Chapter 10
Contracts rendered void by statute

SUMMARY

Of the various contracts rendered void by statute, there are only two which seem to require discussion in a general book upon contract. These are, firstly, wagering contracts and, secondly, agreements prohibited by competition law.

A WAGERING CONTRACTS

1 THE DEFINITION OF A WAGERING CONTRACT

The primary meaning of 'wagering' is staking something of value upon the result of some future uncertain event, such as a horse race, or upon the ascertainment of the truth concerning some past or present event, such as the population of London, with regard to which the wagering parties express opposite views. In *Carlill v Carbolic Smoke Ball Co*,[1] Hawkins J gave the following definition of a wagering contract which later received the unqualified approval of the Court of Appeal:[2]

> A wagering contract is one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent upon the determination of that event, one shall win from the other, and that other shall pay or hand over to him, a sum of money or other stake: neither of the contracting parties having any other interest in that contract than the sum or stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties.[3]

There are several aspects of this definition which require to be considered.

1 [1892] 2 QB 484.
2 *Ellesmere v Wallace* [1929] 2 Ch 1 at 24, 36, 48-49.
3 [1892] 2 QB 484 at 490-91.

in the first place, its limitation to a future uncertain event is incorrect, for a wager is none the less a wager though it concerns a past or present fact or event.

Secondly, an essential feature of a wagering contract is that one party is to win and the other to lose upon the determination of the event.[4] Each party must stand either to win or lose under the terms of the contract. It is not a wagering contract if one party may win but cannot lose, or if he may lose but cannot win, or if he can neither win nor lose. For instance, in *Ellesmere v Wallace*:[5]

> Edgar Wallace nominated a horse for a race, the advertised conditions of which were that £5 or £2 had to be paid to the Jockey Club according as a nominated horse started or did not start in the race. Another condition was that the owner of the winning horse should receive £200 provided by the Jockey Club and also the entrance moneys paid by the various nominators less a sum of £30. Wallace's horse did not run, and when sued for the recovery of £12 he pleaded that the contract between him and the Jockey Club was void as being a wagering contract.

The Court of Appeal held that the money was recoverable. The argument that the contract was a wager, since if the horse was successful Wallace would win £200 plus a further amount and if it failed he would lose £5, was fallacious, for the Jockey Club did not stand to win or lose anything as a result of the nomination. They did not lose under the contract merely because that particular horse succeeded, for their liability was to pay £200 to the successful owner no matter who he might be. Their liability would be no greater or less whether Wallace nominated or did not nominate a horse. Moreover they did not win anything if Wallace's horse failed in the race, since the nomination fee did not accrue to them but was earmarked for the successful owner.

Thus, a bet placed with the Horseracing Totalisator Board is not a wagering contract within the meaning of the Gaming Act 1845, since the board can neither win nor lose on the transaction. Its function is merely to divide the aggregate amount received, less expenses, among the successful contributors.[6] The same is true of the 'treble chance' on the football pools. It will be seen therefore that many betting transactions are not legally wagers.

Thirdly, if an essential feature of a wager is that there must be two persons either of whom is capable of winning or losing, it follows that there must be no more than two parties or two groups of parties to the contract. It was argued, for instance, in *Ellesmere v Wallace* that there was a multipartite wagering contract between Wallace and each of the other nominators, but, as Russell LJ demonstrated, it was impossible to express in terms of wagers the effect of several persons nominating horses for the race. It could not be shown that Wallace made a bet with each nominator. If his horse lost the race then he himself would lose the alleged bet, ie what he had paid as entrance fee, but the other party to the supposed wager would not necessarily win anything. He would win only if his horse won the race.[7]

4 *Thacker v Hardy* (1878) 4 QBD 685; *Lockwood v Cooper* [1903] 2 KB 428.
5 [1929] 2 Ch 1.
6 *Tote Investors Ltd v Smoker* [1968] 1 QB 509, [1967] 3 All ER 242; *Osorio v Cardona* (1984) 15 DLR (4th) 619.
7 [1929] 2 Ch 1 at 50-51.

> The truth is that you cannot have more than two parties or two sides to a bet. You may have a multipartite agreement to contribute to a sweepstakes (which may be illegal as a lottery if the winner is determined by chance, but not if the winner is determined by skill), but you cannot have a multipartite agreement for a bet unless the numerous parties are divided into two sides, of which one wins or the other wins, according to whether an uncertain event does or does not happen.[7]

The last essential feature of a wager is that the stake must be the only interest which the parties have in the contract.[9] If A lays B ten to one in sovereigns against a particular horse for the St Leger, B stands to win £10, A stands to win £1, but neither of them has any other interest whatsoever in the contract. On the other hand if either party to a contract, under which money is payable upon the determination of an uncertain event, possesses an interest in the subject matter of the contract that will be affected in value according to the determination of the event, the contract is not void as being a wager. Thus in one sense every contract of insurance is a bet on the outcome of a future uncertain event and therefore literally speaking a wager. A wife, for instance, who insures her husband's life for £10,000 in return for an annual premium of £200, stands to gain or lose according to the eventual length of the life assured. To apply this rigorous reasoning, however, would not be practical politics and it has long been established that whether a contract of insurance is a wager depends upon whether the assured has what is called an insurable interest in the event upon which the insurance money becomes payable. If A ships cargo on B's vessel bound for a foreign port, the contract by which he insures the safe arrival of the ship is not a wager since his own property is at risk during the voyage, though in effect it means that the insurer will pay £*x* in one event but nothing in another. But if A has no cargo on board, the contract by which he insures the safe arrival of the vessel is a wager, for his only interest in the fate of the vessel is that if she is lost he recovers £*x*, while if she reaches her destination he loses the amount of his premium.[10] The modern practice of insuring against bad weather provides another example. If a cricketer insures against the fall of more than one-eighth of an inch of rain during the first three days of the Canterbury cricket week, the contract is valid if he is financially interested in the match, as for instance if it is being played for his benefit, but void if he has no such interest.

The question whether the parties are interested in something more than the mere winning or losing of a stake depends upon the substance of the agreement, not upon its outward form.

> In construing a contract with a view to determining whether it is a wagering one or not, the Court will receive evidence in order to arrive at the substance of it, and will not confine its attention to the mere words in which it is expressed, for a wagering contract may be sometimes concealed under the guise of language which, on the face of it, if words were only to be considered, might constitute a legally enforceable contract.[11]

Thus in *Brogden v Marriott*,[12] A agreed to buy a horse from B, the price to be £200 if it trotted within a month at eighteen miles an hour, but a shilling if it failed

8 Ibid at 52, per Russell LJ. See also *Tote Investors Ltd v Smoker*, above.
9 *Carlill v Carbolic Smoke Ball Co* [1892] 2 QB 484.
10 Cf *Kent v Bird* (1777) 2 Cowp 583.
11 *Carlill v Carbolic Smoke Ball Co* [1892] 2 QB 484 at 491-492, per Hawkins J. Cf *Universal Stock Exchange v Strachan* [1896] AC 166 at 173.
12 (1836) 3 Bing NC 88.

to attain this speed. The horse having failed in its attempt, A claimed it at the nominal price of a shilling, but the agreement was held to be a wager, not a *bona fide* conditional contract. A rather more subtle case is *Rourke v Short*[13] where the facts were these:

> The parties to a proposed contract for the sale of rags disagreed about the price that had been paid upon the occasion of a former sale. They ultimately agreed that if the seller's memory proved to be accurate the price of the present sale should be six shillings per cwt, otherwise it should be three shillings per cwt. The seller proved to be correct.

The buyer refused to accept the rags, and an action by the seller to recover the price failed. Lord Campbell expressed the view that:

> The previous price was the point on which the wager was to turn, and the stake was the difference of the price to be now paid ... It makes no difference that there was a real intention to part with the goods.[14]

Another type of case in which it becomes necessary to ascertain the real nature of an agreement is where a client instructs a stockbroker to buy or sell shares. A contract of this nature may be a wager, and it is so where it takes the form of what is called a contract for differences, ie where the parties agree merely to pay or receive the difference between the price of certain shares on one day and their price on another day.[15] For instance:

> A instructs B, a stockbroker, to procure a thousand ordinary shares in a certain company at £80 a share, the transaction to be completed at the next Stock Exchange settling day, a fortnight hence.

If in this case it is found as a fact that neither party contemplated the delivery of shares, but intended that if the market price rose above £80 at the next settling day, B should pay the difference between that price and £80 to A, while if it fell A should pay the difference to B, then the contract is void as a wager. If on the other hand the intention is that the shares shall actually be purchased by B, the contract is not a wager. This is so even though A, to the knowledge of B, is not prepared to take the shares up but intends to resell them before the settling day and thus to gain or lose according as the price since the day of their purchase rises or falls.[16] Where such is the intention of the parties, B is clearly authorised to enter into contracts for the purchase of shares from jobbers, and is entitled to be indemnified by A against the obligations that he thereby incurs.[17] Thus contracts for the purchase of shares are not wagers unless the agreement is that the purchaser has no right to claim delivery and the seller has no right to insist upon it.[18] As Cave J said in his direction to the jury in *Universal Stock Exchange Ltd v Strachan*:[19]

> In order to be a gambling transaction such as the law points at it must be a gambling transaction in the intention of both the parties to it.

13 (1856) 5 E & B 904.
14 Ibid at 910.
15 *Grizewood v Blane* (1852) 11 CB 538.
16 *Thacker v Hardy* (1878) 4 QBD 685; *Weddle, Beck & Co v Hackett* [1929] 1 KB 321; *Woodward v Wolfe* [1936] 3 All ER 529.
17 *Thacker v Hardy*, above.
18 *Ironmonger & Co v Dyne* (1928) 44 TLR 497 at 499, per Scrutton LJ.
19 [1896] AC 166 at 167-168.

Exactly the same principles apply to other potentially speculative transactions, such as dealing in commodity futures.[20]

An interesting modern example is *Morgan Grenfell v Welwyn Hatfield District Council*.[1] In this case, the defendant local authority entered into pairs of contracts in one of which, with the plaintiff, it was a floating interest rate payer and the plaintiff was a fixed interest rate payer and in the second of which the roles were reversed between it and another local authority (Islington). In due course, these transactions were held to be *ultra vires* local authorities.[2] The plaintiff brought an action in restitution and the defendants made a similar claim against Islington. Islington raised a preliminary issue that such transactions partook of the nature of gaming and wagering and were therefore contrary to section 18 of the Gaming Act 1845 and/or section 1 of the Gaming Act 1892.

The judgment of Hobhouse J provides a useful restatement of classic discussions of the line between gaming and wagering contracts and valid contracts. Some transactions, such as betting on which horse will come first in a race, are necessarily wagers. Other contracts may, on their face, appear to have nothing to do with wagering but it may be possible to show in particular circumstances that the transaction is in substance a wager. Interest rate swap contracts are of such a kind. They may in particular cases be gaming contracts but they are not necessarily so. One feature of the present case was clearly that Welwyn were not entering into any speculation since, whatever the movement in interest rates, their element of profit would remain the same. However, this fact is not in itself decisive since a bookmaker who laid off all bets and relied entirely on arbitraging movements of odds might reduce or eliminate his risk but the transactions would still be wagering. A further distinction between Welwyn and the bookmaker was in its purpose which was clearly non speculative. The purpose of Islington was not the same since it was not entering into back to back transactions. Islington's primary purpose was not to speculate on the movement of interest rates but to raise money in advance which could be treated as a revenue receipt by incurring revenue liabilities spread over a period of years. It was therefore not a wager.

Many speculative financial transactions of this kind have been taken out of the law of gaming by the Financial Services Act 1986, section 63 of which provides:

> (1) No contract to which this section applies shall be void or unenforceable by reason of – (a) section 18 of the Gaming Act 1845, section 1 of the Gaming Act 1892 or any corresponding provisions in force in Northern Ireland . . .
>
> (2) This section applies to any contract entered into by either or each party by way of business and the making or performing of which for either party constitutes an activity which falls within paragraph 12 of Schedule 1 to this Act or would do so apart from Parts III and IV of that Schedule.

Para 12 of Schedule 1 provides

> Buying, selling, subscribing for or underwriting investments or offering or agreeing to do so, either as principal or as an agent.

20 *Wilson, Smithett and Cope Ltd v Terruzzi* [1976] QB 683, [1976] 1 All ER 817.
1 [1995] 1 All ER 1.
2 *Hazell v Hammersmith and Fulham London Borough Council* [1991] 1 All ER 545.

In *City Index Ltd v Leslie*[3] the plaintiffs were a company specialising in offering gambling in relation to financial indices such as the FT30. For instance they would offer a forecast of what the FT30 index would be at close of business of the day and a client who thought the forecast too conservative could make a 'buy' bet on the basis that he would win the amount bet per point above the forecast index at the end of the day, although he would lose a similar amount for each point for which the index failed to reach the forecast figure. Contrariwise, if he thought the forecast was too high he could place a 'sell' bet which would have the reverse effect. Such bets have long been regarded as invalid and unenforceable under the Gaming Acts but the Court of Appeal agreed that the 1986 Act had validated and made enforceable this transaction.

2 THE EFFECT OF A WAGERING CONTRACT

a The effect as between the parties

The Gaming Act 1845 in the following section renders all wagering contracts void.

> All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law or equity for recovering any sum of money or valuable thing alleged to be won upon any wager, or which shall have been deposited in the hands of any person to abide the event on which any wager shall have been made.
>
> Provided always that this enactment shall not be deemed to apply to any subscription or contribution or agreement to subscribe or contribute for or towards any plate, prize or sum of money to be awarded to the winner or winners of any lawful game, sport, pastime or exercise.[4]

It is convenient for purposes of exposition to deal separately with the four branches of this section.

The first is as follows:

> All contracts or agreements, whether by parole or in writing, by way of gaming or wagering shall be null and void.

The effect of these words is that a wagering contract is 'struck with invalidity at the outset, ie before the event contemplated by the wager has occurred'.[5] It is void, though not illegal. It confers no rights upon either party. If the loser fails to pay, recovery cannot be enforced by action, whether brought for the amount of the bet or on an account stated.[6] If he stops a cheque which he has given for the amount, he cannot be sued. If he pays the winner in cash or gives him a cheque which is honoured, it might be expected that, as the contract is void and the payments therefore made without consideration, he should be entitled to recover the money. The law does not take this view. The Act is apparently treated as conferring a privilege which the loser may waive if he pleases, and payment constitutes waiver. In the words of Bowen LJ the loser merely 'waives a benefit which the statute has given to him and confers a good title to the money upon the person to whom he pays it'.[7]

3 [1991] 3 All ER 180.
4 S 18.
5 *Hill v William Hill (Park Lane) Ltd* [1949] AC 530 at 552, [1949] 2 All ER 452 at 464 per Lord Greene.
6 *Alberg v Chandler* (1948) 64 TLR 394.
7 *Bridger v Savage* (1885) 15 QBD 363 at 367.

The second branch is as follows:

> No suit shall be brought or maintained in any court of law or equity for recovering any sum of money or valuable thing alleged to be won upon any wager.

The interpretation put upon these words by the House of Lords in *Hill v William Hill (Park Lane) Ltd.*[8] is that they do not merely repeat what is enacted in the first branch, but that they strike at fresh agreements made by the parties subsequently to the original wagering contract itself.

The result of this interpretation is to overrule a number of decisions dating back at least to 1870. These had distinguished the original wager from a later and distinct contract under which the loser, for a fresh consideration, promises to pay the amount of the bet. In several cases of this type the courts had enforced the later contract. What generally happens is that the winner puts pressure upon the loser by a threat to do something to his detriment if he continues to be recalcitrant. He may thus threaten to expose the loser's dishonourable conduct to his club[9] or to his bank manager[10] or, if he happens to be a bookmaker or an owner of a race horse, to report him to Tattersalls[11] or to the Jockey Club.[12] The loser then makes a fresh promise to pay in consideration that the winner will forbear to implement his threat. Thus, in *Hyams v Stuart King*:[13]

> Two bookmakers, A and B, had betting transactions which resulted in a sum becoming due from A to B. A failed to pay, but ultimately agreed to do so in consideration that B would refrain from declaring him a defaulter to the injury of his business with his customers.

Although the agreement was in substance no more than a repetition of the void wagering contract, the majority of the Court of Appeal held it to be enforceable. They took the view that it was free from vice. In the opinion of Farwell LJ, it was unaffected by the Act of 1845 since it was not a wager but merely a contract designed to avoid the consequences of having made a wager. Again, it was not illegal *per se*, since it is not illegal to tell the members of the betting fraternity that a bookmaker is prone to default; nor was it tainted with illegality merely because it sprang from a wager, for a wager, though void, is not illegal. Fletcher Moulton LJ dissented. He could not regard the contract as other than a contract to pay money alleged to have been won upon a wager and therefore directly within the language of the second limb of the statute. The sole object of this colourable agreement was that the bet should be paid.

The controversy aroused by this decision was finally laid to rest forty years later by the decision of the House of Lords in *Hill v William Hill (Park Lane) Ltd.*[14] The facts were these:

> On 22 July 1946, the committee of Tattersalls made an order that the appellant, an owner of race horses, should discharge the amount of his

8 [1949] AC 530, [1949] 2 All ER 452.
9 *Re Browne, ex p Martingell* [1904] 2 KB 133.
10 *Potelinkhoff v Frankle* [1938] 2 KB 816, [1938] 3 All ER 686.
11 *Goodson v Baker* (1908) 98 LT 415. Such a threat does not constitute blackmail: *Barnes v Harris* [1937] 4 All ER 559.
12 *Bubb v Yeverton* (1870) LR 9 Eq 471.
13 [1908] 2 KB 696.
14 [1949] AC 530, [1949] 2 All ER 452.

unpaid bets of £3,635 12s 6d due to the respondents by paying £635 12s 6d within fourteen days and thereafter by paying monthly instalments of £100.

In August 1946, the appellant, having failed to comply with the order, gave the respondents a cheque for £635 12s 6d post-dated to 10 October and promised to begin the monthly instalments in November in consideration that the respondents would refrain from enforcing the order. Enforcement of the order would involve his being posted as a defaulter and warned off Newmarket Heath. The appellant failed to pay the instalments and the respondents sued to recover their amount.

By a majority of four to three, the House of Lords held that this contract, though unaffected by the first branch of the section since it was clearly not a contract 'by way of gaming or wagering', was nevertheless void under the second branch.

The minority were of opinion that the second branch was neither intended nor apt to invalidate a contract that was not itself a wager. In their view, it was a mere procedural provision designed to fortify the preceding words. 'The second or procedural part', said Lord Radcliffe, 'is introduced by the word *and*: the words *alleged to be won* are used to describe the sum of money of which recovery by legal action is forbidden.'[15] Lord Greene expressed his disagreement with this argument in the following words:

> The language of the first branch is entirely different from the language of the second branch. Under the first branch the agreement is a nullity before the race is run. The second branch assumes the race to have been run and the bet to have been lost. It is true that the language of the second branch would prohibit the bringing of an action upon a wager which had been won. To that extent I agree that it covers ground already adequately covered by the first branch. But this is no justification for limiting the words of the second branch as suggested. They are quite general and when read in their ordinary meaning they extend to any action to recover money alleged to be won on a wager.[16]

The same conclusion was reached by the majority of the Law Lords. The respondents; action was brought to 'recover a sum of money alleged to be won upon a wager' and was therefore rendered void by the statute.

The single question of fact, therefore, that always falls to be determined in this type of case is not whether there was a fresh bargain but whether, according to the true nature and substance of the contract, the money sought to be recovered is money alleged, either by plaintiff or defendant, to be won upon a wager.[17] This question is, in essence, one of intention. In each case 'the court must look to the reality of the transaction and come to a finding as to what the true intention was'.[18] Thus in *Hill v William Hill (Park Lane) Ltd*, there could be no doubt that the subject matter of the fresh contract was the very sum of money won on the wager. The contract referred

15 [1949] AC at 579; and see 541, per Lord Jowitt.

16 *Hill v William Hill (Park Lane) Ltd* [1949] AC 530 at 552, [1949] 2 All ER 452 at 465; see also Lord MacDermott at 577 and 480, respectively.

17 Ibid at 578 and 481, respectively, per Lord MacDermott.

18 Ibid at 574 and 478, respectively, per Lord MacDermott. At 559 and 468 respectively, Lord Greene says: 'I must not be understood as suggesting that there can never be a case where a promise by a defaulting backer given in consideration of a promise by the winner of a bet not to report the defaulter may be enforced.'

specifically and solely to the sum fixed in the order of Tattersall's committee, and this sum was identical in amount and character with the wagering debt.[19] Again, if, as in *Coral v Kleyman*,[20] A fails to pay a lost bet to B and his father promises to pay the amount due in consideration that B will not report the failure to Tattersalls, an action brought on this promise must fail: the transaction is but a transparent device to avoid the second branch of the statute. The position, however, may be more doubtful. Suppose, for instance, that the loser promises to transfer his motor car to the winner in return for the latter's promise that the non-payment of the wager shall be concealed from the loser's friends. Is the subject matter of this promise 'a valuable thing alleged to be won on a wager' within the meaning of the statute? If the words of the statute are to be read literally, the promise is not caught by them: it cannot be said that the motor car was 'alleged to be won on the wager'. But the courts are hardly likely to suffer so obvious an evasion. The view emphasised in *Hill v William Hill (Park Lane) Ltd* is that one object of the second branch of section 18 is 'to preclude resort to an obvious way round the earlier provision',[1] and a promise by the loser to transfer to the winner a car substantially equal to the amount of the bet is only a slightly less transparent device to avoid the statute than a new promise to pay the money itself. But the loser's promise may wear, at least on the surface, a more innocent aspect. Suppose he agrees to sell to the winner for £2,000 a horse worth £3,000, and, when sued for breach of contract, pleads that the agreement was made in consideration that his failure to pay the lost bet should not be published by the winner. Such a case may well provoke prolonged argument, and human ingenuity may yet devise more subtle methods of evasion. The principle, however, remains the same however difficult to apply. No fresh contract is valid if, in the opinion of the court, it discloses in substance an intention that the wager shall be paid.[2]

The third branch of section 18 may be rendered as follows:

> No suit shall be brought or maintained in any court of law or equity for recovering any sum of money or valuable thing which shall have been deposited in the hands of any person to abide the event on which any wager shall have been made.

The construction put upon these words is that they merely prevent recovery by the winner of the money deposited with the stakeholder by his opponent.[3] They do not prevent either party from recovering his own stake before it has been paid away by the stakeholder.[4]

The last branch of the section consists of the proviso and is expressed in these words:

19 Ibid at 564 and 472, respectively, per Lord Normand; at 546 and 461, respectively, per Lord Simon.

20 [1951] 1 All ER 518.

1 [1949] AC 530, [1949] 2 All ER 452 at 577 and 480, respectively, per Lord MacDermott.

2 The attitude of the courts is indicated by the case of *R v Weiss* [1951] 2 KB 611, [1951] 2 All ER 408. A client alleged that a firm of bookmakers owed him £375 upon bets placed with them, and, to induce them to pay, he instructed his solicitors to issue a writ. The writ was endorsed as a claim for money due on an account stated, though the endorsement was completely fictitious. It was held that an attempt to deceive the court by disguising the true nature of the claim and putting forward a feigned issue was a contempt of court and could be punished as such.

3 *Varney v Hickman* (1847) 5 CB 271; *Diggle v Higgs* (1877) 2 Ex D 422.

4 P 365, below.

> Provided always that the enactment shall not be deemed to apply to any subscription or contribution or agreement to subscribe or contribute for or towards any plate, prize or sum of money to be awarded to the winner or winners of any lawful game, sport, pastime or exercise.

The object of this is that lawful prizes shall be recoverable. It does not, however, save any transaction which is substantially a wager. If the so-called prize is in truth nothing more than a stake put up by wagering parties and merely masquerading as a prize, it is not recoverable.[5] This was the position in *Diggle v Higgs*,[6] where:

> A and B agreed to walk a match for £200 a side and each deposited this amount with X to be paid to the winner.

It was held that the winner was not entitled to recover the loser's deposit from X, since the money was deposited by way of wager. It was held in *Ellesmere v Wallace*,[7] as we have already seen,[8] that there cannot be a multipartite wagering contract. It would seem to follow, therefore, that the winner of a lawful game in which there are several competitors can recover the agreed prize, even though it consists wholly of money deposited by the competitors themselves, always presuming, of course, that they are not divided into two sides.

At common law games of mere skill, ie those in which the element of chance is negligible, such as football, cricket, billiards, horse and foot racing, are lawful. Formerly, certain games in which success depended upon chance, such as pharaoh, passage, roulette and all games played with dice, except backgammon, were declared illegal by statute.[9] Now no game is *per se* illegal, but 'gaming' will be illegal if it contravenes the Gaming Act 1968. To attempt any detailed analysis of this Act in the present book would be out of place, but two points may be made.

Firstly, 'gaming' for the purposes of the Act is defined by section 52 as:

> the playing of a game of chance for winnings in money or money's worth, whether any person playing the game is at risk of losing any money or money's worth or not.[10]

By the same section 'game of chance' excludes any 'athletic game or sport', but with that exception includes 'a game of chance and skill combined and a pretended game of chance and skill combined'.

Secondly, Part I of the Act deals with gaming elsewhere than on premises licensed or registered under Part II; Part II deals with gaming on premises which are so licensed or registered; and Part III deals with gaming by means of machines. Under Part I, which is alone relevant to this book, gaming is prohibited if:

(a) the game involves playing or staking against a bank, whether the bank is held by one of the players or not: (or)

5 *Diggle v Higgs* (1877) 2 Ex D 422; *Trimble v Hill* (1879) 5 App Cas 342.
6 (1877) 2 Ex D 422.
7 [1929] 2 Ch 1.
8 Pp 356-357, above.
9 Gaming Act 1738, s 2; Gaming Acts 1739 and 1744. These statutes were repealed by the Betting and Gaming Act 1960, Sch 6.
10 Contrast the definition of a 'wagering contract' given above at p 356. If one party is not at risk, there is no wagering contract within the meaning of that definition; but the statutory definition of 'gaming' is satisfied.

(b) the nature of the game is such that the chances in the game are not equally favourable to all the players; (or)

(c) the nature of the game is such that the chances in it lie between the player and some other person, or (if there are two or more players) lie wholly or partly between the players and some other person, and those chances are not as favourable to the player or players as they are to that other person.

Moreover, no charge, whether in money or money's worth, may be made 'in respect of the gaming', and no levy may be charged, directly or indirectly, on any of the stakes or winnings of the players.[11] In streets and public places gaming, subject to an exception for certain games played on licensed premises, is completely prohibited.[12] The Act lays down penalties for contraventions of any of these prohibitions.[13]

b The effect as between principal and agent

The relationship of principal and agent may arise under a wagering contract in two distinct cases.

Firstly, where the stakes are deposited with an agent as a stake-holder.

Secondly, where a principal instructs an agent to effect wagering transactions on his behalf.

Where the two wagering parties, A and B, each deposit a stake with X to abide the event, the legal position of X is that he is the agent of A with regard to A's stake and the agent of B with regard to B's stake. In each case his authority is the same, namely, to pay the money to the winner. The rule of agency law relevant to this case is that if an agent acts within the scope and during the continuance of his lawful authority the principal is bound, but that if he exercises the authority after it has been revoked he is liable to his principal for the consequences.

The effect of this upon a wagering contract in which stakes are deposited is that, notwithstanding the determination of the event upon which the wager turns, either party may require the repayment of his stake before it has been paid away in accordance with his former instructions. If the loser makes no demand until his stake has been paid to the winner, his right of recovery is gone, for the stakeholder has merely exercised the authority actually conferred upon him.[14] If, on the other hand, the loser demands the return of his money before it has been paid to the winner, the stakeholder is personally liable if he disregards the revocation of his authority and hands the stake to the winner.[15] In *Diggle v Higgs*, the facts of which have already been given,[16] the stakeholder paid both stakes to the winner in spite of a written order to the contrary from the loser, and he resisted an action for its recovery by relying upon the words of the Gaming Act 1845 that 'no suit shall be brought to recover any sum of money ... deposited

11 Gaming Act 1968, s 2(1). By s 2(2), this prohibition does not apply to gaming on a domestic occasion in a private dwelling, or to gaming in a hostel, hall of residence, etc by the residents or inmates thereof. As to gaming at entertainments not held for private gain, see s 41.

12 Sections 8 and 4. See however s 40 as to special charges for playing at certain clubs and institutes.

13 Ss 5 and 6. See also s 7 for special provisions as to persons under eighteen.

14 S 8. See also s 40 as to forfeiture of anything relating to the offence.

15 *Varney v Hickman* (1847) 5 CB 271.

16 *Hampden v Walsh* (1876) 1 QBD 189.

17 P 364, above.

in the hands of any person to abide the event'.[18] But, as we have seen, the meaning attributed to these words by the Court of Appeal was that the winner cannot recover his *opponent's* stake from the stakeholder, not that a depositor is disentitled to recover his own stake.[19]

Where an agent is instructed to effect a wagering transaction on behalf of his principal, litigation may arise in two ways: the agent may claim relief against the consequences of having acted within the scope of his authority, or the principal may sue the agent for failure to carry out the authority.

In considering the first of these problems it is necessary to notice the general rule of law that an agent is entitled to be indemnified by his principal against liability incurred by him in executing his instructions, unless the instructions are unlawful.[20] The rule has been neatly summarised by Hawkins J in these words:

> If one man employs another to do a legal act, which in the ordinary course of things will involve the agent in obligations pecuniary or otherwise, a contract on the part of the employer to indemnify his agent is implied by law.[1]

The question whether this doctrine applies where an agent is employed to effect a wager arose in *Read v Anderson*:[2]

> The defendant instructed the plaintiff, a turf commission agent and a member of Tattersalls, to back certain horses at the Ascot meeting. The plaintiff did so, and in the result a sum of £175 became due to him from the defendant in respect of the bets that had been lost. A turf commission agent always backs a horse in his own name and becomes solely responsible to the person with whom the bet is made. If he is declared a 'defaulter' owing to his failure to pay a lost bet, he becomes subject to certain disqualifications which have a serious effect upon his business.

It was held that the plaintiff, having paid £175 out of his own pocket to the person with whom he had made the bet, was entitled to recover the amount from the defendant.

The decision in *Read v Anderson* provoked so many actions of a similar nature that eight years later the legislature intervened and stopped the practice by the Gaming Act 1892. This provides as follows:

> Any promise, express or implied, to pay any person any sum of money paid by him under or in respect of any contract or agreement rendered null and void by the ... (Gaming Act 1845), or to pay any sum of money by way of commission, fee, reward, or otherwise in respect of any such contract, or of any services in relation thereto or in connexion therewith, shall be null and void, and no action shall be brought or maintained to recover any such sum of money.[3]

In short, any promise, express or implied, to pay to X any money which has been *paid by him under or in respect of* a wagering contract is void. Thus, although the rule that a principal must indemnify his agent against the consequences

18 P 363, above.

19 It has also been decided that the recovery of a party's own stake is not prevented by the Gaming Act 1892 (p 345, below), since the word 'paid' there means 'paid out and out': *O'Sullivan v Thomas* [1895] 1 QB 698.

20 *Thacker v Hardy* (1878) 4 QBD 685 at 687, per Lindley J.

1 *Read v Anderson* (1882) 10 QBD 100 at 108.

2 (1882) 10 QBD 100; affd 13 QBD 779.

3 S 1.

of exercising a lawful authority is still a leading doctrine of English law, it has no application where the consequences result from steps taken in furtherance of a wagering contract. The agent has no cause of action either on an account stated[4] or for money paid at the request of his principal.

With regard to the other aspect of agency, ie to claims made by the principal against the agent, two rules have been established.

Firstly, the principal cannot sue the agent for a failure to carry out instructions. In *Cohen v Kittell*[5] the defendant, who had been employed by the plaintiff to bet on commission, failed to place bets upon certain horses which he had been instructed to back. The plaintiff therefore sued him for breach of the contract of agency, and claimed as damages the money that he would have received had the bets been made.

It was held that the action failed, since an agent can incur no legal liability for failure to make a contract which, even if it had been made, would have been void.

In *A R Dennis & Co Ltd v Campbell*[6] the defendant was employed as the manager of one of the plaintiffs' betting shops. Betting was on a cash basis only and credit was not allowed, but in breach of his instructions the defendant allowed one customer to bet on credit terms. The customer made bets totalling £1,000, lost, and failed to pay up. The plaintiffs sued the defendant for the £1,000. The Court of Appeal held that the action failed since the £1,000 was 'a sum of money ... alleged to be won upon a wager' within section 18 of the Gaming Act 1845. In addition, it was not shown that the plaintiffs had suffered any loss by the defendant's breach of his instructions since if he had refused the customer credit, the transaction would probably have not taken place at all.

Secondly, it is well established as a general rule of law that where a person has received money on behalf of another he cannot resist an action for its recovery by the plea that he received it in respect of a void transaction.[7] In accordance with this rule it has been held that a principal can successfully maintain an action for money had and received against an agent who has made bets on his behalf and who refuses to hand over winnings received from the loser.[8]

> If one agrees to receive money for the use of another upon consideration executed, however frivolous or void the consideration might have been in respect of the person paying the money, if indeed it were not absolutely immoral or illegal, the person so receiving it cannot be permitted to gainsay his having received it for the use of that other.[9]

The result is that if A backs a horse with B and wins, the Gaming Act 1845 prevents him from recovering his winnings from B. But if he employs C to make the bet with B, he can recover any winnings that are actually paid by B to C. In this last case C, if he is unscrupulous, may plead that he did not in fact place the bet as agent but accepted it himself as a principal. If, however, C holds himself out as a betting agent he may, at any rate in the absence of clear evidence to the contrary, be estopped from denying that he acted as agent.[10]

4 *Law v Dearnley* [1950] 1 KB 400, [1950] 1 All ER 124.
5 (1889) 22 QBD 680.
6 [1978] QB 365, [1978] 1 All ER 1215.
7 *Cheshire & Co v Vaughan Bros & Co* [1920] 3 KB 240 at 255, per Scrutton LJ.
8 *Bridger v Savage* (1885) 15 QBD 363; *De Mattos v Benjamin* (1894) 63 LJQB 248.
9 *Griffith v Young* (1810) 12 East 513 at 514-515, per Lord Ellenborough.
10 *Moore v Peache* (1891) 7 TLR 748; *Potter v Codrington* (1892) 9 TLR 54; *Grimerd v Wiltshire* (1894) 10 TLR 505.

c Securities given in respect of wagering contracts

The type of question that requires consideration here is this: suppose that a cheque or other security, given by A to B in payment of money due under a wagering contract, is transferred by B to X, is it enforceable in the hands of X or some subsequent transferee from him? In order to answer this question it is necessary to distinguish two classes of wagers, namely those on games and those on events other than games, for the Gaming Acts of 1710 and 1835 have dealt specially with securities given for gaming wagers.

The first section of the Gaming Act 1710, may be summarised as follows:

> All securities given for money won by playing at any game whatsoever, or by betting on games, or for the repayment of money knowingly lent for the purpose of gaming or betting as aforesaid shall be utterly void, frustrate and of no effect.

This stringent enactment might well cause disaster to an innocent person, for a cheque or other negotiable instrument given in any of the circumstances specified by the statute would be worthless in the hands of a subsequent transferee, notwithstanding that he had given value for it in ignorance of its origin. This injustice was therefore nullified by section one of the Gaming Act 1835, which provides that every security rendered void by the Act of 1710 shall no longer be void but shall be deemed to have been given for an illegal consideration.

To illustrate the operation of this section, let us suppose that A, having lost a bet to B on a horse race, gives B a cheque for the amount. Let us suppose further that the cheque in the ordinary course of business passes through several hands and that the present holder, X, sues A to recover the amount for which it is drawn.

Now here X holds a cheque which at the time when it was given suffered from two defects: firstly, it was unsupported by consideration, since it was given in respect of a void wagering contract; secondly, it was tainted by illegality, since it came within the terms of the Act of 1835. X, however, can cure these defects by proof that he is a 'holder in due course', an expression which describes the holder of a bill of exchange, cheque or promissory note, complete and regular on the face of it, who takes it in good faith and for value without notice of any defect of title in the person who negotiated it to him.[11] Normally every holder is presumed to be a holder in due course; but where the instrument is tainted in its origin by illegality, as it is in the hypothetical case under discussion, the burden is on the holder to prove affirmatively that 'subsequent to the ... illegality value has in good faith been given'.[12]

The result, therefore, is that X can recover on the cheque provided that he proves two facts, namely, that he or some previous holder gave value for it and that he had no notice of the illegal consideration. When the action is heard, the defendant, A, will give evidence that the cheque was drawn in payment of a gaming debt, and then X must prove that when he took the cheque he was unaware of the circumstances in which it was given.[13] In short, the effect of the Act of 1835 is to throw the burden of proving value and good faith upon the holder of the bill or note.

11 Bills of Exchange Act 1882, s 29(1)(a) and (b).
12 Ibid. s 30.
13 *Hay v Ayling* (1851) 16 QB 423; *Woolf v Hamilton* [1898] 2 QB 337.

The position with regard to a cheque which is drawn to enable a person to game on licensed premises is considered later.[14]

A cheque or other security given for money lost under a non-gaming wager is given without consideration, since the wager itself is void, but there is no rule either at common law or by statute which taints it with illegality. Its one defect is want of consideration, and this is cured by its subsequent transfer for value. If, for instance, a cheque is given by A to B in payment of a bet on the date of the next war, and is later indorsed by B to X in settlement of an account for goods delivered, it is enforceable at the suit of X. It is quite immaterial that at the time of taking the cheque he was aware of the circumstances in which it was given by A to B.

Further, in a case such as this, where the consideration for the original drawing of the cheque is void but not illegal, there is a presumption that the holder, ie X in the above example, has given consideration. In other words the burden is on the defendant to prove that consideration has not been given.[15] Thus in *Fitch v Jones*:[16]

> Jones made a bet with B concerning the amount of the hop duty in 1854. Having lost, he gave B a promissory note for £40 in payment. B indorsed the note to Fitch. When sued on the note, Jones pleaded that a duty lay on Fitch to prove that consideration had been given.

The plea failed and judgment was given for the plaintiff.

What has been said in this section applies only to subsequent transfers of a security. An original party to a wagering contract cannot sue upon a security given in respect of the wager, no matter whether it is given for a void or for an illegal consideration.[17]

d The effect as between lender and borrower

The law which regulates the right of a lender to recover loans made for wagering purposes is both confused and illogical, and precludes a scientific analysis. It may be considered under five heads.

It was held in 1838 that money lent for playing at or betting on an illegal game is irrecoverable.[18] Now no game is *per se* illegal, but the right of recovery will still be excluded if the gaming is conducted illegally, ie in contravention of the provisions of the Gaming Act 1968.[19]

The second question is whether a loan is recoverable if made for the purpose of gaming that will be lawfully conducted. In *Carlton Hall Club v Laurence*,[20] the divisional court invoked the Gaming Acts of 1710 and 1835 and denied any right of recovery. The first of these statutes, as we have seen, provided that all securities given for the repayment of money knowingly lent for the purpose of playing at or betting upon any game whatsoever should be utterly void. The second enacted that such a security should not be void but

14 P 371, below.
15 *Fitch v Jones* (1855) 5 E & B 238; *Lilley v Rankin* (1886) 56 LJQB 248.
16 (1855) 5 E & B 238.
17 *William Hill (Park Lane) Ltd v Hofman* [1950] 1 All ER 1013.
18 *M'Kinnell v Robinson* (1838) 3 M & W 434.
19 Certain games were declared illegal by various statutes, but these have now been repealed; p 364, above.
20 [1929] 2 KB 153.
1 P 368, above.

should be deemed to have been given for an illegal consideration. Neither statute, it will be noticed, provided in terms that a loan for gaming as distinct from a security given by the borrower should be void, and the question was whether the contract of loan itself was also statutorily affected. The facts were these:

> The plaintiffs, proprietors of a club in Maida Vale, were accustomed to sell chips representing a money value to members who wished to play games for money. They supplied the defendant with chips to the value of £28 7s 3d for the express purpose of playing poker and snooker, and accepted his cheque for this amount. The cheque was dishonoured.

It was clear that the plaintiffs could not recover on the cheque, since it constituted a security within the meaning of the statutes. Instead, they sued on the contract of loan, arguing that the statutes did not invalidate the contract and its consideration but only the cheque, and they were able to cite several authorities prior to 1835 in which it had been held that a loan of money for the purpose of gaming, as distinct from a security given in respect of the loan, was valid and enforceable. There is considerable force in this argument. Neither statute deals with the loan itself, but only with the right of a person to enforce a security given in respect of the loan. Moreover, the later statute, so far from prejudicing the rights of lenders, is merely designed to afford some measure of protection to third parties. The court, however, followed a dictum of the Court of Exchequer in 1842,[2] and found for the defendant, holding that the combined effect of the Acts of 1719 and 1835 is to avoid all loans where the contractual undertaking is that the money shall be used in playing at or betting upon games.

In *CHT Ltd v Ward*,[3] the Court of Appeal doubted *Carlton Hall Club v Laurence* and expressed the view obiter that a loan for lawful gaming is recoverable, but found that in the instant circumstances the lender was precluded from recovery by the Gaming Act 1892.[4]

> The plaintiffs, proprietors of a club, issued chips on credit to the defendant which she used for the purpose of gaming. They sued her to recover the amount by which her losses had exceeded her winnings.

The plaintiffs contended that the issue of chips was equivalent to a loan for lawful gaming and as such recoverable; but the fatal flaw in this argument was that they had in fact paid the gaming losses of the defendant, since their practice was to pay cash to the winners at the end of each session. Therefore the promise of the defendant was rendered void by the Gaming Act 1892, as being a promise to pay a sum paid by the club in respect of her gaming contracts.

Special provision, however, has now been made for loans connected with gaming that is lawfully conducted on licensed premises. The Gaming Act 1968 provides that where gaming takes place upon premises licensed for this purpose, neither the licensee nor his agent shall make any loan or allow any

2 *Applegarth v Colley* (1842) 10 M & W 723 at 732.
3 [1965] 2 QB 63 at 86, [1963] 3 All ER 335 at 842-843, *per curiam*. See also *MacDonald v Green* [1951] 1 KB 594 at 600, per Cohen LJ.
4 P 366, above.

credit (a) for enabling any person to take part in the game, or (b) in respect of any losses incurred by any person in the gaming.[5] To contravene this provision is an offence under the Act.[6]

But a cheque drawn to enable a person to take part in gaming on licensed premises is enforceable if it satisfies certain conditions. It is enacted that neither the licensee nor his agent shall accept such a cheque and give in exchange cash or tokens, unless:

(a) it is not a post-dated cheque;
(b) it is exchanged for the equivalent amount of cash or tokens;
(c) it is delivered to a bank within two 'banking days' for payment or collection.[7]

It is expressly provided that nothing in the Gaming Acts of 1710, 1835, 1845 or 1892 shall affect the validity of, or any remedy in respect of, any cheque which is accepted in exchange for cash or tokens to be used by a player on premises licensed or registered under Part II of the Act of 1968.[8]

The third proposition concerns loans made for the purpose of gaming in foreign countries and later sued upon in England. It is now well established that money lent for the purpose of play abroad can be recovered in England provided that it is recoverable in the country where the gaming takes place.[9] Moreover, a lender who accepts an English cheque or other security in payment of the amount, though he is precluded by the Acts of 1710 and 1835 from enforcing the security, may disregard the cheque and successfully maintain an action in England upon the original contract of loan.[10]

Fourthly, a lender who pays the amount of the loan, not to the borrower, but directly to the person to whom the borrower has lost money under a wagering contract, whether it be a wager upon a game or some other event, has no right of recovery.[11] Further it was held in *MacDonald v Green*[12] that there is no right of recovery if the money is paid directly to the borrower, provided that it is lent subject to an undertaking that it shall be passed to the winner in discharge of the bet. The reason in these cases is that the money has been paid 'under or in respect of' a wagering contract, and is therefore rendered irrecoverable by the Gaming Act 1892. For the same reason the amount of a loan is irrecoverable if, at the request of the borrower, it is paid to a stakeholder to abide the event of a wager made by the borrower with a third party.[13]

Fifthly, money lent to a borrower and used by him to pay bets which he has already lost is recoverable,[14] provided that it does not impose any obligation

5 Gaming Act 1968, s 16(1).
6 Ibid, s 23.
7 Ibid, s 16(2) and (3). The expression 'banking days' means a day which is a business day under s 92 of the Bills of Exchange Act 1882: Gaming Act 1968, s 16(5).
8 Gaming Act 1968, s 16(4), in conjunction with s 9.
9 *Quarrier v Colston* (1842) 1 Ph 147; *Saxby v Fulton* [1909] 2 KB 208.
10 *Société Anonyme des Grands Etablissements du Touquet Paris-Plage v Baumgart* (1927) 96 LJKB 789.
11 *Tatam v Reeve* [1893] 1 QB 44; *Woolf v Freeman* [1937] 1 All ER 178; *Saffery v Mayer* [1901] 1 KB 11. *CHT Ltd v Ward* [1965] 2 QB 63, [1963] 3 All ER 835.
12 [1951] 1 KB 594, [1950] 2 All ER 1240; *Hill v Fox* (1859) 4 H & N 359.
13 *Carney v Plimmer* [1897] 1 QB 634.
14 *Re O'Shea, ex p Lancaster* [1911] 2 KB 981.

upon him to employ the money in this particular manner. The contract of loan in this case is unobjectionable. It is not void under the Gaming Act 1845 since it is not a wagering contract; it is not caught by the Gaming Acts 1710 and 1835 which, so far as regards loans, are confined to money lent for the purpose of gaming or betting on games, and do not extend to loans in respect of games or bets already completed; and it is not void under the Gaming Act 1892 for the money is at the free disposal of the borrower and therefore, in the view of the Court of Appeal, it has not been paid to him 'under or in respect of' a wagering contract.

> The distinction is clear enough: a loan which leaves the borrower at liberty to apply the money as he wishes, is not invalidated by the Gaming Act 1892, even though it is contemplated by both parties that he will probably pay betting debts with it; but when a loan is hampered by a stipulation that the money *is* to be used for payment of a betting debt, then no matter whether the stipulation is express or implied or to be inferred from the circumstances, the loan is a payment in respect of the betting debt and is hit by the Act.[15]

The Court of Appeal construed a contract in the first of these two senses, in the case of *Re O'Shea*,[16] where one Lancaster guaranteed the overdraft of a debtor to the extent of £500 which in fact enabled him to pay lost bets. The debt that thus became due to Lancaster was held to be valid and enforceable. Kennedy LJ described the position in these words:

> What was done here was that the debtor went to Lancaster and said 'I have incurred a debt, will you increase the guarantee to the bank in order to enable me to pay it?' I cannot without forcing the words treat that as a transaction in which there was a payment by Lancaster to the creditor. There has been no payment by him 'in respect of any contract or agreement', and unless there has been such a payment the statute does not apply.[17]

Thus what should be observed with some care is that a loan is not irrecoverable under the Gaming Act 1892 unless there is a definite agreement, express or implied, that the money is to be used for gaming or for paying lost bets. The mere probability that it will be so used is no bar to recovery. In the *Carlton Hall* case there was perhaps some justification for inferring an agreement in that sense, since apparently the poker chips were useless for any other purpose; in *MacDonald v Green* the Court of Appeal was satisfied that the understanding to apply the money to the payment of betting losses was a true term of the contract; but in *Re O'Shea* the evidence disclosed no obligation binding the borrower to employ the money for any particular purpose.

