the defect is that the contract calls for the creation or vesting of a right and, under the contract, that creation or vesting will occur later than the time at or before which the creation or vesting must occur under an enactment or at common law,

(e) one or more parties to the contract are minors,

(f) the contract is avoided by frustration, or

(g) the defect is that the contract has not been filed or registered as required by an enactment.]

Comment: Enacting jurisdictions will wish to consider very carefully the interface between an *Illegal Contract Act* and their existing statute-base. There may be certain contracts that should be excluded from the operation of the Act. A particular kind of contract may be excluded for one of two reasons.

First, an enactment may render a contract unenforceable for reasons that are central to the system of justice. Many jurisdictions might regard their statute of limitations as falling into this category.

A second reason for excluding certain kinds of contracts is that specialized enactments may provide relief from the consequences of illegality that are more finely-tuned to the body of law involved than a law of general application. For example, some provinces have replaced their old *Statute of Frauds* legislation with a more modern statement of the principle that incorporates a benevolent version of the equitable doctrine of part performance and allowing a party to rely on a change of position. Supervening illegality may cause a contract to be frustrated in which case the position of the parties are best dealt with under local frustrated contracts legislation (if it exists). Some provinces will have moved to modernize their laws in relation to minors' contracts while others will not.

Individual jurisdictions must decide the precise types of contracts to be listed in section 2(3). This decision will be informed by local policy and statutes. The only element in the list that should be retained in all cases is paragraph (a).

Claims for relief

4 (1) Any party to an illegal contract may claim relief under section 5.

(2) Without limiting subsection (1) but subject to subsection (3), if an illegal contract purported to transfer an interest in property to a person, a person who acquires or who purports to have acquired some or all of that interest in property from

(a) the first mentioned person, or

(b) any other person whose right to transfer that interest depends on the first mentioned person having acquired the interest under the illegal contract,

may claim relief under section 5.

(3) Subsection (2) does not apply if

(a) the relief sought by the person claiming relief under subsection (2) is expressly, or by necessary implication, prohibited by an enactment other than this Act, or

(b) an enactment, other than this Act, expressly provides for the relief that may be granted in those circumstances to the person claiming relief.

Comment: Even where specific legislation exists to define the legal position of, and provide relief in appropriate circumstances to, the parties to an illegal contract, that legislation may not address the question of relief for a non-party who has a claim to property passing under the contract. Section 4 permits enacting jurisdictions to fine-tune the applicability of the Act by filling that gap without doing violence to the legislative scheme for relief inter-partes.

The Québec Perspective: In the *Civil Code* of Québec, there already exist a number of provisions protecting both the true owner and a third party purchaser of property sold under an illegal contract (see art. 1454, 1455, 1701, 1707, 1713-1715).

Relief

5 (1) A court may grant relief in relation to an illegal contract in one or more of the following ways:

(a) restitution;

(b) compensation;

(c) apportionment of a loss arising from the formation, existence or performance of the contract;

(d) damages from a party at fault;

(e) a declaration;

(f) an order vesting property in any person or directing a person to assign or transfer property to another person;

(g) if the court is satisfied that

(i) the contract would be reasonable and lawful if

(A) one or more provisions of the contract were deleted, or

(B) the contract as a whole, or one or more of its provisions,

were given limited effect only, and

(ii) the deletion or limitation would not so alter the bargain between the parties that it would be unreasonable to give effect to the contract as modified,

an order that the contract be modified to effect the severance or limitation and that the contract, as modified, be performed in a lawful manner specified by the court;

(h) any other relief the court could have granted under common law or equity had the contract not been an illegal contract.

Comment: Section 5(1) sets out a list of remedies that may be granted by the court when relief is sought from the consequences of an illegal contract. It gives the court a flexible set of tools necessary to fashion an outcome that will do justice between the parties.

Paragraphs (a), (b) and (c) parallel the remedies available under the *Uniform Frustrated Contracts Act*. A claim for damages under paragraph (d) will not arise often, but the kind of circumstances where damages might be properly claimed is where the validity of a contract hinges on getting the approval of a particular authority, and one of the parties is obliged by the terms of the contract to obtain it. If that party willfully or negligently fails to do so and damages would seem to be appropriate.

Paragraph (g) empowers the court to to sever portions of an illegal contract and notional severance of the kind endorsed in the *New Solutions* case is expressly covered.

Paragraph (h) is intended to act as a backstop to the other remedies and does not constitute an invitation to the courts simply to enforce an illegal contract. Given the breadth of the other remedies, it is not likely to be invoked often. The kind of situation where it might be invoked is where restitution is made of a parcel of land and the conduct of the adverse party suggests that an injunction enjoining trespass on the parcel is necessary for the protection of the successful party. Paragraph (h) would allow the injunction to be joined with the other relief.

The Québec Perspective: In the *Civil Code* of Québec as in paragraphs (a) and (b), taking into account section 5(2), the general rule is that the court must order restitution as between the parties to an illegal contract (art. 1422). Where restitution in kind has become impossible or is liable to affect third parties, the court must order restitution by monetary equivalence (art. 1700). For instance, if a service is performed under an illegal contract, the court will order restitution by equivalence, to the extent necessary to prevent unjust enrichment. Property purchased under an illegal contract may also be restituted by equivalence, where a third party has acquired rights in such property. The apportionment of losses incurred in relation to property or otherwise is governed by articles 1701 to 1706 of the *Civil Code*.

