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Backgrounder

LRC 69—Report on Illegal Transactions

Date: November 1983

This report examines the common law governing the rights of parties to illegal transactions. “Transactions” is deliberately used, as it covers both contractual and non-contractual arrangements. The word “illegal” is often confusing in this context. It does not refer to criminal conduct. Rather, it is much broader in scope, embracing any breach of a provision of a law.

The rules governing illegal transactions are centuries old. They were formulated at a time when regulation by legislation was much less common. The report concentrates on the manner in which courts deal with illegality, focusing on the approach taken by the courts to four main issues that they must consider when the defence of illegality is raised in an action.

Before undertaking this examination, a brief chapter is devoted to explaining to the reader what is meant by “the general rule” governing illegal transactions, as this is a term that crops up frequently in the report. The case law indicates that the general rule has two heads. First, the courts will neither enforce an illegal contract nor grant a remedy for its breach. Second, a court will not, except in exceptional circumstances, intervene to assist a party to an illegal transaction, even when they seek to resile from the transaction. The general rule is equally applicable to non-contractual type cases.

The report then looks at the first issue faced by a court when illegality is pleaded: balancing the public policy allegedly infringed with the general policy of the law favouring freedom of action. To determine whether a transaction is contrary to public policy, the courts refer to four sources: domestic statutes, foreign law if relevant by British Columbia choice of law rules, the positive rules of the common law, and the judge’s own perception of the legal and moral values of our society. Each of these sources is examined individually.

Chapter four discusses the question of whether a transaction does in fact violate the statute or otherwise infringe public policy. This is the second main issue that the court has to consider. Often the answer will be clear but sometimes cases arise where the issues are not so clear. For example, transactions arise which are not illegal *per se* but which are tainted by

or connected with illegality. These types of cases and other less straightforward situations are examined in more detail.

The third issue that has to be addressed by the courts is whether the case falls within one of the exceptions to the general rule. Some of the exceptions vindicate certain policies of the law while others are purely technical devices used by the courts to evade the harsh results that would flow from applying the general rule. The following exceptions are considered: (1) The *pari delicto* rule which provides that the parties must be roughly in the same position. Fraud, duress, oppression at the hands of the defendant, and abuses of fiduciary position constitute the most obvious examples of factors that will lead a court to conclude that the parties to an illegal contract are not *pari delicto*; (2) Where a statute invalidates a transaction to protect a certain class of individuals and to decline to grant relief to the protected class would render the statute nugatory; (3) The plaintiff does not need to rely on the illegal transaction. Essentially the exception can be invoked provided an action can be framed in such a way that the illegal contract is not relied upon; (4) Where a court is able to sever that part of the contract which is illegal and enforce the balance of the contract terms.

The final issue that a court will need to address when faced with an illegal contract is the effect of the illegality. Aside from the general prohibition against judicial intervention are questions of property and title. Who owns a motor vehicle sold pursuant to an illegal contract when the purchase price has been paid? Can a third party acquire good title? These questions are complicated by the intervention of statute. Chapter six considers these issues and examines in greater detail the effect of characterizing a contract as illegal.

The report then turns to consider the need for reform. As a first step, an evaluation of the policy grounds advanced in support of the general rule is provided. These are, that the courts should not assist in enforcing the illegal contract, the general rule acts as a form of punishment for wrongdoers, it acts as a form of deterrence, and a plaintiff who has “polluted hands” is unfit to be heard in court. Notwithstanding these policy arguments, the commission concludes that there is a need for reform and cites two principal reasons. First, the current law leads to unjust enrichment. Second, the law has become increasingly technical and uncertain as courts have striven to refine it by creating exceptions, inventing technical distinctions, and employing creative statutory interpretation. In assessing the options for reform, reference is made to the work of other law reform agencies and a conclusion reached that a scheme that vests in courts a discretion to depart from the strictures of the general rule when necessary in the interests of justice is the most appropriate vehicle.

Chapter eight defines the manner in which the judicial discretion recommended should be applied. This is achieved by identifying a number of key questions concerning a power to modify the consequences in law flowing from the application of the general rule. The questions address such issues as the relationship between the judicial power to grant relief and the present law, the type of transactions that should be covered by the discretion, the effect of illegality, and whether the power should be applied retrospectively.

The final chapter of the report contains a list of all of the recommendations made by the commission. A draft *Illegal Transaction Act* is set out in an appendix to the report.

Further Developments

The recommendations have not been implemented.

The subject has been revisited in BCLI Report No. 52 on Relief Under Legally Defective Contracts. This report deals with implementation of the *Uniform Illegal Contracts Act* in British Columbia (UICA). The UICA was promulgated by the Uniform Law Conference of Canada in 2004.