Lastly, the question whether money lent for the purpose of making a bet, or paying a lost bet, on a non-gaming wager, which has not yet called for a judicial decision, presumably depends upon the same considerations. The money will be recoverable unless it is lent subject to a binding obligation, express or implied, that it is to be used solely for the purpose of betting.

15 *Macdonald v Green* [1951] 1 KB 594 at 605-660, [1950] 2 All ER 1240 at 1244-1245, per Denning LJ.
16 [1911] 2 KB 981.
17 Ibid at 988.

B AGREEMENTS PROHIBITED BY COMPETITION LAW[18]

EC and UK Competition Rules

The validity of contracts may be affected by both EC and UK competition laws. UK competition law underwent fundamental reform in 1998 with the passing of the Competition Act 1998 and UK domestic law is now largely based upon the EC provisions. For this reason it is necessary to look at the EC competition rules before turning to the UK provisions. At present the EC rules and the UK rules are not mutually exclusive. Although the EC rules can apply *only* where there is an effect on inter-Member State trade[19] UK law can also apply where there is an effect on inter-Member State trade so long as there is an effect inside the UK. It must be noted, however, that the EC Commission is currently proposing the 'modernisation' of the way in which the EC competition rules are implemented.[20] Under Article 3 of the draft Regulation proposed by the Commission Community competition law would apply to the *exclusion* of national competition laws in situations where there was an effect on inter-Member State trade.[1]

1 THE EC COMPETITION RULES

The EC competition rules are contained in Articles 81-89 (ex Articles 85-94) of the Treaty of Rome.[2] The principal substantive provisions which affect transactions between private parties are Article 81 (ex Article 85) and Article 82 (ex Article 86).[3] Of these Article 81, which deals with agreements between undertakings, has the greatest impact on the enforceability of contracts. However, Article 82 deals with abuses by firms in a dominant position and can in some situations affect the enforceability of contractual arrangements entered into by such firms. Hitherto, despite the direct effect of Article 81 (1) and (2) and of Article 82, EC competition law has primarily been enforced by the EC Commission.[4] It is important to note that the policy objectives behind

18 In previous editions of this work the discussion of competition law was divided between this chapter and the two succeeding chapters. The statutory provisions are now all discussed in this chapter. The common law rules as to restraint of trade are still discussed in Chapter 12. Purists may object that sometimes competition law makes contracts illegal rather than void but it is now believed that this objection is outweighed by the advantages of having all the discussion in the same place.

19 However, see p 377, below for the wide interpretation which is given to this concept.

20 Commission White Paper on Modernisation of the Rules Implementing Articles 85 and 86 (now Articles 81 and 82) of the EC Treaty OJ [1999] C 132/1.

1 Draft Council Regulation on the implementation of the rules on competition laid down in Arts 81 and 82 of the Treaty and amending Regulations 1017/68, 2988/74, 4056/86 and 3975/87, COM [2000] 582. The Regulation would need to be adopted by the Council, acting on a qualified majority under Art 83, and the requisite number of Member States may not agree to this proposal.

2 The Articles of the Treaty of Rome were renumbered by the Treaty of Amsterdam. The renumbering took effect on 1 May 1999. In this Chapter the new Article numbers are used even when referring to matters taking place before 1 May 1999.

3 Arts 83-85 (ex Arts 87-89) concern matters of procedure and enforcement; Art 86 (ex Art 90) concerns the application of the competition rules to public undertakings and undertakings given special or exclusive rights by the State; and Arts 87-89 concern State Aids.

4 The Competition Directorate-General was previously known as DG IV.

the competition rules are not only to protect competition as the best means of promoting consumer welfare but also to promote the single European market. EC competition law is therefore concerned to prevent undertakings hindering inter-Member State trade and this means that contractual terms which hinder the free flow of goods and services between Member States will normally be prohibited.

Article 81

Article 81 contains three paragraphs. Article 81(1) prohibits agreements, concerted practices and decisions of associations of undertakings which have as their object or effect the prevention, restriction, or distortion of competition within the common market and which may affect trade between Member States. It then gives a non-exhaustive list of five particular examples. Article 81(2) says that agreements or decisions prohibited by Article 81(1) are void. Article 81(3), however, provides that Article 81(1) may be declared inapplicable to agreements, decisions and concerted practices which fulfil certain criteria.

Article 81(1)—the prohibition of anti-competitive agreements

Article 81(1) provides:

> The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> (b) limit or control production, markets, technical development, or investment;
> (c) share markets or sources of supply;
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Article 81 and its supporting structure has produced a complex body of law into which it would be inappropriate to venture here[5] but the following major points should be noted. The Treaty of Rome contains no definition clause, so the meaning of the terms used in Article 81 has been clarified by judgments of the European Court of Justice and decisions of the Commission.

(a) 'Agreement' is interpreted very widely and encompasses any kind of understanding between the parties whether or not intended to be legally binding. The concept of an agreement within the meaning of Article 81(1) centres around the existence of a concurrence of wills between at least two parties, the form in which it is manifested being unimportant so long as it constitutes the faithful expression of the parties' intention.[6] It is therefore

5 See Whish *Competition Law* (Butterworths, 4th edn, 2001); Jones and Sufrin *EC Competition Law: Text, Cases and Materials* (OUP, 2001); Bellamy and Child *European Community Law of Competition* (Sweet and Maxwell, 5th edn, 2001); *Butterworths Competition Law* (looseleaf); Korah *An Introductory Guide to EC Competition Law and Practice* (Hart Publishing, 7th edn, 2000); Furse *Competition Law of the UK and EC* (Blackstone, 2nd edn, 2000).

6 Case T-41/96 *Bayer AG v EC Commission* [2001] 4 CMLR 126, para 69.

wider than the concept of a contract in UK law as discussed elsewhere in this book. It covers written agreements, oral agreements, informal understandings, 'gentlemen's agreements', standard conditions of sale, and trade association rules, but not a collective agreement between trade unions and employers.[7] For an agreement to exist it is 'sufficient that the undertakings in question should have expressed their joint intention to conduct themselves on the market in a specific way'.[8] An agreement may be spelt out of a course of dealings between the parties where one party may be taken as having tacitly acquiesced in terms imposed by the other,[9] and out of decisions taken by a supplier in the context of a selective distribution network.[10] However, genuinely unilateral conduct on the part of one party, where the other party has not acquiesced, is not an agreement because it does not involve the concurrence of wills which is the hall-mark of an agreement.[11] Undertakings may be taken as having entered into agreements prohibited by Article 81(1) through the activities of their employees, despite the ignorance of the senior management.[12]

There is no 'intra-enterprise conspiracy' in EC competition law. Under the so-called 'single economic entity doctrine' two or more legally separate entities may be regarded as one party for the purposes of Article 81(1), so that arrangements between parent and subsidiary companies, or between different subsidiaries of the same parent, will not be regarded as 'agreements'. This is so however anti-competitive the arrangements seem to be.[13] The same applies to the application of the concept of a 'concerted practice'. For the purposes of competition law the notion of the parties to the agreement includes the parties' connected companies.

(b) 'Concerted practice' is a problematic concept covering behaviour which amounts to collusion between parties falling short of an agreement (even given the wide interpretation of 'agreement' under Article 81(1)). The ECJ has described a concerted practice as 'any form of coordination by undertakings which, without having reached the stage where an agreement properly so called has been concluded, knowingly substitutes practical cooperation between them for the risks of competition'.[14] Nothing turns on whether the conduct of parties is categorised as an agreement or as a concerted practice: all that matters is that they have colluded. Where undertakings have been engaged in a cartel, proof that they have entered into concerted practices may be difficult to find, and the Commission is not able to rely on parallel behaviour, such as similar price increases, as evidence that they have

7 Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751, [2000] 4 CMLR 446.

8 Case T-41/96 *Bayer AG v EC Commission* [2001] 4 CMLR 126, para 67; Case T-7/89 *SA Hercules Chemicals NV v Commission* [1991] ECR II-711, para 2.

9 Case C-277/87 *Sandoz Prodotti v Commission* [1990] ECR I-45.

10 Case 107/82 *AEG-Telefunken v Commission* [1983] ECR 3151, [1984] 3 CMLR 325.

11 Case T-41/96 *Bayer AG v EC Commission* [2001] 4 CMLR 126 (a unilateral refusal to supply is not an agreement).

12 Cases 100-103/80 *Musique Diffusion Française SA v Commission (Pioneer)* [1983] ECR 1825 [1983] 3 CMLR 221.

13 Eg Case C-73/95P *Viho Europe BV v Commission* [1996] ECR I-5457, [1997] 4 CMLR 419 (dividing the common market by export bans).

14 Case 48/69 *ICI v Commission (Dyestuffs)* [1972] ECR 619, [1972] CMLR 557, para 64. Case C-49/92P *EC Commission v Anic Partecipazioni SpA* [2001] 4 CMLR 602, para 115; see also Case 40/73 *Suiker Unie v EC Commission* [1975] ECR 1663, [1976] 1 CMLR 295. Cases C-89/85 etc *A Ahlstrom Oy v Commission* [1993] ECR I-1307, [1993] 4 CMLR 407.

infringed Article 81(1) unless there is no other plausible explanation for the parallel behaviour.[15] A concerted practice requires the parties to it to actually behave collusively on the market, rather than merely to plot to behave anti-competitively. However, once parties have been proved to have engaged in concertation their subsequent behaviour on the market is presumed to have been influenced by the concertation, and the burden of proof therefore shifts to the undertakings to disprove the concerted practice.[16]

(c) 'Decisions by associations of undertakings' means that collusion between undertakings within the context of trade associations or similar bodies[17] is caught by the Article 81(1) prohibition. The rules and constitution of the association will count as a 'decision'. A non-binding recommendation by the association will count as a decision if its object or effect is to influence the members' commercial behaviour.[18]

(d) An 'undertaking' is 'any entity engaged in an economic activity, regardless of its legal status and the way in which it is financed'.[19] An economic activity is any activity consisting in offering goods and services on a given market.[20] 'Undertaking' is therefore a wide concept embracing everything from a multi-national company to an individual person[1] and the entity does not have to take a legally recognised form. The greatest problem is in the area of public bodies and bodies acting in some way under the aegis of the State, and the ECJ has said that the distinction is between 'a situation where the State acts in the exercise of official authority and that where it carries on economic activities of an industrial or commercial nature by offering goods and services on the market'.[2] The crucial factor is the nature of the activity rather than the nature of the body performing it.[3]

(e) In order to be caught by Article 81(1) the agreement, concerted practice or decision must have as its 'object or effect' the 'prevention, restriction or distortion of competition'. The terms 'prevention', 'restriction' and 'distortion' are generally used interchangeably, although one or the other may be more suitable in a particular context.[4] The competition to which Article 81(1) refers may be that between the parties to the agreement or that between one or more of them and a third party, which means that both horizontal agreements (agreements between parties at the same level of the

15 Cases C-89/85 etc *A Ahlstrom Oy v Commission* [1993] ECR I-1307, [1993] 4 CMLR 407. This creates particular difficulties where oligopolistic industries are concerned as the economic theory of oligopolistic interdependence predicts that oligopolies can indulge in parallel behaviour without colluding, see Bishop and Walker *The Economics of EC Competition Law*, 2.19-2.6 (Sweet and Maxwell).

16 Case C-49/92 *EC Commission v Anic Partecipazioni SpA* [2001] 4 CMLR 602.

17 Such as agricultural co-operatives, see eg *MELDOC* [1986] OJ L348/50.

18 Cases 96-102,104,105,108 and 110/82 *NV IAZ International Belgium SA v Commission* [1983] ECR 3369, [1984] 3 CMLR 276.

19 Case C-41/90 *Höfner v Macroton* [1991] ECR-I 1979, [1993] 4 CMLR 306, para 21.

20 Case 118/85 *Commission v Italy* [1987] ECR 2599, para 7.

1 Although it does not include employees, Case 40/73 *Suiker Unie v EC Commission* [1975] ECR 1663, [1976] 1 CMLR 295, para 539.

2 Case C-343/95 *Diego Cali v SEPG* [1997] ECR I-1547, [1997] 5 CMLR 484, para 16.

3 See Case C-41/90 *Höfner v Macroton* [1991] ECR-I 1979, [1993] 4 CMLR 306; Case C-244/94 *Federation Francaise des Societes d'Assurance v Ministere de l'Agriculture* [1995] ECR I-4013, [1996] 4 CMLR 536); Case 364/92 *SAT Fluggesellschaft v Eurocontrol* [1994] ECR I-43, [1994] 5 CMLR 208); Case C-159/91 *Poucet v Assurances Générales de France* [1993] ECR I-637; Case C-343/95 *Diego Cali v SEPG* [1997] ECR I-1547, [1997] 5 CMLR 484.

4 'Restriction' will be used in this chapter as shorthand.

market, such as two manufacturers) and vertical agreements (agreements between parties at a different level of the market, such as a supplier and its distributors) can be caught.[5] Some agreements are prohibited by Article 81(1) because their object is anti-competitive, which does not necessarily mean that the parties had a subjective intention to behave anti-competitively, but that the agreement restricts competition by its very nature. Example of this are agreements between competitors to fix prices or divide up markets between them, and export bans in vertical agreements. If the object of the agreement is not the restriction of competition, then its effect on the market has to be examined.[6]

The 'prevention, restriction or distortion of competition' test is an economic one, which means that the agreement should be looked at in its economic context in order to assess the impact which it really has on competition.[7] There have been decades of controversy about whether the test is applied too broadly, particularly by the Commission, to catch agreements which are not really anti-competitive. The question is to what extent the pro- and anti-competitive aspects of an agreement should be weighed up under Article 81(1) (the so-called 'rule of reason' approach) rather than under Article 81(3). The current approach of the Commission is to take a more economic approach to the application of Article 81(1) than it has done in the past, thus catching fewer agreements within the prohibition.[8] However, in *Métropole Télévision v Commission*[9] the CFI said that the existing case law did not establish the existence of a rule of reason in Community law and that the pro- and anti-competitive aspects of a restriction should be weighed under Article 81(3) rather than Article 81(1).

(f) The Article 81(1) prohibition applies only if there is an effect on inter-Member State trade. This effect may be direct or indirect, actual or potential[10] and, again, this test has been widely interpreted by the Commission and the ECJ and an agreement will be caught by Article 81(1) if it is merely capable of having such an effect. There may be an effect on inter-Member State trade if there is likely to be an impact on the competitive structure in the EC.[11]

5 Cases 56 & 58/64 *Etablissements Consten SA & Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, [1966] CMLR 418.

6 Case 56/65 *Société Technique Minière v Maschinebau Ulm GmbH* [1966] ECR 235, [1966] 1 CMLR 357.

7 Cases 56 & 58/64 *Etablissements Consten SA & Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, [1966] CMLR 418; Case C-234/89 *Stergios Delimitis v Henninger Bräu* [1991] ECR I-935, [1992] 5 CMLR 210; Case C-250/92 *Gøttrup Klim v KLG* [1994] ECR -I 5641, [1996] 4 CMLR 191.

8 See the Guidelines on Horizontal Restraints OJ [2001] C 3/2, and the intention expressed by the Commission in the White Paper on Modernisation of the Rules Implementing Articles 85 and 86 (now Articles 81 and 82) of the EC Treaty OJ [1999] C 132/1, para 78.

9 Case T-112/99 *Métropole Télévision v Commission*, judgment 18 September 2001, paras 72-78.

10 Case 56/65 *Société Technique Minière v Maschinebau Ulm GmbH* [1966] ECR 234, [1966] 1 CMLR 357.

11 This form of the test is usually used in Art 82 rather than Art 81 cases. See Cases 6.7/73 *Istituto Chemioterapico Italiano Spa and Commercial Solvents Corpn v EC Commission* [1974] ECR 223 [1974] 1 CMLR 309. In cases concerning maritime transport on shipping routes between the EC and third countries there has been held to be an effect on inter-Member State trade because of the effect on the competition between ports in different Member States, see eg *CEWAL* OJ [1993] L34/20, [1995] 5 CMLR 198 (affirmed in Cases C-395 and 396P *Compagnie Maritime Belge v Commission* [2000] 4 CMLR 1076), concerning shipping between the North Sea ports and West Africa.

(g) The restriction of competition and the effect on inter-Member State trade have to be 'appreciable' before Article 81 (1) applies.[12] The Commission periodically publishes a Notice as to the thresholds below which it considers that Article 81 does not normally apply because the agreement is *de minimis*. The current Notice[13] sets the thresholds in terms of the parties' market shares: if the parties to a horizontal agreement have a combined market share of less than 10% or the parties to a vertical agreement have a combined market share of less than 5%, the transaction will be *de minimis*. The Notice also says that Article 81 (1) will not usually apply to agreements to which the only parties are small and medium sized undertakings (SMEs).[14] However, the Notice makes it clear that the applicability of Article 81 (1) to horizontal price-fixing or market-sharing agreements, and to territorial protection clauses in vertical agreements cannot be ruled out even if the market share thresholds are not exceeded. An agreement will also not necessarily be *de minimis* if it is one of a network of agreements between the parties and the Notice states that it does not apply if the relevant market is restricted by the cumulative effects of parallel networks of similar agreements operated by other undertakings.[15]

(h) EC competition law has extra-territorial effect. The ECJ has held that agreements wholly between undertakings outside the EU may be caught by Article 81 (1) if they are 'implemented' inside the EU.[16] Also, the single economic entity doctrine[17] may bring foreign parent companies into the jurisdiction of the EU through the activities of their subsidiaries.[18]

(i) As explained above Article 81 (1) applies to both horizontal and vertical agreements.[19] Apart from resale price maintenance many national systems of competition law take a more relaxed attitude to vertical agreements than to horizontal agreements as they are considered less injurious to the competitive process and indeed may be positively beneficial to consumer welfare.[20] In EC competition law, however, distribution and other vertical agreements have been seen as a threat to the single market because of their tendency to divide markets on geographical lines and hinder the free flow of goods between Member States. In 1996 the EC Commission launched a review of its attitude towards vertical agreements[1] which culminated in a new block exemption on

12 Case 5/69 *Völk v Vervaecke* [1969] ECR 295.

13 Commission Notice on Agreements of Minor Importance OJ [1997] C372/13. The Commission has proposed a revision of this Notice: OJ [2001] C 149/18.

14 The criteria for an SME are laid down in the Annex to Commission Recommendation 96/280/EC OJ 1996 L107/4.

15 Para 18.

16 Cases 89,104,114,116,117 and 125-129/85 *A Ahlström Oy v Commission* [1988] ECR 5193, [1988] 4 CMLR 901. In a case concerning the EC Merger Regulation the CFI has held that the EC Commission has jurisdiction over mergers between non-EU companies where 'it was foreseeable that a proposed concentration would have an immediate and substantial effect within the Community', Case T-102/96 *Gencor Ltd v Commission* [1999] ECR II-753, [1999] 4 CMLR 971. The concept of 'having effects' may be wider than that of 'implementation'. See further, Whish *Competition Law* (4th edn, Butterworths, 2001). For the position under the UK Competition Act 1998, below p 389.

17 See above p 375.

18 Case 48/69 *ICI v Commission (Dyestuffs)* [1972] ECR 619, [1972] CMLR 557.

19 Cases 56 & 58/64 *Etablissements Consten SA & Grundig-Verkaufs-GmbH v Commission* [1966] ECR 299, [1966] CMLR 418: see pp 376-377.

20 See Jones and Sufrin EC *Competition Law: Text, Cases and Materials* (OUP, 2001) Ch 9.

1 *Green Paper on Vertical Restraints in Competition Policy* (COM(96) 721, final, 22 January 1997 [1997] 4 CMLR 519.

vertical restraints in December 1999.[2] This Regulation provides an exemption from Article 81(1) to vertical agreements which comply with its terms, provided that the supplier does not have a market share exceeding 30%.[3] Resale price maintenance provisions and provisions hindering imports and exports between Member States are not block exempted pursuant to Regulation 2790/1999 and are extremely unlikely to receive individual exemption.[4]

Article 81(3)—inapplicability of Article 81(1) to certain agreements

Article 81(3) provides:

> The provisions of paragraph 1 may, however, be declared inapplicable in the case of:
> - any agreement or category of agreements between undertakings;
> - any decision or category of decisions by associations of undertakings;
> - any concerted practice or category of concerted practices,
>
> which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
>
> (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
>
> (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Thus Article 81(3) sets out the four criteria which agreements caught by Article 81(1) must meet if they are to escape from the prohibition. There are two positive criteria (firstly, improving production or distribution, or promoting technical or economic progress and second, allowing consumers a fair share of these benefits) and two negative (no indispensable restrictions and no substantial elimination of competition). All four criteria must be met.

Until now only the EC Commission has had the power to apply Article 81(3) and declare Article 81(1) inapplicable because the criteria have been met.[5] Neither national competition authorities, national courts or the ECJ have any power to do so. Article 81(3) has not been directly applicable. The Commission exercises its power by granting individual exemptions to agreements which are notified to it[6] and by issuing block exemptions.[7]

2 Regulation 2790/1999, the 'Verticals Regulation', OJ [1999] L336/21. The Commission has issued a Notice explaining the Regulation and its new policy, Guidelines on Vertical Restraints, OJ [2000] C 43/1. For an explanation of block exemptions, see below p 380.

3 In certain situations the market share cap applied to the buyer rather than to the distributor. Regulation 2790/1999, Art 3(2).

4 For individual exemptions, see p 380, below.

5 Council Regulation 17 OJ Spec Ed [1959-62], 87, Art 9(1). Regulation 17 is the main regulation implementing the competition rules. There are provisions analogous to Art 9(1) in the regulations implementing the competition rules in the special sectors eg Council Regulation 1017/68 OJ Spec Ed [1968] 302, applying the competition rules to rail, road and inland waterway transport.

6 Regulation 17, Art 4(1). Art 4(2) provides for a category of 'non-notifiable agreements'.

7 Art 81(3), it will be noted, provides for Art 81(1) to be declared inapplicable in respect of 'categories' of agreements etc. The Council conferred on the Commission the power to do this by way of block exemptions in respect of vertical agreements and bilateral intellectual property licences (Council Regulation 19/65 OJ [1965-66] 35 as amended by Council Regulation 1215/99) and in respect of horizontal co-operation agreements (Council Regulation 2821/71 OJ [1971] 1032). The Council has also authorised the Commission to issue block exemptions in parts of the transport sector, and in certain cases the Council has itself issued block exemptions (for instance, Council Regulation 4056/86 OJ [1986] L378/4 on maritime transport).

Individual exemptions take the form of a decision, one of the forms of EC legislation provided for by Article 249 (ex Article 189) of the EC Treaty. In practice the Commission issues very few individual exemptions.[8] In the great majority of cases the Commission settles the case informally by sending the parties a 'comfort letter' telling them that it considers that the agreement does meet the criteria for exemption but that it does not intend to proceed to a formal decision. This leaves the parties without legal security as comfort letters cannot be treated by national courts as equivalent to a decision.[9]

Block exemptions are regulations which provide that agreements which comply with their terms satisfy the Article 81(3) criteria and are exempted without notification to the Commission. Older block exemptions[10] contained lists of both 'black' clauses—provisions which an agreement could not include if it was to come within the block exemption, and 'white' clauses—provisions which the agreement *could* contain. However, the most recent block exemptions such as that on vertical restraints contain only black clauses.[11] As block exemptions are regulations and therefore directly applicable,[12] national courts are able to apply them and so a UK court may declare an agreement which complies with a block exemption to be exempted from Article 81(1) by virtue of Article 81(3).[13]

In 1999 the Commission put forward proposals for the 'modernisation' of the rules applying Articles 81 and 82,[14] and in 2000 published a draft regulation for the implementation of its proposed reforms.[15] The Commission is proposing the abolition of the notification and individual exemption system. Instead, Article 81(3) would become a 'directly applicable legal exception', which could be invoked by parties in any court or before any competition authority. Agreements which are prohibited by Article 81(1) but meet the Article 81(3) criteria would be lawful from the time of their conclusion without any need for a prior constitutive decision as at present. The whole of Article 81 would therefore become directly applicable, and would be applied by national courts and national competition authorities if and when the matter of the lawfulness of an agreement became an issue before them. This radical proposal therefore does two interconnected things: it abolishes individual exemptions and decentralises the application and enforcement of competition law to national competition authorities and

8 See the Commission's Annual Reports on Competition Policy.

9 For the position of national courts in applying the EC competition rules see Case C-234/89 *Stergios Delimitis v Henninger Bräu* [1991] ECR 1-935, [1992] 5 CMLR 210; Commission Notice on Cooperation between National Courts and the Commission OJ 1993 C39/5; and below, p 383.

10 For example, Commission Regulation 1983/83 on exclusive distribution agreements; Commission Regulation 1984/83 on exclusive purchasing agreements; Commission Regulation 240/96 on technology transfer agreements.

11 Commission Regulation 2790/1999, OJ [1999] L336/21 on vertical restraints.

12 Art 249EC.

13 As explained further in Commission Notice on Cooperation between National Courts and the Commission OJ 1993 C39/5.

14 Commission White Paper on Modernisation of the Rules Implementing Articles 85 and 86 (now Articles 81 and 82) of the EC Treaty OJ [1999] C 132/1.

15 Proposal for a Council Regulation on the implementation of the rules on competition laid down in Arts 81 and 82 of the Treaty and amending Regulations (EEC) 1017, (EEC) 2988/74, (EEC) 4056/86 and 3975/87, COM(2000) 582.

national courts.[16] The changes would have an important effect on the way that questions of the validity and legality of agreements to which Article 81 may apply are dealt with in national courts, discussed below.

Voidness under Article 81(2) and the other consequences of entering into a prohibited agreement

There are a number of consequences of parties entering into an agreement prohibited by Article 81(1) which is neither individually nor block exempted. Under the implementing regulations the Commission may fine the parties[17] and/or adopt a decision ordering them to bring the infringement of the competition rules to an end.[18] As Article 81(1) is directly applicable third parties may rely on it as a cause of action[19] or as a defence.[20]

Article 81 expressly provides for the sanction of voidness. Article 81(2) says:

> Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

Despite this plain wording the ECJ has held that only the elements of an agreement which infringe Article 81 are void, not the whole agreement.[1] Whether the non-infringing provisions of the agreement can stand depends on the test for severability in the law applied by the national court before which the status of the agreement has arisen in litigation.[2] There is no Community

16 For a discussion of the proposals see Whish and Sufrin *Community Competition Law: Notification and Exemption—Goodbye to All That* in Hayton (ed) *Law's Future(s)* (Hart Publishing, 2000); the proposals are discussed in the context of the historical development of Community competition law in Wesseling *The Modernisation Of EC Antitrust Law* (Hart Publishing, 2000).

17 Regulation 17, Art 15. The fine may be as much as £1 million or 10% of the undertaking's turnover in the previous year. In theory this relates to all products (or services), worldwide, see Cases 100-103/80 *Musique Diffusion Francaise SA v Commission (Pioneer)* [1983] ECR 1825 [1983] 3 CMLR 221, and the turnover concerned is that of the group of connected companies to which the infringing undertaking belongs. In practice the turnover accounted for by the product to which the infringement relates will be relevant, see eg Case T-77/92 *Parker Pen v Commission* [1994] ECR II-549.

18 Regulation 17, Art 3(1).

19 It appears from the *Factortame* case, Case C-213/89 *R v Secretary of State for Transport, ex p Factortame (No 2)* [1990] ECR I-2433, [1990] 3 CMLR 1 that there is in Community law an obligation on national courts to grant interlocutory relief to protect Community rights. The UK courts have granted interlocutory relief in several competition cases, such as *Cutsforth v Mansfield Inns* [1986] 1 CMLR 1, a brewery tie agreement which excluded the plaintiff from the list of approved amusement machine suppliers. The House of Lords has accepted that the competition rules can give rise to an action for damages by third parties (*Garden Cottage Foods Ltd v Milk Marketing Board* [1984] AC 130, [1983] 2 All ER 770) but there has been no case in which such damages have actually been awarded, although cases have been settled on the basis that such damages would be available. There have been cases in other Member States in which damages have been awarded, eg *Euro Garage v Renault*, 23 March 1989 (Cour d'Appel de Paris).

20 For example, in cases alleging infringement of the plaintiff's intellectual property rights, as in *Philips Electronics v Ingman Ltd* [1998] 2 CMLR 839.

1 Case 56/65 *Société Technique Minière v Maschinebau Ulm GmbH* [1966] ECR 235, [1966] 1 CMLR 357, 376.

2 Case 319/82 *Société de Vente de Ciments et Bétons de L'Est SA v Kerpen and Kerpen GmbH* [1983] ECR 4173, [1985] 1 CMLR 511. For severance in UK law see pp 470-475, below.

law doctrine of severance. This means that the outcome of litigation can vary depending on the applicable law of the contract, a problem which could be mitigated by harmonisation of the Member States rules on severance. In UK law the leading case on severability in competition cases is *Chemidus Wavin*[3] in which Buckley LJ said that the question was whether after excising the prohibited provisions the contract could be said to fail for consideration or any other ground, or would be so changed in its character as not to be the sort of contract that the parties intended to enter into at all.[4] This was applied in *Inntrepreneur Estates Ltd v Mason*[5] in which a Deputy High Court judge said that in the lease of a public house it would be possible to sever a beer tie obligation from the obligation to pay rent.[6]

A question which arose before the English High Court in *Passmore v Morland plc*[7] was whether an agreement which is void for infringing the competition rules is void for ever or can be void or valid depending on its economic effects from time to time.[8] In that case Passmore took a lease of a pub from Inntrepreneur in February 1992. The tenancy agreement contained a beer tie, an exclusive purchasing agreement whereby Passmore contracted to buy all its beer from Inntrepreneur, its assigns and nominees. Five months later Inntrepreneur transferred the reversion of the lease, and it was eventually acquired by the defendant, Morland. The terms of the lease did not fall within the relevant block exemption,[9] and a notification to the Commission for individual exemption made in July 1992 was later withdrawn, apparently because the Commission informed Inntrepreneur that the terms did not qualify for exemption. In 1997 Passmore informed Morland that he considered the beer tie was unenforceable for infringing Article 81(1) and that he reserved the right to buy beer products from other brewers with immediate effect. The crucial fact was that Inntrepreneur owned approximately 4,500 on-licensed premises in 1992, all let on terms which included a beer tie similar to that in Passmore's lease, whereas Morland was a small brewer whose tied estate amounted to only 0.19% of licensed outlets in the UK. The Court of Appeal held that even if the cumulative effect of Inntrepreneur's agreements was to restrict competition because it foreclosed the market to other producers, so that according to the judgment of the ECJ in *Delimitis*[10] the agreement with Passmore infringed Article 81(1) and was void under Article 81(2), the infringement and therefore the voidness came to an end when Morland acquired the lease. Morland's share of the market was so insignificant that the arrangement with Passmore was *de minimis* and not brought within Article 81(1) by the network effect. The Court of Appeal held that in such a situation an agreement which is void at its inception can spring to life when its economic effects change, *in casu* by a change in the parties, and become valid.

3 *Chemidus Wavin v Société pour la Transformation* [1978] 3 CMLR 514, CA.
4 Ibid, at 520.
5 [1993] 2 CMLR 293, QB.
6 See also *Inntrepreneur Estates (GL) Ltd v Boyes* [1993] 2 EGLR 112.
7 [1998] 4 All ER 468; affd [1999] 3 All ER 1005, [1999] 1 CMLR 1129, CA.
8 Passmore's action was for a declaration that the beer-tie was unenforceable. He had originally claimed damages and restitution as well, but the claims were not pursued because of the Court of Appeal judgment in *Gibbs Mew v Gemmell*, discussed below p 384 which had been delivered in the meantime.
9 Commission Regulation 1984/83 on exclusive purchasing agreements.
10 Case C-234/89 *Stergios Delimitis v Henninger Bräu* [1991] ECR I-935, [1992] 5 CMLR 210.

The reverse can also occur, so that a previously valid agreement may become void. As Chadwick LJ said:

> Agreements are prohibited when and while they are incompatible with competition in the common market and not otherwise.

In coming to this decision Chadwick LJ distinguished the case before him from *Shell UK Ltd v Lostock Garage Ltd*[11] in which the Court of Appeal held that a petrol tie agreement valid at the time that it was entered into did not become unenforceable for restraint of trade because it subsequently became unreasonable or unfair. That rule could not apply in the context of EC competition law.[12]

The greatest problem for national courts in applying Article 81(2) is the Commission's monopoly over individual exemptions.[13] The bifurcation of Article 81, whereby Article 81(1) is directly applicable and national courts have a duty to apply it whereas only the Commission decides whether an agreement can be individually exempted, puts courts faced with questions as to the validity of agreements in a difficult position. If the court decides that the agreement infringes Article 81(1), it can come to no definitive conclusion as to its validity without knowing whether it satisfies Article 81(3). If there is a relevant block exemption with which the agreement complies, the court can hold the agreement valid. If not, and the agreement has not been notified to the Commission it will usually be invalid as there can normally be no possibility of exemption in respect of any period before the date of notification: exemptions are not retrospective.[14] However, if an agreement *has* been notified to the Commission, or it is a non-notifiable agreement, the possibility of exemption exists and the national court may have to stay proceedings to await the outcome of proceedings before the Commission.[15] In 1993 the Commission issued a Notice giving guidance to national courts in their application of the competition rules.[16] Nevertheless, there is no satisfactory solution either there or elsewhere to the problems caused by the present Commission monopoly. The position will be remedied if the modernisation proposals are implemented, as national courts will be able to decide themselves whether or not Article 81(3) applies.

11 [1977] 1 All ER 481, [1977] 1 WLR 1187.

12 And will not apply in the context of domestic competition law under the Competition Act 1998, see below p 388.

13 See above, p 379-380.

14 Regulation 17, Art 6(1). The exceptions to this are agreements falling within Regulation 17, Art 4(2), which do not have to formally notified to the Commission and can be retrospectively exempted. Art 4(2) was of little importance until amended by Regulation 1216/99 OJ [1999] L148/5, as it covered a very narrow category of agreements. However, Regulation 1216/99 brought all vertical agreements within Art 4(2)(2)(a) (many vertical agreements are block exempted by Regulation 2790/99 but there are market share thresholds in that Regulation, above which it does not apply). The 'non-notifiable' category of agreements in Art 4(2)(2) is therefore now of considerable significance. Also, there is a doctrine of 'provisional validity' in respect of old agreements (those which were in existence before 1962) which probably applies in addition to agreements only brought within the competition rules because of the accession to the EU of a new Member State.

15 A national court cannot treat a comfort letter as an individual exemption because the comfort letter is not a decision of the Commission.

16 Commission Notice on Cooperation between National Courts and the Commission OJ 1993 C39/5, which is based on and elaborates on the judgment of the ECJ in Case C-234/89 *Stergios Delimitis v Henninger Bräu* [1991] ECR I-935, [1992] 5 CMLR 210.

The UK courts have had to grapple with the issue of what are the consequences as between the parties of entering into a prohibited agreement. We have seen above in *Passmore v Morland* a situation where one party attempted to escape its contractual obligations by pleading that the contract infringed Article 81(1). The UK courts have not shown themselves sympathetic to this tactic, the so-called 'Euro-defence', which has been used as a sword as well as a shield. The singer George Michael, for example, asked for a declaration that his recording contract with Sony was void on the basis that it infringed Article 81(1) as well as arguing that it was void as being in restraint of trade at common law. Parker J held that Article 81(1) was not infringed as the recording contract did not have an appreciable effect on inter-Member State trade.[17] Many of the cases where parties have pleaded Article 81 in the UK courts have involved tied house agreements, because for a long time the Commission, fearing the foreclosure effect on the beer market of networks of tying agreements, applied Article 81(1) very widely to such agreements and was very restrictive as to the terms to which it would grant exemption.[18] More recently the Commission has been readier to hold that beer ties are either not caught by Article 81(1),[19] or can be exempted,[20] and the new block exemption on vertical restraints takes a broader brush approach and does not contain special provisions for beer ties.[1]

One major question which has arisen is whether a party to a contract which is void for infringing the competition rules can not only avoid its enforcement but also claim restitution of benefits it has paid to the other party under the contract and/or damages for the harm it suffered from the contract's operation. In *Gibbs Mew plc v Gemmell*,[2] another tied house case, the Court of Appeal said *obiter* that such recovery was impossible since an agreement prohibited by Article 81(1) is not only void but illegal: being illegal the principle *in pari delicto* applies and in English law neither party can claim from the other party for loss caused to him by being party to an illegal contract.[3] The categorisation

17 *Panayiotou v Sony Music Entertainment (UK) Ltd* [1994] ECC 395. The conclusion about the lack of effect on inter-Member State trade was rather strange but the case did not go to appeal as it was settled.

18 The inter-Member State trade effect arises in these cases from the difficulties of importers trying to penetrate a market networked with tying agreements. Commission Regulation 1983/84, the block exemption on exclusive purchasing agreements, contained special provisions on beer ties. Case C-234/89 *Stergios Delimitis v Henninger Bräu* [1991] ECR I-935, [1992] 5 CMLR 210, a seminal judgment of the ECJ on the application of art 81(1), concerned a beer tie which was outside the block exemption because of specific clauses which did not comply with the detailed requirements of the block exemption.

19 An approach approved by the CFI in Case T-25/99 *Roberts v Commission*, judgment 5 July 2001 following the test laid down by the ECJ in *Delimitis* (see note 18 above) for ascertaining whether a beer tie is caught by art 81(1).

20 Eg *Whitbread* OJ [1999] L88/26, [1999] 5 CMLR 118; *Bass* OJ [1999] L 186/1, [1999] 5 CMLR 782; *Scottish and Newcastle* OJ [1999] L186/28, [1999] 5 CMLR 831.

1 Regulation 2790/1999 on vertical restraints, OJ [1999] L336/21.

2 [1999] ECC 97, [1998] Eu LR 588.

3 This rule is discussed below, pp 429 ff. In general English contract law it would make a difference whether the contract is classified as illegal or as void (see chs 11 and 12); whether the doctrine of severance applies (see pp 470-475) and whether the parties are treated as equally at fault (see pp 422 ff). It is a conceivable argument that a publican who has a beer tie imposed on him by the brewer's contract is not equally at fault with the brewer but that view has not been taken in the cases here cited. This firm statement by the CA was in line with a number of unreported High Court decisions where claims by a party to an agreement infringing Art 81 for restitution or damages had been rejected: eg *Inntrepreneur Estates v Milne*, 30 July 1993; *Inntrepreneur Estates plc v Smythe*, 14 October 1993; *Trent Taverns v Sykes* [1998] Eu LR 571; *Parkes v Esso Petroleum Co Ltd* [1998] Eu LR 550 (concerning a petrol rather than a beer tie).

of an infringing agreement as illegal therefore bars any restitutionary or damages claim by either party. Peter Gibson LJ rejected the argument that the parties were not *in pari delicto* because the publican was much the weaker party, and said that Article 81(1) was concerned not with inequality of bargaining power between the parties to the illegal agreement but with the effect of that agreement on competition.

The point in *Gibbs Mew*, however, was referred by a later Court of Appeal to the ECJ under the Article 234 reference procedure in *Courage v Crehan*.[4] The CA asked the ECJ, in effect, whether a party to a prohibited tied house agreement was entitled to claim from the other party damages arising from his adherence to the prohibited agreement and whether, or in what circumstances, a rule of national law which prevented him doing so (ie as enunciated in *Gibbs Mew*) was inconsistent with Community law. The ECJ said that Community law did preclude an absolute rule in national law which prevented any party to an agreement which infringed Community law from recovering damages; Community law did not however preclude a rule to the effect that a party who bore significant responsibility for the distortion of competition could not recover.[5] The question is whether one party found himself in a markedly weaker position than the other, such as seriously to compromise or even eliminate his freedom of negotiation and his capacity to avoid or reduce loss.[6] In other words the ECJ, unlike the Court of Appeal, is prepared to recognise inequality of bargaining power in this context.

The ECJ judgment in *Crehan*, contrary to *Gibbs Mew*, allows damages and restitution actions to parties who have had the contractual terms imposed upon them, and this would apply not only where Article 81 was being applied in UK courts but also where the parties had entered into an agreement prohibited by the equivalent provision in domestic competition law, the Chapter I prohibition under the Competition Act 1998.[7]

Article 82

Article 82 prohibits an undertaking in a dominant position in the common market or a substantial part of it from abusing that position. It provides:

> Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.
>
> Such abuse may, in particular, consist in:
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
> (b) limiting production, markets or technical development to the prejudice of consumers;
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

4 Case C-453/99 *Courage v Crehan*, judgment 20 September 2001.
5 Ibid, para 36.
6 Ibid, para 33.
7 See below, p 393.

The question of whether or not an undertaking is in a dominant position in a substantial part of the common market is a complex one on which there is 40 years of cases and decisions by the ECJ and the EC Commission, and the reader is referred to the specialist works on the subject.[8] The terms 'undertaking' and 'may affect trade between Member States 'are given the same interpretation as they are for the purposes of Article 81.[9] Unlike Article 81 there is no exemption procedure[10] and the problems discussed above concerning notifications and exemptions are therefore not an issue in respect of Article 82.

As with 'dominant position' the concept of an 'abuse' is complex. The list in paragraphs (a) to (d) of the Article is non-exhaustive and 'anti-competitive' as well as 'exploitative' conduct is caught by Article 82.[11] In particular the ECJ has held that it can be an abuse for a dominant firm to enter into some kinds of contractual arrangements. This may be because they are unfair to the other party[12] or because they have the effect of foreclosing the market to competitors. So, for example, agreements by which a dominant firm enters into requirements contracts, exclusive purchasing arrangements, contracts providing for loyalty rebates (whereby the buyer gets a discount if it buys solely from the dominant firm) or tying arrangements, may amount to an abuse.[13]

The underlying idea behind Article 82 is that a firm in a dominant position can distort competition by its unilateral conduct. The other party to an agreement which amounts to an abuse of a dominant position can therefore be seen as among the victims of the abuse, rather than a party to it. Although Article 82 does not expressly say that the abusive provisions of the agreement are void it is assumed that that is the consequence of the Article 82 prohibition and that the other party can treat them as unenforceable (the same issue of severability arises as in respect of Article 81[14]).[15] As far as the other party claiming restitution or damages is concerned, the issue in UK law could be whether the principle in respect of Article 81 stated *obiter* by the Court of Appeal in *Gibbs Mew*, that a prohibited agreement is illegal and therefore *in pari delicto* applies,[16] applies equally to Article 82. There is a good argument that it should not, because the rationale for the two provisions is different, as whereas Article 81(1) prohibits *agreements*, Article 82 prohibits *abuses*. However, after the ECJ judgment in *Courage v Crehan*,[17] this might well become a moot point, because *ex hypothesi* an agreement between a dominant and non-dominant firm is one in which one party is in a weaker position. The question

8 See fn 5, p 374, above.
9 See above, pp 374-375, 377.
10 The only derogation lies in Art 86 which provides for the non-application of the competition rules in limited circumstances to undertakings entrusted with 'services of general economic interest' by the State.
11 Case 6/72 *Europemballage Corpn & Continental Can Co Inc v EC Commission* [1973] ECR 215 [1973] CMLR 199.
12 As is contemplated in Art 82(a) itself.
13 See for example Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461 [1979] 3 CMLR 211; Case 322/81 *Nederlandsche Banden-Industrie Michelin v Commission* [1983] ECR 3461 [1985] 1 CMLR 282.
14 See above pp 381-382.
15 See R Whish *The Enforceability of Agreements under EC and UK Competition Law* in F D Rose (ed) *Lex Mercatoria: Essays in International Commercial Law in Honour of Francis Reynolds* (LLP, 2000) 297-319 at 317.
16 Discussed above pp 384-385.
17 Case C-453/99 *Courage v Crehan*, judgment 20 September 2001.

is therefore whether it is always assumed that the non-dominant firm had the terms of the contract imposed upon it, without any genuine freedom to choose.

2 THE UK COMPETITION RULES

The position before 1 March 2000

United Kingdom legislation for the regulation of restrictive trading agreements was consolidated by the Restrictive Trade Practices Act 1976. For some twenty years before that restrictive agreements relating to goods had been subject to statutory regulation by virtue of Part I of the Restrictive Trade Practices Act 1956.[18] During that period Part I of the 1956 Act was amended by the Restrictive Trade Practices Act 1968 and further amended five years later by the Fair Trading Act 1973.[19] In particular, provision was made by the Acts of 1968 and 1973 for the extension of the scope of Part I of the 1956 Act by statutory order. Part I was applied in 1969 to information agreements relating to goods[20] and in 1976 to restrictive agreements relating to services. Minimum resale price maintenance was dealt with by specific legislation. It was prohibited by the Resale Prices Act 1964, and then by the Resale Prices Act 1976. Procedures under the Fair Trading Act 1973 (FTA), which provided for industry-wide investigations in situations of scale and complex monopoly, and under the Competition Act 1980, which provided for investigations into anti-competitive practices by particular firms,[1] could result in firms being prohibited from entering into certain types of agreement.

The position after the coming into force of the Competition Act 1998

The Restrictive Trade Practices Act 1976 and the Resale Prices Act 1976 were repealed by the Competition Act 1998, which came into force on 1 March 2000.[2] There are transitional provisions for agreements which were made before 1 March 2000 (the 'starting date').[3] The Competition Act 1998 applies to all agreements made on or after the starting date to the exclusion of the two 1976 Acts. The anti-competitive practices provisions of the Competition Act 1980 were repealed[4] but the monopoly provisions of the FTA remain in force.

18 From 1948 to 1956 such agreements had been subject to statutory regulation by virtue of the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948.

19 Fair Trading Act 1973, Parts IX and X.

20 Restrictive Trade Practices (Information Agreements) Order 1969 (SI 1969/1842). The order was made under the Restrictive Trade Practices Act 1968, s 5(2) but later took effect as if made under the Restrictive Trade Practices Act 1976. No order was ever made by the Secretary of State under s 12 of the 1976 Act for regulating information agreements relating to services.

1 Market-share and turnover thresholds below which businesses were excluded from the provisions of the1980 Act were set by Order. The relevant figures were 25% of the market and £10 million (after 1994) annual turnover: Anti-Competitive Practices (Exclusions) Order 1994, SI 1994/1557 amending Anti-Competitive Practices (Exclusions) Order 1980, SI 1980/979.

2 Competition Act 1998, s 74 and Sch 14.

3 Competition Act 1998, Sch 13; The Competition Act 1998 (Notification of Excluded Agreements and Appealable Decisions) Regulations 2000, SI 2000/263; The Competition Act 1998 (Director's Rules) Order 2000, SI 2000/293; OFT Guideline 406 *Transitional Arrangements*.