In the civil law as in paragraph (d), a party may obtain compensation by way of damages where wrongful conduct by the other party has caused him or her to suffer a loss, including a loss of profits (art. 1457, 1611).

As in paragraph (g), the *Civil Code* of Québec provides that an illegal clause may be deleted and the remainder of the contract upheld in appropriate cases (art. 1438). Notional severance, as set out in paragraph (g)(i)(B), is presently available in certain cases only, such as adhesion and consumer contracts (art. 1437). An even broader power to vary the terms of the contract is conferred upon the courts in the case of money loans (art. 2332). The adoption of notional severance as a general remedy would be desirable.

(2) The amount to which a person is entitled by way of restitution, compensation or apportionment under subsection (1) (a), (b) or (c) must be determined in accordance with the following:

(a) the amount must not include loss of profits, and

(b) the amount must be reduced by the fair market value of

(i) any benefits that remain in the hands of the claimant, and

(ii) any property that has been returned to the claimant within a reasonable time after the contract is challenged as being null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective, and

(c) if and to the extent that the claim is for expenditures incurred in performing the contract, other than in performing an obligation under the contract to pay money, the amount must be limited to reasonable expenditures.

Comment: Section 5(2) provides guidance as to the way that restitutionary relief is to be assessed. It embodies the same policy as sections 7 and 8 of the *Uniform Frustrated Contracts Act*.

(3) A court making an order under this section may include, in that order, any terms and conditions it considers appropriate.

Discretionary Factors

6 (1) In granting or refusing to grant relief under section 5, a court must consider the following:

(a) the public interest;

(b) the circumstances of the formation, existence or performance of the illegal contract, including the intent, knowledge, conduct and relationship of the parties;

(c) whether a party to the illegal contract was, at a material time, acting under a mistake of fact or law;

(d) the extent to which the illegal contract has been performed;

(e) whether the contract was illegal from the time of its formation or whether the circumstances of its operation led to an illegal result;

(f) if the defect arose out of an enactment, whether the enactment has been substantially complied with;

(g) the consequences of refusing to grant relief;

(h) any other factor the court considers relevant.

(2) In granting or refusing to grant relief in respect of an illegal contract that was entered into before the coming into force of this Act, a court, in addition to the factors set out in subsection (1), must consider whether or not:

(a) a party to the contract has so altered that party's position that granting relief would, in the circumstances, be inequitable,

(b) another proceeding has been commenced in respect of the contract, and

(c) a party to the contract has settled a claim in respect of the contract.

Comment: Section 6 sets out the factors to be considered by the court in granting or withholding relief. Additional factors may come into play if the contract predates the Act. These are set out in subsection (2).

The Québec Perspective: In civil law jurisdictions, while restitution is the general rule, a court may refuse to order restitution in favour of a party who has acted fraudulently, immorally or by deliberately breaching the law. The factors underlying this exception to the general rule are identified at paragraphs (b) and (c). A codification of the exception in the *Civil Code* of Québec would be desirable.

In the *Civil Code* of Québec, a distinction is made between rules of public order which exist to protect a contracting party and rules of public order which exist in the interests of society as a whole (art. 1417, 1419). In the first instance, violation of the rule entails a relative nullity: only the party protected by the rule may have the contract annulled; he or she may also opt to affirm the contract (art. 1420). In the second instance, violation of the rule entails an absolute nullity: any person with sufficient legal interest may have the contract annulled (art. 1418).

———————

APPENDIX B

Version of *Uniform Illegal Contracts Act* Recommended for British Columbia

(Italics indicate modifications recommended in this report)

Interpretation

1 In this Act:

"contract" includes
(a) an agreement, a trust, a transaction and an arrangement,
(b) any provision of an agreement, a trust, a transaction or an arrangement, including a provision transferring or otherwise disposing of property, and
(c) if the context requires, the instrument recording the contract;

"court" includes a tribunal, and an arbitrator, acting within its proper jurisdiction;

"defect", in relation to a contract, *means one or more of the following:*
(a) the formation, existence or performance of the contract does not comply with or is contrary to an enactment;
(b) by virtue of a rule of equity or common law, the contract is contrary to public policy;
(c) a party to the contract lacked status, capacity or power to enter into the contract;
(d) the operation of an enactment, or of a rule of equity or common law, affects the enforceability of the contract other than in the manner contemplated by paragraph (a) or (b);

"enactment" means any primary or subordinate legislation passed by

(a) the legislative or executive branch of any level of government in Canada, including any legislation passed by any minister or other official of such a government that is passed in accordance with that person's authority*, or*

(b) the competent authority in another country, the law of which governs a contract or its performance;

"*legally defective contract*" means a contract that is null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective as a result of a defect;

"performance" includes intended performance;

Exception

2 The fact that the formation, existence or performance of a contract does not comply with or is contrary to an enactment, or that a contract does not comply with a formality required by an enactment, *renders* the contract null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective *only if* that result is clearly required

(a) by the enactment, or

(b) in order to further the enactment's purpose.