4 Competition Act 1998, s 17.

In July 2001 the Government published a White Paper *A World Class Competition Regime*[5] which contains proposals for some changes to the regime under the Competition Act 1998, including measures for more stringent enforcement.

The Competition Act 1998

UK competition law was fundamentally reformed by the Competition Act 1998. The reasons for the reform were the unsatisfactory and inadequate nature of the previous law,[6] the need for more stringent provisions, including more effective enforcement measures and more effective sanctions, and the desirability of harmonising UK law with EC competition law.[7]

The Competition Act 1998 brings into domestic competition law provisions analogous to Article 81 and Article 82EC, but without the 'affect on trade between Member States' criteria. The 'Chapter I prohibition', contained in s 2 of the Act, is equivalent to Article 81 and the 'Chapter II prohibition', contained in s 18, is equivalent to Article 82. The whole essence of the UK provisions is that they broadly replicate EC law. The key to the Act is s 60, the 'governing principles' clause. It provides that so far as is possible, and 'having regard to any relevant differences between the provisions concerned', the authorities and courts in the UK are to maintain consistency with EC law. This is to be done by following the decisions of the ECJ and 'having regard to' decisions or statements of the Commission. The scope and significance of s 60 is considered further below[8] but the basic position is that the concepts in the Act, such as 'agreement', 'undertaking', and 'object or effect the prevention, restriction or distortion of competition' must be given the same meaning in UK law as they have in EC law.

Primary responsibility for enforcing the Competition Act lies with the Director General of Fair Trading (DGFT), who heads the Office of Fair Trading (OFT), a non-ministerial government department. The OFT has published a series of Guidelines explaining the provisions of the Competition Act and indicating how the DGFT expects them to operate.[9] The Guidelines include explanations of the relevant EC law. Appeals from decisions of the DGFT lie to the Competition Commission Appeal Tribunals and thence on a point of law to the Court of Appeal.[10]

The Chapter I Prohibition

The Competition Act 1998 s 2(1)-(3) provides:

5 Cm 5233 (2001).

6 For an account of the 1976 Acts, see Ch 10 of the 13th edn of this book.

7 See the Secretary of State (Margaret Beckett) during the Second Reading of the Bill, Hansard, HC, 11 May 1998, col 25. The genesis of the reform of UK law was the Liesner reports of the late 1970's, *A Review of Monopolies and Mergers Policy* Cm 7198(1978) and *A Review of Restrictive Trade Practices Policy* Cm 7512 (1979). Under the Conservative government there were two Green Papers, *Review of Restrictive Trade Practices Policy: A Consultative Document*, Cm 331 (1988) and *Abuse of Market Power: A Consultative Document on Possible Legislative Options*, Cm 2100 (1992), a White Paper *Opening Markets: New Policy on Restrictive Trade Practices* Cm 727 (1989), and a further consultation document and a draft Bill in 1996. The incoming Labour government announced its intention to reform competition law in the Queen's Speech in May 1997 and introduced the Competition Bill into the House of Lords in October 1997. It received the Royal Assent on 9 November 1998.

8 See p 393-394, below.

9 As required by Competition Act 1998, s 52.

10 Competition Act 1998, ss 46-49.

(1) Subject to section 3, agreements between undertakings, decisions by associations of undertakings or concerted practices which–
(a) may affect trade within the United Kingdom, and
(b) have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom,
are prohibited unless they are exempt in accordance with the provisions of this Part.

(2) Subsection (1) applies, in particular, to agreements, decisions or practices which–
(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

(3) Subsection (1) applies only if the agreement, decision or practice is, or is intended to be, implemented in the United Kingdom.

The wording of subsection (2) is identical to the corresponding para of Article 81(1). The wording of subsection (1) is almost identical, except that competition must be distorted *in the United Kingdom* and trade affected *in the United Kingdom*. Section 2(7) provides that 'the United Kingdom' means, in relation to an agreement which operates or is intended to operate only in a part of the United Kingdom, that part. It does not provide, however, that the part has to be substantial or significant, and this means that the Act can catch agreements which have only a very localised effect. Subsection 2(3) addresses the question of extra-territorial effect which is not expressly provided for in Article 81(1) but has been dealt with by the ECJ.[11] Subsection 2(3) uses the wording used by the ECJ in the *Wood Pulp* judgment ie that the agreement be 'implemented in' the territory.[12] By making express provision for this Parliament intended to exclude the possibility of a full-scale 'effects doctrine'[13] becoming applicable under the Act in the future as a result of developments in European jurisprudence being imported into domestic competition law via section 60.[14]

As with Article 81, there is provision for agreements which fall within the Chapter I prohibition to be exempted. Section 4 allows for individual exemption to be given by the DGFT to agreements notified to him in accordance with s 14. Section 6 provides for the Secretary of State, on the DGFT's recommendation, to issue block exemptions. The criteria for exemption are laid down in section 9 and are identical to those in Article 81(3). The Act also provides for 'parallel exemptions'[15] by which an agreement

11 See above p 378.
12 Cases 89, 104, 114, 116, 117 and 125-129/85 *A Ahlström Oy v Commission* [1988] ECR 5193, [1988] 4 CMLR 901.
13 For the effects doctrine in US antitrust law see *Butterworths Competition Law*, Division XII; Jones and Sufrin, fn 5, p 374, above, Ch 17.
14 Lord Simon, Hansard, HL, 13 November 1997, col 261. The CFI has used the word 'effect' in a merger case, Case T-102/96 *Gencor Ltd v Commission* [1999] ECR II-753, [1999] 4 CMLR 971.
15 Competition Act 1998 s 10.

either individually or block exempted by EC law[16] is automatically exempt from the Chapter I prohibition. This also applies to agreements which do not infringe Article 81(1) because they do not affect inter-Member State trade but which would come within a block exemption if they did. The parallel exemption provision is of great importance because it means that it has not been necessary for the Secretary of State to make Orders providing for block exemptions, as it has been considered sufficient to rely on the EC exemptions.

The scheme of the Chapter I prohibition, with its notifications and exemptions, was deliberately modelled on Article 81(1). If the Commission's modernisation proposals are implemented[17] the notification and exemption procedure in EC law will be abolished and the UK and EC systems for the control of restrictive agreements will once again operate differently.

One way in which the Chapter I prohibition differs from Article 81(1) is that the Act provides for certain types of agreement to be *excluded* (rather than exempted) from the prohibition.[18] This means that such agreements are not caught by section 2(1) in the first place. The exclusions are: mergers and concentrations; matters regulated by competition provisions in other UK legislation (Financial Services and Markets Act 2000,[19] Companies Act 1989, Broadcasting Act 1990, Environment Act 1995); compliance with planning requirements; agreements cleared under RTPA, section 21(2);[20] the rules of 'EEA regulated' financial markets'; undertakings entrusted with services of general economic interest;[1] agreements made to comply with a legal requirement; agreements made to avoid conflict with the UK's international obligations (to be excluded by Order of the Secretary of State); agreements needed to be excluded for exceptional and compelling reasons of public policy (to be excluded by Order of the Secretary of State); coal and steel agreements covered by the ECSC Treaty; agreements relating to certain agricultural products; and rules of professional bodies (as designated by Order of the Secretary of State). It is provided that the Secretary of State may make add to these exclusions, or make deletions.[2] In addition Competition Act 1998, section 50 provides that the Secretary of State may exclude vertical agreements and land[3] agreements, or modify the way in which the Act applies to them. The Secretary of State has exercised the section 50 power.[4]

16 Or which comes within the 'opposition procedure' in a block exemption, by which an agreement which does not come within the relevant block exemption for certain reasons can be notified to the Commission and will become covered by the block exemption if the Commission does not take action against it within a specified time. There is, for example, an opposition procedure in Commission Regulation 240/96, the block exemption on technology transfer agreements (ie patent and know-how licences).

17 See p 380, above.

18 Competition Act 1998, s 3 and Schs 1-4.

19 As from its coming into force on 1 December 2001; until then the relevant statute is the Financial Services Act 1986.

20 This is part of the transitional arrangements for the replacement of the RTPA 1976 with the Competition Act 1998, see fn 3, above.

1 This exclusion corresponds to Art 86EC.

2 Competition Act 1998, s 3(2) and (3).

3 A land agreement is one which creates, alters, transfers or terminates an interest in land, or an agreement to enter such an agreement, and the obligations and restrictions in such an agreement: see SI 2000/310, fn 4, below.

4 Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000, SI 2000/310, see below p 392.

As discussed above[5] the ECJ has read a *de minimis* requirement into Article 81(1) by which the prohibition does not apply unless the restriction of competition or the affect on inter-Member State trade is appreciable. Although the appreciability requirement does not appear in the Act, it was Parliament's intention that it should apply, and it is imported into the Chapter I prohibition by section 60.[6] The DGFT's Guideline on the Chapter I prohibition states that an agreement will generally have no appreciable effect on competition if the parties' combined share of the relevant market does not exceed 25 per cent (unless it is price-fixing agreement, a resale price maintenance agreement or one of a network of agreements with a cumulative effect on the market).[7] This differs from the Commission's *de minimis* thresholds set out in the 1997 Notice.[8] The Guideline therefore appears to be at odds with the Notice. Section 60(2) instructs the UK courts to 'have regard to' any relevant decision or statement of the Commission, a category which undoubtedly includes the Commission Notice, and it may be that a party prejudiced by the non-application of the Chapter I prohibition to an agreement which fell below the 25% threshold but above the Commission's thresholds could challenge that non-application.

Vertical Agreements and Resale Price Maintenance under the Chapter I Prohibition

Historically UK competition law was not much concerned with vertical agreements. The Restrictive Trade Practices Acts were directed towards the suppression of anti-competitive horizontal agreements. Vertical agreements such as distribution arrangements normally escaped the RTPA 1976 by virtue of section 9(3) and Schedule 3(2).[9] Minimum resale price maintenance was, however, prohibited, first by the Resale Prices Act 1964 and then by the Resale Prices Act 1976. The 1964 Act accomplished the dismantling of individual resale price maintenance agreements which had begun some thirty years before in the grocery trade in response to normal market forces. The effect of the Acts was to prohibit suppliers of goods which did not qualify for exemption granted by the Restrictive Practices Court (RPC) from establishing minimum prices at which those goods could be resold or from seeking to compel dealers to observe those prices, whether by discriminatory action or the withholding of supplies. Only two exemption orders were made by the RPC. These were in respect of books[10] and medicaments.[11] The Net Book Agreement exemption was challenged as being incompatible with EC law,[12] but before the matter was finally determined resale price maintenance on books was abandoned in the UK by various leading publishers in the mid-1990s, and given the collapse of the agreement the RPC discharged the

5 P 378.
6 Lord Simon, Hansard, HL, 9 February 1998, col 887.
7 OFT Guideline 401, paras 2.19-2.22.
8 Commission Notice on Agreements of Minor Importance OJ [1997] C372/13, discussed above, p 378.
9 And by the fact that under the Act agreements were caught only if at least two parties accepted restrictions. A distribution agreement which imposed obligations on only one party was therefore outside the Act.
10 *Re Net Book Agreement 1957* [1962] 3 All ER 751, LR 3 RP 246. The Net Book Agreement involved both collective and individual resale price maintenance.
11 *Re Medicaments Reference (No 2)* [1971] 1 All ER 12, LR 7 RP 267.
12 Case C-360/92P *Re the Net Book Agreement: Publishers Association v Commission* [1995] ECR I-23, [1995] 5 CMLR 33.

exemption order on the application of the DGFT.[13] Upon the repeal of the Resale Prices Act by the Competition Act 1998, special transitional provisions provided for the continuance of the exemption granted by the RPC to medicaments (over-the-counter medicines).[14] However, in 1998 the DGFT had begun the process of applying to the RPC to remove the exemption and when the pharmaceutical manufacturers abandoned their opposition to this on 15 May 2001 the RPC immediately made an order removing the exemption.

Except for resale price maintenance UK law never shared EC law's preoccupation with vertical restraints because the fear that vertical restraints impede the single market is not relevant in the domestic sphere. The Competition Act 1998 continued that UK policy, by providing for the Secretary of State to exclude vertical restraints from the Chapter I prohibition.[15] This was done by the Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000.[16] Under the Order a vertical agreement is:

> an agreement between undertakings, each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services and includes provisions contained in such agreements which relate to the assignment to the buyer or use by the buyer of intellectual property rights, provided that those provisions do not constitute the primary object of the agreement and are directly related to the use, sale or resale of goods or services by the buyer or its customers.

To come within the exclusion the parties must operate at different levels of the market. Therefore an agreement between a supplier and all its same level distributors is not within the exclusion as the agreement between the distributors *inter se* is horizontal, not vertical.

Article 4 provides that this exclusion does not apply to *minimum* resale price maintenance and therefore the prohibition of resale price maintenance remains. Article 4 says, however, that merely *recommended* resale prices are not forbidden. This is in line with EC law which differentiates between the imposition of resale price maintenance and the recommending of a price.[17] Nevertheless, any suggestion that the recommendation is enforced directly or indirectly, for instance by the imposition of sanctions on non-complying distributors, brings the recommendation within the prohibition.

Where vertical restraints are imposed by firms in a dominant position they can fall within the Chapter II prohibition (below). Where the possible anti-competitive conduct involves undertakings who constitute a 'complex monopoly' within the meaning of the FTA[18] the DGFT may, unless he is satisfied by taking undertakings from the parties, make a monopoly reference to the Competition Commission who will carry out an investigation into the

13 *Re Net Book Agreement 1957 (M and N)* [1997] 16 LS Gaz R 29.
14 Competition Act 1998, Sch 13, para 23.
15 Competition Act 1998, s 50.
16 SI 2000/310, explained in OFT Guideline 419 (Vertical Agreements and Restraints).
17 Case 161/84 *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986] ECR 353, [1986] 1 CMLR 414; Guidelines on Vertical Restraints, OJ [2000] C 43/1 paras 225-228.
18 Fair Trading Act 1973 ss 6(1), 7(1), 11. It is also still possible for 'scale monopolies' to be investigated under the FTA provisions but since the coming into force of the Competition Act 1998 the DGFT intends to do that only in certain limited circumstances: OFT Guideline 400 (The Major Provisions) para 13.4.

situation.[19] As a result of the *Domestic Electrical Goods* reports in 1997[20] Orders were made forbidding the suppliers of domestic electrical goods from notifying recommended retail prices to their dealers.[1]

In the July 2001 White Paper *A World Class Competition Regime*[2] the Government proposed removing the exclusion of vertical agreements from the Competition Act 1998.

The Chapter II Prohibition

The Chapter II prohibition mirrors Article 82EC. Section 18(1) provides:

> Subject to section 19,[3] any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.

The section then goes on to give a list of particular abuses which is identical to the list in Article 82. Section 18(3) says that a 'dominant position' means a dominant position within the United Kingdom and that the 'United Kingdom' means the United Kingdom or any part of it. As with the Chapter I prohibition, therefore, the Chapter II prohibition can apply to very localised situations: the 'any part' does not have to be a substantial part.

Since as a result of s 60 the Chapter II prohibition is to be interpreted in the same way as Article 82, agreements which are entered into by dominant firms are capable of constituting an abuse.[4] An agreement may infringe both prohibitions, and an agreement covered by a block exemption may nevertheless constitute an abuse.

Section 60

As already noted, section 60 sets out principles designed to ensure consistency between domestic and EC law. Subsections (1) to (3) provide:

> (1) The purpose of this section is to ensure that so far as is possible (having regard to any relevant differences between the provisions concerned), questions arising under this Part in relation to competition within the United Kingdom are dealt with in a manner which is consistent with the treatment of corresponding questions arising in Community law in relation to competition within the Community.
>
> (2) At any time when the court determines a question arising under this Part, it must act (so far as is compatible with the provisions of this Part and whether or not it would otherwise be required to do so) with a view to securing that there is no inconsistency between–

19 Fair Trading Act 1973 ss 47-50. Examples of distribution arrangements which were the subject of Competition Commission (formerly the Monopolies and Mergers Commission) reports are *Fine Fragrances* Cm 2380 (1993) and *Supermarkets* Cm 4842 (2000).

20 *Domestic Electrical Goods I and II* Cmnd 3675 and 3676 (1997).

1 The Restriction on Agreements and Conduct (Specified Domestic Electrical Goods) Order 1998, SI 1998/1271.

2 Cm 5233 (2001).

3 S 19 provides that the Chapter II prohibition does not apply to the matters excluded by Sch 1 and Sch 3 or to such other exclusions as the Secretary of State shall provide. These are similar to, but less extensive than, the exclusions from the Chapter I prohibition listed above, p 390.

4 See the discussion of Art 82, p 386, above. The types of agreement which may constitute an abuse are discussed in the OFT Guidelines 402 (The Chapter II Prohibition) and 414 (Assessment of Individual Agreements and Conduct).

(a) the principles applied, and decision reached, by the court in determining that question; and

(b) the principles laid down by the Treaty and the European Court, and any relevant decision of that Court, as applicable at that time in determining any corresponding question arising in Community law.

(3) The court must, in addition, have regard to any relevant decision or statement of the Commission.

'Court' includes tribunals, the DGFT and the sector regulators.[5] Whereas the courts must ensure so far as is possible, having regard to any relevant differences between the provisions concerned, that there is no inconsistency with the principles laid down by the Treaty of Rome and the European Court or with any relevant decision of the European Court, they must only 'have regard to' any relevant decision or statement of the Commission. Examples of statements include notices, decisions, the Annual Reports on Competition Policy, comfort letters which have been the subject of a notice in the Official Journal (but not individual statements of opinion by individual Commission officials). Part I of the Act covers both the substantive rules and matters of procedure but the OFT's view, based on statements made by the Government during the Bill's passage, is that UK law may diverge from EC procedures. To some extent there are procedural differences written into the Act itself, so those matters are covered by the proviso about relevant differences, but the DGFT's detailed procedural rules are made under the enabling provision in section 51. Nevertheless, the DGFT considers that section 60 does not apply to procedural matters other than the 'high level principles' of EC law.[6] The 'high level principles' are the general principles of law and fundamental human rights jurisprudence developed by the ECJ, such as the principles of proportionality, legal certainty and the right against self-incrimination. In fact to a large extent these would have to be recognised in the application of the Competition Act 1998 regardless of section 60 because of the jurisprudence of the European Court of Human Rights and the Human Rights Act 1998.

Some of the differences between the Competition Act and EC law, such as the existence of exclusions in the Act, including the (present) exclusion of vertical agreements,[7] the different *de minimis* thresholds and the embedding of the implementation test for extra-territorial jurisdiction, have already been noted. Other differences are that the UK rules can be applied concurrently by the sector regulators as well as by the DGFT,[8] and that the Competition Commission Appeal Tribunals hear appeals on the merits while challenges to Commission decisions before the ECJ are by way of judicial review.[9] Other procedural variations include different rules on legal professional privilege;[10]

5 The sector regulators have concurrent powers under the Act, s 54 and Sch 10.

6 See eg the Denning Lecture 1999 *The Competition Act 1998 and EC Jurisprudence: Some Questions Answered* given by the then DGFT, John Bridgeman, on 12 October 1999.

7 The Government is proposing to remove this exclusion, see p 393, above.

8 In relation to the telecommunications, gas, electricity, water and rail industries: Competition Act 1998, s 54 and Sch 10; OFT Guideline 405 (Concurrent Application to Regulated Industries).

9 Under Art 230EC.

10 Competition Act 1998, s 30. The EC rules, which were laid down in Case 155/79 *AM&S Ltd v Commission* [1982] ECR 1575, [1982] 2 CMLR 264 are more restrictive than the UK rules.

the possibility of forcible entry by OFT inspectors conducting investigations;[11] differences in the documents and information which can be obtained during investigations;[12] slight differences in the 'leniency' provisions whereby favourable treatment is offered to cartel participants who 'whistleblow';[13] and the fact that the DGFT may fine infringing firms up to 10% of their *UK* turnover in *each of the preceding three years*.[14] Two other departures from the EC provisions are that it is possible to notify an agreement to the DGFT for 'guidance';[15] and that there is an immunity from penalties for 'small agreements' and 'conduct of minor significance' under the Act.[16] If the Government proposals in the July 2001 White Paper are implemented it will become a criminal offence to infringe either the Chapter I prohibition *or Article 81* by engaging in 'hard-core' cartels, so that individuals involved in price-fixing, market-sharing and bid-rigging arrangements including senior executives and directors who encourage or condone them, would be liable to imprisonment. This would be a major difference from EC law itself which does not impose criminal sanctions, but would bring the UK into line with the US, Canada and Japan which already have custodial penalties for breaches of competition law.

It is anticipated that the interpretation and application of section 60 will give rise to much argument. There are difficult issues to be resolved as to what amounts to a 'corresponding question arising in Community law' in subsection (1) for example, or what 'have regard to' means in subsection (3). The greatest problem is the meaning of the proviso 'having regard to any relevant differences between the provisions concerned' in respect of differences which are not expressed in the Act. As mentioned above[17] a major objective of EC competition law is the attainment and maintenance of the single market. Many decisions of the ECJ have been driven by single market rather than competition imperatives and Community case law which concerns single market issues cannot be seen as 'corresponding' to questions arising under the Act. During the passage of the Bill Government ministers made it quite clear that this difference in objectives did constitute a 'relevant difference' for the purpose of the proviso.[18] Single market concerns have had the most profound effect

11 Competition Act 1998, s 28(2). Such entry can only be affected under a warrant issued by a High Court judge and force ('such force as is reasonably necessary for the purpose') can only be used against the premises, not against persons.

12 Competition Act 1998, s 26(1). This power is wider than that contained in the equivalent EC provision Regulation 17, Art 11(1).

13 OFT Guideline 423 (DGFT's Guidance as to the Appropriate Amount of a Penalty), cf Commission Notice on the Non-imposition or Reduction of Fines in Cartel Cases OJ [1996] C 207/4.

14 OFT Guideline 423; in EC law it is 10% of worldwide turnover in the preceding year. Regulation 17, Art 15. Cases 100-105/80 *Musique Diffusion Francaise SA v Commission (Pioneer)* [1983] ECR 1825 [1983] 3 CMLR 221.

15 Competition Act 1998, ss 12 and 13; undertakings may also notify conduct for guidance as to the application to it of the Chapter II prohibition: ss 20 and 21.

16 'Small agreements' and 'conduct of minor significance' are defined by Order, currently The Competition Act 1998 (Small Agreements and Conduct of Minor Significance) Regulations 2000, SI 2000/262, in terms of the annual turnover of the parties involved (an aggregate of £20 million in the case of agreements and £50 million in the case of conduct). The immunity does not affect the voidness of agreements, see below p 396.

17 See p 374, above.

18 Lord Simon, Hansard, HL, 25 November 1997, col 961 and Hansard, HL, 5 March 1998, col 1365.

on the development of the EC rules of vertical agreements, an area which is (at present) excluded from the operation of the Chapter I prohibition,[19] but they have arisen in many other cases, and it is difficult to see how UK courts are to go about unpicking ECJ judgments to ascertain which parts s 60 is instructing them to follow. Furthermore, while the objective of the Competition Act 1998 was to purely to promote competition as part of the 'enterprise culture',[20] EC competition law has at times appeared to be protecting competitors rather than competition, protecting the weaker parties to agreements, or taking social (such as employment or environmental) considerations into account. Whether UK courts will look for these kind of strands in Community cases for the purpose of the proviso is not yet clear.

Voidness and other consequences of breaching the prohibitions in the Competition Act 1998

The Competition Act 1998, section 2(4) provides that 'any agreement or decision which is prohibited by subsection (1) is void'. This mirrors Article 81(2) which is considered above.[1] As explained there, under Article 81(2) it is the infringing provisions, rather than the whole agreement, which is void. The original draft bill, which was published in August 1997, was worded to try to make clear that the voidness extended only to the infringing provisions but this was later changed, apparently in order not to depart from the wording in Article 81(2). Given that the matter is governed by the consistency requirement in section 60 it seems right to conclude that section 2(4) renders void only the parts of the agreement which are prohibited and that the ECJ case law on the effect of Article 81(2) will apply equally to section 2(4). What is said above[2] about severance therefore applies equally in respect of the Chapter I prohibition.

It would also appear that the judgments of the Court of Appeal in *Passmore v Morland*[3] about the possibility of the transient voidness of prohibited agreements, and in *Gibbs Mew v Gemmell*,[4] holding that a prohibited agreement is not just void but illegal, apply equally in respect of agreements prohibited by the Competition Act 1998. It will, however, be interesting to see whether the UK courts follow the ECJ judgment in *Crehan v Courage*[5] and allow the weaker party to a prohibited agreement to obtain damages or restitution from the other party. Reluctant UK courts could possibly rely on the proviso to section 60 and say that there is a relevant difference in that the Competition Act 1998 has (in some respects) different objectives to EC law.

Where the Chapter II prohibition is concerned, the same considerations as pertain to agreements which amount to an abuse of a dominant position under Article 82 will apply.[6]

A surprising feature of the Act is that it does not expressly provide that parties which infringe the Chapter I or Chapter II prohibitions are liable to

19 See above p 392.

20 See the statement of the Secretary of State, Margaret Beckett, moving the Second Reading of the Competition Bill in the House of Commons, Hansard, HC, 11 May 1998, col 23.

1 See p 381.

2 See pp 381-382.

3 [1999] 3 All ER 1005, [1999] 1 CMLR 1129.

4 [1999] ECC 97, [1998] Eu LR 588.

5 Case C-453/99, see above p 385.

6 See above p 386.

third parties. The provisions in the Act only refer to, or appear to assume, rights which are not specifically granted. Section 55(3)(b) refers in a provision about confidential information to 'civil proceedings brought under ... this Part', section 58(2) refers to 'proceedings in respect of an alleged infringement ... which are brought otherwise than by the Director' and section 60(6)(b) says that the obligation to maintain consistency with ECJ decisions includes decisions as to 'the civil liability of an undertaking for harm caused by its infringement of Community law'. During the passage of the Bill government ministers referred in Parliament to third parties having rights of action.[7] There seems to be no doubt that injunctive relief is available because the courts have granted such relief in respect of the EC provisions. Where damages are concerned, however, the position is less clear, but section 60(6)(b) seems to assume that there is the same right to damages as there is in EC law although, as we have seen, the position on damages in EC law is not absolutely certain.[8] The assumption that such a right exists under the 1998 Act is also made in the Government's July 2001 White Paper.[9] The White Paper says that the Government wants to achieve a system where 'private actions are less inhibited than at present' and proposes that the Competition Commission Appeal Tribunals should be able to hear claims for damages in cases where the DGFT has brought infringement proceedings. It also proposes that determinations of infringements under the 1998 Act should be binding on the courts, to enable damages actions to be heard more swiftly.

7 Lord Simon, Hansard, HL, 30 Oct 1997, col 1148; Lord Haskel, Hansard, HL, 25 November 1997, cols 955 and 956.

8 See above p 381.

9 Cm 5233 (2001) paras 8.2-8.9.

Chapter 11

Contracts illegal by statute or at common law

SUMMARY

1 Contracts prohibited by statute

A contract that is expressly or impliciuly prohibited by statute is illegal. In this context, 'statute' includes the orders, rules and regulations that ministers of the Crown and other officials are so frequently authorised by Parliament to make.

If the contract in fact made by the parties is expressly forbidden by the statute, its illegality is undoubted. Express statutory prohibition of contracts is by no means uncommon. So Parliament may provide in pursuance of a policy of controlling credit, that no contract of hire purchase shall be

entered into, unless at least 25% of the cash price is paid by way of an initial payment.[1] Where it is alleged that the prohibition is implied, the court is presented with a problem the solution of which depends upon the construction of the statute. What must be ascertained is whether the object of the legislature is to forbid the contract. In pursuing this enquiry a variety of tests have been applied. For instance, if the sole object of the statute is to increase the national revenue, as for instance by requiring a trader to take out a licence; or to punish a contracting party who fails to furnish or furnishes incorrectly certain particulars, the contract that he may have made is not itself prohibited.[2] On the other hand, if even one of the objects is the protection of the public or the furtherance of some other aspect of public policy, a contract that fails to comply with the statute may be implicitly prohibited.[3] But no one test is decisive, for in every case the purpose of the legislature must be considered in the light of all the relevant facts and circumstances.[4]

It has been persuasively argued that an important question ought to be whether the statute necessarily contemplates that the prohibited acts will be done in performance of a contract.[5] This distinction can be simply illustrated. Let us suppose that a Road Traffic Act makes it an offence (a) to sell a car in unroadworthy condition and (b) to drive on certain roads at more than 30 mph.[6] It can readily be seen that breach of provision (a) will always involve the making of a contract, while breach of provision (b) will only in exceptional circumstances do so. It is plausible therefore to argue that the statute impliedly prohibits contracts to sell unroadworthy cars but does not impliedly prohibit contracts to drive cars in excess of the speed limit.[7]

An example of a revenue statute is afforded by *Smith v Mawhood*,[8] where a tobacconist was allowed to recover the price of tobacco delivered, notwithstanding his failure to take out a licence and to have his name painted on his place of business as he was statutorily required to do under a penalty of £200. Parke B said:

> I think the object of the legislature was not to prohibit a contract of sale by dealers who have not taken out a licence pursuant to the act of Parliament. If it was, they certainly could not recover, although the prohibition were merely for the

1 See eg *Stoneleigh Finance Ltd v Phillips* [1965] 2 QB 537, [1965] 1 All ER 513; *Kingsley v Sterling Industrial Securities Ltd* [1967] 2 QB 747, [1966] 2 All ER 414. Of course there may still be problems of construction involved in discovering exactly which contracts are prohibited. See eg *Wilson, Smithett and Cope Ltd v Terruzzi* [1976] QB 683, [1976] 1 All ER 817.

2 *Learoyd v Bracken* [1894] 1 QB 114. *London and Harrogate Securities Ltd v Pitts* [1976] 3 All ER 809, [1976] 1 WLR 1063.

3 *Victorian Daylesford Syndicate v Dott* [1905] 2 Ch 624 at 630.

4 *St John Shipping Corpn v Joseph Rank Ltd* [1957] 1 QB 267 at 285-287, [1956] 3 All ER 683 at 690, per Devlin J; p 404, below. In some cases a statute while prohibiting an act may expressly provide that contractual liability is not affected, eg Banking Act 1979, s 1(8). See *SCF Finance Co Ltd v Masri (No 2)* [1987] QB 1002, [1987] 1 All ER 175.

5 Buckley 38 MLR 535.

6 See Road Traffic Act 1934, s 8(1), reversed Road Traffic Act 1972, s 60(5) and *Vinall v Howard* [1953] 2 All ER 515, [1953] 1 WLR 987; reversed on other grounds [1954] 1 QB 375, [1954] 1 All ER 458.

7 Such a contract may still be illegal on common law principles, as being a contract to commit a crime. See p 410, below.

8 (1845) 14 M & W 452.

> purpose of revenue. But, looking at the act of Parliament, I think its object was not to vitiate the contract itself, but only to impose a penalty upon the party offending, for the purpose of the revenue.[9]

Again, a stockbroker who has bought or sold shares for his principal is not prevented from recovering his commission by his failure in breach of the Stamp Act 1891, to issue a stamped contract note containing details of the transaction.[10] The more numerous statutes, however, are those directed either to the protection of the public or to the fulfilment of some object of general policy. This is especially true at the present day when State intervention in individual activity is more pronounced than formerly and where even revenue statutes are used in part at least as instruments of policy.

The approach of the courts to this problem of implied prohibition may be illustrated by contrasting the two cases of *Cope v Rowlands*[11] and *Archbolds (Freightage) Ltd v S Spanglett Ltd.*[12]

In the former, a statute provided that any person who acted as broker in the City of London without first obtaining a licence should forfeit and pay to the City the sum of £25 for every such offence. The plaintiff, who was unlicensed, sued the defendant for work that he had done in buying and selling stock. In delivering judgment for the defendant, Parke B said:

> The legislature had in view, as one object, the benefit and security of the public in those important transactions which are negotiated by brokers. The clause, therefore, which imposes a penalty, must be taken ... to imply a prohibition of all unadmitted persons to act as brokers, and consequently to prohibit, by necessary inference, all contracts which such persons make for compensation to themselves for so acting.[13]

The facts of *Archbolds (Freightage) Ltd v S Spanglett Ltd*[14]

> The Road and Rail Traffic Act 1933 provided that no person should *use* a vehicle for the carriage of goods unless he held a 'A' or a 'C' licence. The former entitled him to carry the goods of others for reward: the latter to carry his own goods but not the goods of others.
>
> The defendants, who held a 'C' licence, agreed with the plaintiffs to carry 200 crates of whisky belonging to third parties from Leeds to London. The plaintiffs were unaware that the defendants held no 'A' licence. The whisky was stolen *en route* and the plaintiffs claimed damages for its loss.

One question that arose in the action,[15] was whether the contract for carriage was prohibited by the Act, either expressly or implicitly.

It was not expressly prohibited, for the Act did not in terms strike at a contract to carry goods, but at the use of an unlicensed vehicle on the road. It was not as if the plaintiffs had contracted for the use of an unlicensed vehicle and had used it themselves. It was argued, however, that contracts for the carriage of goods made with unlicensed carriers were implicitly forbidden by the Act. This depended upon the construction of the Act. What was its

9 Ibid at 468.
10 *Learoyd v Bracken* [1894] 1 QB 114.
11 (1836) 2 M & W 149.
12 [1961] 1 QB 374, [1961] 1 All ER 417.
13 (1836) 2 M & W 149 at 159.
14 See Furmston 24 MLR 394.
15 For the further question, see p 404, below.

fundamental purpose?[16] The Court of Appeal was satisfied that the instant contract did not fall within the ambit of the legislation and that there was no implied prohibition. In the words of Pearce LJ:

> The object of the Road and Rail Traffic Act, 1933, was not (in this connection) to interfere with the owner of goods or his facilities for transport, but to control those who provided the transport, with a view to promoting its efficiency. Transport of goods was not made illegal but the various licence holders were prohibited from encroaching on one another's territory, the intention of the Act being to provide an orderly and comprehensive service.[17]

If it is alleged that a contract has been impliedly prohibited, then it clearly is important to look at the policy of the relevant statute and to consider whether that policy is served by holding that the particular contract has been impliedly prohibited. On the other hand, if the argument is that the contract has been expressly prohibited there is, in principle, no room for such considerations since of course Parliament is entitled to prohibit contracts even when it makes no sense to do so. Of course, one would not expect Parliament to make foolish decisions but so wide is the scope of statutory interference with ordinary life and so complex the process of parliamentary drafting that it is certain that from time to time statutes will prohibit contracts where the results of doing so look extremely odd.

This is well brought out in a series of cases arising out of the Insurance Companies Act 1974. This Act was a major piece of public regulation of the insurance industry. In broad terms the Act involved dividing insurance business up into a large number of categories requiring those who wished to conduct insurance business to obtain authorisation to do so. What was to happen where someone carried on insurance business when they were not authorised? The leading case is now *Phoenix General Insurance Co of Greece SA v Administratia Asigurarilor de Stat.*[18] The plaintiffs had been authorised under the original scheme of the 1974 Act to write the insurance business which they were in fact writing. In 1977 regulations issued under the 1974 Act substituted a new set of categories which were complex and difficult to understand. The plaintiffs went on writing the same categories of insurance. The trial judge, Hobhouse J, held that the policies which they were writing were now unauthorised. The Court of Appeal reversed this decision and held that in fact what the plaintiffs had done was authorised under the transitional provisions contained in the 1977 regulations but the Court of Appeal went on to consider very fully what the legal position was where the insurer was writing business of a kind which he was not entitled to write. This question could arise in at least three different contexts. One is an attempt by the insurer to enforce the policy directly; the second is an attempt by the insurer, having paid out on the policy, to recover under a reinsurance contract; the third is an attempt by an insured

16 See *St John Shipping Corpn v Joseph Rank* [1957] 1 QB 267 at 285-287, [1956] 3 All ER 683 at 688-690; *Hughes v Asset Management* [1995] 3 All ER 669; *Fuji Finance Inc v Aetna Insurance Co Ltd* [1994] 4 All ER 1025.

17 [1961] 1 QB at 386, [1961] 1 All ER at 423.

18 [1988] QB 216, [1987] 2 All ER 152. See also the same case at first instance [1986] 1 All ER 908, [1987] 2 WLR 512 and the earlier first instance decisions in *Bedford Insurance Co Ltd v Instituto de Resseguros do Brasil* [1985] QB 966, [1984] 3 All ER 766 and *Stewart v Oriental Fire and Marine Insurance Co Ltd* [1985] QB 988, [1984] 3 All ER 777.

to recover on the policy. It is clear that, at least in regard to the third situation, one ought to hold that the insured can recover if it is at all possible to do so since the whole purpose of the Insurance Companies Act is to protect the insured against the activities of unauthorised insurers and in the nature of things an insured will seldom if ever know whether the insurer is authorised or not. The Court of Appeal entirely accepted the force of these considerations but held that effect could not be given to them because it was clear that the wording of the Act expressly forbad recovery. This was because the Act did not merely prohibit unauthorised insurers from 'effecting contracts of insurance' but also from 'carrying out contracts of insurance'. The Court of Appeal held that this could not be read otherwise than as prohibiting not only the entry into contracts of insurance but also their performance by paying when the risk occurred. This is clearly a deeply unsatisfactory result but one for which Parliament and not the Court of Appeal must take the blame.[19]

Illegality may infect either formation or performance of contract

A distinction which has an important bearing upon the consequences of illegality is that the disregard of a statutory prohibition may render the contract either illegal as formed or illegal as performed.[20]

A contract is illegal as formed if its very creation is prohibited, as for example where one of the parties has neglected to take out a licence as required by statute.[1] In such a case it is void *ab initio*. It is a complete nullity under which neither party can acquire rights whether there is an intention to break the law or not.

A contract is illegal as performed if, though lawful in its formation, it is performed by one of the parties in a manner prohibited by statute. In *Anderson Ltd v Daniel*,[2] for instance:

> A statute required that every seller of artificial fertilizers should give to the buyer an invoice stating the percentages of certain chemical substances contained in the goods. In the instant case, the sellers had delivered ten tons of artificial manure without complying with the statutory requirement. The sellers brought an action for the price of the goods.

In such circumstances as these, where the contract is lawful in its inception but is executed illegally, the position of the party responsible for the infraction of the statute is clear. All contractual rights and remedies are withheld from him. Thus the sellers in *Anderson Ltd v Daniel* lost their action. They had failed to perform the contract in the only way in which the statute allowed it to be performed. On the other hand, as will be seen later,[3] the appropriate remedies are available to the other party provided that he can establish his innocence. If, however, he has been privy to or has condoned

19 As far as enforcement of such policies by the insured against the insurer was concerned, Parliament acted quickly to remedy the situation by the Financial Services Act 1986, s 132, as to the interpretation of which see *Deutsche Ruckversicherung AG v Walbrook Insurance Co Ltd* [1996] 1 All ER 791.

20 See especially the judgment of Devlin J in *St John Shipping Corpn v Joseph Rank Ltd* [1957] 1 QB 267 at 283–287.

1 *Cope v Rowlands* (1836) 2 M & W 149; *Re Mahmoud and Ispahani* [1921] 2 KB 716; *Bostel Bros Ltd v Hurlock* [1949] 1 KB 74, [1948] 2 All ER 312.

2 [1924] 1 KB 138.

3 P 422, below.

the illegality, he will be in the same position as if the contract had been illegal in its formation and he will therefore be remediless.[4]

But it must be emphasised that a contract is not automatically rendered illegal as performed merely because some statutory requirement has been violated in the course of its completion.[5] Whether this is the result raises a question of construction similar to that which was considered in *Archbolds (Freightage) Ltd v S Spanglett Ltd.*[6] What has to be determined here is whether it was the express or implied intention of the legislature that such a violation as that which the guilty party has committed should deprive him of all remedies. Was the observance of the particular enactment regarded as a necessary prerequisite of his right to enforce the contract? That such is the intention, though clear enough in *Anderson Ltd v Daniel*, is not lightly to be implied. Commercial life is nowadays hedged in by so many statutory regulations, that it would scarcely promote the interests of justice to drive a plaintiff from the seat of judgment merely because he has committed a minor transgression.[7]

If the contract as performed is not expressly prohibited by statute, its alleged illegality must be based upon public policy, and in a passage that has frequently been approved, Lord Wright once remarked that public policy is often 'better served by refusing to nullify a bargain save on serious and sufficient grounds'.[8] The attitude of the courts where some statutory requirement has been infringed during the performance of a contract may be illustrated by two leading cases.

In *St John Shipping Corpn v Joseph Rank Ltd*,[9] the facts were as follows:

> The Merchant Shipping Act 1932 forbids the loading of a ship to such an extent that the loadline becomes submerged. A penalty is imposed for breach of the statute.
>
> The master of the plaintiff's ship, which had been chartered to an English firm for the carriage of grain from a port in Alabama to England, put into a port in the course of the voyage and took on bunkers, the effect of which was to submerge the loadline contrary to the Act. The master was prosecuted in England for the offence and was fined £1,200.
>
> The defendants, to whom the ownership of part of the goods had passed, withheld part of the freight due, contending that the plaintiffs could not enforce a contract which they had performed in an illegal manner.

Devlin J rejected the contention. The illegal loading was merely an incident in the course of performance that did not affect the core of the contact.

> In the statutes to which the principle has been applied, what was prohibited was a contract which had at its centre—indeed often filling the whole space within its circumference—the prohibited act; contracts for the sale of prohibited

4 *B & B Viennese Fashions v Losane* [1952] 1 All ER 909; *Ashmore Benson, Pease & Co Ltd v Dawson Ltd* [1973] 2 All ER 856, [1973] 1 WLR 828; criticised Hamson [1973] CLJ 199. Cf Buckley 25 NILQ 421.

5 See the rhetorical question of Sachs LJ in *Shaw v Groom* [1970] 2 QB 504 at 522.

6 P 402, above.

7 *St John Shipping Corpn v Joseph Rank Ltd* [1957] 1 QB 267 at 522, per Devlin J; approved by Sachs LJ in *Shaw v Groom* [1970] 2 QB 504 at 522.

8 *Vita Food Products v Unus Shipping Co Ltd* [1939] AC 277 at 293, [1939] 1 All ER 513 at 523.

9 [1957] 1 QB 267, [1956] 3 all ER 683.

> goods, contracts for the sale of goods without accompanying documents when the statute specifically said there must be accompanying documents; contracts for work and labour done by persons who were prohibited from doing the whole of the work and labour for which they demanded recompense.[10]

Again, in *Shaw v Groom*:[11]

> A landlord sued his tenant for arrears of rent amounting to £103 due in respect of a weekly tenancy. The tenant contended that the action must fail, since the rent book issued to him by the plaintiff did not contain all the information required by the Landlord and Tenant Act 1962. Such a default was punishable by a fine not exceeding £50.

The Court of Appeal dismissed this contention. The contract was not to be stigmatised as illegal in its performance. The intention of the legislature was that non-compliance with the statutory requirement should render the landlord liable to a fine, not that it should deny him access to the courts. Unless this limited construction was placed upon the Act, the result might well be that the landlord would forfeit a sum far in excess of the maximum fine. In the words of Sachs LJ:

> It seems to me appropriate, accordingly, to allow this appeal on the broad basis that, even if the provision of a rent book is an essential act as between landlords and weekly tenants, yet the legislature did not by ... the Act of 1962 intend to preclude the landlord from recovering any rent due or impose any forfeiture on him beyond the prescribed penalty.[12]

2 Contracts illegal at common law on grounds of public policy

A INTRODUCTION

Certain types of contract are forbidden at common law and are therefore prima facie illegal. The first essential to an understanding of this head of the law, which has been clouded by much confusion of thought, is to discover if possible the principle upon which the stigma of illegality is based. The present law is the result of a development that stretches back to at least Elizabethan times,[13] but its foundations were not effectively laid until the eighteenth century. What the judges of that period were at pains to emphasise was that they would not tolerate any contract that in their view was injurious to society.[14] Injury to society, however, is incapable of precise definition, and it is not surprising that the particular contracts found distasteful on this ground were described in somewhat vague and indeterminate language. To give a few examples, nobody would be allowed 'to stipulate for iniquity',[15] no contract would be enforced that was 'contrary

10 Ibid at 289 and 691, respectively.
11 [1970] 2 QB 504, [1970] 1 All ER 702.
12 Ibid at 526 and 714, respectively. Harman LJ also found for the plaintiff, but based his decision on the ground that the provision of a correctly completed rent book was not an essential part of the lawful performance of the contract; ibid at 516.
13 Pollock *Principles of Contract* (13th edn) p 291, note by Winfield.
14 Fifoot *Lord Mansfield* pp 122-125.
15 *Collins v Blantern* (1767) 2 Wils 341 at 350, per Wilmot LCJ.

to the general policy of the law',[16] or 'against the public good',[17] or *contra bonos mores*[18] or which had arisen *ex turpi causa*.[19]

It seems justifiable to infer from such expressions as these that the judges were determined to establish and sustain a concept of public policy. Contractual freedom must be fostered, but any contract that tended to prejudice the social or economic interest of the community must be forbidden.

Not unnaturally, a principle stated in such sweeping terms as these has its disadvantages. It is imprecise, since judicial views will inevitably differ upon whether a particular contract is immoral or subversive of the common good; there is no necessary continuity in the general policy of the law, for what is anathema to one generation seems harmless to another; and the public good affects so many walks of life that the causes of action that can be said to arise *ex turpi causa* must in the nature of things vary greatly in their degree of harm to the community.

It is this variation in the degree of harm done that requires emphasis, for the word 'illegal' has been, and still is, used to cover a multitude of sins and even cases where little, if any, sin can be discovered. The list of 'illegal' contracts includes inter alia agreements to commit a crime or a tort, to defraud the revenue, to lend money to an alien enemy, to import liquor into a country where prohibition is in force, to procure a wife for X in return for a reward, to provide for a wife if she should ever separate from her husband and finally an agreement in restraint of trade between master and servant or between the seller and buyer of a business, such as that by which a servant promises not to work in the future for a trade rival of his present employer. If these contracts are scrutinised in the order given, it will be seen that the improbity which they reveal is a constantly diminishing factor and that it is entirely absent from the agreement in restraint of trade. There is nothing disgraceful in a master and servant coming to such an agreement, and the only complaint that their conduct invokes is the possible economic inexpedience of allowing a workman to restrict his freedom to exploit his skill as and where he will.

Common sense suggests that the consequences at law of entering into one of these so-called illegal contracts should vary in severity according to the degree of impropriety that the conduct of the parties discloses. It is obvious that an agreement to commit a crime cannot be put on the same footing as an undertaking by a servant that he will not later enter the employment of a rival trader. The former is so transparently reprehensible judged by any standard of morals that it must be dismissed as illegal, with the result that both parties must be excluded from access to the courts and denied all remedies; but the latter should certainly not attract the full rigour of the maxim *ex turpi causa non oritur actio*, with its implication that it can originate no rights or liabilities whatsoever. The parties have done nothing disgraceful, they have not conspired against the proprieties and, although they cannot be allowed to enforce such part of the contract as is tainted, it would be unjustifiable to regard them as outcasts of the law unable to enforce even the innocent part of their bargain. To describe their contract as illegal as a whole is an abuse of language. Speaking of the contract in restraint of trade, for instance, Farwell LJ said, 'it is not unlawful in the sense that it is criminal or would give any cause of action

16 *Lowe v Peers* (1768) 4 Burr 2225 at 2233, per Aston J.
17 *Collins v Blantern*, above.
18 *Girardy v Richardson* (1793) 1 Esp 13, per Lord Kenyon.
19 *Holman v Johnson* (1775) 1 Cowp 341 at 343, per Lord Mansfield.

to a third person injured by its operation, but it is unlawful in the sense that the law will not enforce it'.[20] In the eighteenth century, when the principle of public policy was taking root and the instances of unsavoury bargains were comparatively simple, it was perhaps not strange that the judges should have used somewhat exaggerated language in rejecting contracts that revealed wickedness, but in the complex conditions of today the indiscriminate use of the term 'illegal' is, to say the least, confusing.

Modern judges have in fact taken a more realistic view of this part of the law and have concluded that the so-called illegal contracts fall into two separate groups according to the degree of mischief that they involve.[1] Some agreements are so obviously inimical to the interest of the community that they offend almost any concept of public policy; others violate no basic feelings of morality, but run counter only to social or economic expedience. The significance of their separation into two classes, as we shall see, lies in the different consequences that they involve.

That the various contracts traditionally called illegal do not involve similar consequences was stressed by Somervell LJ, in the following passage:[2]

> In *Bennett v Bennett*, it was pointed out that there are two kinds of illegality of differing effect. The first is where the illegality is criminal, or *contra bonos mores*, and in those cases, which I will not attempt to enumerate or further classify, such a provision [*sic*], if an ingredient in the contract, will invalidate the whole, although there may be many other provisions in it. There is a second kind of illegality which has no such taint; the other terms in the contract stand if the illegal portion can be severed, the illegal portion being a provision which the court, on grounds of public policy, will not enforce. The simplest and most common example of the latter class of illegality is a contract for the sale of a business which contains a provision restricting the vendor from competing in or engaging in trade for a certain period or within a certain area. There are many cases in the books where, without in any way impugning the contract of sale, some provision restricting competition has been regarded as in restraint of trade and contrary to public policy. There are many cases where not only has the main contract to purchase been left standing but part of the clause restricting competition has been allowed to stand.

Assuming, then, that contracts vitiated by some improper element must be divided into two classes, how are the more serious examples of 'illegality' at common law to be distinguished from the less serious? Which of the contracts that have been frowned upon by the courts are so patently reprehensible—so obviously contrary to public policy—that they must be peremptorily styled illegal? Judicial authority is lacking, but it is submitted that the epithet 'illegal' may aptly and correctly be applied to the following six types of contract:

20 *North-Western Salt Co v Electrolytic Alkali Co* (1912) 107 LT 439 at 444. See also *Mogul Steamship Co v McGregor, Gow & Co* [1892] AC 25 at 39, per Lord Halsbury. In the court below (1889) 23 QBD 598 at 619, Lindley LJ said, 'The term "illegal" here is a misleading one. Contracts ... in restraint of trade are not in my opinion illegal in any sense, except that the law will not enforce them.' See also *A-G Commonwealth of Australia v Adelaide Steamship Co Ltd* [1913] AC 781 at 797, per Lord Parker.

1 *Bennett v Bennett* [1952] 1 KB 249, [1952] 1 All ER 413. The actual decision in *Bennett v Bennett* was reversed by the Maintenance Agreements Act 1957 (now the Matrimonial Causes Act 1973, s 34).

2 *Goodinson v Goodinson* [1954] 2 QB 118 at 120-121, [1954] 2 All ER 255 at 256. It should be noticed that the concluding sentence of this citation refers to two forms of severance that are in fact distinguishable; see pp 470-474 ff, below.

A contract to commit a crime, a tort or a fraud on a third party.
A contract that is sexually immoral.
A contract to the prejudice of the public safety.
A contract prejudicial to the administration of justice.
A contract that tends to corruption in public life.
A contract to defraud the revenue.

There remain three types of contract which offend 'public policy', but which are inexpedient rather than unprincipled.

A contract to oust the jurisdiction of the court.
A contract that tends to prejudice the status of marriage.
A contract in restraint of trade.

If the word 'illegal' is to be reserved for the more reprehensible type of contract another title must be chosen to designate those which fall within the second degree of public policy, and which for that reason have been treated with comparative leniency by the courts. The most appropriate title seems to be 'void', since these contracts are in practice treated by the courts as void either as a whole or at least in part. In *Bennett v Bennett* Denning LJ described covenants in restraint of trade as 'void not illegal'.

> They are not 'illegal', in the sense that a contract to do a prohibited or immoral act is illegal. They are not 'unenforceable', in the sense that a contract within the Statute of Frauds is unenforceable for want of writing. These covenants lie somewhere in between. They are invalid and unenforceable.[3]

The word 'void' used as a descriptive title certainly has its disadvantages. It is already applied to a number of disparate contracts and is not applied to them in any uniform sense or with uniform results. At common law it has long been used to indicate the consequences of mistake; by statute it has been used with dubious results in wagering transactions and in contracts made by infants. But linguistic precision cannot survive the complexity of life. A continental jurist has said that, unlike the physical sciences where there is no interim stage between effect and no-effect, in legal science the effects of disobeying a legal rule may be graded to suit the individual situation.

> Thus, the difference between an act that is valid and an act that is void is unlike the difference between 'yes' and 'no', between effect and no-effect. It is a difference of grade and quantity. Some effects are produced, while others are not.[4]

For better or for worse, then, it has been decided for the purposes of this book to describe the three less serious types of 'illegal' contracts as *contracts void at common law on grounds of public policy*.

Some general observations must be added upon the doctrine of public policy in the current law.[5]

Since public policy reflects the mores and fundamental assumptions of the community, the content of the rules should vary from country to country and from era to era. There is high authority for the view that in matters of public

3 [1952] 1 KB 249 at 260, [1952] 1 All ER 413 at 421.
4 Baumgarten, cited by Cohn, 64 LQR 326.
5 See Lloyd *Public Policy* (1953); Winfield 42 Harvard L Rev 76; Gellhorn 85 Columbia L Rev 679; Shand [1972A] CLJ 144.

policy the courts should adopt a broader approach than they usually do to the use of precedents.[6]

Such flexibility may manifest itself in two ways: by the closing down of existing heads of public policy and by the opening of new heads. There is no doubt that an existing head of public policy may be declared redundant. So in the nineteenth century it was stated that Christianity was part of the law of England and that accordingly a contract to hire a hall for a meeting to promote atheism was contrary to public policy[7] but fifty years later this view was decisively rejected.[8]

More controversy surrounds the question of whether the courts still retain freedom to recognise new heads of public policy. It has been denied that any such freedom exists[9] and Lord Thankerton said that the task of the judge in this area was 'to expound and not to expand', the law.[10] It may be thought surprising however that in this of all areas, the courts should abrogate their function of developing the common law. To some extent the discussion is artificial since much development may take place within the existing heads but it is difficult to assert that new circumstances cannot arise which do not fall readily into any of the recognised heads. Courts have responded to this challenge in the past by the development of new heads[11] and it is thought that they will, in exceptional circumstances, do so again.

This question would be relevant, for instance, if it were argued that contracts involving racial, religious or sexual discrimination were contrary to public policy. It is arguable that the Court of Appeal's decision in *Nagle v Feilden*[12] represents recognition of such a possibility and there is some Australian authority too.[13] Undoubtedly any such argument would raise important questions, in particular whether the existence of legislation in this area[14] should be regarded as relevant either as (a) delimiting precisely the area of reprehensible discriminatory conduct or (b) (preferably) as a legislative signal that discrimination is against the public interest.[15] It is thought

6 See *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] AC 535, per Lord Watson at 553.

7 *Cowan v Milbourn* (1867) LR 2 Exch 230.

8 *Bowman v Secular Society Ltd* [1917] AC 406.

9 See *Janson v Driefontein Consolidated Mines* [1902] AC 484 at 491. *Geismar v Sun Alliance and London Insurance Ltd* [1978] QB 383 at 389, [1977] 3 All ER 570 at 575.

10 *Fender v St John-Mildmay* [1938] AC 1 at 23, [1937] 3 All ER 402 at 407. Cf the illuminating judgment of Windeyer J in *Brooks v Burns Philp Trustee Co Ltd* [1969] ALR 321 at 331-349.

11 See eg *Neville v Dominion of Canada News Co Ltd* [1915] 3 KB 556; Furmston 16 U of Toronto LJ 267 at 293-297. This case, involving, as it did, the balancing of conflicting public interests in the preservation of confidentiality and the free availability of information was the precursor of many important modern cases. Many, but not all, of these cases have been litigated outside the contractual context but the underlying policies involved must be constant although how they are to be applied must depend on the context. See in particular *D v NSPCC* [1978] AC 171, [1977] 1 All ER 589; *Riddick v Thames Board Mills Ltd* [1977] QB 881, [1977] 3 All ER 677; *Initial Services Ltd v Putterill* [1968] 1 QB 396, [1967] 3 All ER 145.

12 [1966] 2 QB 633, [1966] 1 All ER 689.

13 *Newcastle Diocese (Church Property Trustees) v Ebbeck* (1960) 34 ALJR 413.

14 Eg Race Relations Act 1968; Equal Pay Act 1970.

15 See further Lester and Bindman *Race and Law*; Hepple *Race: Jobs and the Law in Britain*; Garner 34 MLR 478. It is thought that the view in the text is substantially the same as that stated by Lord Wilberforce in *Blathwayt v Baron Cawley* [1976] AC 397 at 425-426, [1975] 3 All ER 625 at 636. See also *Ahmad v Inner London Education Authority* [1978] QB 36, [1978] 1 All ER 574; Race Relations Act 1976, s 72.

however that the least satisfactory answer would be that the law is totally petrified. Another recently canvassed head of public policy has involved the validity of contractual provisions, which attempt to allocate some of the risks of inflation by tying repayment of debts to foreign currencies. In *Treseder-Griffin v Co-operative Insurance Society Ltd*,[16] Denning LJ expressed the opinion, obiter, that such provisions were contrary to public policy but this view was not followed by Browne-Wilkinson J in *Multiservice Bookbinding Ltd v Marden*,[17] a decision approved in its turn by Lord Denning MR in *Staffordshire Area Health Authority v South Staffordshire Waterworks Co.*[18] In none of these cases was any weight attached to any argument based on novelty.

Similarly, in *Lancashire County Council v Municipal Mutual Insurance Ltd*[19] the plaintiff County Council had an insurance policy with the defendant insurers in respect of claims made against it. The defendants repudiated liability in respect of two claims where exemplary damages had been awarded against the plaintiffs. The defendants argued that it was against public policy to allow insurance against the payment of exemplary damages. This was a question entirely free from English authority although research showed that this was the rule in some but not all American States (where awards of exemplary damages are much more common and in general much larger in amount). If novelty had been of itself decisive there would have been no need for further discussion. Although Simon Brown LJ said that 'The Courts should be wary of minting new rules of public policy when the legislature had not done so' the Court of Appeal's rejection of the defendants' argument turns on a careful analysis of the relevant policy considerations.

A final observation may be made as to the way in which the courts determine the content of public policy. Apart from reliance on previous precedents, this is done by a priori deduction from broad general principles. It is not the practice in English courts for the parties to lead sociological or economic evidence as to whether particular practices are harmful and it is doubtful to what extent such evidence would be regarded as relevant if it were adduced.[20]

B THE CONTRACTS DESCRIBED[1]

It is now necessary to describe and discuss the six contracts that are properly to be termed illegal at common law on the ground of public policy.

a A contract to commit a crime, a tort or a fraud on a third party

There is no need to stress the obvious fact that an agreement is illegal and void if its object, direct or indirect, is the commission of a crime or a tort. The rule has been applied to many cases, as for instance where the design was to obtain

16 [1956] 2 QB 127, [1956] 2 All ER 33.
17 [1979] Ch 84, [1978] 2 All ER 489; Bishop and Hindley 42 MLR 338.
18 [1978] 3 All ER 769, [1978] 1 WLR 1387.
19 [1996] 3 All ER 545
20 See eg *Texaco Ltd v Mulberry Filling Station* [1972] 1 All ER 513, [1972] 1 WLR 814. Cf the use of Monopolies Commission Report in *Esso Petroleum Co Ltd v Harpers Garage (Stourport) Ltd* [1968] AC 269, [1967] 1 All ER 699. Cf the use of the 'Brandeis Brief' in American law: *Muller v Oregon* 208 US 412 (1908).
1 See Furmston 16 U of Toronto LJ 267.

goods by false pretences;[2] to defraud prospective shareholders;[3] to disseminate obscene prints;[4] to publish a libel;[5] to assault a third party;[6] or to rig the market, ie artificially to enhance the true value of shares by entering into a contract to purchase them at a fictitious premium.[7]

An agreement made with the object of defrauding or deceiving[8] a third party is illegal, and a familiar illustration of this is where A agrees to recommend B for a post, whether public or private, in consideration that B, if appointed, will pay part of the emoluments or a secret commission to A.[9]

In this context it is appropriate to remember the ambit of the crime of conspiracy[10] and that any agreement which amounts to a criminal conspiracy will also be an illegal contract.

An allied rule of public policy is that no person shall be allowed to benefit from his own crime.[11] This is a doctrine of general application. So it is important not only in the law of contract but also, for example, in the law of succession. In one case, for instance, a wife, who had killed her husband by a single blow with a domestic chamber pot, was convicted of manslaughter by reason of her diminished responsibility and was sentenced to be detained without limit of time in Broadmoor hospital. Such a 'hospital order' is remedial in nature, and it implies that the convicted person is not deserving of punishment. It was therefore, argued that the wife was not precluded from taking a benefit under her deceased husband's will. The argument was rejected. Having been justly convicted of a crime, the degree of her moral guilt was irrelevant.[12]

The rule that the court will not assist a person to recover the fruits of his crime applies equally to his representatives. This is well illustrated by *Beresford v Royal Insurance Co Ltd.*[13]

> X, who had insured his life with the defendant company for £50,000, shot himself two or three minutes before the policy would have been invalidated by non-payment of the premium. He was sane at the time of his death. As the law then stood, suicide was a crime.[14] On the true construction of the

2 *Berg v Sadler and Moore* [1937] 2 KB 158, [1937] 1 All ER 637. But for a criticism of this difficult case, see Furmston 16 U of Toronto LJ 267 at 290-291. See Theft Act 1968 ss 15 and 16.

3 *Begbie v Phosphate Sewage Co* (1875) LR 10 QB 491.

4 *Fores v Johnes* (1802) 4 Esp 97.

5 *Apthorp v Neville & Co* (1907) 23 TLR 575.

6 *Allen v Rescous* (1676) 2 Lev 174.

7 *Scott v Brown, Doering, McNab & Co* [1892] 2 QB 724.

8 *Brown Jenkinson & Co Ltd v Percy Dalton (London) Ltd* [1957] 2 QB 621, [1957] 2 All ER 844.

9 *Waldo v Martin* (1825) 4 B & C 319. See also *Harrington v Victoria Graving Dock Co* (1878) 3 QBD 549.

10 Which is not as wide as it once was. Criminal Law Act 1977.

11 *Cleaver v Mutual Reserve Fund Life Association* [1892] 1 QB 147 at 156, per Fry LJ; *Re Crippen's Estate* [1911] P 108 at 112, per Sir Samuel Evans P; Youdan 89 LQR 235; Goval and Smith [1973] CLJ 81.

12 *Re Giles, Giles v Giles* [1972] Ch 544, [1971] 3 All ER 1141. But see now Forfeiture Act 1982.

13 [1937] 2 KB 197, [1937] 2 All ER 243; affd [1938] AC 586, [1938] 2 All ER 602.

14 This is no longer so: Suicide Act 1961, s 1. It can therefore be argued that if the facts of *Beresford* recurred the result would now be different. See *Dunbar v Plant* [1997] 4 All ER 289.

> contract, the company had agreed to pay the money to X's representatives even though he should die by his own hand and whether he should then be sane or insane.

An action in which X's executor claimed payment of the £50,000 failed. In the words of Lord Macmillan:

> To enforce payment in favour of the assured's representative would be to give him a benefit, albeit in a sense a post-mortem benefit, the benefit, namely, of having by his last and criminal act provided for his relatives or creditors.[15] Neither the House of Lords nor the Court of Appeal stigmatised the contract of insurance itself as illegal. It was not void *in toto*. Lord Atkin and Lord Thankerton were therefore of opinion that if, for example, X had assigned his policy as security for a loan, the lender would have been entitled to recover the amount of the loan from the insurance company.[16]

In *Gray v Barr*,[17] this rule was applied again.

> The defendant involuntarily killed X in the course of making an unlawful and violent attack upon him with a loaded gun. This amounted to manslaughter. Judgment was given against him in a civil action for the payment of £6,668 by way of compensation to X's widow. He admitted liability, but claimed an indemnity against this sum under an insurance policy which indemnified him against all sums that he might become liable to pay as damages in respect of bodily injury caused by an accident.

His claimed failed. Having intentionally attacked the deceased in a violent and unlawful manner, it was contrary to public policy that he should be indemnified against the consequences, however unintentional the killing of his victim might have been. At first sight this decision appears inevitable but it has been forcefully criticised.[18] It has been pointed out that since the policy was one of liability insurance; the defendant would have no claim against the insurance company unless he were liable to the plaintiff and it would be the plaintiff who suffered from the decision unless the defendant were sufficiently wealthy to pay the damages from his own resources.[19]

Such considerations, though not adopted in *Gray v Barr* have prevailed in the case of motor car insurance. A motorist, who is insured against liability for damages payable to third persons injured as a result of his negligent driving, is entitled to an indemnity under the policy even though the negligence has been so gross as to amount to manslaughter. This right, however, does not avail him if the injury has been deliberately caused in cold blood. Even in this case, however, the victim of the assault, if he receives no

15 [1938] AC at 605.

16 Ibid at 600, per Lord Atkin, with whom Lord Thankerton agreed. Lord Macmillan reserved his opinion on the question: ibid at 605; *Hardy v Motor Insurers' Bureau* [1964] 2 QB 745 at 760, per Lord Denning MR; *Davitt v Titcumb* [1990] Ch 110, [1989] 3 All ER 417. For further illustrations, see Furmston 16 U of Toronto LJ 267 at 269-272.

17 [1970] 2 QB 626, [1970] 2 All ER 702; affd [1971] 2 QB 554, [1971] 2 All ER 949.

18 Fleming 34 MLR 176. Cf *Fire and All Risks v Powell* [1966] VR 513.

19 There is no evidence in the report as to the defendant's wealth nor is it easy to see how a rule could apply which involved a means test on the defendant. It is clear however that in most tort actions defendants are not worth suing unless they carry liability insurance: Atiyah *Accidents, Compensation and The Law* (5th edn, 1993) chs 9 and 10.

compensation from the guilty party, has a right of recovery against the assurers in accordance with the compulsory insurance regulations laid down by modern legislation.[20]

The principle that no benefit can accrue to a criminal from his crime, however, must obviously not be pushed too far.[1] Nowadays there are many statutory offences, some of them involving no great degree of turpitude, which rank as crimes, and it has several times been doubted whether they are all indiscriminately affected by the rule of which *Beresford*'s case is an example.[2]

b A contract that is sexually immoral

Although Lord Mansfield laid it down that a contract *contra bonos mores* is illegal,[3] the law in this connection appears to concern itself only with what is sexually reprehensible. The precise ambit of this head of public policy is, however, very far from clear. It has been plausibly argued that sexual mores have changed radically and that public policy should reflect this,[4] but it is not easy to state how far the changes have gone. It seems very unlikely that prostitutes can sue for their fees. Equally, if a landlord lets a room to a prostitute for ten times the normal rent, knowing that she will use it to receive clients, the contract is surely illegal. On the other hand, in the older cases, it is stated that an agreement intended to bring about or facilitate illicit cohabitation is illegal,[5] though it has also been held that an agreement to pay for such cohabitation after the event is bad only for lack of consideration and therefore enforceable if under seal.[6]

These latter cases must now require reconsideration. It is extremely common for landlords to let accommodation, knowing or reasonably suspecting that the occupants are living together but are not married. The courts have shown no disposition to resolve landlord-tenant disputes in such cases by invoking public policy.[7] Similarly, it is common for such unmarried couples to enter into arrangements for the pooling of their incomes and the acquisition of assets, including houses or flats. Several such cases have been before the

20 *Tinline v White Cross Insurance Association Ltd* [1921] 3 KB 327; *James v British General Insurance Co Ltd* [1927] 2 KB 311. *Hardy v Motor Insurers' Bureau* [1964] 2 QB 745 at 761, per Lord Denning MR citing Road Traffic Act 1960, s 207. *Gardner v Moore* [1984] AC 548, [1984] 1 All ER 1100.

1 *Howard v Shirlstar Container Transport Ltd* [1990] 3 All ER 366, [1990] 1 WLR 1292.

2 *Beresford v Royal Insurance Co Ltd* [1937] 2 KB 197 at 220, per Lord Wright MR; *Marles v Philip Trant & Sons Ltd (No 2)* [1954] 1 QB 29 at 37, per Denning LJ; *St John Shipping Corpn v Joseph Rank Ltd* [1957] 1 QB 267 at 292, [1956] 3 All ER 683 at 687, per Devlin J; *Osman v J Ralph Moss Ltd* [1970] 1 Lloyd's Rep 313.

3 *Jones v Randall* (1774) 1 Cowp 37.

4 Dwyer 93 LQR 386; Devlin 89 MLR 1 at 12; Honoré *Sex Law* pp 44-51, 131-132.

5 *Benyon v Nettlefold* (1850) 3 Mac & G 94; *Ayerst v Jenkins* (1873) LR 16 Eq 275.

6 *R v Bernhard* [1938] 2 KB 264, [1938] 2 All ER 140; *Nye v Moseley* (1826) 6 B & C 133. Although this distinction, as stated, sounds very odd, it produces a comprehensible result, since the practical purpose of the agreement in the last cited case was to provide for a discarded mistress, a not dishonourable course of conduct.

7 In most cases the point has gone by default. See eg *Somma v Hazelhurst* [1978] 2 All ER 1011, [1978] 1 WLR 1014; *Dyson Holdings Ltd v Fox* [1976] QB 503, [1975] 3 All ER 1030 (but note that the court is bound to take public policy points of its own motion, see p 428, below). It was however expressly taken and rejected in *Heglibiston Establishment v Heyman* (1977) 246 Estates Gazette 567, 36 P & CR 351 (not following *Upfill v Wright* [1911] 1 KB 506).

courts, when the relationship has broken down and it has been assumed that in principle such arrangements are capable of being binding contracts.[8]

It is plausible to argue that in such relationships the agreement is enforceable because there is other consideration to support it[9] or that, in modern times, it is not to be assumed that one party rather than the other is providing sexual services.

c A contract prejudicial to the public safety

In an early case Lord Alvanley said:

> We are all of opinion that ... it is not competent to any subject to enter into a contract to do any thing which may be detrimental to the interests of his own country; and that such a contract is as much prohibited as if it had been expressly forbidden by act of parliament.[10]

Detrimental contracts within the meaning of this statement are those which tend either to benefit an enemy country or to disturb the good relations of England with a friendly country.

Contracts made in time of war afford the outstanding example of the first class. A state of war between Great Britain and another country must clearly react upon a contract made with an alien enemy by a British subject or a person owing obedience to the Crown, since it may result in injury to the Commonwealth or advantage to the enemy.[11]

The expression 'alien enemy' is not necessarily restricted to its popular meaning. It denotes a status that depends not upon the nationality of the contracting party, but upon whether he is voluntarily resident in or carrying on a business in the enemy's country or in a country within the effective control of the enemy.[12] Thus a British subject or a neutral who is resident in enemy territory is treated as an alien enemy in the present context. An enemy national who happens to be present in England during the war may be sued in the Queen's courts, but he cannot himself bring any action.[13] On the other hand, if he is resident here with the licence of the Crown, as for instance where he is registered under the Aliens Restriction Acts, the courts are open to him and a contract may be enforced by him even during the continuance of hostilities.[14] It goes without saying that a contract made during war with an alien enemy is illegal. If it is made during peace with a person who later becomes an alien enemy owing to the outbreak of war and if it involves

8 Clearly in practice many such arrangements like those made between husband and wife fall short of being contractually binding for other reasons. See eg *Tanner v Tanner* [1975] 3 All ER 776, [1975] 1 WLR 1346; *Eves v Eves* [1975] 3 All ER 768, [1975] 1 WLR 1338; *Horrocks v Forray* [1976] 1 All ER 737, [1976] 1 WLR 230; *Chandler v Kerley* [1978] 2 All ER 942, [1978] 1 WLR 693.

9 Barton 92 LQR 168.

10 *Furtado v Rogers* (1802) 3 Bos & P 191 at 198. See in general McNair and Watts *Legal Effects of War*, especially ch 4.

11 The following account is confined to the position at common law. In time of war, many of the matters that arise are governed by special legislation.

12 *Porter v Freudenberg* [1915] 1 KB 857; *Sovracht (V/O) v Van Udens Scheepvart en Agentuur Maatschappij (NV Gebr)* [1943] AC 203, [1943] 1 All ER 76. For the purposes of the Trading with the Enemy Act 1939, which penalises persons having intercourse with the enemy, de facto residence, though not voluntary, is sufficient; *Vamvakas v Custodian of Enemy Property* [1952] 2 QB 183, [1952] 1 All ER 629.

13 *Porter v Freudenberg* [1915] 1 KB 857; *Halsey v Lowenfeld* [1916] 2 KB 707.

14 *Schaffenius v Goldberg* [1916] 1 KB 284.

intercourse with the enemy country or is in other respects obnoxious from the standpoint of public policy, then it is immediately abrogated *in so far as it is still executory*.[15] It is not merely suspended during hostilities, but is cut short *eo instanti* upon the commencement of the war. It can give rise to no further rights and obligations for the object of the law is to provide certainty at a time when everything else is uncertain and to enable the parties to engage in another adventure without waiting to see whether hostilities cease soon enough to render fulfilment of the contract possible.[16] If, for instance, an Englishman agrees to charter a ship to a German company for a period of ten years, the effect of an outbreak of war between Great Britain and Germany is to absolve the parties at once from their future obligations, notwithstanding that peace may be restored before the expiration of ten years. This rule applies not only to contracts with an enemy alien, but also to those made between British subjects and neutrals or even between British subjects themselves if benefit may thereby accrue to the enemy country.[17]

The doctrine of abrogation, then, affects the contract so far as it is still executory. It does not affect it so far as performance has already been completed.[18] Accrued rights, though not immediately enforceable, are not destroyed. Common law, it must be stressed, does not countenance the confiscation of enemy property and, subject to what may be arranged in the ultimate peace treaty and to any statutory provisions for the administration of enemy property found in this country, it is well established that contractual rights already accrued in favour of an alien enemy at the outbreak of war remain intact, though of course the right to enforce them is suspended until hostilities cease.[19]

No attempt has ever been made to give an exhaustive definition of 'accrued rights', but it is clear that the right to the payment of a liquidated sum of money already due under a contract falls within this category and therefore survives the outbreak of war.[20] Such a sum is regarded as a debt incurred before the creditor was infected with enemy status, and since nothing remains outstanding except its payment and since confiscation of his property is ruled out, he is entitled to enforce a payment when hostilities cease. Thus he may ultimately recover the bank balance that was standing to his credit at the outbreak of war.[1] Even future instalments of a debt that have fallen due after the outbreak of war are regarded as liquidated sums within the meaning of the rule, so that the right to recover them is merely postponed.[2]

15 *Ertel Bieber & Co v Rio Tinto Co* [1918] AC 260 at 267-268, 274, per Lord Dunedin.
16 *Esposito v Bowden* (1857) 7 E & B 763 at 792, per Willes J.
17 *Schering Ltd v Stockholms Enskilda Bank Aktiebolag* [1946] AC 219 at 257, [1946] 1 All ER 36 at 40; *Kuenigl v Donnersmarck* [1955] 1 QB 515, [1955] 1 All ER 46.
18 *Ottoman Bank v Jebara* [1928] AC 269 at 276; *Schering Ltd v Stockholms Enskilda Bank Aktiebolag*, above, at 241, 258 and 41, and 55 respectively.
19 *Daimler Co Ltd v Continental Tyre and Rubber Co (Gt Britain) Ltd* [1916] 2 AC 307 at 347, per Lord Parker.
20 McNair and Watts *Legal Effects of War* (4th edn) pp 137-138, approved in *Schering Ltd v Stockholms Enskilda Bank Aktiebolag* [1946] AC 219 at 240, [1946] 1 All ER 36 at 40, per Lord Thankerton; and in *Arab Bank Ltd v Barclays Bank Ltd* [1954] AC 495 at 537, [1954] 2 All ER 226 at 239, per Lord Asquith.
1 *Arab Bank Ltd v Barclays Bank* [1954] AC 495, [1954] 2 All ER 226.
2 *Schering Ltd v Stockholms Enskilda Bank Aktiebolag* [1946] AC 219, [1946] 1 All ER 36. Though well established, this rule is in fact illogical, since the creditor might, for instance, assign the debt for immediate payment and thus increase the resources of the enemy, per Lord Goddard at 269 and 57 respectively.

A further exception to the principle of abrogation, as described by Lord Dunedin, is that those contracts 'which are really the concomitants of property' are suspended, not destroyed, even though they are still executory.[3] These, as in the case of accrued rights, have never been precisely defined, but they are generally taken to mean contracts connected with land such as restrictive covenants and covenants running with the land at common law or by statute.[4]

There is, therefore, no general rule that all executory contracts with an alien enemy are abrogated. 'The executory contract which is abrogated must either involve intercourse, or its continued existence must be in some other way against public policy as that has been laid down in decided cases.[5] The judges have refused to formulate what contracts escape abrogation as being innocuous from the point of view of public policy, but one example at least is a separation agreement under which a husband has agreed to make periodic payments to his wife. If in such a case the wife becomes an alien enemy, the husband none the less remains liable to pay the sums falling due under the contract.[6]

A contract which contemplates the performance in a foreign and friendly country of some act which is inimical to the public welfare of that country is a breach of international comity, and is regarded as illegal by the English courts.[7] Thus it is unlawful to make an agreement in England to raise money in support of a revolt against a friendly Government,[8] to enter into a partnership for the purpose of importing liquor into a country contrary to its prohibition laws,[9] or to do something in a foreign country which will violate the local law.[10] In *Lemenda Trading Co Ltd v African Middle-East Petroleum Co Ltd*[11] the defendants, a London company, entered into a contract with the plaintiffs, a company registered in Nassau, under which the plaintiffs agreed to assist the defendants in procuring the renewal of a supply contract with the Qatar National Oil Company for the supply of crude oil. The understanding was that the plaintiff would use its influence with the Chairman or Managing Director of the Qatar National Oil Company and would be paid, if successful, on a commission basis. This contract was subject to English law. The defendants had also entered into a contract with the Qatar National Oil Company and had executed a side letter to that contract agreeing that the contract had been negotiated without the assistance of agents or brokers paid on a commission basis. Under Qatar law a commission contract for the supply of oil was void and unenforceable. The defendants obtained the renewal of the supply contract and the plaintiff claimed commission. The defendant argued that even if the plaintiff had been instrumental in helping them get the supply contract renewed, any agreement to pay him commission was contrary to English public policy. This view was accepted by Phillips J who said:

3 *Ertel Bieber & Co v Rio Tinto Co Ltd* [1918] AC 260 at 269.
4 *Schering Ltd v Stockholms Enskilda Bank Aktiebolag* [1946] AC 219 at 252, [1946] 1 All ER 36 at 47, per Lord Russell of Killowen.
5 *Ertel Bieber & Co v Rio Tinto Co Ltd* [1918] AC 260 at 269, per Lord Dunedin.
6 *Bevan v Bevan* [1955] 2 QB 227, [1955] 2 All ER 206.
7 *Foster v Driscoll* [1929] 1 KB 470 at 510, 520-522.
8 *De Wütz v Hendricks* (1824) 2 Bing 314.
9 *Foster v Driscoll* [1929] 1 KB 470.
10 *Regazzoni v K C Sethia (1944) Ltd* [1958] AC 301, [1957] 3 All ER 286. This is a principle of considerable width. See Mann 21 MLR 130, cf A L G 73 LQR 32. See also *Fielding and Platt v Selim Najjar* [1969] 2 All ER 150, [1969] 1 WLR 357; *National Westminster Bank Ltd v Barclays Bank International Ltd* [1975] QB 654, [1974] 3 All ER 834.
11 [1988] QB 448, [1988] 1 All ER 513.

In my judgment, the English courts should not enforce an English law contract which falls to be performed abroad where
(i) it relates to an adventure which is contrary to a head of English public policy which is founded on general principles of morality and
(ii) the same public policy applies in the country of performance so that the agreement would not be enforceable under the law of that country. In such a situation international comity combines with English domestic public policy to militate against enforcement.

d A contract prejudicial to the administration of justice

'It is admitted that any contract or engagement having a tendency, however slight, to affect the administration of justice, is illegal and void.[12] There are many examples of this rule, as for instance, an agreement not to appear at the public examination of a bankrupt nor to oppose his discharge,[13] an agreement not to plead the Gaming Acts as a defence to an action on a cheque given for lost bets,[14] and an agreement to withdraw divorce proceedings;[15] an agreement by a witness not to give evidence or only to give evidence for one side,[16] but perhaps the most familiar example is an agreement to stifle a prosecution.

It is in the interests of the public that the suppression of a prosecution should not be made the matter of a private bargain.[17] Whether a man ought to be prosecuted or not depends upon considerations that vary in each case, but the person with whom the decision rests is under a social duty in the discharge of which he must be free from the influence of indirect motives.[18] It is therefore well established that the courts will neither enforce nor recognise any agreement which has the effect of withdrawing from the ordinary course of justice a prosecution for a public offence.[19] An agreement to stifle a prosecution, ie to prevent proceedings already instituted from running their normal course, or to compromise a prosecution, is illegal and void, even though the prosecutor derives no gain, financial or otherwise, and even though the agreement secures the very object for which the proceedings were taken.[20]

This rule, however, applies only where the offence for which the defendant is prosecuted is a matter of public concern, ie one which pre-eminently affects the interests of the public. If the offence is not of this nature, but is one in which the injured person has a choice between a civil and a criminal remedy, as for instance in the case of a libel or an assault, a compromise is lawful and enforceable. The question whether the offence was of public concern arose in the leading case of *Keir v Leeman*.[1]

A commenced a prosecution for riot and assault against seven defendants who had assaulted and ejected a sheriff's officer and his assistants while they were levying an execution in respect of a judgment debt due to A.

12 *Egerton v Brownlow* (1853) 4 HL Cas 1 at 163, per Lord Lyndhurst.
13 *Kearley v Thomson* (1890) 24 QBD 742.
14 *Cooper v Willis* (1906) 22 TLR 582.
15 *Gipps v Hume* (1861) 2 John & H 517.
16 *Harmony Shipping Co S A v Davis* [1979] 3 All ER 177, [1979] 1 WLR 1380.
17 *Clubb v Hutson* (1865) 18 CBNS 414 at 417, per Erle CJ.
18 *Jones v Merionethshire Permanent Benefit Building Society* [1892] 1 Ch 173 at 183, per Bowen LJ.
19 *Windhill Local Board of Health v Vint* (1890) 45 ChD 351 at 363, per Cotton LJ.
20 *Keir v Leeman* (1846) 9 QB 371; *Windhill Local Board of Health v Vint*, above.
1 Above.

> Before the trial began. X and Y agreed to pay to A the amount of the debt, together with costs, in consideration that A would not proceed with the prosecution. A accordingly gave no evidence against the defendants and he consented with the leave of the judge to a verdict of 'not guilty' being entered. X and Y, when sued upon the agreement, pleaded that it was an unlawful compromise and therefore void. This plea prevailed.

Denman CJ after remarking that some indictments for misdemeanour might be compromised, said:

> We shall probably be safe in laying it down that the law will permit a compromise of all offences, though made the subject of criminal prosecution, for which the injured party might sue and recover damages in an action. It is often the only manner in which he can obtain redress. But if the offence is of a public nature, no agreement can be valid that is founded on the consideration of stifling a prosecution for it ... In the present instance the offence is not confined to personal injury, but is accompanied with riot and obstruction of a public officer in the execution of his duty. These are matters of public concern and therefore not legally the subject of a compromise.

Other instances of public offences in respect of which no compromise is permitted are perjury,[2] obtaining money or credit by false pretences,[3] forgery,[4] interference with and obstruction of a public highway.[5]

An example of the rule, that an offence for which either a civil or a criminal remedy is available may be the subject of a lawful compromise, is *Fisher & Co v Apollinaris Co*[6] where the facts were these:

> The Apollinaris Co prosecuted Fisher under the Trade Marks Act for selling his mineral water in bottles that bore their trade mark. It was then agreed that, in consideration of the abandonment of the prosecution, Fisher would give a letter of apology to the company and would authorise them to make what use of it they considered appropriate. After the abandonment, the company proceeded to publish continuously the letter of apology in the daily press. Fisher sued to restrain this publication on the ground that the apology had been obtained by an improper use of criminal proceedings.

It was held that the agreement was valid, since there was nothing unlawful in the withdrawal of a prosecution for an offence of that particular kind.

The account given above is based on the law as it was before the Criminal Law Act 1967. That act made a number of changes in the criminal law. Section 1 abolished the distinction between felonies and misdemeanours and section 5(1) introduced a new offence of concealing an arrestable offence, which replaced the wider offences of misprision of felony and compounding a felony. The act makes no mention of the law of contract but it is arguable that it alters it indirectly.[7] Before the act any agreement to conceal a felony was itself a criminal offence and therefore necessarily an illegal contract. So the public-private dichotomy which previously applied only to misdemeanours

2 *Collins v Blantern* (1767) 2 Wils 341.
3 *Clubb v Hutson* (1865) 18 CBNS 414; *Jones v Merionethshire Permanent Benefit Building Society* [1892] 1 Ch 173. See Theft Act 1968, ss 15 and 16.
4 *Brook v Hook* (1871) LR 6 Exch 89.
5 *Windhill Local Board of Health v Vint* (1890) 45 ChD 351.
6 (1875) 10 Ch App 297.
7 For a fuller account, see Buckley 3 Anglo-American L Rev 472; Hudson 43 MLR 532.

might in theory be applied to all offences. In the same way since an agreement to conceal an arrestable offence is no longer a criminal offence if the only consideration for it is the making good of the loss or injury caused by the offence, it can be argued that such an agreement should now be enforceable. On balance, however, it is thought that to take an agreement out of the ambit of the criminal law does not by itself indicate that it should be enforced.

Maintenance and champerty

A further example of contracts that tend to pervert the due course of justice are those which savour of maintenance or champerty. 'Maintenance may nowadays be defined as improperly stirring up litigation and strife by giving aid to one party to bring or defend a claim without just cause or excuse.'[8] Champerty is where there is a further agreement that the person who gives the aid shall receive a share of what may be recovered in the action.

Formerly, maintenance was a misdemeanour, and also a tort for which damages were recoverable by the other party in the action. This is no longer the case. The Criminal Law Act 1967 provides that maintenance, including champerty, shall no longer be punishable as a crime or actionable as a tort.[9] It is further provided, however, that this abolition of criminal and civil liability 'shall not affect any such rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal'.[10] Therefore, the long established rule still stands that an agreement tainted by maintenance or champerty is void as being contrary to public policy.

The Act did not therefore reverse the long established rule that agreements tainted by maintenance or champerty were void as being contrary to public policy.[11] However, recent developments have shown that apparently well settled policies in this area are now open to debate and reconsideration.

For centuries it has been taken for granted that it was professionally improper as well as illegal for lawyers to agree with claimant clients to conduct litigation on the basis that payment would be related to results. (It was not improper or illegal for lawyers to do work for no payment nor was it improper or illegal to take on as a client someone who in practice was unlikely to be able to pay the fees if the claim was not successful.) For certain kinds of litigation this rule has now been reversed by the Courts and Legal Services Act 1990, section 58. The most obvious example is personal injuries where in practice a very high percentage of claims are successful. The details of this change are outside the scope of this book but this development has raised the question whether there might be a parallel change in the common law.

In *Thai Trading v Taylor*[12] the second defendant was a lawyer who had acted for the first defendant, his wife, in a contract dispute with the plaintiffs on the

8 *Re Trepca Mines Ltd (No 2)* [1963] Ch 199 at 219, [1962] 3 All ER 351 at 355E, per Lord Denning.

9 Ss 13(1) and 14(1).

10 S 14(2).

11 *Rees v De Bernardy* [1896] 2 Ch 437. As to whether an arrangement is champertous see *Giles v Thompson* [1993] 3 All ER 321. As to whether any exceptions may exist to this rule, see now the differing views in *Wallersteiner v Moir (No 2)* [1975] QB 373, [1975] 1 All ER 849. It was agreed in *Trendtex Trading Corpn v Crédit Suisse* [1982] AC 679, [1981] 3 All ER 520 that the modern tendency was for the scope of maintenance to diminish.

12 [1998] 3 All ER 65 not following *Aratra Potato Co Ltd v Taylor Johnson Garrett* [1995] 4 All ER 695.

basis that he would charge his usual fees if the defence was successful and make no charge if it were not. The Court of Appeal held this agreement lawful. This decision has however since been held wrong[13] on the basis that it contravened the Solicitors Practice Rules which had been held by the House of Lords in *Swain v Law Society*[14] to have the force of a statute.

In *Bevan Ashford v Geoff Yeadle (Contractors) Ltd*[15] the plaintiff solicitors entered into an arrangement with the defendant company to conduct an arbitration on the basis that they would receive their normal fees if successful. Counsel were engaged on the basis that he would receive no fee if the defendants claim in the arbitration failed and an uplift of 50% above his normal fee if the claim succeeded. Sir Richard Scott V-C held that these arrangements were outside section 58 of the Courts and Legal Services Act 1990 but that they were lawful at common law by virtue of a change in public policy.

In *Mohamed v Alaga & Co*[16] the claimant was a leading member of the Somali community in the United Kingdom. He alleged that he had made a deal with the defendant solicitors under which he would introduce Somali refugees to the defendant with a view to the refugees applying for legal aid and the defendant representing them on their asylum applications. He further alleged that he had agreed to give help in preparing and presenting the applications and that the defendants had agreed to pay commission equivalent to one half of any fees received by them on legal aid. It was accepted that such an agreement would be contrary to section 7 of the Solicitors Practice Rules 1990.

The Court of Appeal held that any such contract would be illegal even if, as he alleged, the claimant was ignorant of the prohibition. However, it was held that the claimant could recover on a *quantum meruit* basis for the value of any work he had done for the defendant.[17]

An allied problem arises where a company is in financial difficulties and has as its main asset a cause of action which if successfully pursued would generate funds which would resolve or at least reduce the difficulties. In this situation it may be attractive to sell the cause of action to an individual since individuals, unlike companies, may be eligible for legal aid and less likely to be subject to orders to provide security for costs. In *Norglen Ltd v Reeds Rains Prudential Ltd*[18] the House of Lords held that an assignment by a company to an individual would not be invalid for this reason.[19]

e A contract liable to corrupt public life

It has long been the rule that any contract is illegal which tends to corruption in the administration of the affairs of the nation. A familiar example of a transaction offensive to this principle is a contract for the buying, selling or procuring of public offices.[20] Story says:

13 *Hughes v Kingston upon Hull City Council* [1999] 2 All ER 49; *Awwad v Geraghty & Co* (a firm) [2000] 1 All ER 608.
14 [1982] 2 All ER 827.
15 [1998] 3 All ER 238.
16 [1999] 3 All ER 699
17 As to contingency fees and other professions see *Pickering v Sogex Services (UK) Ltd* (1982) 263 Estates Gazette 770.
18 [1998] 1 All ER 218. A liquidator has special powers to deal in causes of action under s 214 of Insolvency Act 1986. See *Re Oasis Merchandising Services Ltd* [1997] 1 All ER 1009.
19 For further consideration of circumstances in which funding another's cause of action is an abuse of process see *Stocznia Gdanska SA v Latvian Shipping Co (No 2)* [1998] 1 All ER 883.
20 *Blachford v Preston* (1799) 8 Term Rep 89.

> It is obvious that all such contracts must have a material influence to diminish the respectability, responsibility and purity of public officers, and to introduce a system of official patronage, corruption and deceit wholly at war with the public interest.[1]

Thus in one case:

> A agreed that if by the influence of B he were appointed Customs Officer of a port, he would appoint such deputies as B should nominate and would hold the profits of the office in trust for B. It was held, after A had secured the post, that no action lay against him for breach of this agreement.[2]

Similarly a contract to procure a title for a man in consideration of a money payment is illegal at common law.[3]

On the same principle an agreement to assign or mortgage future instalments of the salary of a public office is void, since the law presumes that the object of the salary is to maintain the dignity of the office and to enable the holder to perform his duties in a proper manner.[4] This restriction was applied in the eighteenth century to officers in the army,[5] and the common assumption is that it extends to judges[6] and to civil servants generally, such as clerks of the peace[7] and parliamentary counsel to the Treasury,[8] but whether the extension is justified either by the authorities themselves or by the change that has gradually occurred in the status of the civil service is doubtful.[9]

To attract the doctrine the office must be public in the strict sense of that word, and the holder of an office whose emoluments do not derive from national funds, such as a clergyman of the Church of England, is not subject to the restriction.[10]

f A contract to defraud the revenue

There is a clear infringement of the doctrine of public policy if it is apparent, either directly from the terms of the contract or indirectly from other circumstances, that the design of one or both of the parties is to defraud the revenue, whether national[11] or local.[12] In *Miller v Karlinski*, for instance,[13]

> The terms of a contract of employment were that the employee should receive a salary of £10 weekly and repayment of his expenses, but that he should be entitled to include in his expenses account the amount of income tax due in respect of his weekly salary.

1 *Equity Jurisdiction* s 295.
2 *Garforth v Fearon* (1787) 1 Hy Bl 328.
3 *Parkinson v College of Ambulance Ltd and Harrison* [1925] 2 KB 1. See now the Honours (Prevention of Abuses) Act 1925, which makes the parties to such a contract guilty of a misdemeanour.
4 *Liverpool Corpn v Wright* (1859) John 359.
5 *Flarty v Odlum* (1790) 3 Term Rep 681; *Barwick v Reade* (1791) 1 Hy Bl 627.
6 *Arbuthnot v Norton* (1846) 5 Moo PCC 219.
7 *Palmer v Bate* (1821) 2 Brod & Bing 673.
8 *Cooper v Reilly* (1829) 2 Sim 560. For the view that this decision and those cited in the two preceding notes are not conclusive, see Logan 61 LQR 241 at 247-248.
9 The authorities are closely and critically reviewed by Logan 61 LQR 241.
10 *Re Mirams* [1891] 1 QB 594.
11 *Miller v Karlinski* (1945) 62 TLR 85; *Napier v National Business Agency Ltd* [1951] 2 All ER 264, 67 LQR 449-451.
12 *Alexander v Rayson* [1936] 1 KB 169; applied in *Edler v Auerbach* [1950] 1 KB 359, [1949] 2 All ER 692.
13 Above.