Application

3 (1) This Act applies to a *legally defective contract* whether or not

(a) subject to subsection (2), the contract was entered into before or after the coming into force of this Act, or

(b) the defect is a provision of the contract and that provision is severable.

(2) This Act does not apply to a *legally defective contract* that was entered into before the coming into force of this Act if, within a proceeding commenced before the coming into force of this Act, the contract is challenged as being null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective as a result of the defect.

(3) Despite subsections (1) and (2) but subject to section 4(2), this Act does not apply to a *legally defective contract* if

(a) the defect is that the formation, existence or performance of the contract does not comply with or is contrary to an enactment and the enactment expressly sets out the relief that may be granted in relation to such a contract,

(b) the defect arises through the operation of the *Limitation Act* or legal or equitable doctrines relating to delay,

(c) the defect is that the contract is not in writing or signed or witnessed

as provided by an enactment,

(d) the defect is that the contract calls for the creation or vesting of a right and, under the contract, that creation or vesting will occur later than the time at or before which the creation or vesting must occur under an enactment or at common law,

(e) one or more parties to the contract are minors,

(f) the contract is avoided by frustration, or

(g) the defect is that the contract has not been filed or registered as required by an enactment.

Claims for relief

4 (1) Any party to a *legally defective contract* may claim relief under section 5.

(2) Without limiting subsection (1) but subject to subsection (3), if a *legally defective contract* purported to *transfer property* to a person, a person who acquires or who purports to have acquired some or all of *that property* from

(a) the first mentioned person, or

(b) any other person whose right to transfer that *property* depends on the first mentioned person having acquired the *property* under the *legally defective contract*,

may claim relief under section 5.

(3) Subsection (2) does not apply if

(a) the relief sought by the person claiming relief under subsection (2) is expressly, or by necessary implication, prohibited by an enactment other than this Act, or

(b) an enactment, other than this Act, expressly provides for the relief that may be granted in those circumstances to the person claiming relief.

Relief

5 (1) A court may grant relief in relation to a *legally defective contract* in one or more of the following ways:

(a) restitution;

(b) compensation;

(c) apportionment of a loss arising from the formation, existence or performance of the contract;

(d) damages from a party at fault;

(e) a declaration;

(f) an order vesting property in any person or directing a person to assign or transfer property to another person;

(g) if the court is satisfied that

(i) the contract would be reasonable and lawful if

(A) one or more provisions of the contract were deleted, or

(B) the contract as a whole, or one or more of its provisions, were given limited effect only, and

(ii) the deletion or limitation would not so alter the bargain between the parties that it would be unreasonable to give effect to the contract as modified,

an order that the contract be modified to effect the severance or limitation and that the contract, as modified, be performed in a lawful manner specified by the court;

(h) any other relief the court could have granted under common law or equity had the contract not been a *legally defective contract*.

(2) The amount to which a person is entitled by way of restitution, compensation or apportionment under subsection (1) (a), (b) or (c) must be determined in accordance with the following:

(a) the amount must not include loss of profits, and

(b) the amount must be reduced by the fair market value of

(i) any benefits that remain in the hands of the claimant, and

(ii) any property that has been returned to the claimant within a reasonable time after the contract is challenged as being null, void, voidable, illegal, unlawful, invalid, unenforceable or otherwise ineffective, and

(c) if and to the extent that the claim is for expenditures incurred in performing the contract, other than in performing an obligation under the contract to pay money, the amount must be limited to reasonable expenditures.

(3) A court making an order under this section may include, in that order, any terms and conditions it considers appropriate.

Discretionary Factors

6 (1) In granting or refusing to grant relief under section 5, a court must consider the following:

(a) the public interest;

(b) the circumstances of the formation, existence or performance of the *legally defective contract*, including the intent, knowledge, conduct and relationship of the parties;

(c) whether a party to the *legally defective contract* was, at a material time, acting under a mistake of fact or law;

(d) the extent to which the *legally defective contract* has been performed;

(e) whether the contract was *legally defective* from the time of its formation or whether the circumstances of its operation led to a *legally defective* result;

(f) if the defect arose out of an enactment, whether the enactment has been substantially complied with;

(g) the consequences of refusing to grant relief;

(h) any other factor the court considers relevant.

(2) In granting or refusing to grant relief in respect of a *legally defective contract* that was entered into before the coming into force of this Act, a court, in addition to the factors set out in subsection (1), must consider whether or not:

(a) a party to the contract has so altered that party's position that granting relief would, in the circumstances, be inequitable,

(b) another proceeding has been commenced in respect of the contract, and

(c) a party to the contract has settled a claim in respect of the contract.

———————

PRINCIPAL FUNDERS IN 2007

The British Columbia Law Institute expresses its thanks to its principal funders in the past year:

- The Law Foundation of British Columbia
- Ministry of the Attorney General
- Notary Foundation
- British Columbia Real Estate Foundation
- Real Estate Foundation

The Institute also reiterates its thanks to all those individuals and firms who have provided financial support for its present and past activities.