In an action brought by him to recover ten weeks' arrears of salary and £21 2s 8d for expenses it was divulged that about £17 of this latter sum represented his liability for income tax. It was held that the contract was illegal, since it constituted a fraud upon the revenue. No action lay to recover even arrears of salary, for in such a case the illegal stipulation is not severable from the lawful agreement to pay the salary.[14]

It is doubtful whether the well-known case of *Alexander v Rayson*[15] exemplifies this principle. The facts were these:

> The plaintiff agreed to let a service flat to the defendant at an annual rent of £1,200. This transaction was expressed in two documents, one a lease of the premises at a rent of £450 a year, the other an agreement by the plaintiff to render certain specified services for an annual sum of £750. It was alleged that his object was to produce only the lease to the Westminster Assessment Committee, and by persuading this body that the premises were worth only £450 a year, to obtain a reduction of their rateable value. The defendant was ignorant of this alleged purpose. The plaintiff ultimately failed to accomplish his fraudulent object. He sued the defendant for the recovery of £300, being a quarter's instalment due under both documents.

The Court of Appeal held that, if the alleged fraud was not disproved by the plaintiff when the trial was resumed in the court of first instance, he could recover neither on the lease nor on the contract.

It is clear that both the agreement and the lease were harmless in themselves and might well have been performed without any fraud on the part of the lessor. In the words of one critic:

> The contract was not one to do an act contrary to the policy of the law (defrauding the revenue); but one to do an act in itself legal but intended by one of the parties to provide a setting for an act contrary to the policy of the law (defrauding the revenue).[16] The case exemplifies the general principle that a contract *ex facie* lawful will be unenforceable by the plaintiff if his intention is to exploit it for an illegal purpose.[17]

3 The consequence of illegality

A INTRODUCTION: THE RELEVANCE OF THE STATE OF MIND OF THE PARTIES

Whether the parties are influenced by a guilty intention is inevitably material in estimating the consequences of an illegal contract. Its materiality may be stated in three propositions.

First, if the contract is illegal in its inception, neither party can assert that he did not intend to break the law. Both parties have expressly and clearly

14 *Napier v National Business Agency Ltd*, above; *Warburton v Birkenhead & Co Ltd* (1951) 102 L Jo 52. It seems that the position may be different where the tax irregularity arises entirely on the initiative of the employer, *Hall v Woolston Hall Leisure Ltd* [2000] 4 All ER 787, though this case can also be explained on the basis that the right not to be discriminated against on the ground of sex is independent of the validity of the contract.

15 [1936] 1 KB 169.

16 Furmston 16 U of Toronto LJ 267 at 287.

17 Pp 440 ff. below.

agreed to do something that in fact is prohibited at common law, as for example, where a British subject agrees to insure an alien enemy against certain risks. The position is the same if the parties have agreed to do something that is expressly or implicitly forbidden by statute.[18] In both these cases, the contract is intrinsically and inevitably illegal, and, so far as consequences are concerned, no allowance is made for innocence. The British subject, for instance, may well be ignorant that it is unlawful to contract with an alien enemy, but none the less he will be precluded by the maxim *ignorantia juris haud excusat* from relying upon his ignorance.[19] The very contract is unlawful in its formation.

Secondly, if the contract is *ex facie* lawful, but both parties intend to exploit it for an illegal purpose, it is illegal in its inception despite its innocuous appearance. Both parties intend to accomplish an unlawful end and both are remediless. This is true, for instance, of an agreement to let a flat if there is a common intention to use it for immoral purposes.

Thirdly, if the contract is lawful in its formation, but one party alone intends to exploit it for an illegal purpose, the law not unnaturally takes the view that the innocent party need not be adversely affected by the guilty intention of the other.[20] This has been frequently stressed by the judges. In one case in 1810, for instance, the plaintiffs, acting on behalf of a Russian owner, had insured goods on a vessel already en route from St Petersburg and had paid the premium. The contract was made after war had broken out between Russia and England, but the fact was not known, and could not have been known to the plaintiffs. The ship was seized by the Russians and taken back to St Petersburg. The plaintiffs succeeded in an action for the recovery of the premium.[1] Lord Ellenborough, after remarking that the insurance would have been illegal in its inception had the plaintiffs known of the outbreak of war, said:

> But here the plaintiffs had no knowledge of the commencement of hostilities by Russia, when they effected this insurance; and, therefore no fault is imputable to them for entering into the contract; and there is no reason why they should not recover back the premiums which they have paid for an insurance from which, without any fault imputable to themselves, they could never have derived any benefit.[2]

Whether a party is innocent or guilty in this respect depends upon whether 'he is himself implicated in the illegality',[3] or more precisely whether he has participated in the furtherance of the illegal intention.[4] If, for instance, A lets a flat to B, a woman whom he knows to be a prostitute, the very contract will be

18 *Re Mahmoud and Ispahani* [1921] 2 KB 716.

19 *Waugh v Morris* (1873) LR 8 QB 202 at 208, *per curiam*, as explained in *J M Allan (Merchandising) v Cloke* [1963] 2 QB 340, [1963] 2 All ER 258.

20 See for example, *Oom v Bruce* (1810) 12 East 225; *Clay v Yates* (1856) 1 H & N 73 at 80; *Pearce v Brooks* (1866) LR 1 Exch 213 at 217, 221; *Alexander v Rayson* [1936] 1 KB 169 at 182; *Re Trepca Mines Ltd (No 2)* [1963] Ch 199 at 220-221, [1962] 3 All ER 351 at 356. If the agreement is legal in its inception, the mere fact that it *could* be illegally performed is no ground of invalidity: *Laurence v Lexcourt Holding Ltd* [1978] 2 All ER 810, [1978] 1 WLR 1128.

1 *Oom v Bruce* (1810) 12 East 225.

2 Ibid at 226.

3 *Scott v Brown, Doering, McNab & Co Ltd* [1892] 2 QB 724 at 728, per Lindley LJ.

4 *Re Trepca Mines Ltd (No 2)* [1963] Ch 199, [1962] 3 All ER 351; *J M Allan (Merchandising) Ltd v Cloke* [1963] 2 QB 340 at 348. *Belmont Finance Corpn Ltd v Williams Furniture Ltd* [1979] Ch 250, [1979] 1 All ER 118.

unlawful if he knows that B's object is to use the premises for immoral purposes,[5] but this will not be the case if all that he is aware of is B's mode of life, for a reasonable person might not necessarily infer that the purpose of the letting was to further immorality.[6] Even a prostitute must have a home.

Perhaps the best known case on this subject so far as illegality at common law is concerned, is *Pearce v Brooks*,[7] where the facts were as follows:

> The plaintiffs agreed to supply the defendant with a new miniature brougham on hire until the purchase money should be paid by instalments during a period that was not to exceed twelve months. The defendant was a prostitute and she undoubtedly intended to use the carriage, which was of a somewhat intriguing nature, as a lure to hesitant clients. One of the two plaintiffs was aware of her mode of life, but there was no direct evidence that either of them knew of the use to which she intended to put the carriage. The jury, however, found that the purpose of the woman was to use the carriage as part of her display to attract men and that the plaintiffs were aware of her design. On this finding, Bramwell B gave judgment for the defendant in an action brought against her to recover a sum due under the contract.

It was held on appeal that there was sufficient evidence to support the finding of the jury. The Court of Exchequer Chamber was satisfied on the evidence that the plaintiffs were not only aware of the defendant's intention, but were even guilty of some complicity in her provocative scheme.

In order to emphasise the distinction between innocence and guilt that affects this branch of the law, the precise consequences of an illegal contract will now be detailed under two separate heads, namely: the consequence where a contract is illegal in its inception; the consequence where a contract lawful in its inception is later exploited illegally or is illegally performed.

B THE CONSEQUENCE WHERE THE CONTRACT IS ILLEGAL IN ITS INCEPTION

The general principle, founded on public policy, is that any transaction that is tainted by illegality in which both parties are equally involved is beyond the pale of the law. No person can claim any right or remedy whatsoever under an illegal transaction in which he has participated.[8] *Ex turpi causa non oritur actio.* The court is bound to veto the enforcement of a contract once it knows that it is illegal, whether the knowledge comes from the statement of the guilty party or from outside sources.[9] Even the defendant can successfully plead the *turpis causa*, and though his 'defence is very dishonest'[10] and 'seems only worthy of the Pharisee who shook himself free of his natural obligations by saying Corban,'[11] it is allowed for the reasons given by Lord Mansfield in *Holman v Johnson*:

5 *Girardy v Richardson* (1793) 1 Esp 13. See p 413, above.
6 *Crisp v Churchill* (1794) cited in 1 Bos & P at 340. In practice the size of the rent may be a very good guide to the landlord's state of mind.
7 (1866) LR 1 Exch 213.
8 *Gordon v Metropolitan Police Chief Comr* [1910] 2 KB 1080 at 1098, per Buckley LJ.
9 *Re Mahmoud and Ispahani* [1921] 2 KB 716 at 729, per Scrutton LJ.
10 *Thomson v Thomson* (1802) 7 Ves 470 at 473, per Sir William Grant MR.
11 The words of Lord Dunedin in *Sinclair v Brougham* [1914] AC 398 at 436, adapted to the present context by Street *Law of Gaming* 464.

> The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but it is found in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may say so. The principle of public policy is this: *ex dolo malo non oritur actio*. No Court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appear to arise *ex turpi causa*, or the transgression of a positive law of this country, then the Court says he has no right to be assisted. It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally in fault *potior est conditio defendentis*.[12]

The practical application of this general principle must now be stated in some detail.

a The contract is void

A contract that is illegal as formed and is therefore void *ab initio* is treated by the law as if it had not been made at all.[13] It is totally void, and no remedy is available to either party. No action lies for damages, for an account of profits or for a share of expenses. Thus, in the case of an illegal contract for the sale of goods, the buyer, even though he has paid the price, cannot sue for non-delivery; the seller who has made delivery cannot recover the price. A servant cannot recover arrears of salary under an illegal contract of employment.[14] In the case of an illegal lease, the landlord cannot recover the rent or damages for the breach of any other covenant.[15] The position is the same not only where a contract is prohibited at common law on grounds of public policy, but also where its very formation is prohibited by statute. An apt illustration is afforded by *Re Mahmoud and Ispahani*[16] where the facts were these:

> The plaintiff agreed to sell linseed oil to the defendant, who refused to take delivery and was sued for non-acceptance of the goods. A statutory order provided that no person should buy or sell certain specified articles, including linseed, unless he was licensed to do so. Before the conclusion of the contract, the defendant untruthfully alleged that he held a licence and the plaintiff, who himself was licensed, believed the allegation.

Once it was established that each party was forbidden by statute to enter into the contract, the court had no option but to enforce the prohibition even though the defendant relied upon his own illegality. The honest belief of the plaintiff that the defendant held a licence was irrelevant.[17]

Again, an award made by an arbitrator in respect of a prohibited contract will be set aside by the court.[18] A builder who does work at a cost exceeding

12 (1775) 1 Cowp 341 at 343.
13 *Mogul Steamship Co v McGregor, Gow & Co* [1892] AC 25 at 39, per Lord Halsbury.
14 *Miller v Karlinski* (1945) 62 TLR 85.
15 *Alexander v Rayson* [1936] 1 KB 169.
16 [1921] 2 KB 716.
17 Distinguish the case when a contract *lawful* in its formation is performed in an illegal manner by one of the parties; pp 440 ff, below.
18 *David Taylor & Son Ltd v Barnett Trading Co* [1953] 1 All ER 843, [1953] 1 WLR 562.

the sum authorised by statute cannot recover the excess,[19] and if, having done both authorised and unauthorised work, he receives payment under the contract generally, he cannot appropriate the sum to the unlawful work.[20] In all cases where a contract is illegal in its formation, neither party can circumvent the rule—*ex turpi causa non oritur actio*—by pleading ignorance of the law.[1]

Although a contract is illegal in its formation and therefore void, the Court of Appeal has now held that the ownership of goods may pass to the buyer under an illegal contract of sale even if both parties are *in pari delicto*.[2] This decision requires to be examined with some particularity.

Since an illegal contract is totally void, the inescapable conclusion would seem to be that the ownership of movables cannot pass by virtue of the contract itself if this arises *ex turpi causa* and if both parties to it are *in pari delicto*. *Nil posse creari de nilo*.[3]

If, therefore, the ownership is to pass at all, this must be affected by some independent rule of law extraneous to the so-called but abortive contract. It is true that in the case of a gift the ownership of goods may be transferred by delivery, provided that this is what the parties intend. But since this intention is one of the decisive elements of the transaction, it would seem logical to insist that it must be disregarded if it is tainted by illegality.[4] In 1960, however, Lord Denning, giving the opinion of the Privy Council in *Singh v Ali*[5] expressed a view which it is respectfully suggested goes beyond previous statements of the law.

> There are many cases which show that when two persons agree together in a conspiracy to effect a fraudulent or illegal purpose—and one of them transfers property to the other in pursuance of the conspiracy—then, so soon as the contract is executed and the fraudulent or illegal purpose is achieved, the property (be it absolute or special) which has been transferred by the one to the other remains vested in the transferee, notwithstanding its illegal origin ... The reason is because the transferor, having fully achieved his unworthy end, cannot be allowed to turn round and repudiate the means by which he did it—he cannot throw over the transfer.[6]

This statement invites three comments.

Firstly, the transfer of ownership is here said to depend not upon delivery, but upon the execution of the contract. A contract is executed as soon as one party has fully performed his side of the bargain, even if it still remains in whole or in part to be performed by the other party. A contract of sale, therefore, is executed by the seller when he delivers the goods to the buyer; and in this context at least delivery and execution are synonymous.

Secondly, Lord Denning cited, as authority for his statement, an obiter dictum of Parke B in *Scarfe v Morgan*.[7] In that case the court was concerned with

19 *Bostel Bros Ltd v Hurlock* [1949] 1 KB 74, [1948] 2 All ER 312; *Dennis & Co Ltd v Munn* [1949] 2 KB 327, [1949] 1 All ER 616.

20 *A Smith & Son (Bognor Regis) Ltd v Walker* [1952] 2 QB 319, [1952] 1 All ER 1007.

1 *J M Allan (Merchandise) Ltd v Cloke* [1963] 2 QB 340, [1963] 2 All ER 258. See also Higgins 25 MLR 149.

2 *Belvoir Finance Co Ltd v Stapleton* [1971] 1 QB 210, [1970] 3 All ER 664.

3 Lucretius *De Rerum Natura* i 155.

4 See, however, an obiter dictum by Parke B in *Simpson v Nicholls* (1838) 3 M & W 240, as revised (1839) 5 M & W 702, where he was commenting upon the earlier case of *Williams v Paul* (1830) 6 Bing 653.

5 [1960] AC 167, [1960] 1 All ER 269.

6 [1960] AC at 176, [1960] 1 All ER at 272.

7 (1838) 4 M & W 270.

the validity of a bailee's lien which, it had been argued, was illegal and void. The lien was in fact held to be untainted by illegality. But Parke B said that even if it had been illegal, it would still exist 'because the contract was executed and the special property' had passed by the delivery of the chattel to the defendant. The maxim would apply—*in pari delicto potior est conditio possidents.*' It will be seen that this dictum of Baron Parke was confined to the case of a 'special property' in the chattel, but that in *Singh v Ali* it was extended to include the 'general property'. Thus the vital distinction between ownership and the limited interest which a bailee might enjoy in the chattel was obscured.

Thirdly, as between the parties themselves, the question whether the property has passed is academic, for if the contract is illegal and if the parties are *in pari delicto* neither can establish a cause of action against the other without disclosing his own wrongdoing. So if, in an illegal contract of sale, the seller has delivered the goods he cannot recover them and for this purpose it matters not whether the seller or the buyer is the owner of the goods. Conversely, if the seller has not delivered the goods, the buyer cannot demand them whether he is the owner or not. But if an innocent third party becomes involved in the cycle of events, it is vital to determine which of the original parties is the owner of the contractual subject matter. This is well illustrated by *Belvoir Finance Co Ltd v Stapleton*,[8] the facts of which were as follows:

> The plaintiffs bought three cars from dealers, paid for them and let them on hire-purchase terms to the Belgravia Car Co, who kept a fleet of cars for letting out on hire to the public. The plaintiffs never took delivery of the three cars in question, which went directly from the dealers to the Belgravia Car Co. Both the contract of sale between the dealers and the plaintiffs and the hire-purchase contracts between the plaintiffs and the Belgravia Car Co were illegal to the knowledge of all three parties as contravening statutory regulations. The Belgravia Car Co, fraudulently and in breach of the hire-purchase contracts, sold the three cars to innocent purchasers. One of these sales was effected by the defendant, the assistant manager of the Belgravia Car Co, and the plaintiffs now sued him personally in conversion.

To succeed in this action the plaintiffs had to show that the ownership of the car was vested in them at the time of the conversion. They had therefore to prove that despite the illegality of the original contract of sale, they had acquired and still enjoyed the 'general property' in the car. The Court of Appeal decided this issue in their favour. Lord Denning MR cited his statement in *Singh v Ali*[10] and continued:

> Although the plaintiffs obtained the car under a contract which was illegal, nevertheless, inasmuch as the contract was executed and the property passed, the car belonged to the finance company and they can claim it.[11]

It is submitted with respect that this decision is contrary to the established principles which determine the effect of illegality. It will be observed, moreover, that in the instant case the car had never been delivered to the plaintiffs. The

8 That is, possession.
9 [1971] 1 QB 210, [1970] 3 All ER 664.
10 P 426, above.
11 [1971] 1 QB 210 at 218, [1970] 3 All ER 664 at 667.

court endeavoured to counter this formidable objection by falling back upon the rules for the passing of property contained in sections 17 and 18 of the Sale of Goods Act 1893. These rules are based essentially upon the intention of the parties as disclosed by their conduct, the terms of the contract and the circumstances of the case. But they clearly envisage the existence of a valid contract and can scarcely operate where the parties have deliberately sought to implement an agreement that is vitiated by illegality.

The Lords Justices expressed the opinion that, were the finance company to be precluded by the illegality of the contract from maintaining the action, any stranger would be free to seize the car with impunity since there would be nobody able to establish a legal title against him. This would be to recognise a right of confiscation. It is submitted with respect, however, that the suggestion is not well founded. The person who happens to be in possession of the car after and as a result of the illegal contract (as in the instant case the Belgravia Car Co or the ultimate purchaser), would be able to maintain trespass against a wrongful intruder. In an action of trespass, the existing possession of the plaintiff, even though held without title, is conclusive evidence of his right to possession against a wrongdoer. The latter cannot set up the better title of a third person, unless he shows that he acted with the authority of that third person.[12] The position is the same in conversion, unless the wrongdoer shows that he acted with the authority of a third person who has a better right to possession than the plaintiff.[13]

In *Saunders v Edwards*[14] the defendant entered into a contract to sell the lease of a flat to the plaintiffs. In the course of the negotiations he fraudulently represented that the flat included a roof terrace. In fact, he had improperly created an access onto a flat roof outside the flat over which he had no rights. The plaintiffs agreed to take the flat and it is clear that if these had been the only facts, the plaintiffs would have had an action for fraud when they discovered the true state of affairs. However, when the conveyance was completed, it was agreed between the plaintiffs and the defendant that the purchase price of £45,000 should be apportioned as to £40,000 for the flat and as to £5,000 for some chattels which were being thrown in. Both parties knew that the chattels were not worth anything like £5,000. When sued for his fraud, the defendant argued that the plaintiffs' action was barred because of their participation in this conveyancing scheme so as to minimise their liability to stamp duty. The Court of Appeal agreed that the plaintiffs' behaviour in regard to the apportionment of the price of the flat and the chattels was improper and that they would not have been entitled to enforce the contract for the sale of the flat. The court took the view however that the plaintiffs' action in respect of the fraud was wholly separate from the contract and should therefore succeed.

Similarly, in *Euro-Diam Ltd v Bathurst*[15] the plaintiffs had agreed to sell diamonds to German buyers which they had insured with the defendant. While the diamonds were still at the plaintiffs' risk they were stolen and they claimed on the insurance policy. There was no impropriety in connection with the policy but it appeared that in order to oblige the German buyers the

12 *Jeffries v Great Western Rly Co* (1856) 5 E & B 802.
13 Ibid.
14 [1987] 2 All ER 651, [1987] 1 WLR 1116.
15 [1990] 1 QB 1, [1988] 2 All ER 23. See also *Thackwell v Barclays Bank plc* [1986] 1 All ER 676.

plaintiffs had supplied an invoice stating the value of the diamonds to be significantly less than the true value so as to enable the German buyers to reduce or exclude payment of German customs duty. The insurers argued that this prevented the plaintiffs from enforcing their rights under the insurance contract. The Court of Appeal rejected this conclusion. There had been no deception of the insurers; there was no causal connection between the policy of insurance and the undervaluation of the diamonds in the sale contract and the plaintiffs themselves had made no profit from the transaction.

Both these cases can be said to turn on the plaintiffs' course of action being independent of the contract which was illegal. They can also be seen to exemplify a robust attitude by the courts to arguments of this kind. In both cases the defendants were devoid of merits and the delinquencies of the plaintiffs were relatively small compared to the loss they would suffer if the defendants' argument had been allowed to succeed.

b Money paid and chattels or land transferred are irrecoverable

Neither party can recover what he has given to the other under an illegal contract if in order to substantiate his claim he is driven to disclose the illegality.[16] The maxim *in pari delicto potior est conditio defendentis* applies and the defendant may keep what he has been given. If, for instance, a seller sues for the recovery of goods sold and delivered under an illegal contract he will fail, for to justify his claim he must necessarily disclose his own iniquity. Thus in *Taylor v Chester*:[17]

> The plaintiff deposited with the defendant the half of a £50 note as a pledge to secure the payment of money due for a debauch held by the plaintiff and divers prostitutes at the defendant's brothel.

An action of detinue, based upon a refusal by the defendant to redeliver the note, was dismissed, for the plaintiff could not impugn the validity of the pledge without revealing the immoral character of the contract.

The result is that gains and losses remain where they have accrued or fallen. If, for instance, a scheme to defraud X, concocted by A and B, succeeds, and the money is obtained by B, no action for an account or recovery lies at the suit of A,[18] as was once solemnly adjudged in a case where one highwayman sued another for an account of their plunder.[19] The general position is well illustrated by *Parkinson v College of Ambulance Ltd and Harrison*,[20] where the facts were these:

> The secretary of the defendant charity fraudulently represented to the plaintiff that the charity was in a position to divert the foundation of honour in his direction and to procure him at least a knighthood, if he would make an adequate donation. After a certain amount of bargaining, the plaintiff paid £3,000 to the charity and undertook to do more when the knighthood was forthcoming. He did not, however, receive any honour and he sued for the return of the money as had and received to his use.

16 *Scott v Brown, Doering, McNab & Co* [1892] 2 QB 724 at 734, per A L Smith LJ; *Chettiar v Chettiar* [1962] AC 294, [1962] All ER 494.

17 (1869) LR 4 QB 309.

18 *Sykes v Beadon* (1879) 11 ChD 170; *Berg v Sadler and Moore* [1937] 2 KB 158.

19 *Everet v Williams* (1725) cited in Lindley *The Law of Partnership* (13th edn) p 130n; *Sykes v Beadon*, above, at 195-196, per Jessel MR; 9 LQR 197.

20 [1925] 2 KB 1.

It was held by Lush J that the action must fail. The transaction was manifestly illegal to the knowledge of the plaintiff. He could sue neither for money had and received for the recovery of damages, nor could he repudiate the contract and regain his money on the plea that the transaction was executory.

Property recoverable if disclosure of illegality not essential to cause of action

A plaintiff, however, may recover money, chattels or land transferred under an illegal contract to the defendant, if he can frame a cause of action entirely independent of the contract, for in these circumstances he is not compelled to disclose the illegality. 'Any rights which he may have irrespective of his illegal interest will, of course, be recognised and enforced.'[1]

Suppose, for instance, that a lease for ten years is made by A to B for a purpose known by both parties to be illegal. A cannot sue for the recovery of rent, since to substantiate his claim he must necessarily rely upon the illegal transaction.[2] Nor, it is apprehended, can he recover possession of the land before expiry of the agreed term. If he attempted to do so, B would allege possession by virtue of the lease, the illegality of which would preclude A from enforcing the covenant for the payment of rent.[3] But once the term of ten years has expired, A has an independent cause of action by virtue of his ownership. Though he cannot be allowed to recover what he has transferred in pursuance of the illegal transaction, yet he cannot be denied the right of ownership which he has not transferred.[4] Once the illegal, but temporary, title has ceased, he can rely upon his prior and lawful title.

The principle, that a plaintiff can recover what he has transferred under an illegal contract if he can found his action upon some independent and lawful ground, was applied by the Privy Council in *Amar Singh v Kulubya*[5] on the following facts:

> A statutory ordinance in Uganda prohibited the sale or lease of 'Mailo' land by an African to a non-African except with the written consent of the Governor. Without obtaining this consent, the plaintiff, an African, agreed to lease such land of which he was the registered owner to the defendant, an Indian, for one year and thereafter on a yearly basis. The agreement, therefore, was void for illegality, and no leasehold interest vested in the defendant. After the defendant had been in possession for several years, the plaintiff gave him seven weeks' notice to quit and ultimately sued him for recovery of the land.

He succeeded. His claim to possession was based not upon the agreement, to the illegality of which on his own admission he had been a party, but on the independent and untainted ground of his registered ownership. He was not forced to have recourse to the agreement.[6]

1 *Scott v Brown, Doering, McNab & Co* [1892] 2 QB 724 at 729, per Lindley LJ. Gooderson [1958] CLJ 199. *Iraqi Ministry of Defence v Arcepey Shipping Co SA* [1981] QB 65, [1980] 1 All ER 480.

2 *Gas Light and Coke Co v Turner* (1840) 6 Bing NC 324.

3 *Alexander v Rayson* [1936] 1 KB 169 at 196-197, [1935] All ER 185 at 193, *per curiam*. See Salmond and Williams *Principles of the Law of Contracts* p 347, n d.

4 *Jajbhay v Cassim* [1939] App D 537 at 557.

5 [1964] AC 142, [1963] 3 All ER 499; criticised Cornish 27 MLR 225.

6 The Privy Council considered that the notice of seven weeks to quit the land, which was insufficient to determine a yearly tenancy was not referable to the illegal agreements: [1964] AC 142 at 150.

This decision illustrated the familiar statement of du Parcq LJ in an earlier case when delivering the judgment of the court:

> Prima facie, a man is entitled to his own property, and it is not a general principle of our law (as was suggested) that when one man's goods have got into another's possession in consequence of some unlawful dealings between them, the true owner can never be allowed to recover those goods by an action. The necessity of such a principle to the interests and advancement of public policy is certainly not obvious.[7]

In *Tinsley v Milligan*[8]

> The parties, who were lovers, jointly purchased a house which was registered in the name of Tinsley as the sole legal owner. The house was used by the parties as a lodging house which was run jointly by them and which provided most of their income. The parties had registered the house in the sole name of Tinsley so as to enable Milligan to make fraudulent claims for benefit to the Department of Social Security. The money obtained from these deceptions formed part of the parties' shared income. After this practice had gone on for some time, Milligan made a clean breast of it to the Department of Social Security and the matter was resolved to the satisfaction of the Department without prosecution. Thereafter, Milligan only claimed benefit to which she was properly entitled. In due course, the parties quarrelled and Tinsley moved out. Tinsley then started an action for possession on the basis that the house was solely hers. Milligan counterclaimed for an order for sale and a declaration that the house was held by Tinsley on trust for the parties in equal shares.

On these facts it would, but for the deception practised on the Department of Social Security, have been clear that Milligan was entitled to the relief which she sought. Tinsley argued that Milligan should be denied relief either on the basis of the maxim *ex turpi causa oritur non actio* or on the equitable principle that he who comes to equity must come with clean hands. In both cases, the thrust of the argument was that by choosing to put the house in Tinsley's name in order to obtain benefits to which she was not legally entitled, Milligan had debarred herself from asserting the equitable rights which she would otherwise have had to the property. The Court of Appeal had held that Milligan's claim should succeed on the basis that the improper conduct by Milligan was not sufficiently serious to merit the severe penalty which would be inflicted by depriving her of her interest in the house. The House of Lords were agreed that the test used by the Court of Appeal was not correct and that the result of the case could not depend on a balancing exercise between the impropriety of Milligan and the severity of the penalty imposed or whether any result which arose out of the balancing exercise would shock the public conscience.

Nevertheless, the House of Lords was divided as to the result in the present case. The majority view of Lord Jauncey, Lord Lowry and Lord Browne-Wilkinson was most fully expressed by the latter. He stated the general principles as follows:

> (1) Property in chattels and land can pass under a contract which is illegal and therefore would have been unenforceable as a contract.

7 *Bowmakers Ltd v Barnet Instruments Ltd* [1945] KB 65 at 70.
8 [1993] 3 All ER 65.

(2) A plaintiff can at law enforce property rights so acquired provided that he does not need to rely on the illegal contract for any purpose other than providing the basis of his claim to a property right.

(3) It is irrelevant that the illegality of the underlying agreement was either pleaded or emerged in evidence: if the plaintiff has acquired legal title under the illegal contract that is enough.[9]

He went on to deny that there was any significant difference in the general principles between common law and equity. It was clear that Milligan was putting forward an equitable claim since the sole legal title was in Tinsley. However, Milligan's equitable claim did not depend in any way on the fraud practised on the Department of Social Security. It depended only on the presumption of resulting trust which arose from the fact that Milligan had put up half of the purchase price of the house and that the relationship between Tinsley and Milligan was not such as to give rise to a presumption of advancement. Of course, it follows on this line of reasoning that if the relationship between Tinsley and Milligan had been such as to give rise to a presumption of advancement then the result would have been different since Milligan would then have needed to rely on the fraudulent purpose to explain why the presumption of advancement should be negated. The minority view was that the matter should still be governed by the principle stated by Lord Eldon in *Muckleston v Brown*[10] where he said:

The plaintiff stating, he had been guilty of a fraud upon the law, to evade, to disappoint, the provision of the Legislature, to which he is bound to submit, and coming to equity to be relieved against his own act, and the defence being dishonest, between the two species of dishonesty the Court would not act; but would say 'Let the estate lie, where it falls'.

In *Tribe v Tribe*[11] the Court of Appeal had to consider the effect of *Tinsley v Milligan* in a situation where there was a presumption of resulting trust.

The plaintiff owned 49 out of 500 shares in a family company and was the tenant of two leasehold premises which were occupied by the company as licensee. In 1987 the landlords of those premises served schedules of dilapidations on the plaintiff requiring him to carry out substantial repairs. The plaintiff was advised by his solicitor that he was facing the possibility of heavy payments. In an effort to put resources outside the reach of the landlords, the plaintiff transferred his shares to the defendant who was one of his sons. The transfer was expressed to be for a consideration of £78,030 but this sum was never paid nor was it ever intended to be paid. In fact, the payments to the landlords never eventuated because one of the landlords accepted the surrender of the lease and the other landlord sold the reversion. The plaintiff asked for the shares back but his son refused to redeliver them. When the father brought an action, the son argued that there was a presumption of advancement in his favour and that the father could not rebut the presumption of advancement without revealing his illegal purpose in making the transfer in the first place.

This reasoning was rejected by the Court of Appeal. The Court held that one of the major exceptions to the *in pari delicto* rule arose where the transferor had

9 Ibid at 86.
10 (1801) 6 Ves 52 at 68 and 69, [1775-1802] All ER Rep 501 at 506.
11 [1995] 4 All ER 236; [1996] CLJ 23.

repented of the transaction before it was carried into effect—the so called *locus poenitentiae*. In this case the illegal purpose was to defraud creditors but no creditors had ever been defrauded. Accordingly, it was not too late for the father to change his mind and recover the shares from his son.

A similar, though perhaps more dubious decision was given in *Bowmakers Ltd v Barnet Instruments Ltd* upon the following facts:[12]

> S sold machine tools to the plaintiffs. This sale was illegal, since it contravened an Order made by the Minister of Supply under the Defence of the Realm Regulations. The plaintiffs delivered the tools to the defendants under three separate hire-purchase agreements which were assumed by the Court of Appeal to be themselves illegal. The defendants, after paying only a few of the instalments due under the contracts, sold the tools delivered under the first and third agreements and refused the demand of the plaintiffs to redeliver those that were the subject matter of the second agreement.

Judgment was given for the plaintiffs in their action to recover damages for the conversion of the tools.

In considering this decision it is necessary to distinguish the first and third agreements—where the defendants had wrongfully sold the goods—from the second—where they had retained them contrary to the demand of the plaintiffs.

The significant feature of the wrongful sales was that they constituted an act of conversion which *ipso facto* terminated the bailment.[13] The plaintiffs might therefore argue that there was no longer any existing contract upon which the defendants could found a possessory right. The right to immediate possession had automatically revested in the plaintiffs. Could it not thus be said that owing to the termination of the bailment the plaintiffs had an independent cause of action in virtue of their admitted ownership? The defendants, on the other hand, might argue that they had acquired effective possession under the bailment and that the plaintiffs were driven to rely upon that illegal transaction in order to show that the sale was a breach of the contractual terms, just as a lessor who alleged the termination of a lease for condition broken would be required to prove the existence of a proviso for re-entry.

The Court of Appeal preferred the first line of reasoning. It was completely irrelevant that the chattels had originally come into the possession of the defendants by virtue of the illegal contract. That contract was now defunct. It formed no part of the cause of action. Thus, with the disappearance of the only transaction that could restrict their rights, the plaintiffs could base their claim to possession solely upon their ownership of the chattels.

While few would dispute this conclusion and the limitation thus put upon the application of the maxim *ex turpi causa non oritur actio*, it is a little difficult to agree that the second agreement was susceptible of the same *ratio decidendi*. In the case of this agreement the cause of action was the refusal of the defendants to comply with the demand for the return of the goods. Since the effective possession had passed to them by virtue of its delivery, the sole justification for this demand was their failure to pay the agreed instalments. The plaintiffs, therefore, were inevitably driven back to the contract in order

12 [1945] KB 65, [1944] 2 All ER 579. See Hamson 10 CLJ 249; Coote 35 MLR 38; Teh 26 NILQ 1; Stewart 1 JCL 134.

13 *North Central Wagon and Finance Co Ltd v Graham* [1950] 2 KB 7, [1950] 1 All ER 780.

to prove the amounts of the instalments, the dates at which they were due and the agreed effect of their non-payment. This part of the decision, therefore, seems open to question.

Two exceptions to the ban on recoverability

There are two exceptions to the general rule that a party cannot recover what he had given to the other party under an illegal contract. These are (a) where the parties are not *in pari delicto*, and (b) where the plaintiff repents before the contract has been performed.

(a) *Where the parties are not in pari delicto* If the parties to an illegal contract are not *in pari delicto*, the court in certain circumstances will allow the less blameworthy to recover what he may have transferred to the other. This relief is granted to the plaintiff upon proof that he has been the victim of fraud, duress or oppression at the hands of the defendant, or that the latter stood in a fiduciary position towards him and abused it.[14] Where, for instance, the plaintiff has effected an insurance which in fact is illegal but which was represented to him by the insurer as lawful, he will be entitled to recover the premiums which he has paid if the representation was fraudulent,[15] but not if it was not.[16] A common illustration of want of delictual parity is oppression. 'It can never be predicated as *par delictum* where one holds the rod and the other bows to it.'[17] For instance, in *Smith v Cuff*,[18] the defendant, a creditor of the plaintiff, agreed with the other creditors to accept a composition of ten shillings in the pound, but he consented to this only after he had secretly arranged that the plaintiff should give him a promissory note for the remainder of his debt. The note was given, negotiated to a third party and its amount paid by the plaintiff. It was held that, since there had been oppression on one side and submission on the other, the plaintiff was entitled to recover the amount from the defendant. In a later case where the facts were similar, Cockburn CJ said: 'It is true that both are *in delicto*, because the act is a fraud upon the other creditors, but it is not *par delictum*, because the one has the power to dictate, the other no alternative but to submit.'[19]

Another type of case where the parties are not regarded as equally delictual is where the contract is rendered illegal by a statute, the object of which is to protect one class of persons from the machinations of another class, as for example where it forbids a landlord to take a premium from a prospective tenant. Here, the duty of observing the law is placed squarely upon the shoulders of the landlord, and the protected person, the tenant, may recover an illegal premium in an action for money had and received, even if the statute omits to afford him this remedy either expressly or by implication.[20] In the words of Lord Mansfield:

14 *Harse v Pearl Life Assurance Co* [1904] 1 KB 558 at 564. *Shelley v Paddock* [1980] QB 348, [1980] 1 All ER 1009; Buckley 94 LQR 484.

15 *Hughes v Liverpool Victoria Legal Friendly Society* [1916] 2 KB 482.

16 *Harse v Pearl Life Assurance Co*, above.

17 *Smith v Cuff* (1817) 6 M & S 160 at 165, per Lord Ellenborough.

18 (1817) 6 M & S 160.

19 *Atkinson v Denby* (1862) 7 H & N 934 at 936.

20 *Kiriri Cotton Co Ltd v Dewani* [1960] AC 192, [1960] 1 All ER 177, where there was no express provision in the statute that the premium should be recoverable. If there is such a provision, as in *Gray v Southouse* [1949] 2 All ER 1019, the fact that the tenant is *particeps criminis* does not affect his right of recovery. See also *Nash v Halifax Building Society* [1979] Ch 584, [1979] 2 All ER 19.

> Where contracts or transactions are prohibited by positive statutes, for the sake of protecting one set of men from another set of men; the one, from their situation and condition being liable to be oppressed and imposed upon by the other; there, the parties are not *in pari delicto*; and in furtherance of these statutes, the person injured after the transaction is finished and completed, may bring his action and defeat the contract.[1]

(b) *Where party to executory contract repents before performance.*[2] The second exception to the ban on restitution recognises the virtue of repentance in the case of a contract which is still executory. A party to such a contract, despite its illegality, is allowed a *locus poenitentiae*, and he may recover what he has transferred to his co-contractor, provided that he takes proceedings before the illegal purpose has been substantially performed. If he repents in time, he will be assisted by the court, but in the present state of the authorities it is not clear at what point his repentance is to be regarded as overdue.

The leading case on the subject is *Kearley v Thomson*,[3] where the defendants, who were the solicitors of the petitioning creditor in certain bankruptcy proceedings, agreed neither to appear at the public examination of the bankrupt nor to oppose his discharge in consideration of a sum of money paid to them by the plaintiff. They did not appear at the examination, and before any application had been made for the discharge of the bankrupt they were sued by the plaintiff for the return of the money. The contract was illegal as tending to pervert the course of justice, and it was held that the non-appearance at the examination was a sufficient execution of the illegal purpose to defeat the plaintiff's right to recovery. Fry LJ said:

> I hold, therefore, that where there has been a partial carrying into effect of an illegal purpose in a substantial manner, it is impossible, though there remains something not performed, that the money paid under that illegal contract can be recovered back.[4]

The word 'partial' in this statement must be regarded as qualified by the later word 'substantial', for otherwise it is difficult to reconcile the earlier case of *Taylor v Bowers*.[5] In that case:

> T, being financially embarrassed and desiring to avoid the seizure of his stock by his creditors, made a fictitious assignment of it to A, and received sham bills of exchange in return. The stock, having been removed, was later mortgaged by A to the defendant without the knowledge of T. The defendant was aware of the unlawful assignment.

It was held that T was entitled to recover his goods. It is clear that the illegal purpose had been *partially* effected, for the creditors, realising that the greater part of T's visible wealth had disappeared with the removal of his stock, would probably abandon any attempt to exact payment by process of law. In the unanimous opinion of seven judges, however, nothing had been done to carry out the illegal purpose beyond the removal of the stock and this was insufficient

1 *Browning v Morris* (1778) 2 Cowp 790 at 792. See *Barclay v Pearson* [1893] 2 Ch 154 at 166-168.

2 Merkin 97 LQR 420.

3 (1890) 24 QBD 742. See *Re National Benefit Assurance Co Ltd* [1931] 1 Ch 46; *Harry Parker Ltd v Mason* [1940] 2 KB 590, [1940] 4 All ER 199; *Ouston v Zurowski and Zurowski* [1985] 5 WWR 169. Beatson 91 LQR 313.

4 Ibid at 747.

5 (1876) 1 QBD 291.

to defeat the plaintiff. In *Kearley v Thomson*, on the other hand, the fraudulent injury to the creditors had been *substantially* accomplished, for the general body of creditors would be influenced by the abstention of the petitioning creditor from the cross-examination of the debtor.[6]

In *Taylor v Bowers*, Mellish LJ made a statement that is transparently too wide if it is divorced from the facts. He said:

> If money is paid or goods delivered for an illegal purpose, the person who has so paid the money or delivered the goods may recover them back before the illegal purpose is carried out.[7]

If this were correct, it would frequently happen that the mere frustration of his illegal scheme owing to circumstances beyond his control would entitle such a person to recover his property. *Bigos v Bousted*,[8] concerned with statutory illegality, is a case in point.

> A, in contravention of the Exchange Control Act 1947, agreed to supply B with the equivalent of £150 in Italian currency. B, as security for his promise to repay the loan, deposited a share certificate with A. A failed to supply any Italian currency and B sued him for recovery of the certificate.

The statement of Mellish LJ literally construed, would justify recovery, since the illegal purpose had not been carried out. B had in fact received no more Italian money than was permissible by law. He therefore pleaded that he had repented in time. His so-called repentance, however, was 'but want of power to sin', for it is clear that he would gladly have accepted the promised lire had his illegal design not been foiled by A's breach of faith. Pritchard J therefore held that the case was on all fours wit *Alexander v Rayson*[9] and that B's change of heart after his scheme had failed did not bring him within the exception.

Another type of case in which recovery can be had despite a partial performance of the illegal purpose is where money has been deposited with a stakeholder under an illegal contract, as for example where competitors in a lottery, such as a missing-word competition, pay entrance fees to the organiser. Here the money is recoverable, not merely before the result has been ascertained, but even after this event, provided that payment has not been made to the winner.[10] In such a case the illegal purpose has obviously been performed by the holding of the lottery, yet it is said that 'the contract is not completely executed until the money has been paid over, and therefore the party may retract at any time before that has been done'.[11]

The truth is that it is difficult to extract from these authorities the precise meaning in the present context of an 'executory' contract. Over a hundred years ago, Fry LJ observed that the principle which forbids the recovery of property delivered under an illegal contract requires reconsideration by the House of Lords.[12] Such reconsideration is still awaited.

6 In *George v Greater Adelaide Land Development Co Ltd* (1929) 43 CLR 91, a decision of the High Court of Australia, Knox CJ, at 100, regarded *Taylor v Bowers* as a case of property deposited with a stakeholder, as to which see n 10, below.
7 (1876) 1 QBD 291 at 300.
8 [1951] 1 All ER 92.
9 [1936] 1 KB 169, [1935] All ER 185; p 385, above.
10 *Barclay v Pearson* [1893] 2 Ch 154; *Greenberg v Cooperstein* [1926] Ch 657 at 665.
11 *Hastelow v Jackson* (1828) 8 B & C 221 at 226-227, per Littledale J.
12 *Kearley v Thomson* (1890) 24 QBD 742 at 746. For a critical appraisal of the present state of the law, see Grodecki 74 LQR 254.

c A subsequent or collateral contract, which is founded on or springs from an illegal transaction, is illegal and void[13]

It would be singular if the law were otherwise.[14] It is irrelevant that the new contract is in itself innocuous, or that it formed no part of the original bargain, or that it is executed under seal,[15] or that the illegal transaction out of which it springs has been completed. If money is due from A to B under an illegal transaction and A gives B a bond[16] or a promissory note[17] for the amount owing, neither of these instruments is enforceable by B.

The leading authority is *Fisher v Bridges*,[18] where A agreed to sell to B certain land which was to be used for the purposes of a lottery that was illegal because forbidden by statute. The land was conveyed to B and the price except for £630 was paid. Later, B executed a deed by which he covenanted to pay £630 to A. In an action to enforce this covenant, it was pleaded that the action must fail, since the agreement to sell was made 'to the intent and in order, and for the purpose, as the defendant well knew', that the land when conveyed should be sold by way of an illegal lottery.[19] The Exchequer Chamber, reversing the Court of Queen's Bench, held the plea to be good and dismissed the action.

> It is clear that the covenant was given for the payment of the purchase money. It springs from, and is the creature of, the illegal agreement; and, as the law would not enforce the original illegal contract, so neither will it allow the parties to enforce a security for the purchase money, which by the original bargain was tainted with illegality.[20]

In *Fisher v Bridges* the parties to the illegal transaction and to the subsequent contract were the same persons. The question arises, therefore, whether a contract made by a third party in furtherance of the illegal purpose is itself tainted. This was the issue in *Cannan v Bryce*[1] where the court made the solution of this problem turn upon the knowledge of the third party. Did he know that the original contract was illegal?

> X had entered into a stock-jobbing contract by which he agreed to pay differences according to the rise and fall of the stock.[2] A statute of 1733 prohibited the practice of stock-jobbing.[3] He borrowed money from Y in order to pay the losses that he ultimately incurred, and by way of security

13 *Simpson v Bloss* (1816) 7 Taunt 246; *Redmond v Smith* (1844) 7 Man & G 457; *Geere v Mare* (1863) 2 H & C 339; *Clay v Ray* (1864) 17 CBNS 188.

14 *Redmond v Smith*, above, at 494, per Tindal J.

15 *Fisher v Bridges* (1854) 3 E & B 642.

16 Ibid.

17 *Jennings v Hammond* (1882) 9 QBD 225.

18 (1854) 3 E & B 642.

19 See the report of the case in the court of first instance: (1853) 2 E & B 118.

20 (1854) 3 E & B 642, *per curiam* at 649. It is respectfully submitted that in *Belvoir Finance Co Ltd v Cole Ltd* [1969] 2 All ER 904, [1969] 1 WLR 1877, Donaldson J was scarcely justified in holding that the original purchase of the two Triumph cars was not tainted by the illegality of the subsequent hire-purchase transaction. As in *Fisher v Bridges*, the contract of sale was made to the intent and in order that the cars should be bailed by way of hire-purchase transactions which both parties knew were to be effected in a manner contrary to a statutory order. It is a little difficult to subscribe to the view of the learned judge that the two pairs of contracts, though commercially connected, were not legally connected.

1 (1819) 3 B & Ald 179.

2 As to contracts for differences, see p 358, above.

3 7 Geo 2 c 8; repealed by the Gaming Act 1845.

he assigned to Y the proceeds of certain cargoes which he had shipped abroad. X then became bankrupt and his trustee claimed that the cargoes still formed part of the bankrupt estate, since the assignment to Y was illegal.

It was held that the trustee was entitled to judgment. In the words of Abbott CJ 'if it be unlawful for one man to pay, how can it be lawful for another to furnish him with the means of payment?' But the Chief Justice was careful to emphasise that his statement was confined to a case where the third party had full knowledge of the object to which the loan was to be applied.[4]

A similar question arose in *Spector v Ageda*[5] on the following facts.

A memorandum dated 8 September 1967, stated that a Mrs Maxwell, a moneylender, had lent £1,040 to the borrower, to be paid on 8 November with interest at 2% a month. In fact only £1,000 was lent, since interest for two months, amounting to £40, had been added to the principal sum. Such a provision for the payment of compound interest is illegal under the Moneylenders Act 1927.[6] The illegal loan was not repaid on 8 November and Mrs Maxwell sued the borrower in the following February for the recovery of £1,180, the amount then due.

At that point the plaintiff entered upon the scene. She was the sister and the solicitor of Mrs Maxwell, but she was now also acting as the solicitor of the borrower. She agreed to advance to the latter £1,180 with interest at 12% per annum. She honoured this agreement and the Maxwell loan was repaid.

In the present action, the question was whether the plaintiff could recover from the borrower £1,180 with interest at 12%. In the view of Megarry J, *Cannan v Bryce* did not wholly support the contention that the agreement to make the advance was illegal, but he had no doubt that it was warranted by *Fisher v Bridges*. 'In that case, the subsequent contract was between the original parties: but a third party who takes part in the subsequent transaction with knowledge of the prior illegality can, in general, be in no better position.'[7] In the instant case, it was clear that the plaintiff had concurred in the making of the Maxwell loan and had been fully aware of the illegal provision for the payment of compound interest. Therefore her action failed.

d A foreign contract, if contrary to English public policy, is unenforceable

An action is frequently brought in England upon a foreign contract. By a foreign contract is meant one which is more closely connected with a foreign country than with England, as, for instance, when it is made in France by an Englishman and a Frenchman and is performable only in France. In such a case the rule is that the substance of the obligation—the essential validity of the contract—must be governed by what is called the 'proper law', ie in effect the law of the country with which the transaction is most closely connected. The English doctrine of consideration, for instance, could not be invoked in an action for breach of the contract given above. Nevertheless,

4 Ibid at 185.
5 [1973] Ch 30, [1971] 3 All ER 417. See also *Portland Holdings Ltd v Cameo Motors Ltd* [1966] NZLR 571.
6 S 7.
7 [1973] Ch 30 at 43, [1971] 3 All ER 417 at 427.

the rights of the parties as fixed by the proper law, if put in suit in England, are subject in general to the English doctrine of public policy. If the contract, though valid by the foreign law, is repugnant to what has been called the 'stringent domestic policy' of England,[8] it cannot be enforced in England. This, however, does not mean that each individual rule comprised in the comprehensive doctrine of public policy applies to a foreign contract. That doctrine strikes at acts which vary greatly in their degree of turpitude. Certain of its prohibitory rules exemplify principles which in the English view it is of paramount importance to maintain in English courts; others, such as that directed against a fraud on the revenue, are presumably designed to protect purely English interests. It is the former rules only, those upon which there can be no compromise, that apply to an action on a foreign contract.

Which of the rules are sufficiently important to be applied without exception is a somewhat controversial question that cannot be adequately discussed in a book on the elements of contract.[9] The decisions, however, at least warrant the statement that most of the contracts already described in this chapter as being repugnant to public policy and illegal, would not be enforced in an English action, whatever view might be taken of their validity by their proper law.[10] This is clearly so, for instance, in the case of a French contract to commit a crime or a tort, or to promote sexual immorality, or to prejudice the public safety of England. It might be thought that an agreement to stifle a foreign prosecution would scarcely arouse the moral indignation of an English court, but no such indifference to what is normal in certain countries was shown by the Court of Appeal in *Kaufman v Gerson*.[11] In that case:

> A Frenchman coerced a Frenchwoman into signing a contract in France by the threat that if she refused to sign he would prosecute her husband for a crime of which he was accused.

The contract was valid by French law, but an action brought for its breach in England was dismissed on the ground that to enforce it 'would contravene what by the law of this country is deemed an essential moral interest'.[12] It is to be noted that the objection of the Court of Appeal was at least as much to the coercive nature of the plaintiff's behaviour as to any stifling of the prosecution. Presumably, therefore, an English court would apply the rule that has been laid down in the United States of America and would refuse to enforce any contract which tended to promote corruption in the public affairs of a foreign country, however irreproachable such conduct might be in the view of the foreign law.[13]

8 Westlake *Private International Law* (7th edn) p 31.

9 See eg Dicey and Morris *The Conflict of Laws* (11th edn) pp 1215-1232; Cheshire and North's *Private International Law* (11th edn) pp 482-489; Kahn-Freund 39 Grotius Society 39.

10 *Robinson v Bland* (1760) 2 Burr 1077 at 1084; *Dynamite Act v Rio Tinto Co* [1918] AC 260.

11 [1904] 1 KB 591.

12 Ibid at 599-600.

13 *Oxnyan v Arms Co* 103 US 261 at 277 (1881). See also *Lemenda Trading Co Ltd v African Middle East Petroleum Co Ltd* [1988] QB 448, [1988] 1 All ER 513. Discussed above p 416. Cf *Westacre Investments Inc v Jugo Import—SDPR Holding Co Ltd* [1999] 3 All ER 864; *Royal Boskalis Westminster NV v Mountain* [1997] 2 All ER 929.

C THE CONSEQUENCE WHERE A CONTRACT LAWFUL IN ITS INCEPTION IS LATER ILLEGALLY EXPLOITED OR PERFORMED

The situation envisaged here is that a contract is lawful *ex facie* and is not disfigured by a common intention to break the law, but that one of the parties, without the knowledge of the other, in fact exploits it for some unlawful purpose. In these circumstances, the guilty party suffers the full impact of the maxim *ex turpi causa non oritur actio* and all remedies are denied to him.[14] 'Any party to the agreement who had the unlawful intention is precluded from suing upon it... The action does not lie because the court will not lend its help to such a plaintiff.'[15]

On the other hand, the rights of the innocent party are unaffected, except in respect of anything done by him after he has learned of the illegal purpose. In *Cowan v Milbourn*,[16] for instance, the defendant agreed to let a room to the plaintiff on 20 January, but chancing to hear that the premises were to be used for an unlawful purpose, he notified the plaintiff that the agreement would not be fulfilled. An action brought against him for breach of contract failed. But if, after the intended purpose had come to his knowledge, he had let the defendant into possession in accordance with the contract, Bramwell B observed that he could not have recovered the agreed price.[17]

Apart from this exceptional case of acquired knowledge, however, all the normal contractual remedies are available to the innocent party. He may enforce the contract;[18] he may sue on a *quantum meruit* or *quantum valebant* for the value of work or goods supplied before discovery of the unlawful intention;[19] and he may recover property that he has transferred to the guilty party.[20]

It must be noticed that this right to recover property does not conflict with the decision of the Exchequer Chamber in *Feret v Hill*, where:[1]

> 'The plaintiff, induced the defendant to grant him a lease of premises in Jermyn Street by falsely representing that he intended to carry on therein the business of a perfumier. His intention, however, was to use them for immoral purposes, and, having obtained possession he converted them into a common brothel. He refused to quit and was forcibly ejected by the defendant. He brought an action of ejectment to recover possession and was successful.

This decision of a common law court must not be misunderstood. The elemental facts are simple: the lease had been executed, the tenant had been let into possession, and therefore in the eyes of the law a legal estate, together with the right to possession, had become vested in him. The court did not decide that the landlord was precluded from recovering possession. It merely decided that the tenant was not prevented by his antecedent fraud from acquiring a right to possession and that his right was not automatically

14 *Cowan v Milburn* (1867) LR 2 Exch 230; *Alexander v Rayson* [1936] 1 KB 169.
15 *Alexander v Rayson* [1936] 1 KB 169 at 182, *per curiam*.
16 Above.
17 This had been made clear in *Jennings v Throgmorton* (1825) Ry & M 251.
18 *Lloyd v Johnson* (1798) 1 Bos & P 340; *Mason v Clarke* [1955] AC 778 at 793, 805, [1955] 1 All ER 914 at 920, 927; *Fielding and Platt Ltd v Najjar* [1969] 2 All ER 150, [1969] 1 WLR.
19 *Clay v Yates* (1856) 1 H & N 73; *Bowry v Bennett* (1808) 1 Camp 348.
20 *Oom v Bruce* (1810) 12 East 225.
1 (1854) 15 CB 207.

forfeited either by his fraud or by his subsequent immoral use of the premises.[2] The landlord was ill-advised. He was not entitled to take the law into his own hands, to treat the lease as a nullity and to extrude the tenant from a possession recognised, at any rate for the time being, as lawful. But he would have been entitled, as indeed was assumed by the members of the court,[3] to take proceedings in equity for the rescission of the lease.

The rule is that if X transfers an interest in land or goods to Y, being induced to do so by a fraudulent misrepresentation similar to that made in *Feret v Hill*, he can, subject to any rights that may have been obtained for value by innocent third parties, take proceedings in any division of the High Court to secure the rescission of the contract and the recovery of his property.[4]

The superior position of the innocent party is equally apparent where a contract, though lawful as formed, is performed by his co-contractor in a manner prohibited by statute. In such a case, the party responsible for the illegal performance is remediless. So far as he alone is concerned, he is in exactly the same position as if the contract had been illegal and void *ab initio*.[5] But the innocent party is little affected, for in the words of Pollock:

> The fact that unlawful means are used in performing an agreement which is *prima facie* lawful and capable of being lawfully performed does not of itself make an agreement unlawful.[6]

If, indeed, the innocent party knows or ought to know that the contract can only be performed illegally or that the party responsible intends to perform it illegally, he is precluded from enforcing it either directly or indirectly.[7] Otherwise the normal remedies are open to him.

Thus he may recover damages for breach of contract.[8] It is not open to the defendant to plead that, because he himself adopted an illegal mode of performance, the apparent contract is no contract.

> Suppose that B has agreed to sell goods to A and that upon making delivery he is required by statute to furnish A with an invoice stating certain prescribed particulars. B in fact delivers goods that fall short of the standard fixed by the contract, and also fails to furnish the statutory invoice.

A, as the innocent party, must surely be able to sue B for breach of contract. Otherwise the absurd result would follow that if B delivered no goods at all he would be liable in damages, since there would have been no performance and no illegality; but that if he broke his contract by delivering inferior goods without the requisite invoice, this illegal mode of performance would free him from liability. Escape from a lawful obligation can scarcely be gained by a self-induced act of illegality.

That the sensible is also the judicial solution was adumbrated in 1924 in *Anderson v Daniel*,[9] where the Court of Appeal stressed that in such a case as

2 See the remarks of Maule J (one of the judges in *Feret v Hill*) in *Canham v Barry* (1855) 15 CB 597 at 611-612.
3 *Feret v Hill*, above, at 226, per Maule J.
4 *Alexander v Rayson* [1936] 1 KB 169 at 192, *per curiam*.
5 *Anderson Ltd v Daniel* [1924] 1 KB 138 at 145, per Parker LJ.
6 *Principles of Contract* (13th edn) p 346.
7 *Archbolds (Freightage) Ltd v S Spanglett Ltd* [1961] 1 QB 374 at 374, [1961] 1 All ER 417 at 422, per Pearce LJ.
8 *Neilson v James* (1882) 9 QBD 546.
9 [1924] 1 KB 138 at 145, per Bankes LJ; at 147, per Scrutton LJ; at 149, per Atkin LJ.

that supposed above it is only the guilty party who is remediless, a conclusion which was confirmed by *Marles v Philip Trant & Sons Ltd (No 2)*:[10]

> X agreed to sell to the defendants seed described as spring wheat. He delivered winter wheat and thereby broke his contract, but no illegality had as yet been committed either in the formation or the performance of the contract. The defendants innocently resold the wheat as spring wheat to the plaintiff, a farmer. This contract was still lawful as formed. It was, however, illegal as performed, since the defendants failed to comply with a statute which required an invoice to be delivered with the goods.

The farmer, upon discovering the seed to be winter wheat, sued the defendants for breach of contract. Despite the illegality of performance, he was allowed, as the innocent party, to recover damages. It was also held that the defendant's illegal performance of his contract with the plaintiff did not debar him from recovery against X for X's breach of their contract.

It is also reasonably clear in principle that the innocent party is entitled to take legal action to recover money or other property transferred by him under the contract.[11] Since he has taken no part in the unlawful performance, he can be in no worse position than a party to a contract illegal in its formation, who is allowed at common law to recover what he has parted with if he is not *in pari delicto* with the other party.[12]

Where a contract will become illegal unless performed in the manner required by statute, one party, as a condition of entering into it, may exact a promise from the other agreeing to keep performance free from the taint of illegality. If so, this exchange of promises creates a distinct promise separate from the main contract and in the event of its breach the guilty party is liable in damages. Such a case was *Strongman (1945) Ltd v Sincock*.[13]

> The plaintiffs, a building firm, agreed to modernise certain houses belonging to the defendant, an architect. In view of certain statutory regulations, it was illegal to carry out the work without the licence of the Ministry of Works. Before the contract was made, the defendant orally promised that he would make himself responsible for obtaining the necessary licences. The plaintiffs did work to the value of £6,359, but since licences for only £2,150 had been obtained, the defendant, who had paid them £2,900, refused to pay the balance of £3,459 on the ground that the work had been illegally performed.

The plaintiffs' claim to enforce the main contract for the recovery of the balance failed. They could not evade the consequences of the contravention of the law by passing to the defendant the responsibility for legalising the work. But in the sense that they had trusted him to take the necessary steps, the Court of Appeal were prepared to regard them as so far 'innocent' as to allow them an independent cause of action based on the defendant's promise to obtain the requisite licences. This promise was given before the work started and in consideration of the undertaking by the plaintiffs to do the work. There was thus constituted a 'collateral' or 'preliminary' contract valid in itself and distinct from the main contract.

10 [1954] 1 QB 29, [1953] 1 All ER 651.
11 *Siffken v Allnutt* (1813) 1 M & S 39.
12 P 438, above.
13 [1955] 2 QB 525, [1955] 3 All ER 90.

It was stressed by the Court of Appeal, however, that only exceptionally will a collateral contract relieve the promisee from his obligation to observe a statutory regulation.[14] The circumstances must justify his belief that the obligation is no longer his. There was adequate justification in the instant circumstances, for the defendant said in evidence: 'I agree that where there is an architect it is the universal practice for the architect and not the builder to get licences.'

4 Proof of illegality

The rules of evidence that govern the proof of illegality, whether the contract is illegal by statute or at common law, may be summarised as follows:

Firstly, where the contract is *ex facie* illegal, the court takes judicial notice of the fact and refuses to enforce the contract, even though its illegality has not been pleaded by the defendant.

Secondly, where the contract is *ex facie* lawful, evidence of external circumstances showing that it is in fact illegal will not be admitted, unless those circumstances have been pleaded.

Thirdly, when the contract is *ex facie* lawful, but facts come to light in the course of the trial tending to show that it has an illegal purpose, the court takes judicial notice of the illegality notwithstanding that these facts have not been pleaded. But it must be clear that all the relevant circumstances are before the court.[15]

5 Reform

It is clear that the rules relating to the effects of an illegal contract are complex, difficult to state accurately and lead to decisions which are not obviously fair as between the parties or effectively promote the underlying policy objectives.

In 1998 the Law Commission produced a Consultation Paper (No 154) which criticised the existing law and provisionally proposed that it should be replaced by a structured discretion. This Paper has not so far been followed by a report containing definitive proposals for legislation.

14 See especially per Birkett LJ at 540. In a case where the defendant represented that he already held a licence, the Supreme Court of New South Wales held that the plaintiff, upon learning the truth and upon disaffirming the contract, could sue the defendant in fraud for damages to the amount of the work done and materials supplied: *Hatcher v White* (1953) 53 SRNSW 285.

15 *North Western Salt Co Ltd v Electrolytic Alkali Co Ltd* [1914] AC 461; *Edler v Auerbach* [1950] 1 KB 359, especially at 371, [1949] 2 All ER 692; *Chettiar v Chettiar* [1962] AC 294, [1962] 1 All ER 494; *Snelling v Unity Finance Co Ltd* [1964] 2 QB 203, [1963] 3 All ER 50. Cf *Pfeffer v Rigg* [1978] 3 All ER 745, [1977] 1 WLR 285; *Ferguson v John Dawson & Partners (Contractors) Ltd* [1976] 3 All ER 817, [1976] 1 WLR 346.

Chapter 12

Contracts void at common law on grounds of public policy

SUMMARY

It is now necessary to describe the three types of contract which, though they offend public policy, are treated by the courts not as illegal but as void, and to discuss their consequences.

1 The contracts described

A CONTRACTS TO OUST THE JURISDICTION OF THE COURTS

It has long been established that a contract which purports to destroy the right of one or both of the parties to submit questions of law to the courts is contrary to public policy and is *pro tanto* void.[1] Speaking of the common practice of referring disputes to domestic tribunals, Lord Denning said:

1 *Thompson v Charnock* (1799) 8 Term Rep 139. An agreement to oust the jurisdiction of the courts must be distinguished from the case where the parties do not intend that their legal relations shall be affected by their agreement (pp 126 ff, above). Parties are at liberty to declare that they do not wish to make a legally binding contract, but only a 'gentleman's agreement'. But having decided to make and having in fact made a binding contract, they are not allowed to exclude it from the supervision of the courts.

> Parties cannot by contract oust the ordinary courts from their jurisdiction ... They can, of course, agree to leave questions of law, as well as questions of fact, to the decision of the domestic tribunal. They can, indeed, make the tribunal the final arbiter on questions of fact, but they cannot make it the final arbiter on questions of law. They cannot prevent its decisions being examined by the courts. If parties should seek, by agreement, to take the law out of the hands of the courts and put it into the hands of a private tribunal, without any recourse at all to the courts in cases of error of law, then the agreement is to that extent contrary to public policy and void.[2]

In *Baker v Jones*,[3] for instance, an association was formed to promote the sport of weightlifting in the United Kingdom, and control of its affairs was vested in a central council. It was provided that this council should be the sole interpreter of the rules of the association and that its decisions should in all cases and in all circumstances be final. It was held that to give the council the sole right of interpretation was void and that the court had jurisdiction to consider whether the interpretation adopted by the council in a given case was correct in law.

It should be observed, however, that an arbitration agreement, by which contracting parties provide that, before legal proceedings are taken, questions of law and fact shall be decided by a private tribunal, is not *per se* a contract to oust the jurisdiction of the courts, but is valid and enforceable. If, in breach of its terms, one of the parties commences legal proceedings against the other party, the latter may apply to the court for an order staying those proceedings.[4] Under the Arbitration Act 1996, section 9 the court is directed to grant a stay 'unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed'.[5]

In *Scott v Avery*,[6] the House of Lords held that though it is lawful to make the award of an arbitrator on a question of law a condition precedent to the institution of legal proceedings, it is contrary to public policy to agree that the submission of such a question to the court shall be prohibited. The Arbitration Act 1979 introduced for the first time a general right of appeal from an Arbitrator to the High Court on a point of law,[7] replacing the complex provisions for stating a special case.[8] The position is now governed by the Arbitration Act 1996, section 69, which largely reflects the way in which the 1979 Act was interpreted by the courts. The parties may agree either that there shall or shall not be appeals on questions of law. In the absence of such agreement the party wishing to appeal must apply for leave to the court and stringent conditions for leave are contained in the Act.

Another example of this principle is an agreement by a wife not to apply to the court for maintenance. It is clear that there is a public interest against

2 *Lee v Showmen's Guild of Great Britain* [1952] 2 QB 329 at 342, [1952] 1 All ER 1175 at 1181.

3 [1954] 2 All ER 553, [1954] 1 WLR 1005. *Re Davstone Estates Ltd's Leases, Manprop v O'Dell* [1969] 2 Ch 378, [1969] 2 All ER 849; *Re Tuck's Settlement Trusts, Public Trustee v Tuck* [1978] Ch 49, [1978] 1 All ER 1047; *Johnson v Moreton* [1978] 3 All ER 37, [1978] 3 WLR 538. Cf *Jones v Sherwood Computer Services plc* [1992] 1 WLR 277, Berg 109 LQR 35.

4 Arbitration Act 1996, s 9.

5 This provision replaces the position under the previous legislation where the court had a discretion. A term in the arbitration agreement that no application for a stay of proceedings shall be made is void: *Czarnikow v Roth, Schmidt & Co* [1922] 2 KB 478.

6 (1856) 5 HL Cas 811. *Czarnikow v Roth, Schmidt & Co* [1922] 2 KB 478.

7 Arbitration Act 1979, s 1.

8 Under Arbitration Act 1950, s 21(1).

such promises since if the husband does not maintain his wife, her support may become a charge on public funds[8] but where such a promise by the wife is given in exchange for a promise by the husband to pay maintenance, it may appear unmeritorious to allow the husband to escape performance of his promise. After producing much litigation[10] such situations are now governed by legislation.[11] An agreement may also be invalid[12] in so far as it attempts to exclude mandatory rules of law. So for instance a perfectly valid agreement between two companies as to how accounts between them are to be settled may become inoperative if one goes into liquidation because it runs contrary to the provisions of the insolvency legislation.[13]

B CONTRACTS PREJUDICIAL TO THE STATUS OF MARRIAGE

The status of marriage is a matter of public interest in all civilised countries and it is important that nothing should be allowed to impair the sanctity of its solemn obligations or to weaken the loyalty that one spouse owes to the other. The general view of English law is that any contract is void which unduly restricts or hampers the freedom of persons to marry whom they will, or which after marriage tends to encourage in one or both of the parties an immoral mode of life incompatible with their mutual obligations.

Marriage ought to be free, and therefore a contract which restrains a person from marrying anybody, or from marrying anybody except a particular person without imposing a similar and reciprocal restriction on that person, is void as being contrary to the social welfare of the state.[14] Thus in *Lowe v Peers*[15] a contract made by a man under seal to the following effect was held to be contrary to public policy:

> I do hereby promise Mrs Catherine Lowe, that I will not marry with any person besides herself: if I do, I agree to pay the said Catherine Lowe £1,000 within three months next after I shall marry anybody else.

Again, it is in the interests of society that reckless or unsuitable marriages should be prevented, but this desirable state of affairs is not likely to be

8 *Hyman v Hyman* [1929] AC 601. *Sutton v Sutton* [1984] Ch 184, [1984] 1 All ER 168.

10 See eg *Bennett v Bennett* [1952] 1 KB 249, [1952] 1 All ER 413; *Brooks v Burns Philp Trustee Co* [1969] ALR 321.

11 Matrimonial Causes Act 1975, s 34. And see *Minton v Minton* [1979] AC 593, [1979] 1 All ER 79; *Jessel v Jessel* [1979] 3 All ER 645, [1979] 1 WLR 1148.

12 Does a clause providing that disputes under a contract are to be litigated in a foreign forum infringe the principle? This question has been much discussed in the United States. See Nadelman 21 Am J Comp L 124; Denning 2 J Maritime Law and Commerce 17; Mendelssohn ibid 661; Delaume 4 ibid 275. *Bremen v Zapata* 407 US 1 (1972), [1972] 2 Lloyd's Rep 315; *Carvalho v Hull Blyth (Angola) Ltd* [1979] 3 All ER 280, [1979] 1 WLR 1228. In general the problem has not been approached in this way in English law. For signatories it is now substantially governed by the Brussels Convention enacted into English law by the Civil Jurisdiction and Judgments Act 1992. For other countries see *The Eleftheria* [1969] 2 All ER 641, [1970] P94.

13 *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 2 All ER 390, [1975] 1 WLR 758. Similarly an agreement between master and servant to release the master from a statutory duty to provide safe working conditions is invalid: *Baddeley v Earl Granville* (1887) 19 QBD 423. But cf *Imperial Chemical Industries v Shatwell* [1965] AC 656, [1964] 2 All ER 999. See Dias [1966] CLJ 75.

14 Story *Equity Jurisprudence* s 274.

15 (1768) 4 Burr 2225. See also *Re Michelham's Will Trusts* [1964] Ch 550, [1963] 2 All ER 188.

attained if third parties are free to reap financial profit by bringing about matrimonial unions. It has therefore been ruled that what is called a marriage brokage contract, ie a contact by which A undertakes in consideration of a money payment to procure a marriage for B, is void.[16] This is so whether the contract is to procure B's marriage with one particular person or with one out of a whole class of persons.[17]

Considerations of public policy, which, as we have just seen, apply to contracts made prior to marriage, also affect those made after marriage. The difficulty is to state the governing principle with precision, and we probably cannot venture further than this: that any contract which during cohabitation tends to encourage infidelity in one or both of the spouses or to provide an inducement for immoral conduct is void as being contrary to public policy. It is sometimes claimed that any contract whatsoever, that tends to induce a course of conduct inconsistent with the maintenance of the marriage tie, is void, but the authorities show that this is to state the rule too widely. Two lines of decisions illustrate the subject: those relating to separation agreements and those concerned with a promise made by a married person to marry a third person at some future time.

It has been established for over a hundred years that a contract providing for immediate separation of the spouses is valid and enforceable if followed by immediate separation, notwithstanding that this breaks the *consortium vitae* and is therefore to that extent inconsistent with the primary and fundamental obligation of the marriage tie.[18] On the other hand, a contract for a possible future separation, eg a promise by a husband that he will make provision for his wife if she should ever live apart from him, is contrary to public policy and void as being opposed to elementary considerations of morality.[19] The distinction between the two classes of agreement is obvious. Once the melancholy fact is apparent that the parties cannot live together in amity, it is desirable that the separation which has become inevitable should be concluded upon reasonable terms; but a promise for the benefit of one of the parties in the event of a possible future separation, if it does not put a premium on immorality, at least weakens the resolve of the promisee to maintain with loyalty and fidelity the obligations of the marriage tie.

> If a separation has actually occurred or become inevitable, the law allows the matter to be dealt with according to realities and not according to a fiction. But the law will not permit an agreement which contemplates the future possibility of so undesirable a state of affairs.[20]

The one exception to the rule that a contract for future separation is void occurs where parties, who have been separated already, make a reconciliation agreement and resume cohabitation. In this case the agreement is valid although it may make provision for a renewed separation.[1]

16 *Hermann v Charlesworth* [1905] 2 KB 123. See Powell 1953 Current Legal Problems 254.

17 *Hermann v Charlesworth*, above.

18 *Wilson v Wilson* (1848) 1 HL Cas 538; subsequent proceedings (1854) 5 HL Cas 40.

19 *H v W* (1857) 3 K & J 382; *Brodie v Brodie* [1917] P 271.

20 *Fender v St John-Mildmay* [1938] AC 1 at 44, [1937] 3 All ER 402 at 429, per Lord Wright.

1 *Harrison v Harrison* [1910] 1 KB 35. See also *Re Johnson's Will Trusts, National Provincial Bank v Jeffrey* [1967] Ch 387, [1967] 1 All ER 553; *Re Hepplewhite Will Trusts* [1977] CLY 2710.

The second lie of cases is concerned with a contract by A, who is already married to B, to marry X at some future date. In *Spiers v Hunt*[2] and *Wilson v Carnley*,[3] Phillimore J, in the former, and the Court of Appeal in the latter, case, held that a promise of marriage made by a man, who to the knowledge of the promisee was at the time married to another woman, was void on grounds of public policy, and that it could not be enforced after the death of the wife. In *Fender v St John-Mildmay*[4] the House of Lords held, by a majority, that these decisions did not extend to a promise of marriage made by a married man whose marriage was so moribund that it had already been the subject of a decree nisi of divorce.[5] The practical situation in these cases can no longer be the subject of litigation since the abolition of actions for breach of promise of marriage[6] but they are still of interest as illustrating the public policy in respect of marriage.

C CONTRACTS IN RESTRAINT OF TRADE[7]

A contract in restraint of trade is one by which a party restricts his future liberty to carry on his trade, business or profession in such manner and with such persons as he chooses. A contract of this class is prima facie void, but it becomes binding upon proof that the restriction is justifiable in the circumstances as being reasonable from the point of view of the parties themselves and also of the community.

Such has long been the legal effect of two familiar types of contract. First, one by which an employee agrees that after leaving his present employment he will not compete against his employer, either by setting up business on his own account or by entering the service of a rival trader. Secondly, an agreement by the vendor of the goodwill of a business not to carry on a similar business in competition with the purchaser.

This doctrine of restraint of trade is based upon public policy, and its application has been peculiarly influenced by changing views of what is desirable in the public interest.[8] This is inevitable. 'Public policy is not a constant', and it necessarily alters as economic conditions alter.[9] In Elizabethan days all restraints of trade, whether general or partial, were regarded as totally

2 [1908] 1 KB 720.

3 [1908] 1 KB 729; *Sivyer v Allison* [1935] 2 KB 403.

4 [1938] AC 1, [1937] 3 All ER 402. See especially the judgment of Lord Atkin.

5 This reasoning could be argued to cover the case of a marriage factually dead but not yet the subject of legal proceedings. See Furmston 16 U of Toronto LJ 267 at 300-302. Cf *Dobersek v Petrizza* [1968] NZLR 211.

6 By theLaw Reform (Miscellaneous Provisions) Act 1970. Under the previous law a woman who accepted a proposal of marriage from a married man in ignorance of his status could enforce the contract. *Shaw v Shaw* [1954] 2 QB 429, [1954] 2 All ER 638. This was a valuable remedy where, as in that case, the parties went through a ceremony of marriage and lived together for years. The action for breach of contract would provide a substitute for the succession rights which the 'wife' would have had if the 'marriage' has been valid. As to the present law, see s 6 of the 1970 Act; Thomson 87 LQR 158; Gower 87 LQR 314.

7 Heydon *The Restraint of Trade Doctrine*. Trebilcock *The Common Law of Restraint of Trade*. Smith 15 Oxford JLS 565.

8 *Attwood v Lamont* [1920] 3 KB 571 at 581, per Younger LJ. See Holdsworth *History of English Law* vol 8, pp 56-62.

9 *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd* [1934] AC 181 at 189, per Lord Macmillan.

void because of their tendency to create monopolies. This view, however, did not prevail, for it was gradually realised that a restriction of trading activities was in certain circumstances justifiable in the interests both of the public and of the parties themselves. It was clear, for instance, that the purchaser of a business was at the mercy of the vendor, if the latter were free to carry on his former trade in the same place; and that a master was equally at the mercy of his servants and apprentices if they were free to exploit to their own gain the knowledge that they had acquired of his personal customers or his trade secrets. Moreover, the evil was not limited to one side, for if all contracts against future competition were to be regarded as unlawful, the aim of employers, it was feared, might be to reduce the number of their servants to a minimum and so to increase unemployment. The law was therefore relaxed, though only gradually, and in 1711 in *Mitchel v Reynolds*,[10] a case which is the foundation of the modern law, Lord Macclesfield stated what he understood to be the current position. He said:

> Wherever a sufficient consideration appears to make it a proper and useful contract, and such as cannot be set aside without injury to a fair contractor, it ought to be maintained; but with this constant diversity—namely where the restraint is general not to exercise a trade throughout the kingdom, and where it is limited to a particular place; for the former of these must be void, being of no benefit to either party and only oppressive.[11]

The true significance of this passage, no doubt, was that everything must turn upon whether the contract was reasonable and fair. Lord Macclesfield, in speaking of the 'diversity', presumably did not intend to create a rigid distinction between a general and a limited restraint, the former void, the latter valid if reasonable. He was merely illustrating what, in the conditions of transport and communications prevailing in 1711, obviously could not be reasonable. 'What does it signify', he said in a later passage, 'to a tradesman in London what another does in Newcastle?' But no doubt he would have been the first to admit that, as conditions changed and communications improved, any rigid demarcation between general and limited restraints would be inconsistent with commercial realities. Indeed a time was to come when it might signify a great deal to the purchaser of a business in London what the vendor did in Newcastle. A long line of authority, however, interpreting Lord Macclesfield's words literally, established, and maintained until the close of the nineteenth century, that a contract, whether made between a master and servant or between a vendor and purchaser of a business which imposed a general restraint, was necessarily and without exception void; but that a partial restraint was prima facie valid, and if reasonable was enforceable. In summing up these authorities, Bowen LJ said:

> Partial restraints, or, in other words, restraints which involve only a limit of places at which, or persons with whom, or of modes in which, the trade is to be carried on, are valid when made for a good consideration, and where they do not extend further than is necessary for the reasonable protection of the covenantee.[12]

The first inroad on this rule came in 1894 in the *Nordenfelt* case,[13] when Nordenfelt, a manufacturer of quick-firing guns and other implements of war,

10 (1711) 1 P Wms 181.
11 Ibid at 182.
12 *Maxim Nordenfelt Guns and Ammunition Co v Nordenfelt* [1893] 1 Ch 630 at 662.
13 *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] AC 535 especially at 536.

sold his business to a company for £287,500 and entered into a contract restraining his future activities. Two years later the company was amalgamated with another company which agreed to employ Nordenfelt as managing director at a salary of £2,000 a year. The deed of employment continued, indeed amplified, the contract in restraint of trade made by him two years earlier. He covenanted that he would

> not during the term of twenty-five years ... if the company so long continued to carry on business, engage except on behalf of the company either directly or indirectly in the trade or business of a manufacturer of guns gun mountings or carriages, gunpowder explosives or ammunition, or *in any business competing or liable to compete in any way with that for the time being carried on by the company.*

This restraint was general in the most absolute sense, since the business of the company extended to all parts of the world. Nevertheless, the House of Lords held that, except for the part which has been italicised above, it was in the particular circumstances valid. The actual decision marked a break with the past. It came to this—that a contract in general restraint of trade, made between a vendor and purchaser of a business, was not necessarily void, but only prima facie void, and that it was valid if it was reasonable in the interests of the parties and in the interests of the public. It was reasonable in the interests of the parties to restrain Nordenfelt from trading in guns, gun mountings or carriages, gunpowder explosives or ammunition, since the business that he had sold for a large sum of money consisted in the manufacture of those very things. This part of the covenant was also reasonable in the interests of the public, since it secured to England the business and inventions of a foreigner and thus increased the trade of the country. On the other hand, to restrain Nordenfelt from engaging in 'any business competing or liable to compete in any way with that for the time being carried on by the company' was unreasonable, since it was wider than was reasonably necessary to protect the proprietary interest that the company had bought. That part of the covenant must therefore be severed from the rest and declared void.

So much then for the actual decision. But the case is equally important for the further break with tradition made by Lord Macnaghten, when he denied that general and partial restraints fell into distinct categories. A partial restraint, in his opinion, was not prima facie valid. It was on the same footing as a general restraint, ie prima facie void, but valid if reasonable. The relevant part of his speech is this:

> All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade ... may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable—reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.[14]

In a later passage he summarised the law in these words:

> My Lords ... I think the only true test in all cases, whether of partial or general restraint, is the test proposed by Tindal CJ: What is a reasonable restraint with reference to the particular case?[15]

14 Ibid at 565.
15 Ibid at 574. The words of Tindal CJ appear in *Horner v Graves* (1831) 7 Bing 735.

Lord Macnaghten's view, so far as it related to partial restraints, did not meet with the approval of all the Law Lords, and indeed it was irrelevant, since the issue in the *Nordenfelt* case was confined to the validity of a general restraint. Until 1913 his view was not adopted by the lower courts, which consistently acted on the assumption that partial restraints were prima facie valid,[16] but in that year the House of Lords in *Mason v Provident Clothing and Supply Co Ltd*.[17] held that Lord Macnaghten's proposition was a correct statement of the modern law. The House of Lords in this case developed the law in two respects:

First, it held that all covenants in restraint of trade, partial as well as general, are prima facie void and that they cannot be enforced unless the test of reasonableness as propounded by Lord Macnaghten is satisfied.

Secondly, it made a sharp distinction, stressed as long ago as 1869 by James LJ,[18] between contracts of service and contracts for the sale of a business. It confirmed that a restraint may be imposed more readily and more widely upon the vendor of a business in the interests of the purchaser, than upon a servant in the interests of the master. In the former case, not only are the parties dealing at arm's length, but the purchaser has paid the full market value for the acquisition of a proprietary interest, and it is obvious that this will lose much of its value if the vendor is free to continue his trade with his old customers. Indeed public policy demands that the covenantor should be allowed to restrict his future activities, for otherwise he will find it impossible to sell to the best advantage what he has created by his skill and labour.[19] Different considerations affect a contract of service. For one thing the parties are not in an equally strong bargaining position, and the servant will often find it difficult to resist the imposition of terms favourable to the master and unfavourable to himself.[20] He may even find his freedom to request higher wages seriously impeded, for should he be unsuccessful his choice of fresh employment will be considerably narrowed if the restraint is binding.[1] Again, the master cannot as a rule show any proprietary interest of a permanent nature that requires protection, since the servant's skill and knowledge, even though acquired in the service, as not bought for his life, but only for the duration of the employment.[2] The possibility that the servant may be a competitor in the future is not a danger against which the master is entitled to safeguard himself. On the contrary, it accords with public policy that a

16 *Attwood v Lamont* [1920] 3 KB 571 at 585-586, per Younger LJ: the whole judgment is worthy of the closest attention.

17 [1913] AC 724.

18 *Leather Cloth Co v Lorsont* (1869) LR 9 Eq 345. An agreement between professional partners is for this purpose equated to the sale of a business: *Whitehill v Bradford* [1952] Ch 236, [1952] 1 All ER 115. And see *Oswald Hickson Collier & Co v Carter-Ruck* [1984] AC 720n, [1984] 2 All ER 15; *Bridge v Deacons* [1984] AC 705, [1984] 2 All ER 19; *Kerr v Morris* [1987] Ch 90, [1986] 3 All ER 217.

19 *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724 at 734, per Lord Haldane; *Ronbar Enterprises Ltd v Green* [1954] 2 All ER 266, [1954] 1 WLR 815, per Jenkins LJ at 820 and 270, respectively. If no provision is made upon the sale of goodwill for the prevention of competition, the vendor may set up a rival business, but he may not canvass his former customers: *Trego v Hunt* [1896] AC 7.

20 *Leather Cloth Co v Lorsont* (1869) LR 9 Eq 345 at 354. This might appear less true with the development of powerful trade unions but most restraints affect 'white-collar' workers, who are much less unionised.

1 *M and S Drapers (a firm) v Reynolds* [1956] 3 All ER 814 at 820, [1957] 1 WLR 9 at 18, per Denning LJ.

2 *Attwood v Lamont* [1920] 3 KB 571 at 589.

servant shall not be at liberty to deprive himself or the state of his labour, skill or talent.[3] Decisive effect was given to these considerations in *Herbert Morris Ltd v Saxelby*,[4] where the House of Lords held that a covenant which restrains a servant from competition is always void as being unreasonable, unless there is some exceptional proprietary interest owned by the master that requires protection. In the course of his speech Lord Parker said:

> The reason, and the only reason, for upholding such a restraint on the part of an employee is that the employer has some proprietary right, whether in the nature of trade connection or in the nature of trade secrets, for the protection of which such a restraint is—having regard to the duties of the employee—reasonably necessary. Such a restraint has, so far as I know, never been upheld, if directed only to the prevention of competition or against the use of the personal skill and knowledge acquired by the employee in his employer's business.[5]

The most recent landmark in the history of the subject is the decision of the House of Lords in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd*.[6] This is of general importance on several counts. The speeches show how the issues that arise in a contested case should be segregated; they show that the broad generalisations which figure so frequently in the reports are misleading guides; they reaffirm the true role of public policy in this context; and they contain much of value upon the categories of contract that attract the doctrine of restraint of trade.

In the first place, their Lordships stress the importance of segregating the two independent questions that require an answer where the doctrine is invoked. The first is whether the contract under review is so restrictive of the promisor's liberty to trade with others that it must be treated as prima facie void. If such is the finding of the court, the second question is whether the restrictive clause can be justified as being reasonable. If so the contract is valid.

To neglect this segregation is to court confusion, for the facts relevant to the second question are not necessarily relevant to the first. If, for instance, the first is under investigation, it is a matter of indifference that the contract is contained in a mortgage; but in estimating the reasonableness of the restriction, the harshness or moderation of the mortgage terms may be the decisive element.[7] Where a judge combines the two questions, it is often impossible to discern to which of the two issues his remarks are directed.

It is in connection with the first question that some confusion has been caused by judicial generalisations. The reports abound with statements of the most sweeping nature, such as that of Lord Macnaghten quoted above,[8] in which he dismissed as contrary to public policy 'all interferences with individual liberty of action in trading and all restraints of trade themselves, if there is nothing more'. But, as was pointed out in the *Esso* case, such statements are not to be taken literally.[9] They were not intended to indicate that 'any contract which in whatever way restraints a man's liberty to trade was (either historically

3 *Leather Cloth Co v Lorsont* (1869) LR 9 Eq 345 at 353, per James LJ.
4 [1916] 1 AC 688.
5 Ibid at 710.
6 [1968] AC 269, [1967] 1 All ER 699. Heydon 85 LQR 229.
7 Ibid, at 326 and 725, respectively, per Lord Pearce.
8 P 451, above.
9 [1968] AC 269, [1967] 1 All ER 699, at 293-295 and at 705, respectively, per Lord Reid; at 307 and 713, respectively, per Lord Morris of Borth-y-Gest.

under the common law or at the time of which they were speaking) prima facie unenforceable and must be shown to be reasonable'.[10] Moreover, the changing face of commerce must always be borne in mind.[11] Restrictions which in an earlier age were classified as restraints of trade may, in the different circumstances of today, have become 'part of the accepted pattern or structure of trade' as encouraging rather than limiting trade.[12]

Where, then, is the line to be drawn between restrictions that require justification and those that are innocuous? What at any rate is clear beyond doubt is that two categories of contract are prima facie void as being in restraint of trade: those which restrict competition by an employee against his employer or by the vendor of a business against the purchaser.

On the other hand, it may be said with reasonable confidence that certain restrictive agreements have now 'passed into the accepted and normal currency of commercial or contractual or conveyancing relations',[13] and are therefore no longer suspect. If, for instance, a manufacturer agrees that X shall be the sole agent for the sale of his output, the scope of his liberty of disposition is no doubt fettered, but the object of the arrangement is to increase his trade, and it has become a normal incident of commercial practice.[14] Again, it has been established for well over a hundred years that an agreement by the lessee of a public house that he will sell no beer on the premises except that brewed by his lessor is outside the doctrine of restraint of trade.[15] The same reasoning applies to the negative covenants, so familiar in practice, by which a lessee or purchaser of land agrees to surrender his common law right to use the premises for trading purposes. These have long been an accepted, indeed an essential, feature of conveyancing practice and for that reason are excluded from the doctrine of restraint of trade.[16] So much is reasonably clear. Two categories of contract are subject to the doctrine of restraint; certain other categories are exempt. Where a contract which falls within none of these categories places some degree of restriction upon a party's trading activities, the court may feel obliged to consider whether in the light of its terms and of the attendant circumstances it must be construed as prima facie void. This may be an enquiry of some delicacy, for it involves the adjustment of two freedoms, both based on public policy—

10 Ibid, per Lord Wilberforce at 333 and 730, respectively. Strictly speaking, the word 'unenforceable' used in this passage should be replaced by 'void'.

11 Ibid, at 324 and 724, respectively, per Lord Pearce.

12 Ibid, at 335 and 731, respectively, per Lord Wilberforce.

13 Ibid at 332-333 and 729, respectively, per Lord Wilberforce; see also at 327 and 724, respectively, per Lord Pearce.

14 Ibid at 328-329 and 726, respectively, per Lord Pearce; at 336 and 731, respectively, per Lord Wilberforce. See *Servais v Prince's Hall Restaurant Ltd* (1904) 20 TLR 574.

15 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 325, [1967] 1 All ER at 725, per Lord Pearce; per Lord Wilberforce at 333-334 and 730-731, respectively. 'Tied houses' became common while partial restraints were thought prima facie valid. Such agreements may, however, fall foul of statutory competition law. See above pp 382 ff.

16 Ibid at 334-335, and 731, respectively, per Lord Wilberforce. The reason for this exclusion given by the other Law Lords was that the covenantor surrenders no freedom that he formerly possessed, since prior to the contract he had no right to trade on the land. This however, would not explain the exclusion where the owner of two properties sells one and covenants not to trade on the other that he retains. This reason was relied on however in *Cleveland Petroleum Co Ltd v Dartstone Ltd* [1969] 1 All ER 201, [1969] 1 WLR 116.

the one the freedom to contract, the other the freedom to trade'[17]—or, as Lord Shaw once put it, 'the right to bargain and the right to work'.[18] The perplexing problem is to identify the type of restrictive contract that requires the intervention of the court. Is there any rigid test that serves to distinguish the impeachable from the unimpeachable restriction? It may be answered at once that such a simple solution is unattainable. Any attempt to classify the categories of contract that are prima facie void is hazardous in the extreme. There is no accurate rubric under which they can be brought. 'The classification must remain fluid and the categories can never be closed.'[19]

The manner in which the courts approach the problem is illustrated by the decision of the House of Lords in the *Esso* case,[20] where the respondent company had tied its two garages to the appellant company under what is called the '*solus* system'.[1] Separate contracts were entered into in respect of each garage, but each contained the following main provisions.

> The respondent company agreed to buy its total requirements of motor fuel from Esso; and to operate the garages in accord with the Esso co-operation plan under which it was obligatory to keep the garages open at all reasonable hours and not to sell them without ensuring that the purchaser entered into a similar sale agreement with Esso. The appellant agreed to allow a rebate of 1d a gallon on all fuels bought. The agreements were to operate for four years five months in the case of one of the garages, but for twenty-one years in respect of the other. In addition, the latter was mortgaged to Esso in return for an advance of £7,000 which was to be repaid by instalments lasting for twenty-one years and not at any earlier date. In other words, the mortgage was not redeemable before the end of that period.

It was held unanimously that both agreements fell within the category of contracts in restraint of trade. They were not mere contracts of exclusion as in the case of a sole agency, for they restricted the manner in which the respondent company was to carry on its trade during a fixed period that could not be terminated before it had run its full course. Nor could it be said that the solus system had become a normal and established incident of the motor trade, since it was of far too recent an origin. Moreover, there was no substance in the appellant's main argument that the restrictions against trading were imposed not upon the respondent company personally, but upon its use of the land, and that therefore, as in the case where a tenant covenants not to use the demised land for the purposes of trade, they were excluded from the doctrine of restraint

17 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 306, [1967] 1 All ER 699 at 712, per Lord Morris of Borth-y-Gest.

18 *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724 at 738.

19 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 337, [1967] 1 All ER 699 at 732, per Lord Wilberforce.

20 [1968] AC 269, [1967] 1 All ER 699.

1 A *solus* agreement normally contains a 'tying covenant' by which the garage owner agrees, in return for a rebate on the price, to sell only the supplier's brand of petrol; a 'compulsory trading covenant', which obliges him to keep the garage open at reasonable hours and to provide the public with an efficient service; and a 'continuity covenant' which requires him, if he sells his business, to procure the acceptance of the agreement by the purchaser. As a further incentive, the supplier frequently makes a loan to the garage owner on favourable terms: see generally Whiteman 29 MLR 507; Graupner 18 ICLQ 879.

of trade. Lord Wilberforce stigmatised this argument as artificial and unreal,[2] while Lord Pearce said that the practical effect of the contract was to create a personal restraint since it imposed a positive obligation upon the respondent to carry on the business in the manner prescribed in the co-operation plan.[3] The further argument that the restriction in respect of the second garage, since it was contained in a mortgage, was exempt from the doctrine of restraint was dismissed as unsound in principle.

Thus, both contracts were prima facie void and required to be justified according to the test of reasonableness.[4]

An attempt will now be made to summarise the main rules applicable to contracts in restraint of trade, especially those that relate to the test of reasonableness.

The basic rule is that, if the contract is so restrictive of the promisor's liberty to trade as to require review by the court, it is prima facie void and cannot become binding unless it is reasonable in the interest of both parties and also in the interest of the public.

The view that the interest of the public should be consulted was current in the nineteenth century, but for many years the courts have usually concentrated their attention on the interests of the parties. In the *Esso* case, however, three of the Law Lords deprecated this dismemberment of the principle of public policy on which the doctrine of restraint of trade is based. In every case 'there is one broad question: Is it in the interests of the community that this restraint should be held to be reasonable and enforceable?'[5] This is a revival of the view expressed by the Court of Exchequer as long ago as 1843: 'The test appears to be whether the contract be prejudicial or not to the public interest, for it is on grounds of public policy alone that these contracts are supported or avoided.'[6]

The concept of public interest admits of no precise definition, and it is not surprising that at times it has been allowed a latitude which it is difficult to defend. An instance of this in the context of restraint of trade is the decision of the Court of Appeal in *Wyatt v Kreglinger and Fernau*,[7] where the facts were as follows:

> In June 1923, the defendants wrote to the plaintiff, who had been in their service for many years, intimating that upon his retirement they proposed to give him an annual pension of £200 subject to the condition that he did not compete against them in the wool trade. The plaintiff's reply was lost, but he retired in the following September and received the pension until

2 Ibid at 338 and 733, respectively.
3 Ibid at 327 and 726, respectively.
4 The decision on this aspect of the case is discussed below.
5 Ibid at 324 and 724, respectively, per Lord Pearce. See also at 319 and 720, respectively, per Lord Hodson; at 340-341 and 733-735, respectively, per Lord Wilberforce; and see *Herbert Morris v Saxelby* [1916] 1 AC 688 at 716, per Lord Shaw; *Bull v Pitney-Bowes Ltd* [1966] 3 All ER 384, [1967] 1 WLR 273 at 282, per Thesiger J.
6 *Mallan v May* (1843) 11 M & W 653 at 665, per Parke B, delivering the judgment of the court. The onus of proving that the restraint is reasonable in the interests of the parties lies upon the party who seeks to enforce the agreement; whether it is reasonable in the public interest lies upon the party so alleging. As to these rules, see the *Esso* case at 319 and 323-324 and 720-721, 724, respectively.
7 [1933] 1 KB 793; followed by Thesiger J in *Bull v Pitney-Bowes Ltd* [1966] 3 All ER 384, [1967] 1 WLR 273; p 462, below.

June 1932, when the defendants refused to make further payments. The plaintiff sued them for breach of contract. The defendants denied that any contract existed, and also pleaded that if a contract did exist it was void as being in restraint of trade.

The Court of Appeal gave judgment for the defendants, but there was no unanimity with regard to the *ratio decidendi*. Scrutton LJ held that the defendants had not bound themselves contractually but had merely made a gratuitous promise. The other two Lords Justices inclined to a contrary view on this point, but all three held that if the contract existed it was void, since it imposed a restraint that was too wide. It also appeared to them that the contract was injurious to the interests of the public, for to restrain the plaintiff from engaging in the wool trade was to deprive the community of services from which it might derive advantage. This is a somewhat extravagant suggestion. It is a little difficult to appreciate what injury was caused to the public by the retirement of a man who, in common with a very considerable number of his fellow citizens, occupied but a comparatively humble position in the trade. Reason and justice would seem to prescribe that an agreement, reasonable between the parties, should not be upset for some fancied and problematical injury to the public welfare.

In applying the test of public policy, the first task of the court is to construe the contract in the light of the circumstances existing at the time when it was made in order to determine the nature and extent of the restraint contemplated by the parties. The decisive factor is not the mere wording of the contract, but the object that the parties had in view. In one case, for instance, a contract with a milk roundsman contained the following clause:

> The Employee expressly agrees not at any time during the period of one year after the determination of his employment, ... either on his own account or as representative or agent of any person or company, to serve or sell milk or dairy produce to ... any person or company who at any time during the last six months of his employment shall have been a customer of the Employer and served by the Employee in the course of his employment.[8]

The expression 'dairy produce' manifestly includes butter and cheese and therefore the agreement, literally construed, would preclude the roundsman from entering the employment of a grocer who dealt in those commodities. The Court of Appeal, however, held that so stringent a restraint was not contemplated by the parties. The clear object of the contract was to protect the employers *qua* purveyors of milk which was the only commodity in which they dealt. Since this was the rational construction of the contract, it was held that the restraint was valid.

Once the intention of the parties had been disclosed, the validity of the contract falls to be determined. This is a question of law. Evidence is indeed admissible to prove the special circumstances which are alleged to justify the restriction. The promisee may, for instance, produce evidence to show what is customary in the particular trade, what particular dangers require precautions, what steps are necessary in order to protect him against competition by the promisor, and what is usual among businessmen as to the terms of employment.[9] But evidence that a witness considers the

8 *Home Counties Dairies Ltd v Skilton* [1970] 1 All ER 1227, [1970] 1 WLR 526.
9 *Haynes v Doman* [1899] 2 Ch 13 at 24, per Lindley MR.

restraint to be reasonable is inadmissible, for that is the very question which the court alone can decide.[10]

The onus of proving such special circumstances as are alleged to justify a restraint fall upon the promisee. 'When once they are proved, it is a question of law for the decision of the judge whether they do or do not justify the restraint. There is no question of onus one way or the other.'[11]

In considering the issue of justification, the court must scrutinise the restraint as at the date when the contract was made in the light of the circumstances then existing and also in the light of what at that date might possibly happen in the future. The temptation to consider what in fact has happened by the time of the trial must be resisted, for a contract containing a restraint alleged to be excessive must be either invalid *ab initio* or valid *ab initio*. There cannot come a moment at which it passes from the class of invalid into that of valid covenants.[12]

A restraint to be permissible must be no wider than is reasonably necessary to protect the relevant interest of the promisee.[13] The existence of some proprietary or other legitimate interest such as his right to work,[14] must first be proved, and then it must be shown to the satisfaction of the court that the restraint as regards its area, its period of operation and the activities against which it is directed, is not excessive.

We will now consider the question of reasonableness with reference to the different categories of contracts in restraint of trade. But, as we have seen, any attempt to classify these categories would be a hazardous, if not an impossible, undertaking. The doctrine of restraint is by no means static. Moreover it extends beyond the confines of contract. It has been extended, for instance, to the refusal of the Jockey Club to grant a training licence to a woman merely on the ground of her sex;[15] to the 'retain and transfer' system of the Football League Ltd, by which a player, 'retained' by his club at the end of his year's engagement, is debarred from joining another club unless he obtains the consent of that by which he has been retained,[16] to the rules adopted by the International Cricket Conference and the Test and County Cricket Board as to which players should be permitted to play test cricket and English first class county cricket respectively;[17] and to restrictions imposed by a professional

10 Ibid; *Leng & Co Ltd v Andrews* [1909] 1 Ch 763 at 770-771, per Fletcher Moulton LJ. And as to the admissibility of general economic evidence, see *Texaco Ltd v Mulberry Filling Station Ltd* [1972] 1 All ER 513, [1972] 1 WLR 814.

11 *Herbert Morris Ltd v Saxelby* [1916] AC 688 at 707, per Lord Parker.

12 *Gledhow Autoparts Ltd v Delaney* [1965] 3 All ER 288 at 295, [1965] 1 WLR 1366 at 1377, per Diplock LJ. See also *Putsman v Taylor* [1927] 1 KB 637 at 643, per Salter J. The contrary view was taken by Lord Denning MR in *Shell (UK) Ltd v Lostock Garage Ltd* [1977] 1 All ER 481, [1976] 1 WLR 1187 but this was supported only by a selective and out of context quotation from *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269, [1967] 1 All ER 699 and was not concurred in by the other members of the Court of Appeal. See Russell 40 MLR 582 and *Watson v Prager* [1991] 3 All ER 487. The position may be different with the statutory regime. See above p 382 ff.

13 *E Underwood & Son Ltd v Barker* [1899] 1 Ch 300 at 305, per Lindley MR; *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688 at 710, per Lord Parker.

14 *Nagle v Feilden* [1966] 2 QB 633 at 646, per Lord Denning MR. 'A man's right to work at his trade or profession is just as important to him, perhaps more important than, his rights of property.'

15 *Nagle v Feilden*, above.

16 *Eastham v Newcastle United Football Club* [1964] Ch 413, [1963] 3 All ER 139.

17 *Greig v Insole* [1978] 3 All ER 449, [1978] 1 WLR 302.

body, such as the Pharmaceutical Society, upon the trading activities of its members.[18] In the present book it seems better to limit the discussion to contractual restrictions and to group these under four headings, namely (a) restraints accepted by an employee; (b) restraints accepted by the vendor of a business; (c) restraints arising from combinations for the regulation of trade relations; (d) restraints accepted by distributors of merchandise.

a Restraints accepted by employees

It has already been seen that a restraint imposed upon a servant is never reasonable, unless there is some proprietary interest owned by the master which requires protection. The only matters in respect to which he can be said to possess such an interest are his trade secrets, if any, and his business connection.[19] It is obvious that a restraint against competition is justifiable if its object is to prevent the exploitation of trade secrets learned by the servant in the course of his employment.[20] An instance of this occurred in *Forster & Sons Ltd v Suggett*:[1]

> The works manager of the plaintiffs, who were chiefly engaged in making glass and glass bottles, was instructed in certain confidential methods concerning, inter alia, the correct mixture of gas and air in the furnaces. He agreed that during the five years following the determination of his employment he would not carry on in the United Kingdom, or be interested in, glass bottle manufacture or any other business connected with glass-making as conducted by the plaintiffs.

It was held that the plaintiffs were entitled to protection in this respect, and that the restraint was reasonable. In such a case the employer must prove definitely that the servant has acquired substantial knowledge of some secret process or mode of manufacture used in the course of his business. Even the general knowledge, derived from secret information, which has taught an employee how best to solve particular problems as they arise may be a proper subject matter of protection.[2] But if, as was the case in *Herbert Morris Ltd v Saxelby*,[3] the so-called secret is nothing more than a special method of organisation adopted in the business, or if only part of the secret is known to the servant so that its successful exploitation by him is impossible, there can be no valid restraint.

An employer is also entitled to protect his trade connection, ie to prevent his customers from being enticed away from him by a servant who was formerly in his employ. Protection is required against the unfair invasion of his connection by a servant who has had the special opportunities of becoming acquainted with his clientele, and if the protection is no more than adequate

18 *Pharmaceutical Society of Great Britain v Dickson* [1970] AC 403, [1968] 2 All ER 686.

19 It was held in *Eastham v Newcastle United Football Club* [1964] Ch 413, [1963] 3 All ER 139, that the rules of the Football Association and the Football League relating to the retention and transfer of professional footballers were not justified by any interest capable of protection. Some protection will be granted to trade secrets and trade connection even if there is no express term. *Faccenda Chicken Ltd v Fowler* [1987] Ch 117, [1986] 1 All ER 617.

20 *Hagg v Darley* (1878) 47 LJ Ch 567; *Caribonum Co Ltd v Le Couch* (1913) 109 LT 587; *Haynes v Doman* [1899] 2 Ch 13.

1 (1918) 35 TLR 87.

2 *Commercial Plastics Ltd v Vincent* [1965] 1 QB 623, [1964] 3 All ER 546.

3 [1916] 1 AC 688.

for this purpose it is permitted by the law.[4] The difficulty, however, is to specify the kind of business or the class of servant in respect to which this protection is legitimate. What servants acquire such an intimate knowledge of customers as to make the misuse of their knowledge a potential source of danger to their masters? The answer must depend upon the nature of the business and the nature of the employment entrusted to the servant. In one case Romer LJ proposed a test that would seem to be too wide. He said:

> It is, in my opinion, established law that where an employee is being offered employment which will probably result in his coming into direct contact with his employer's customers, or which will enable him to obtain knowledge of the names of his employer's customers, then the covenant against solicitation is reasonably necessary for the protection of the employer.[5]

This, however, is surely too sweeping, for most shop assistants come into direct contact with customers, and even where this is not so they frequently have access to lists of clients. In *Herbert Morris Ltd v Saxelby*, Lord Parker stressed that, before any restraint is justifiable, the servant must be one who will acquire, not merely knowledge of customers, but in addition influence over them.[6] It seems a reasonable and workable criterion. A restraint is not valid unless the nature of the employment is such that customers will either learn to rely upon the skill or judgement of the servant or will deal with him directly and personally to the virtual exclusion of the master, with the result that he will probably gain their custom if he sets up business on his own account.

Restraints against the invasion of trade connection have been upheld in the case of a solicitor's clerk,[7] a tailor's cutter-fitter,[8] a milk roundsman,[9] a stockbroker's clerk,[10] the manager of a brewery[11] and an estate agent's clerk.[12] On the other hand, they have been disallowed in the case of a grocer's assistant;[13] in the case of a bookmaker's 'manager who had no personal contact with his employer's clients, since the business was conducted mostly by telephone';[14] and in a case where the restriction against future competition, imposed upon the traveller of a firm supplying accessories to the lighting system of motor cars, extended to retailers in the prescribed area even though he might never visit them during his employment.[15]

A restraint is permissible if it is designed to prevent a misuse of trade secrets or business connection, but it will be invalid if it affords any more than adequate protection to the covenantee. In deciding this question the court considers, inter alia, the nature and extent of the trade and of the servant's employment therein, but it pays special attention to the two factors of time and

4 *Dewes v Fitch* [1920] 2 Ch 159 at 181-182, per Warrington LJ.
5 *Gilford Motor Co v Horne* [1933] Ch 935 at 966.
6 [1916] 1 AC 688 at 709.
7 *Fitch v Dewes* [1921] 2 AC 158.
8 *Nicoll v Beere* (1885) 53 LT 659; cf *Attwood v Lamont* [1920] 3 KB 571, p 474, below where the restraint might have been valid had it been less widely framed.
9 *Cornwall v Hawkins* (1872) 41 LJ Ch 435.
10 *Lyddon v Thomas* (1901) 17 TLR 450.
11 *White, Tomkins and Courage v Wilson* (1907) 23 TLR 469.
12 *Scorer v Seymour-Johns* [1966] 3 All ER 347, [1966] 1 WLR 1419, distinguishing *Bowler v Lovegrove* [1921] 1 Ch 642.
13 *Pearks Ltd v Cullen* (1912) 28 TLR 371.
14 *S W Strange Ltd v Mann* [1965] 1 All ER 1069, [1965] 1 WLR 629.
15 *Gledhow Autoparts Ltd v Delaney* [1965] 3 All ER 288, [1965] 1 WLR 1366.

area.[16] 'As the time of restriction lengthens or the space of its operation grows, the weight of the onus on the convenantee to justify it grows too.'[17]

There are many instances of a restraint being invalidated by the excessive area of its sphere of intended operation. Thus contracts have been held void where an agent employed to canvass for orders in Islington was restricted from trading within twenty-five miles of London;[18] where a junior reporter of the *Sheffield Daily Telegraph* agreed that he would not be connected with any other newspaper business carried on within twenty miles of Sheffield;[19] where a traveller for a firm of brewers was restrained, without limit of area, from being concerned in the sale of ale or porter brewed at Burton;[20] where the manager of a butcher's shop at Cambridge agreed not to carry on a similar business within a radius of five miles from the shop;[1] and where an assistant to a dentist carrying on business in London agreed that he would not practise in any of the other towns in England or Scotland where the covenantee might happen to practise before the end of the covenantor's employment.[2] Nevertheless, everything depends upon the circumstances, and these may well justify a far wider restraint than those repudiated in the above examples. A restriction extending throughout the United Kingdom has been allowed,[3] and in one case the Eastern Hemisphere was regarded as a reasonable area.[4] It is not necessary for the covenantee to prove that the business, for the protection of which the restraint was imposed, has in fact been carried on in every part of the area specified in the contract.[5]

A restraint may be invalid on the ground that its duration is excessive.[6] The burden on the covenantee to prove the reasonableness of the covenant is increased by the absence of a time limit, but it by no means follows that a restraint for life is void. In *Fitch v Dewes*,[7] for instance, a contract was enforced by which a solicitor's clerk at Tamworth agreed that, after leaving his employer, he would never practise within seven miles of Tamworth Town Hall.

There are, indeed, many cases in which restraints have been upheld notwithstanding that they have been unlimited as regards both area and time, but all decisions prior to *Mason's* case in 1913,[8] which as we have seen revolutionised the law by adopting Lord Macnaghten's test, should be viewed with suspicion. As Younger LJ remarked in 1920:

16 *Badische Anilin und Soda Fabrik v Schott, Segner & Co* [1892] 3 Ch 447 at 451, per Chitty J. Where the covenant is in general terms, it may be permissible for the court to construe it as no wider than reasonable: *Littlewoods Organisation Ltd v Harris* [1978] 1 All ER 1026, [1977] 1 WLR 1472.

17 *Attwood v Lamont* [1920] 3 KB 571 at 589, per Younger LJ.

18 *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724.

19 *Leng & Co Ltd v Andrews* [1909] 1 Ch 763.

20 *Alisopp v Wheatcroft* (1872) LR 15 Eq 59.

1 *Empire Meat Co Ltd v Patrick* [1939] 2 All ER 85.

2 *Mallan v May* (1843) 11 M & W 653.

3 *E Underwood & Son Ltd v Barker* [1899] 1 Ch 300.

4 *Lamson Pneumatic Tube Co v Phillips* (1904) 91 LT 363 (pneumatic tube system for use in shops was invented in the Western hemisphere and practically unknown in the Eastern hemisphere).

5 *Connors Bros Ltd v Connors* [1940] 4 All ER 179.

6 *Eastes v Russ* [1914] 1 Ch 468 (a lifetime's restraint imposed upon an assistant to a pathologist); *Wyatt v Kreglinger and Fernau* [1933] 1 KB 793; *M and S Drapers (a firm) v Reynolds* [1956] 3 All ER 814, [1957] 1 WLR 9; *Stenhouse Australia Ltd v Phillips* [1974] AC 391, [1974] 2 All ER 117.

7 [1921] 2 AC 158.

8 *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724.

> Restrictive covenants imposed upon an employee which a few years ago would not have seemed open to question would now, I think, with equal certainty be treated as invalid.[9]

The courts are astute to prevent an employer from obtaining by indirect means a protection against competition that would not be available to him by an express contract with his employee. In *Bull v Pitney-Bowes Ltd*,[10] for instance:

> The plaintiff was employed by the defendants, manufacturers of postal franking machines, and it was a condition of his employment that he should become a member of a non-contributory pension scheme. Rule 16 of this scheme provided that a retired member should be liable to forfeit his pension rights if he engaged in any activity or occupation which was in competition with or detrimental to the interests of the defendants.
>
> After twenty-six years service the plaintiff voluntarily retired and joined another company carrying on a business similar to that of the defendants. On being warned that he might lose his pension unless he left his new employment, he sued for a declaration that rule 16 was an unreasonable restraint of trade and therefore void.

If the rule fell to be classified as a restraint of trade, it was manifestly void, since inter alia it was unlimited in duration and area of operation, but the defendants contended that it merely defined the beneficiaries of the pension fund. Thesiger J, following the earlier case of *Wyatt v Kreglinger and Fernau*,[11] rejected this contention. He held that the provisions of the pension fund, including rule 16, were part of the terms of the plaintiff's employment, and that on grounds of public policy this rule was to be treated as equivalent to a covenant in restraint of trade. It was contrary to public policy that the community should be deprived of the services of a man skilled in a particular trade or technique.[12] Another case which bears on this problem of indirect evasion is *Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd*[13] where two companies, manufacturers of similar products, agreed that neither would employ any servant who had been employed by the other during the last five years. The defendants broke their promise, and in the resulting action the arguments and the decision turned solely upon whether the agreement was unreasonable as between the parties. The Court of Appeal held it to be unreasonable in this respect, since it imposed upon the parties a restraint grossly in excess of what was adequate to prevent a misuse of their trade secrets and confidential information.

But Lord Reid and Lord Hodson have since observed that it would have been more correct to have stigmatised the agreement as contrary to the public

9 *Dewes v Fitch* [1920] 2 Ch 159 at 185.

10 [1966] 3 All ER 384, [1967] 1 WLR 273.

11 [1933] 1 KB 793; p 456, above.

12 Thesiger J accepted the reasoning in *Wyatt v Kreglinger and Fernau*, but reached a contrary result. In *Wyatt's* case the plaintiff lost his pension, in *Bull's* case he won it. The reason is clear. In the former case, assuming that there was a contract at all, the covenant in restraint of trade was the only consideration for the promise to give him a pension; in *Bull's* case the covenant formed part of a general agreement for which, apart from the void covenant, there was sufficient consideration. It was held, therefore, that the covenant could and should be severed, with the result that the promise to give the pension was untainted and enforceable; as to severance, see pp 470 ff, below.

13 [1959] Ch 108, [1958] 2 All ER 65.

interest.[14] It is respectfully submitted that this is a just criticism. The agreement was clearly designed to prevent employees from moving from one firm to the other in search of higher wages, but had the defendants attempted to do this by taking covenants against competition from individual employees the attempt would have failed. It is against the interests of the state that a man should be allowed to contract out of his right to work for whom he will. It would surely make a mockery of public policy if this liberty could be effectively restricted by a contract between third parties.[15]

b Restraints accepted by the vendor of a business

Although this type of restraint is more readily upheld than one imposed upon a servant, it will not be enforced unless it is connected with some proprietary interest in need of protection.[16] This requirement has at least two repercussions in the present class of contract.

First, there must be a genuine, not merely a colourable, sale of a business by the covenantor to the covenantee. This essential is well illustrated by *Vancouver Malt and Sake Brewing Co Ltd v Vancouver Breweries Ltd*[17] where the facts were these:

> The appellants held a brewer's licence in respect of their premises under which they were at liberty to brew beer. In fact, however, they brewed only sake, a concoction much appreciated by Japanese. The respondents held a similar licence and did in fact brew beer. The appellants purported to sell the goodwill of their brewer's licence, except so far as sake was concerned, and agreed not to manufacture beer for fifteen years.

Since the appellants were not in fact brewers of beer, the contract transferred to the respondents no proprietary interests in respect of which any restraint was justifiable. The covenant was a naked covenant not to brew beer, and as such it was void.

Secondly, it is only the actual business sold by the covenantor that is entitled to protection. In *British Reinforced Concrete Engineering Co Ltd v Schelff*[18] for instance:

> The plaintiffs carried on a large business for the manufacture and sale of 'BRC' road reinforcements; the defendant carried on a small business for the sale of 'Loop' road reinforcements. The defendant sold his business to the plaintiffs and agreed not to compete with them in the manufacture or sale of road reinforcements.

The covenant was void. All that the defendant transferred was the business of selling the reinforcements called 'Loop'. It was, therefore, only with regards to that particular variety that it was justifiable to curb his future activities.

An express covenant by a vendor not to carry on a business similar to that which he has sold may, therefore, be valid, but only if it is no wider than is

14 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 300 and 319. This was the view taken by Lloyd Jacob J in the court of first instance in *Kores Manufacturing Co Ltd v Kolok Manufacturing Co* [1957] 3 All ER 158, [1957] 1 WLR 1012.

15 The question of indirect evasion was mentioned by the Court of Appeal in the *Kores* case but was left open.

16 P. 458, above.

17 [1934] AC 181.

18 [1921] 2 Ch 563.

necessary for the adequate protection of the proprietary interest acquired by the purchaser. In considering this question, the court, as in the case of an employee's contract, pays special attention to the two factors of time and area. If there is no limit of time[19] or no reasonable limit of area[20] a restraint may be invalidated. Nevertheless, everything depends upon the circumstances, and a covenant which extends over the whole of the United Kingdom[1] or throughout the Dominion of Canada[2] or over the whole world,[3] or which restricts the covenantor for the remainder of his life,[4] may be valid in appropriate circumstances.

c Restraints arising from combinations for the regulation of trade relations

It frequently happens that manufacturers or traders form an association with the object of restricting the output or maintaining the selling price of certain commodities. At common law, a combination of this nature may be void as being in excessive restraint of trade. Whether it is so or not is determined according to the principles described above. The restriction is prima facie void and it cannot be enforced unless it is reasonable between the parties and consistent with the interests of the public.[5]

In applying these principles, however, the courts have in the past borne in mind the difference of environment in the various types of contract in restraint of trade. While they have looked jealously at a restraint imposed upon a servant, they have been unsympathetic to a trader who, having voluntarily entered into a restrictive arrangement with other traders, attempts to escape from his obligation by the plea that he has imposed an unreasonable burden upon himself.[6] In commercial agreements of this kind, the parties themselves are the best judges of their own interests.[7] This disfavour, indeed distaste, for a plea that sounds peculiarly ill in the mouth of a man of business who has negotiated on an equal footing with the other members of the combination is well illustrated by *English Hop Growers v Dering*,[8] where the defendant had agreed to deliver to the plaintiff association, of which he was a member, all hops grown on his land in 1926: short shrift was given by the court to his contention that this restriction upon his power of disposal was unreasonable. Growers were faced with ruin owing to excessive stocks of hops accumulated during government control in the 1914-1918 war, and the association had been formed in order to ensure that in any year when there was a surplus the inevitable loss to members should be reduced to a minimum and should be equitably distributed among them. In the words of Scrutton LJ:

19 *Pellow v Ivey* (1933) 49 TLR 422.
20 *Goldsoll v Goldman* [1915] 1 Ch 292.
1 *Leather Cloth Co v Lorsont* (1869) LR 9 Eq 345.
2 *Connors Bros Ltd v Connors* [1940] 4 All ER 179.
3 *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] AC 535, pp 450-452, above.
4 *Elves v Crofts* (1850) 10 CB 241.
5 *McEllistrim v Ballymacelligott Co-operative Agricultural and Dairy Society* [1919] AC 548 at 562, per Lord Birkenhead.
6 *English Hop Growers v Dering* [1928] 2 KB 174 at 181, per Scrutton LJ.
7 *North-Western Salt Co Ltd v Electrolytic Alkali Co Ltd* [1914] AC 461 at 471, per Lord Haldane.
8 [1928] 2 KB 174. See also *Birtley and District Co-operative Society Ltd v Windy Nook and District Industrial Co-operative Society Ltd (No 2)* [1960] 2 QB 1, [1959] 1 All ER 623.

> I see nothing unreasonable in hop growers combining to secure a steady and profitable price, by eliminating competition amongst themselves, and putting the marketing in the hands of one agent, with full power to fix prices and hold up supplies, the benefit and loss being divided amongst the members.[9]

Everything, however, depends upon the circumstances, and a different decision was reached by the House of Lords in *McEllistrim v Ballymacelligott Co-operative Agricultural and Dairy Society*:[10]

> The respondent society manufactured cheese and butter from milk supplied by its members. The rules of the society provided that no member should sell milk to any other person without the consent of a committee; that no member should be entitled to withdraw from the society unless his shares were transferred or cancelled; and that the consent of the committee, which might be refused without giving reasons, should be essential to the effectiveness of such a transfer or cancellation.

It is not surprising that this arrangement was held to be unreasonable between the parties. The society, no doubt, was entitled to such a degree of protection as would ensure stability in the supply of milk. It was not entitled to impose a life-long embargo upon the trading freedom of its members. The obligation of a member to allocate all his milk to the society was to endure for his life, unless he was fortunate enough to obtain the sanction of the committee to a transfer of his shares. Therefore, as Lord Birkenhead remarked, a member, if he joined the society young enough and lived long enough, would be precluded for a period of sixty years or more from selling his milk in the free market.[11] The arrangement was an attempt to eliminate competition altogether and was void.

d Restrictions accepted by distributors of merchandise

It not infrequently happens that a manufacturer or a wholesaler refuses to make merchandise available for distribution to the public unless the distributor accepts certain conditions that restrict his liberty of trading. The object may be, for instance, to prevent him from selling similar goods supplied by competitors of the manufacturer. Such was the main purpose of the *solus* agreements that were discussed in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd*.[12]

The primary question that arose in this case was whether the agreements were caught by the doctrine of restraint of trade. Nothing need be added to the account already given of this aspect of the dispute.[13] But, having decided that the doctrine applied to the facts, the House of Lords then considered the second question, namely, whether the restrictions were nevertheless justifiable and enforceable on the ground that they were reasonable and not in conflict with the requirements of public policy. On this aspect of the case, it was held that there was nothing unreasonable in the adoption by the parties of the *solus* system. They both benefited. The Esso firm were able to organise a more efficient and economical system of distribution; the distributor not only

9 [1928] 2 KB 174 at 181, [1928] All ER 396 at 400.
10 [1919] AC 548.
11 Ibid at 564.
12 [1968] AC 269, [1967] 1 All ER 69. For the facts, see p 455, above.
13 Pp 453–456, above.

gained a rebate on the wholesale price of petrol, but if short of funds he could rely on the financial backing of a powerful corporation. Nevertheless, tying agreements of this nature, though reasonable in general, will become unreasonable if made to endure for an excessive period. In the instant circumstances, four-and-a-half years was reasonable, twenty-one years was unreasonable. Therefore the first contract was valid, the second was void.[14]

The majority of their Lordships emphasised that, since a restraint of trade implies that the covenantor agrees to surrender some freedom which otherwise he would enjoy, a distinction must be drawn between a convenantor who is already in possession of the garage site when he enters into a *solus* agreement with an oil company, and one who obtains possession from the company after the agreement has been made. In the latter case, the fact that he surrenders no freedom previously enjoyed by him must have a significant bearing upon the question whether the restraint is reasonable.[15] In the later case of *Cleveland Petroleum Co Ltd v Dartstone Ltd*,[16] the Court of Appeal stressed the merit of this distinction and laid down the rule that where a person takes possession of premises under a *solus* agreement, not having been in possession previously, the restrictions placed upon his trading activities are prima facie binding upon him. But the presumption in favour of their validity will be rebutted, it would seem, if the inference from the relevant circumstances is that their enforcement will manifestly be detrimental to the interests of the public. If this were not so, it would be possible to avoid a rule of public policy by a mere conveyancing device. That the question is one of substance and not of form is clearly shown by the decision of the Privy Council in *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd*.[17]

An analogy to the restriction placed upon the distributor in these cases is furnished by that type of exclusive agreement by which a trader promises to take all the goods of a particular kind required in his business from one supplier. Such was the case in *Servais Bouchard v Prince's Hall Restaurant Ltd*[18] where the plaintiff was given the exclusive right for an indefinite period of supplying burgundy to a restaurant keeper. In the Court of Appeal two views were expressed upon the question whether this agreement was subject to the doctrine of restraint of trade. The majority view, which would seem to be preferable, was that it was prima facie void and therefore in need of justification; but Henn Collins MR considered that it was not caught by the doctrine. In the result, however, it was unanimously held that in the instant circumstances the restraint was justifiable as being reasonable.

Similar considerations apply to a contract for exclusive services. So in *A Schroeder Music Publishing Co Ltd v Macaulay*.[19]

14 Distinguishing *Petrofina (Great Britain) Ltd v Martin* [1966] Ch 146, [1966] 1 All ER 126. In *Alec Lobb (Garages) Ltd v Total Oil (GB) Ltd* [1985] 1 All ER 303 the Court of Appeal upheld a restraint for 21 years as reasonable in all the circumstances.

15 *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 298 (Lord Reid); at 309 (Lord Morris of Borth-y-Gest); at 316-317 (Lord Hodson); at 325 (Lord Pearce). Lord Pearce, indeed, citing the analogy of the tie between a publican and brewer expressed the view that if a man takes a lease of land subject to a tie, thereby obtaining favourable terms, he cannot repudiate the tie and retain the benefits. The doctrine of restraint of trade is altogether excluded.

16 [1969] 1 All ER 201, [1969] 1 WLR 116.

17 [1975] AC 561, [1975] 1 All ER 968 and see also *Alec Lobb (Garages) Ltd v Total Oil (GB) Ltd* [1985] 1 All ER 303, [1985] 1 WLR 173, CA.

18 (1904) 20 TLR 574.

19 [1974] 3 All ER 616, [1974] 1 WLR 1308. See also *Clifford Davis Management Ltd v WEA Records Ltd* [1975] 1 All ER 237, [1975] 1 WLR 61.

> The plaintiff, a young and unknown song writer, entered into a contract with the defendants, a music publishing company, on their standard terms. Under the contract the plaintiff assigned the world copyright in any musical composition produced by him solely or jointly. The defendants did not undertake to exploit all or any of the compositions though they agreed to pay royalties on those in fact exploited. The agreement was to run for five years but to be automatically extended for a further five years if the royalties reached a total of £5,000. The defendants could terminate the agreement at any time by giving a month's notice, but there was no similar provision in favour of the plaintiff.

The House of Lords had no difficulty in holding that such an agreement was within the ambit of restraint of trade and that this particular agreement was unreasonable since the terms combined a total commitment by the plaintiff with a striking lack of obligation on the defendant.

These rules of the common law which have brought within the doctrine of restraint of trade restrictions, designed by manufacturers or distributors of goods to stifle competition, have lost much of their value. Their practical importance has been greatly reduced as a result of legislative changes effected since World War II. These changes are discussed in Chapter 10.

2 The legal consequences

A THE CONTRACT IS VOID IN SO FAR AS IT CONTRAVENES PUBLIC POLICY

Contracts that tend to oust the jurisdiction of the courts or to prejudice the status of marriage and contracts in restraint of trade, though contrary to public policy, are by no means totally void. Suppose, for instance, that as part of a contract of employment a servant enters into a contract in restraint of trade which is in fact excessively wide and therefore void. Is it to be said that this invalidity affects the whole contract and precludes the servant from suing for wrongful dismissal or the master from recovering damages if the servant leaves without due notice? It is clear that the law does not go to these lengths.[20] The truth of this was recognised as far back as 1837 by Lord Abinger in *Wallis v Day*.[1] In that case the plaintiff had sold his business of a carrier to the defendant and had agreed, in return for a weekly salary of £2 3s 10d, to serve the defendant as assistant for life. He further agreed that, except as such assistant, he would not for the rest of his life exercise the trade of a carrier. In an action brought by the plaintiff to recover eighteen weeks' arrears of salary, the defendant demurred on the ground that the agreement, being in restraint of trade, was void and that no part of it was enforceable. It became unnecessary to decide this point, since the court held the restraint to be reasonable, but Lord Abinger dealt with the demurrer as follows:

> The defendant demurred, on the ground that this covenant, being in restraint of trade, was illegal, and that therefore the whole contract was void. I cannot

20 *Bennett v Bennett* [1952] 1 KB 249 at 260, [1952] 1 All ER 413 at 421; see also Salmond and Williams *The Law of Contract* p 375.

1 (1837) 2 M & W 273.

> however accede to that conclusion. If a party enters into several covenants, one of which cannot be enforced against him, he is not therefore released from performing the others. And in the present case, the defendants might have maintained an action against the plaintiff for not rendering them the services he covenanted to perform, there being nothing illegal in that part of the contract.[2]

The same reasoning was adopted in a later case,[3] where pensions were payable under a trust which, in one of its clauses, imposed an excessive restraint upon the pensioners. Eve J directed that the trust might lawfully be carried out, since it was not invalidated merely because the restraint might be declared void in future litigation. It was impossible, he said, to regard the trust as destroyed by the invalidity of one of its clauses. Any doubt that might still have survived was finally dispelled in two modern cases where the Court of Appeal held that the invalidity of a promise which is contrary to public policy does not nullify the whole contract, but that the valid promises, if severable, remain fully enforceable.[4]

In short, the invalidity of the class of contract now being considered goes no further than is necessary to satisfy the requirements of public policy. Unless the offending clause is in question in the actual litigation, it has no effect upon the validity of the contract.

B MONEY PAID OR PROPERTY TRANSFERRED BY ONE PARTY TO THE OTHER IS RECOVERABLE

Suppose that the vendor of a business agrees not to compete with the purchaser and that as security for this undertaking he deposits a sum of money with the purchaser. If this restraint against competition is held to be excessive and void, is the vendor precluded from recovering the deposit? It would seem on principle that the right of recovery is unaffected. The contract is not improper in itself, and it would be extravagant to suggest that the whole transaction is so objectionable as to be caught by the maxim *ex turpi causa non oritur actio*. The decisions are too few to be conclusive one way or the other, but there is authority for the view that equity at least does not always regard an infringement of public policy as a bar to relief.[5] Thus Lord Eldon went so far as to say:

> It is settled, that if a transaction be objectionable on grounds of public policy, the parties to it may be relieved; the relief not being given for their sake, but for the sake of the public.[6]

It may be that this statement is too wide in view of the more expanded meaning that has been given to the term 'public policy' since Lord Eldon's day, or it may be that relief will be granted only where one party has been less guilty than the other,[7] but at any rate it is well established that money paid under a

2 Ibid at 280-281.
3 *Re Prudential Assurance Co's Trust Deed* [1934] Ch 338.
4 *Bennett v Bennett* [1952] 1 KB 249, [1952] 1 All ER 413; *Goodinson v Goodinson* [1954] 2 QB 118, [1954] 2 All ER 255. As to when the promises may be severed, see pp 470 ff, below.
5 Ashburner *Principles of Equity* (2nd edn) p 471.
6 *Vauxhall Bridge Co v Earl Spencer* (1821) Jac 64 at 67.
7 *Reynell v Sprye* (1851) 1 De GM & G 656 at 678-679, per Knight Bruce LJ.

marriage brokage contract is recoverable both at common law and in equity. This was decided in *Hermann v Charlesworth*,[8] where the facts were as follows:

> Charlesworth agreed that he would introduce gentlemen to Miss Hermann with a view to matrimony, in consideration of an immediate payment of £52 and a payment of £250 on the day of the marriage. He introduced her to several gentlemen and corresponded with others on her behalf, but his efforts were fruitless. Miss Hermann sued for the return of the £52 and was successful.

Her right at common law rested on the principle that money deposited to abide the result of an event is recoverable if the event does not happen. No marriage had taken place and there had been a total failure of consideration. But quite apart from this she was entitled to exploit the wider form of relief granted by equity. Sir Richard Henn Collins, citing the old case of *Goldsmith v Bruning*[9] amongst other authorities, showed that equity did not apply the rigid test of total failure of consideration, but so disliked contracts of this type that it was prepared to grant relief even after the marriage had been solemnised.

It is difficult to believe that the court would nowadays apply a more stringent test than this to a contract in restraint of trade. If money paid under a marriage brokage contract is recoverable, on what sensible ground can recovery of payments made under a contract in restraint of trade be refused?

C SUBSEQUENT TRANSACTIONS ARE NOT NECESSARILY VOID

It has already been seen that if a contract as formed is illegal at common law, then any transaction which is founded on and springs from it is void.[10] This is not the case with the contracts under discussion. They are not illegal nor, indeed, are they void *in toto*. It follows that subsequent contracts are void only so far as they are related to that part of the original contract that is itself void. Suppose, for instance, that the vendor of a business agrees to terms which are unreasonably wide, not to compete with the purchaser and that after committing a breach of this void undertaking he executes a bond agreeing to pay £1,000 to the purchaser by way of reparation. It goes without saying that no action will lie on the bond. It is impossible to divorce the apparently valid promise of payment from the void restraint. If, on the other hand, the title to part of the premises conveyed with the business turned out to be defective, and the vendor agreed to compensate the purchaser with the payment of £1,000, there would be no obstacle to the recovery of this sum.

D THE CONTRACT, IF SUBJECT TO A FOREIGN LAW BY WHICH IT IS VALID, IS ENFORCEABLE IN ENGLAND

We have seen that a foreign contract which contravenes what is regarded in England as an essential moral interest is not enforceable by action in this

8 [1905] 2 KB 123.
9 (1700) 1 Eq Cas Abr 89, pl 4.
10 Pp 437-438, above. *Fisher v Bridges* (1853) 3 E & B 642.

country, notwithstanding that it is valid by its proper law.[11] Such is the case where the principle of morality infringed by the contract is in the English view of so compelling a nature that it must be maintained at all costs and in all circumstances. In other words, certain of the specific rules derived from the doctrine of public policy are of universal, not merely domestic, application. It would be an exaggeration, however, to assert that the three types of contract now being considered offend any principle of so commanding a nature. The reason why these particular contracts are frowned upon by the law is not that they are essentially reprehensible, but that they conflict with the accepted standards of English life. If, for instance, the employee of a Parisian tradesman were to be sued in England for breach of an undertaking never to enter a similar employment anywhere in France, it would be an affectation of superior virtue for the English court to invoke the doctrine of public policy and to dismiss the action, always assuming, of course, that such an undertaking is valid by French law. The position might no doubt be different in the exceptional case where a French contract imposed an unreasonable restraint on competition *in England*.

After certain indeterminate decisions,[12] this view has now prevailed, and it has been held in *Addison v Brown*[13] that a foreign contract of the present class is unaffected by the English doctrine.

> An American citizen, domiciled in California, agreed to pay his wife a weekly sum by way of maintenance, and it was further agreed that neither party should apply to the Californian court for a variation of the agreement and that if in subsequent divorce proceedings the court should provide for maintenance 'the provisions hereof shall control notwithstanding the terms of any such judgment'. Some years later the Californian court granted a decree of divorce at the instance of the husband and incorporated the agreement as part of the divorce.

To an action brought by the wife in England for the recovery of arrears of maintenance, it was objected that her claim was not sustainable, since the agreement was designed to oust the jurisdiction of the Californian court and was therefore contrary to the English doctrine of public policy. The objection failed. It is not the function of the doctrine to dictate to a foreign law whether an agreement of this kind shall be enforceable.

E LAWFUL PROMISES MAY BE SEVERABLE AND ENFORCEABLE[14]

Severance means the rejection from a contract of objectionable promises or the objectionable elements of a particular promise, and the retention of those promises or of those parts of a particular promise that are valid.

11 Pp 439-440, above.

12 *Rousillon v Rousillon* (1880) 14 ChD 351; *Hope v Hope* (1857) 8 De GM & G 731. These are inconclusive because, certainly in the first case and probably in the second, the proper law was English.

13 [1954] 2 All ER 213, [1954] 1 WLR 779. Compare *Bennett v Bennett* [1952] 1 KB 249, [1952] 1 All ER 413.

14 The history of this branch of the law has been long and tortuous and many of the older decisions and judicial generalisations are no longer acceptable. Its development is fully traced by Marsh 64 LQR 230, 347, 69 LQR 111.

It should be noticed at once that this is not allowed in the case of the contracts discussed in the previous chapter and which are illegal at common law as being contrary to public policy.

> If one of the promises is to do an act which is either in itself a criminal offence or *contra bonos mores*, the court will regard the whole contract as void.[15]

On principle the same is true of contracts prohibited by statute, and there is clear authority to that effect;[16] but in at least one case, *Kearney v Whitehaven Colliery Co*[17] the principle seems to have been ignored.

On the other hand, severance may be allowed if the contract is one that is void at common law on grounds of public policy or if it is void by statute, provided in this latter case that the statute, when properly construed, admits the possibility.[18] Most, but by no means all, of the relevant decisions have been concerned with agreements in restraint of trade.

The doctrine of severance in the case of a void contract is used with two meanings to serve two purposes. First, it may be invoked to cut out altogether an objectionable promise from a contract leaving the rest of the contract valid and enforceable, as, for example, where a promise is void as being designed to oust the jurisdiction of the court. In such a case the offending promise is eliminated from the contract. Secondly, severance may operate to cut down an objectionable promise in extent, but not to cut it out of the contract altogether, as, for example, where an agreement in restraint of trade which is void as being unreasonably wide is converted into a valid promise by the elimination of its unreasonable features. In such a case, the promise remains in the contract shorn of its offending parts and so reduced in extent.

To distinguish these two ways in which the doctrine of severance may operate it is not mere pedantry, for the test of severability is not the same in each case. Whether an entire promise may be eliminated from a contract is tested by the rule laid down in *Goodinson v Goodinson*;[19] whether a particular promise may be reduced in extent is governed by the different principle of divisibility laid down in a series of decisions culminating in *Attwood v Lamont*.[20]

i Elimination of a promise

Whether an entire promise may be eliminated from a contract depends upon whether it forms the whole or only part of the consideration. If it is substantially the only return given for the promise of the other party, severance is ruled out and the contract fails *in toto*. If, on the other hand, it goes only to part of the

15 *Bennett v Bennett* [1952] 1 KB 249 at 253-254; *Goodinson v Goodinson* [1954] 2 QB 118 at 120-121. See for example, *Lound v Grimwade* (1888) 39 ChD 605; *Alexander v Rayson* [1936] 1 KB 169; *Napier v National Business Agency Ltd* [1951] 2 All ER 264; *Kuenigl v Donnersmarck* [1955] 1 QB 515 at 537. In *Fielding and Platt Ltd v Selim Najjar Ltd* [1969] 2 All ER 150 at 153, [1969] 1 WLR 357 at 362, Lord Denning MR suggested that an illegal term might be severed from a contract leaving the rest intact. But his statement was clearly an obiter dictum, and it is respectfully submitted that it was made *per incuriam*. The contract before the court was lawful, not illegal, though one party without the knowledge of the other had exploited it illegally. Therefore the innocent could enforce it, and no question of severance arose.

16 *Hopkins v Prescott* (1847) 4 CB 578; *Ritchie v Smith* (1848) 6 CB 462.

17 [1893] 1 QB 700.

18 See, for example, the Race Relations Act 1968, s 23; ss 86, 88 and 89 of Rent Act 1968; *Ailion v Spiekermann* [1976] Ch 158, [1976] 1 All ER 497.

19 See p 471, n 1, below.

20 P 474, below.

consideration—if it is merely subsidiary to the main purpose of the contract—severance is permissible. This distinction was laid down and applied by the Court of Appeal in *Goodinson v Goodinson*.[1]

> A contract made between husband and wife, who had already separated provided, according to the interpretation put upon it by the court, that the husband would pay his wife a weekly sum by way of maintenance in consideration that she would indemnify him against all debts incurred by her, would not pledge his credit and would not take any matrimonial proceedings against him in respect of maintenance.

The last promise thus made by the wife was void since its object was to oust the jurisdiction of the courts, but it was held that this did not vitiate the rest of the contract. It was not the only, and in the view of the court not the main, consideration furnished by the wife. She had also promised to indemnify the husband against her debts and not to pledge his credit. With the exception of the objectionable promise, therefore, the contract stood and the wife was entitled to recover arrears of maintenance.[2]

ii Reduction of a promise

The second question is whether the scope of an individual promise may be reduced without eliminating it *in toto*.

The predominant principle here is that the court will not rewrite the promise as expressed by the parties. It will not add or alter words and thus frame a promise that the promisor might well have made, but did not make,[3] for that would be to destroy the 'main purport and substance' of what has been agreed.[4] The parties themselves must have sown the seeds of severability in the sense that it is possible to construe the promise drafted by them as divisible into a number of separate and independent parts. If this is the correct construction, then one or more of the parts may be struck out and yet leave a promise that is substantially the same in character as that framed by the parties, though it will be diminished in extent by the reduction of its sphere of operation.[5]

In a modern case, it was argued that a clause in a lease was void as purporting to oust the jurisdiction of the court on question of law.[6] Ungoed Thomas J held that the contract, when properly construed, did not have this object in view. Had such been its purpose, it would have been void. But the learned judge also considered what the situation would have been had he

1 [1954] 2 QB 118, [1954] 2 All ER 255. See also *Brooks v Burns Philp Trustee Co Ltd* [1969] ALR 321 and *Stenhouse Australia Ltd v Phillips* [1974] AC 391, [1974] 1 All ER 117. *Carney v Herbert* [1985] AC 301, [1985] 1 All ER 438. *Marshall v NM Financial Management* [1995] 4 All ER 785.

2 The Matrimonial Causes Act 1973, s 7, now provides that the court may approve any agreement made between husband and wife prior to a divorce suit. This provision, however, in no way affects the rule that any agreement whose object is to oust the jurisdiction of the court is void: *Wright v Wright* [1970] 3 All ER 209 at 213, [1970] 1 WLR 1219 at 1223, per Sir Gordon Willmer. See *Hyman v Hyman* [1929] AC 601. See also Matrimonial Causes Act 1973, s 34.

3 *Putsman v Taylor* [1927] 1 KB 637 at 639-640.

4 *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724 at 745, per Lord Moulton.

5 *Attwood v Lamont* [1920] 3 KB 571.

6 *Re Davstone Estates Ltd's Leases, Manprop Ltd v O'Dell* [1969] 2 Ch 378, [1969] 2 All ER 849.

found that the clause did purport to exclude the court's jurisdiction. Might it then have been severed from the contract as a whole? Its severability would have been prima facie possible, since there was no question of illegality and the offending words were subsidiary to the main purpose of the contract. The stumbling-block, however, would have been that the clause had not been so drafted as to enable these words to be deleted without altering the general character of the contract. The removal of the objectionable clause would have required the contract to be remodelled; and this was not within the province of the court.

The possibility of reducing the scope of promise without eliminating it *in toto* has often arisen in cases of restraint of trade. If a promise not to compete against an employer or against the purchaser of a business is void as being unreasonably wide, the promisee may argue that it may and should be reduced to reasonable dimensions and thus be rendered enforceable.

A clear example of a promise that, according to the language used by the parties, was divisible in the above sense was *Price v Green*[7] where the seller of a perfumery business, apparently carried on in London, agreed with the purchaser that he would not carry on a similar business 'within the cities of London or Westminster or within the distance of 600 miles from the same respectively'. The promise was held to be valid so far as it related to London and Westminster, but void as to the distance of 600 miles. The substantial character of the promise remained unimpaired, despite the loss of one of its parts. Again, in *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co*,[8] as we have already seen, the House of Lords allowed the severance of a covenant against competition that was clearly divisible into two parts, one reasonable the other not.

On the other hand, where the promise is indivisible, where it cannot be construed as falling into distinct parts, severance is ruled out, for to attempt it would inevitably result in an agreement different in nature from that made by the parties. In *Baker v Hedgecock*,[9] for instance:

> A foreman cutter entered the service of the plaintiff, a tailor carrying on business at 61 High Holborn, and agreed that for a period of two years after leaving the employment he would not carry on, either on his own account or otherwise, *any business whatsoever* within a distance of one mile from 61 High Holborn. After his dismissal he set up as a tailor within 100 yards of that address.

The plaintiff admitted that the agreement, since it extended to any business whatsoever, was so wide as to be unreasonable, but he asked the court 'to treat the covenant as divisible, and to enforce it to the extent to which it is reasonable, while declining to enforce such part of it as is unreasonable'.[10] In refusing this request, Chitty J illustrated the fallacy of the plaintiff's argument in these words:

7 (1847) 16 M & W 346. See also *Scorer v Seymour-Johns* [1966] 3 All ER 347, [1966] 1 WLR 1419 (restraint imposed on employee); *Macfarlane v Kent* [1965] 2 All ER 376, [1965] 1 WLR 1019 (restraint imposed on expelled partner); *Bull v Pitney-Bowes* [1966] 3 All ER 384, [1967] 1 WLR 273.

8 Pp 450–452, above. See also *Nicholls v Stretton* (1847) 10 QB 346, *Goldsoll v Goldman* [1915] 1 Ch 292; *Putsman v Taylor* [1927] 1 KB 637.

9 (1888) 39 ChD 520.

10 Ibid at 521, per counsel.

> Thus if the covenant were, eg, not to carry on a business in any part of the whole world, the Court would be asked to uphold it by construing it as a covenant not to carry on the business within, say, a limit of two miles, which would in effect be making a new covenant, not that to which the parties agreed. In *Price v Green* there were in fact two covenants, or one covenant which was capable of being construed divisibly.[11]

A comparison of the two leading cases of *Attwood v Lamont* and *Goldsoll v Goldman* may illustrate the nice problems of discrimination that may arise in this branch of the law. In *Attwood v Lamont*:[12]

> A carried on business as a draper tailor and general outfitter in a shop at Kidderminster which was organised in several different departments each with a manager. X, who was head cutter and manager of the tailoring department but who had nothing to do with the other departments, agreed that he would not at any time either on his own account or on behalf of anybody else carry on the trades of a tailor, dressmaker, general draper, milliner, hatter, haberdasher, gentlemen's, ladies' or children's outfitter at any place within ten miles of Kidderminster.

The question was whether any part of the agreement could be enforced. It would have been legitimate to restrain the improper use by X of the knowledge of customers acquired by him in his capacity as manager of the tailoring department. But the restraint as drafted, since it affected trade in other departments where he would not meet customers, admittedly gave A more than adequate protection. It was argued, however, that the agreement ought to be severed and limited to the business of a tailor.

The divisional court allowed this severance. It took the view that the agreement constituted 'a series of distinct obligations in separate and clearly defined divisions',[13] and that it was possible to run a blue pencil through all the trades except that of tailoring without altering the main 'purport and substance'[14] of what the parties had written. The Court of Appeal unanimously reversed this decision. It took the view that the parties had made a single indivisible agreement the substantial object of which was to protect the entire business carried on by the employer. Younger LJ summarised this view as follows:

> The learned judges of the divisional court, I think, took the view that such severance always was permissible when it could be effectively accomplished by the action of a blue pencil. I do not agree. The doctrine of severance has not, I think, gone further than to make it permissible in a case where the covenant is not really a single covenant but is in effect a combination of several distinct covenants. In that case and where the severance can be carried out without the addition or alteration of a word, it is permissible. But in that case only.
>
> Now, here, I think, there is in truth but one covenant for the protection of the respondent's entire business, and not several covenants for the protection of his several businesses. The respondent is, on the evidence, not carrying on several businesses but one business, and, in any opinion this covenant must stand or fall in its unaltered form.[15]

11 Ibid at 522-523, see also *Continental Tyre and Rubber (Great Britain) Co Ltd v Heath* (1913) 29 TLR 308.
12 [1920] 3 KB 571.
13 [1920] 2 KB 146 at 159.
14 Ibid at 156.
15 [1920] 3 KB at 598.

In *Goldsoll v Goldman*:[16]

> The defendant, who carried on a business in London for the sale of imitation jewellery, sold his business to the plaintiff and agreed that for a period of two years he would not, either solely or jointly, deal in real or imitation jewellery in any part of the United Kingdom or in France, USA, Russia or Spain, or within twenty-five miles of Potsdammerstrasse, Berlin, or St Stefans Kirche, Vienna.

The extension of the restraint to the whole of the United Kingdom was reasonable, for the plaintiff, who had for a considerable time carried on a similar business in London, gained most of his customers from advertisements in the illustrated papers which circulated throughout the country. It was held that the contract could and must be severed in two respects: first, the area outside the United Kingdom must be removed from it; secondly, the prohibition against dealing in real jewellery must also be removed.

The question is whether this decision can be reconciled with that in *Attwood v Lamont*. The crux of the matter seems to be whether in each of these cases the contract as framed by the parties was divisible into a number of separate promises, for if so, and only if so, the elimination of one or more of the objectionable promises would still leave the substantial character of the contract unchanged. It may perhaps fairly be said that this basic element of divisibility, while present in *Goldsoll v Goldman*, was absent in *Attwood v Lamont*,[17] for in the latter case the enumeration of the various trades was only a laborious description of the entire business carried on by the employer. Since the contract was essentially indivisible, it had to stand or fall as originally drafted.

It has been thought, however, that the reconciliation of these two decisions is to be found in the fact that the one concerned a service contract, the other a contract for a sale of a business, for it is now generally accepted that the latter merits a less rigorous treatment than the former. It is only common justice that the purchaser shall be able to reap the benefit of what he has bought, and therefore the courts are more astute than they would be in the case of a service contract to construe an agreement by the seller not to compete as a combination of several distinct promises. This distinction was viewed with apparent approval by the Court of Appeal in *Ronbar Enterprises Ltd v Green*[18] (a case of vendor and purchaser) but it was disapproved in *T Lucas & Co Ltd v Mitchell*[19] (a case of master and servant).

16 [1915] 1 Ch 292.

17 [1954] 2 All ER 266, [1954] 1 WLR 815, where the court merely expunged two words from what appears to have been an indivisible covenant. See also Lord Moulton in *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724 at 745.

18 [1974] Ch 129, [1972] 3 All ER 689.

Chapter 13

Capacity of parties

SUMMARY

1 Minors[1]

A THE EFFECT OF CONTRACTS MADE BY MINORS

Contracts made by minors, ie persons under eighteen years of age,[2] are governed by the rules of common law as altered by the Minors' Contracts Act 1987.[3]

The general rule at common law was that a contract made by an infant was voidable at his option. The word 'voidable', however, was used in two different senses. Certain contracts were voidable in the sense that they were valid and binding upon him unless he repudiated them before, or within a reasonable time after, the attainment of his majority. Other

1 Until 1969 minors were more usually called infants in the legislation and cases. See Family Law Reform Act 1969, s 12.

2 Family Law Reform Act 1969, s 1. At common law, the age of majority was twenty-one. The Act provides that persons over eighteen but under twenty-one years of age on 1 January 1970, shall be regarded as having attained full age on that day. For a comparative survey of the law, see Hartwig 15 ICLQ 780; Thomas 1972 Acta Juridica 151; Valero 27 ICLQ 215. The Act of 1969 was based on the report of the Committee on the Age of Majority (Cmnd 3342). For reform proposals in other common law jurisdictions see Harland *The Law of Minors in Relation to Contracts and Property*; Pearce 44 ALJ 269; Percy 53 Can Bar Rev 1.

3 Between 1874 and 1987 the law was bedevilled by the Infants' Relief Act 1874, a singularly badly drafted statute. Proposals for reform were made by the Committee on the Age of Majority but not enacted. The 1987 Act arose from proposals made by the Law Commission (Law Com No 134).

contracts were voidable in a different sense, ie they were not binding upon the infant unless ratified by him when he reached 21 years of age.

Two types of transactions, namely beneficial contracts of service and contracts for necessaries, were treated as exceptional. The former were regarded as valid. The latter imposed liability upon the infant, though whether this was of a contractual nature or not was a matter of controversy.

It will be convenient to discuss the different types of transactions in the following order:

1 Contracts for necessaries.
2 Beneficial contracts of service.
3 Voidable contracts.
4 Other contracts.

1 CONTRACTS FOR NECESSARIES

It has been recognised from the earliest times that an infant is obliged to pay for necessaries that have been supplied to him. The word *necessaries* is not confined to articles necessary to the support of life, but includes articles and services fit to maintain the particular person in the station of life in which he moves.[4] So far as concerns goods it has been statutorily defined as meaning 'goods suitable to the condition in life of the minor and to his actual requirements at the time of the sale and delivery'.[5] Perhaps the best statement of the law, at least as applied to nineteenth-century conditions, is that given by Alderson B.

> Things necessary are those without which an individual cannot reasonably exist. In the first place, food, raiment, lodging and the like. About these there is no doubt. Again, as the proper cultivation of the mind is as expedient as the support of the body, instruction in art or trade, or intellectual, moral and religious information may be a necessary also. Again, as man lives in society, the assistance and attendance of others may be a necessary to his well-being. Hence attendance may be the subject of an infant's contract. Then the classes being established, the subject matter and extent of the contract may vary according to the state and condition of the infant himself. His clothes may be fine or coarse according to his rank; his education may vary according to the station he is to fill; and the medicines will depend on the illness with which he is afflicted, and the extent of his probable means when of full age. So again, the nature and extent of the attendance will depend on his position in society ... But in all these cases it must first be made out that the class itself is one in which the things furnished are essential to the existence and reasonable advantage and comfort of the infant contractor. Thus, articles of *mere* luxury are always excluded,[6] though luxurious articles of utility are in some cases allowed.[7]

4 *Peters v Fleming* (1840) 6 M & W 42 at 46-47, per Parke B.
5 Sale of Goods Act 1979, s 3(3). Winfield 58 LQR 82.
6 'Suppose the son of the richest man in the kingdom to have been supplied with diamonds and racehorses, the judge ought to tell the jury that such articles cannot possibly be necessaries': *Wharton v Mackenzie* (1844) 5 QB 606 at 612, per Coleridge J. In that case it was held that fruits, ices and confectionery supplied to an Oxford undergraduate for private dinner parties could not without further explanation be treated as necessaries.
7 *Chapple v Cooper* (1844) 13 M & W 252 at 258. It would appear that in the affluent and permissive society of today many articles that would have ranked as luxurious in the learned baron's time would now be regarded as 'things essential to the existence and reasonable advantage and comfort of the infant contractor'.

Necessaries for the members of a married minor's family are on the same footing as necessaries for himself, and it is well established that he is liable on a contract for the burial of his wife or children.[8]

To render a minor liable for necessaries it must be proved, not only that the goods are suitable to his station in life, but also that they are suitable to his actual requirements at the time of their delivery. If he is already sufficiently provided with goods of the kind in question, then, even though this fact is not known to the plaintiff, the price is irrecoverable.[9]

Thus in a case in 1908, where a Savile Row tailor sought to recover £122 19s 6d for clothes (including eleven fancy waistcoats at two guineas each), supplied to an infant undergraduate at Cambridge, it was held that the action must fail, since the evidence showed that the defendant was already amply supplied with clothing suitable to his position.[10]

Whether articles are necessaries is a question of mixed law and fact.[11] The preliminary question of law for the court is whether in the circumstances the article is capable of being a necessary. The onus of establishing this lies on the plaintiff, who must prove that the goods are of a description reasonably suitable to a person in the station in life of the minor defendant. If he fails, the court rules that there is no evidence on which it can properly find for him, and judgment is declared in favour of the defendant.

Thus in one case it was held that a pair of jewelled solitaires worth £25 and an antique goblet worth fifteen guineas could not possibly be regarded as necessaries for an infant possessing an income of £500 a year.[12] There was no case to be submitted to the jury.

If, however, the court decides that the articles are clearly capable of being necessaries, as, for instance, clothes or food, it is a question of fact whether they are necessaries in the particular circumstances. The actual requirements of the minor must be assessed, and it must be decided whether he was adequately supplied with articles of the kind in question at the time of their delivery.[13] Again, if the article is one which may or may not be necessary, such as a watch, an exceptionally expensive coat or a pair of binoculars, it must be decided whether it is so in fact having regard inter alia to the social standing, profession and duties of the minor.

So in *Peters v Fleming*[14] the court decided that prima facie it was not unreasonable for a minor undergraduate to have a watch and consequently a watch-chain, but they left it to the jury to find whether the gold chain supplied to him on credit was of a kind reasonably suitable for his requirements.

In addition to food, clothing and lodging, the following amongst other things, have been held to be necessaries: uniforms for a member of one of the fighting forces;[15] means of conveyance required by a minor for the exercise of his calling;[16] and legal advice.[17]

8 *Chapple v Cooper*, above.
9 *Barnes & Co v Tove* (1884) 13 QBD 410; *Nash v Inman* [1908] 2 KB 1.
10 *Nash v Inman* [1908] 2 KB 1.
11 *Ryder v Wombwell* (1868) LR 4 Exch 32 at 38.
12 *Ryder v Wombwell*, above.
13 *Nash v Inman* [1908] 2 KB 1.
14 (1840) 6 M & W 42.
15 *Coates v Wilson* (1804) 5 Esp 152.
16 *Barber v Vincent* (1680) Freem KB 531 (horse); *Clyde Cycle Co v Hargreaves* (1898) 78 LT 296.
17 *Helps v Clayton* (1864) 17 CBNS 553.

A contract for the supply even of goods or services that are clearly suitable to the requirements of a minor is void if it contains terms that are harsh and onerous to him.[18] In one case, for instance, a contract by which an infant hired a car for the transport of his luggage was held to be void, since it stipulated that he should be absolutely liable for injury to the car whether caused by his neglect or not.[19] In other words, a contract for necessaries will not be binding unless it is substantially for the benefit of the minor. This rule, however, is not confined to the supply of necessaries. It is only a facet of the wider principle that no contract is binding upon a minor if it is prejudicial to his interests, even one which is normally valid.[20]

What is the basis of minor's liability?

A question that is by no means of purely academic interest is what is the basis of a minor's liability for necessaries? Two conflicting theories have been advocated.

First, he is liable *ex contractu* just as a contracting party of full capacity is liable. 'The plaintiff', said Buckley LJ, 'when he sues the defendant for goods supplied during infancy, is suing him in contract on the footing that the contract was such as the infant, notwithstanding infancy, could make.'[1] Secondly, the minor is liable *re*, not *consensu*. In other words his liability is based, not on contract, but on quasi-contract. He is bound, not because he has agreed, but because he has been supplied.[2]

> The old course of pleading was a count for goods sold and delivered, a plea of infancy, and a replication that the goods were necessaries; and then the plaintiff did not necessarily recover the price alleged, he recovered a reasonable price for the necessaries. That does not imply a consensual contract.[3]

The question whether a minor is liable on an executory contract for necessaries depends upon which of these two theories is correct. If his obligation arises *re* and is non-existent in the absence of delivery, he clearly cannot be liable for goods not actually supplied, and presumably his refusal of them when tendered is justifiable. A learned writer on the subject failed to find a single case where liability has been established in the absence of delivery,[4] and it is probably safe to assume that in the case of goods the second theory is correct and that an executory contract is unenforceable.

A further point must be noted. Even if the goods have been actually supplied there is an express enactment that he shall pay a reasonable, not necessarily the contract, price;[5] and those judges who have advocated the contractual basis of a minor's liability have said that he is still liable only for a reasonable sum.[6] This is a curious admission, for if the basis of liability is truly contractual, it is odd that the minor should not be bound by the price that he has agreed to pay, whether reasonable or not.

18 *Roberts v Gray* [1913] 1 KB 520 at 528.
19 *Fawcett v Smethurst* (1914) 84 LJKB 473.
20 See, for example *Shears v Mendeloff* (1914) 30 TLR 342 (appointment of a manager by an infant boxer); *Chaplin v Leslie Frewin (Publishers) Ltd* [1966] Ch 71 at 88. See also beneficial contracts of service, p 481, below.
1 *Nash v Inman* [1908] 2 KB 1 at 12.
2 *Re J* [1909] 1 Ch 574 at 577, per Fletcher-Moulton LJ; *Nash v Inman*, above at 8, per Fletcher-Moulton LJ; see p 741, below.
3 *Pontypridd Union v Drew* [1927] 1 KB 214 at 220, per Scrutton LJ.
4 Miles 43 LQR 389.
5 Sale of Goods Act 1979, s 3.
6 See eg *Nash v Inman* [1908] 2 KB 1 at 12.

It is more difficult to determine the basis of liability where the subject matter is not goods, as for instance in a contract for the hire of lodgings or for education. A case in point is *Roberts v Gray*[7] where the facts were these:

> The defendant, an infant, who desired to become a professional billiard player, made a contract with Roberts, a leading professional, by which the parties agreed to accompany each other on a world tour and to play matches together in the principal countries. Roberts expended much time and trouble and incurred certain liabilities in the course of making the necessary preparations. A dispute arose between the parties and before the tour began Gray repudiated the contract.

Roberts sued for breach of contract and was awarded £1,500 by the court of first instance. The Court of Appeal, in affirming this decision, treated the contract as being one for necessaries. The doctrine of necessaries, said Cozens-Hardy MR, applies not merely to bread and cheese and clothes, but also to education, a word which in this connection extends to any form of instruction that is suitable for the particular infant. It had been argued, however, that though the defendant would have been liable to pay on a *quantum meruit* for services rendered had he actually received the plaintiff's instruction, yet, since he had repudiated the contract while it was still to a large extent executory, he was immune from liability. The court would have none of this. Hamilton LJ said:

> I am unable to appreciate why a contract which is in itself binding, because it is a contract for necessaries not qualified by unreasonable terms, can cease to be binding merely because it is executory ... If the contract is binding at all, it must be binding for all such remedies as are appropriate to the breach of it.[8]

Unless this decision can be discounted on the ground that the contract had been partly executed, it would seem to create a difficult distinction between goods and other types of necessaries such as instruction. In the first case the minor is not liable unless he has actually received the goods, in the second the fact that no instruction has yet been imparted does not release him from his obligation. Perhaps the solution lies in separating the contract for education from the category of necessaries. It is true that Coke included it in the category and that his words have been echoed by modern judges. But there is another and independent type of valid contract, namely the beneficial contract of service, which is wide enough, and certainly more appropriate, to include education and other forms of instruction. As we shall see in the following section such a contract is binding even though it has not been completely executed. It is significant that all the authorities relied upon by the court in *Roberts v Gray* concerned beneficial contracts of service.

2 BENEFICIAL CONTRACTS OF SERVICE

It has been held from a very early date that an infant may bind himself by a contract of apprenticeship or of service, since it is to his advantage that he should acquire the means of earning his livelihood. Such a contract, however, when construed as a whole, must be substantially for his advantage, if he is not

7 [1913] 1 KB 520.

8 Ibid at 530. Yet in *Walter v Everard* [1891] 2 QB 369 at 374, Lord Esher said: 'The person who sues the infant on his covenant must show that he did in fact supply him with the necessary education.'

to be free to repudiate it.[9] Prima facie it is valid, but in the event of a dispute it is the province of the court[10] to decide whether the agreement when carefully examined in all its terms was, at the time when it was entered into,[11] for his benefit. The mere fact that one or more of the stipulations are prejudicial to him is not decisive, for some terms not directly beneficial to the servant must be expected in all service agreements. The court must look at the whole contract, must weigh the onerous against the beneficial terms, and then decide whether the balance is in favour of the minor.

> It must be shewn that the contract which he entered into with the plaintiff company was not merely a contract under which he improved himself in his business, under which he got a salary which I assume to have been adequate and reasonable, but it must be shewn by the plaintiffs that it was a contract which contained clauses, and only clauses, that are usual and customary in an employment of this nature.[12]

Two cases may be contrasted.

In *De Francesco v Barnum*:[13] A girl, fourteen years old, bound herself by an apprenticeship deed to the plaintiff for seven years to be taught stage dancing. She agreed inter alia that she would not marry during the apprenticeship, and would not accept professional engagements without the plaintiff's permission. The plaintiff did not bind himself to provide the infant with engagements or to maintain her while unemployed, and the pay that he agreed to give in the event of her employment was the reverse of generous. It was 9d per night and 6d for each matinee. He was entitled to engage her in performances abroad, and in this event was bound to pay her 5s a week with board and lodging. He could terminate the contract if, after a fair trial, the infant was found unfit for stage dancing.

It was held by Fry J that the provisions of the deed were unreasonable and unenforceable. The learned judge came to the conclusion that the child was at the absolute disposal of the plaintiff. She was to receive no pay and no maintenance except when employed, there was no correlative obligation on the plaintiff to find employment for her, and it was left to him to terminate the contract and thus to destroy her chances of success.

In *Clements v London and North Western Rly Co*:[14]

> An infant, upon entering the service of a railway company as a porter, agreed to join the company's own insurance scheme and to relinquish his right of suing for personal injury under the Employers' Liability Act 1880. The scheme was more favourable to him than the Act since it covered more accidents for which compensation was payable, though on the other hand it fixed a lower scale of compensation.

It was held that the agreement as a whole was manifestly to the advantage of the infant and was binding.

9 *De Francesco v Barnum* (1890) 45 ChD 430; *Clements v London and North Western Rly Co* [1894] 2 QB 482.

10 *Flower v London and North Western Rly Co* [1894] 2 QB 65.

11 *Chaplin v Leslie Frewin (Publishers) Ltd* [1966] Ch 71 at 95, [1965] 3 All ER 764, per Danckwerts LJ; *Mackinlay v Bathurst* (1919) 36 TLR 31 at 33.

12 *Sir WC Leng & Co Ltd v Andrews* [1909] 1 Ch 763 at 769, per Cozens Hardy MR.

13 (1890) 45 ChD 430.

14 [1894] 2 QB 482; followed in *Slade v Metrodent Ltd* [1953] 2 QB 112, [1953] 2 All ER 336 (infant held bound by an arbitration clause contained in an apprenticeship deed).

Benefit to the minor, as we see then, is the keynote to the validity of this type of contract. At the same time there is no general principle that any agreement is binding upon a minor merely because it is for his benefit.[15] For instance, it has been established for over 200 years that a trading contract is not binding upon him however much it may be for his benefit.[16] So in *Cowern v Nield*[17] it was held that an infant hay and straw dealer was not liable to repay the price of a consignment of hay that he failed to deliver, and in a later case that a haulage contractor aged twenty was not liable for instalments due under a hire-purchase agreement by which a lorry had been hired to him for use in his business.[18] The essential fact to appreciate is that, for a beneficial agreement to be valid, it must either be a service or apprenticeship contract properly so called or at least analogous to such a contract.[19] In recent years, however, the courts have taken a progressively wider view of what is a contract of service. So in *Doyle v White City Stadium Ltd*,[20] for instance, it was held that a contract between an infant boxer and the British Boxing Board of Control, under which the infant received a licence to box that enabled him to gain proficiency in his profession, was so closely connected with a contract of service as to be binding.

3 VOIDABLE CONTRACTS

We now have to deal with contracts that are voidable in the sense that they are valid and binding upon a minor unless he repudiates them during infancy or within a reasonable time after the attainment of his majority. They are confined to contracts by which the infant acquires an interest in some subject matter of a permanent nature, ie a subject matter to which continuous or recurring obligations are incident. The principle is that if a minor undertakes such a contractual obligation, it 'remains until he thinks proper to put an end to it'.[1]

The most obvious example is a contract made by a minor for a lease. A minor is precluded by legislation from acquiring a legal estate in land,[2] but a lease which purports to convey to him a term of years absolute gives him an equitable interest for the agreed period.[3] This is voidable at his option, but while in possession he is subject to the liabilities imposed by the contract and may for instance be successfully sued for the non-payment of rent.[4] The same principle

15 *Martin v Gale* (1876) 4 ChD 428 at 431, per Jessel MR; *Clements v London and North Western Rly Co*, above, at 493, per Kay LJ; *Doyle v White City Stadium Ltd* [1935] 1 KB 110 at 131, per Slesser LJ.

16 *Whywall v Champion* (1738) 2 Stra 1083. The remark of McNair J in *Slade v Metrodent Ltd* [1953] 2 QB 112 at 115, [1953] 2 All ER 336 at 337, is presumably confined to the case of a service contract.

17 [1912] 2 KB 419.

18 *Mercantile Union Guarantee Corpn Ltd v Ball* [1937] 2 KB 498, [1937] 3 All ER 1.

19 *Cowern v Nield* [1912] 2 KB 419 at 422.

20 [1935] 1 KB 110; applied in *Chaplin v Leslie Frewin (Publishers) Ltd* [1966] Ch 71; p 487, below, where the Court of Appeal extended the analogy to a contract by a publisher to publish the autobiography of an infant. Similarly a contract by an infant 'pop group' to appoint a manager is valid if beneficial: *Denmark Productions Ltd v Boscobel Productions Ltd* [1967] CLY 1999 (decided on other grounds [1969] 1 QB 699, [1968] 3 All ER 513). See also *IRC v Mills* [1975] AC 38, [1974] 1 All ER 722.

1 *Goode v Harrison* (1821) 5 B & Ald 147 at 169, per Best J.

2 Law of Property Act 1925, s 1(6); Settled Land Act 1925, s 27(1).

3 *Davies v Beynon-Harris* (1931) 47 TLR 424; Settled Land Act 1925, s 27(2).

4 *Davies v Beynon-Harris*, above.

applies to the acquisition of shares. A minor purchaser of shares acquires an interest in a subject matter of a permanent nature carrying with it certain obligations that he is bound to discharge until he repudiates the transaction.[5] Thus a plea of infancy will not relieve him from liability to pay a call, ie a demand to pay to the company what is still due on the shares, if it is made before repudiation,[6] but as soon as he repudiates, or as it is often termed 'rescinds', the transaction, the interest acquired by him is at an end, and with it his liability for future calls.

Much the same principle applies to a partnership. A minor partner in a firm is not liable for partnership debts contracted during his infancy,[7] though he has no right to prevent their discharge out of the common assets. On reaching his majority he may repudiate the partnership contract altogether, but if he fails to do so and thus holds himself out as a continuing partner, he remains responsible for all debts contracted since he came of age.[8]

A contract of the class that we are now considering, in order to become permanently binding upon a minor, does not require ratification by him when he attains his majority. It remains binding upon him unless he repudiates it within a reasonable time after he comes of age.[9]

> If he chooses to be inactive, his opportunity passes away; if he chooses to be active the law comes to his assistance.[10]

What is a reasonable time depends of course upon the particular circumstances of each case. In *Edwards v Carter*,[11] for instance:

> A marriage settlement was executed by which the father of the intended husband agreed to pay £1,500 a year to the trustees, who were to pay it to the husband for life and then to the wife and issue of the marriage. The intended husband, an infant at the time of the settlement, executed a deed binding him to vest in the trustees all property that he might acquire under the will of his father. A month later he came of age and three-and-a-half years later he became entitled to an interest under his father's will. More than a year after his father's death, ie about four-and-a-half years after he came of age, he repudiated his agreement.

It was argued that the repudiation was in time, since the infant, when he signed the agreement, did not realise the extent of his obligation, and could not decide upon his best course of action until he knew the extent of his interest under the will. It was held however, that his repudiation was too late and was ineffective.

Effect of repudiation

It is clear that a minor who repudiates a voidable contract is no longer liable to honour future obligations. What is not authoritatively settled, however, is whether he is freed from those that have accrued due at the time of his repudiation. If, for example, he repudiates a lease of land, is he none the less

5 *North Western Rly Co v McMichael* (1850) 5 Exch 114 at 123 and 124.
6 *Cork and Bandon Rly Co v Cazenove* (1847) 10 QB 935.
7 *Lovell and Christmas v Beauchamp* [1894] AC 607 at 611.
8 *Goode v Harrison* (1821) 5 B & Ald 147.
9 *Carter v Silber* [1892] 2 Ch 278 at 284, per Lindley LJ.
10 *Edwards v Carter* [1893] AC 360 at 366, per Lord Watson.
11 Above.

liable for rent *already* due? This is a question upon which there are conflicting dicta and no direct authority in modern times.[12] Two views have been advanced.

The first is that repudiation is the equivalent of rescission, which, as we have already seen, is retrospective in its operation. It 'terminates the contract, puts the parties in *status quo ante* and restores things, as between them, to the position in which they stood before the contract was entered into'.[13] In *North Western Rly Co v McMichael*,[14] for instance, an action was brought against an infant to recover a call on certain railway shares that he had bought. The defendant merely pleaded that he had never ratified the purchase and had not received any benefit from it. Parke B, however, who delivered the judgment of the court, stated what the position would have been had repudiation been pleaded and substantiated.

> Our opinion is that an infant is not absolutely bound, but is in the same situation as an infant acquiring real estate or any other permanent interest: he is not deprived of the right which the law gives every infant of waiving and disagreeing to a purchase which he has made; and if he waives it the estate acquired by the purchaser is at an end and with it his liability to pay calls, though the avoidance may not have taken place till the call was due.[15]

The court relied upon a case decided in 1613 which is reported under a variety of names in different reports.[16] In this case, it was indeed affirmed that a voidable lease would be rendered void if disclaimed by an infant; and that if the disclaimer had been made *before* the rent fell due, the tenant's liability in this respect would be cancelled. No mention was made of rent already due.[17] Yet Younger LJ once said that an infant shareholder 'is no longer liable to pay the instalments [due under a call] which she has not paid'.[18]

The principle stated by Parke B, however, that the repudiation of his contract by an infant has a retrospective effect, has not been universally accepted. Thus, an Irish judge has reached the opposite conclusion. This was in *Blake v Concannon*,[19] where an infant tenant, after occupying the premises for nearly a year, quitted possession and on attaining full age repudiated the tenancy. Nevertheless, he was held liable for half a year's rent which had accrued due while he was in possession. His liability was based upon his use and occupation of the land.[20] In *Steinberg v Scala (Leeds) Ltd*,[1] there is a dictum of Warrington LJ that an infant shareholder who rescinds his purchase is relieved of liability for future calls, no mention being made of calls already due. Moreover, the views of textbook writers are not unanimous on the question, though their general conclusion is that liability for an accrued debt survives a repudiation of the contract.[2]

12 Hudson 35 Can Bar Rev 1213.
13 *Abram Steamship Co v Westville Steamship Co* [1923] AC 773 at 781, per Lord Atkinson.
14 (1850) 5 Exch 114.
15 Ibid at 125; (italics supplied).
16 *Ketsey's Case* (1613) Cro Jac 320; *Keteley's Case* 1 Brownlow 120; *Kirton v Eliott* Roll Abr 731.
17 See *Re Jones, ex p Jones* (1881) 18 ChD 109 at 117, per Jessel MR.
18 *Steinberg v Scala (Leeds) Ltd* [1923] 2 Ch 452 at 463.
19 (1870) IR 4 CL 323.
20 The citation of this case in an English action provoked Jessel MR to say: 'That is founded on an implied contract. How can a court imply a contract against a person who is incapable of contracting?': *Re Jones, ex p Jones* (1881) 18 ChD 109 at 118.
1 [1923] 2 Ch 452 at 461.
2 Those who take this view include *Sutton and Shannon on Contracts* (8th edn) p 220; Salmond and Winfield *Principles of the Law of Contracts* p 461. The opposite view is expressed by Salmond and Williams *Principles of the Law of Contracts* p 300.

In view of this disarray of opinions it would be misleading to say that the authorities have reached a definite conclusion upon the matter. It is submitted, however, that it is preferable to accept the logic of the retrospective principle as explained by Parke B in *McMichael's* case.

An entirely different question in the present context is whether a minor, on repudiation of a contract, can recover money which he has paid or property which he has delivered to the other party. The rule here is that if, for instance, he has paid money to the defendant, he cannot recover it at common law as being money had and received unless he can show that he has suffered a total failure of consideration.

To succeed, he must prove that he has received no part of what he was promised. This he was able to do in *Corpe v Overton*.[3]

> An infant agreed to enter into a partnership with the defendant in three months' time and to pay him £1,000 when the partnership deed was executed. He also made an immediate payment of £100 as security for the fulfilment of his promise. He rescinded the contract as soon as he came of age and sued for the recovery of the £100.

The money was held to be recoverable since there had been a total failure of consideration. The money had been deposited by the plaintiff to secure the due performance of the partnership contract, but at the time when the contract was effectively rescinded he had received no consideration for what he had paid.[4]

In *Holmes v Blogg*,[5] however, the test of total failure of consideration was not satisfied. An infant paid a sum of money to a lessor as part of the consideration for a lease of premises in which he and a partner proposed to carry on their trade. He occupied the premises for twelve weeks, but the day after he came of age he dissolved the partnership, repudiated the lease and left the premises. He failed in his attempt to recover what he had paid. There was no total failure of consideration, since he had received the very thing he had been promised and for which he had made the payment.

To the same effect in *Steinberg v Scala (Leeds) Ltd.*[6]

> The plaintiff, an infant, applied for shares in a company and paid the amounts due on allotment and on the first call. She neither received any dividends nor attended any meetings of the company, and the shares appear always to have stood at a discount. Eighteen months after allotment, while still an infant, she rescinded the contract and claimed to recover what she had paid.

Her claim failed. The company, by allotting the shares, had done all that it had bargained to do by way of consideration for her payment.

Some of the expressions used by the judges in the relevant cases on this matter appear at first sight to make the right of recovery turn upon whether or not the infant has derived *any* substantial benefit from the contract. This is misleading. In the words of Younger LJ: 'The question is not: Has the infant derived any real advantage? But the question is: Has the consideration wholly

3 (1833) 10 Bing 252.
4 *Steinberg v Scala (Leeds) Ltd* [1923] 2 Ch 452 at 461, per Lord Sterndale MR.
5 (1818) 8 Taunt 508.
6 [1923] 2 Ch 452; overruling *Hamilton v Vaughan-Sherrin Electrical Engineering Co* [1894] 3 Ch 589.

failed?'[7] Thus in *Steinberg's* case, since the infant had obtained the very consideration for which she had bargained, it was irrelevant that what she had obtained might be valueless.

Cases such as *Edwards v Carter*[8] show that a disposition by a minor of any form of property, whether realty or personalty, is not finally and conclusively binding upon him. 'There is a total absolute disability in an infant that by no manner of conveyance can he dispose of his inheritance.'[9] He may either confirm or rescind it on the attainment of his majority. If he exercises his right of rescission, his disposition, hitherto valid until avoided, now becomes retrospectively void *ab initio*. In principle this requires the restoration of the *status quo ante*—a giving back and a taking back on both sides—and it has long been understood that the infant is entitled to recover the property that he has transferred.

This general principle, which allows a minor to recover what he has transferred by a completed disposition, has been somewhat clouded by the decision of the Court of Appeal in *Chaplin v Leslie Frewin (Publishers) Ltd*[10] where the facts were as follows:

> The plaintiffs, an infant and his adult wife, entered into a contract with the defendants by which the latter agreed to publish the autobiography of the infant which was to be written by two journalists based on information furnished by the plaintiffs. The plaintiffs approved the final page proofs on 21 July, and the legal right to the copyright was assigned in writing to the defendants. Advance royalties of £600 were paid to the plaintiffs, who also knew that the defendants had contracted with third parties for the foreign publication of the work.
>
> On 26 August the plaintiffs repudiated the contract on the ground that the book contained libellous matter and attributed to the infant views that he did not hold. They commenced an action for an injunction restraining the publication of the book, and for an order restoring the copyright to them. They conceded that, as part of this equitable relief, they were obliged to repay the money they had received. Pending the trial of the action, they moved for an interlocutory injunction to prevent publication.

The Court of Appeal was unanimous in holding that the contract was analogous to a service contract, which, as has been seen,[11] is valid if it is substantially for the infant's benefit. The majority (Lord Denning MR dissenting) held that the test of substantial benefit was satisfied, since the contract, viewed at the time of its making, would enable the infant to make a start in life as an author. The contract was valid and there was no room for the grant of equitable relief.

This finding was sufficient to dispose of the case and it was unnecessary to consider whether the assignment of the copyright precluded its recovery by the infant. The court, however, canvassed the matter, and again there was a difference of opinion. Danckwerts and Winn LJJ held that, even had the contract been voidable, its rescission by the infant could not divest the

7 *Steinberg v Scala (Leeds) Ltd* [1923] 2 Ch 452 at 465.
8 P 484, above.
9 *Hearle v Greenbank* (1749) 3 Atk 695 at 712, per Lord Hardwicke. See also *Re D'Angibau, Andrews v Andrews* (1879) 15 ChD 228 at 241, per Cotton LJ; *Burnaby v Equitable Reversionary Interest Society* (1885) 28 ChD 416 at 424, per Pearson J.
10 [1966] Ch 71, [1965] 3 All ER 764. See Mummery 82 LQR 471; Yale [1966] CLJ 17.
11 P 481, above.

copyright that had been vested in the publishers. It is submitted with respect that the opposite view expressed by Lord Denning MR is to be preferred.[12] The infant's claim was not at common law for money had and received, but a claim for equitable relief which, since he who seeks equity must do equity, would be granted only on the footing that any advantages already received by him would be returned to the publishers. The majority did not examine the established principles relating to an infant's right of restitution, but were content to accept the authorities cited by counsel for the publishers, namely *Valentini v Canali*,[13] *Pearce v Brain*[14] and *Steinberg v Scala (Leeds) Ltd*.[15] The coupling of the first two of these cases with the last is a further instance of the confusion which surrounds the law of infancy. The first two were cases of void contracts, but in *Steinberg v Scala (Leeds) Ltd* the contract was voidable. It was assumed by counsel and the court that if the contract was not valid, it was voidable. It has been plausibly suggested however that the contract if not valid, was void,[16] but even if the *contract* were void, it would not necessarily follow that the *assignment* was void.

It is suggested that if this part of the decision in the *Chaplin* case is to be supported it must be based upon the impossibility of *restitutio in integrum*. The infant was prepared to restore the royalty payments, but he could not undo the contracts which to his knowledge the defendants had made with foreign publishers.[17]

4 OTHER CONTRACTS

It is clear that if the contract does not fall within one of the three above categories it does not bind the minor but this does not mean that the contract is without legal effect. In principle it appears that the contract is binding on the other party though it is not clear what consideration the infant is providing for the transaction. Before 1874 a minor (or an infant, as he was then called) could become bound if he ratified the contract when he achieved his majority. Ratification was made ineffective by section 2 of the Infants Relief Act 1874 but now that this Act has been repealed it would seem that ratification is once more possible.

In many cases contracts made by minors will be carried out. The practical importance of minors' contracts was greatly reduced when the age of majority was reduced from 21 to 18, since many more long term transactions are entered into by those in the 18 to 21 years age group. Nevertheless, today, even those under 18 dispose in aggregate of a very substantial amount of money and a few, such as entertainers or professional athletes, may command large fees even before they are 18. The general principle appears to be that once the transaction has been carried out, the minor cannot undo it unless the circumstances are such that an adult, having entered into the same transaction, could undo it, for example, because of total failure of consideration. So a

12 [1966] Ch at 90, [1965] 3 All ER at 770.
13 (1889) 24 QBD 166.
14 [1929] 2 KB 310.
15 [1923] 2 Ch 452; p 486, above.
16 Reynolds 10 JSPTL 294 at 295.
17 Leave to appeal to the House of Lords was granted, but the action was settled. The infant withdrew his repudiation of the contract, and it was agreed that the book should be rewritten.

minor cannot buy a compact disc on one Saturday and take it back the following Saturday asking for his or her money back. It would seem too that ownership in the compact disc would have passed to the minor according to the usual rules of passing of property under contracts of sale. This is implicitly assumed by section 3 of the Minors' Contracts Act 1987 which provides:

> (1) Where–
> (a) a person ('the plaintiff') has after the commencement of this Act entered into a contract with another ('the defendant'), and
> (b) the contract is unenforceable against the defendant (or he repudiates it) because he was a minor when the contract was made, the court may, if it is just and equitable to do so, require the defendant to transfer to the plaintiff any property acquired by the defendant under the contract, or any property representing it.
> (2) Nothing in this section shall be taken to prejudice any other remedy available to the plaintiff.

This section is aimed at the situation where the minor has acquired property on credit and refuses, as he is entitled to do, to pay for it. It gives the court a discretionary power to order restoration to the seller or the supplier. It clearly assumes however that property can pass. If property can pass to the minor under a credit sale, all the more so it would seem under a cash sale.

Where the person dealing with the minor realises that he is dealing with a minor, he may ask for a guarantee from an adult. This possibility gave rise to considerable technical difficulties in respect of loans between 1874 and 1987 because the loan was absolutely void under the Infants' Relief Act 1874 and it was believed that the guarantee might be equally void, though this was not clear and the difficulty could be overcome by formulating the transaction as one of indemnity rather than guarantee.[18] This possibility is now controlled by section 2 of the Minors' Contracts Act 1987 which provides:

> (2) Where–
> (a) a guarantee is given in respect of an obligation of a party to a contract made after the commencement of this Act, and
> (b) the obligation is unenforceable against him (or he repudiates the contract) because he was a minor when the contract was made, the guarantee shall not for that reason alone be unenforceable against the guarantor.

B DELICTUAL LIABILITY OF MINORS

Although a minor is generally liable in tort, as, for instance, for defamation, trespass or conversion, he is not answerable for a tort directly connected with any contract upon which no action will lie against him. It is impossible indirectly to enforce such a contract by changing the form of action to one *ex delicto*.[19] Thus an action of deceit does not lie against a minor who, by falsely representing himself to be of full age, has fraudulently induced another to contract with him, for 'it was thought necessary to safeguard the weakness of infants at large, even though here and there a juvenile knave slipped through'.[20]

18 *Coutts & Co v Browne-Lecky* [1947] KB 104, [1946] 2 All ER 207; *Yeoman Credit Ltd v Latter* [1961] 2 All ER 294, [1961] 1 WLR 828; Furmston 24 MLR 648; Stevn 90 LQR 246.

19 *Burnard v Haggis* (1863) 14 CBNS 45, per Bvles J.

20 *R Leslie Ltd v Sheill* [1914] 3 KB 607 at 612, per Lord Sumner.

A fraudulent representation did not estop a minor from relying upon the Infants' Relief Act.[1] Although perhaps this is to put a premium on knavery, it is clear that to enable a plaintiff to convert a breach of contract into a tort would destroy the protection that the law affords to minors.[2]

The only, but a real, difficulty is to determine in each case whether the tort is so directly connected with a contract as to render the minor immune even from delictual liability. It was held, for instance, in *Jennings v Rundall*[3] that if an infant hires a mare for riding and injures her by excessive and improper riding, he is not liable in tort for negligence; but in *Burnard v Haggis*[4] that if, contrary to the express instructions of the owner accepted by himself, he jumps and consequently injures her, he can be successfully sued in tort. At first sight it is not easy to appreciate the exact distinction between these two cases. In each of them the wrongful act of the infant arose out of and was connected with a contract in the sense that it could not have been committed had no contract been made. Why was the wrongful jumping in a different legal category from the wrongful riding? What is the test which determines whether the conduct of the infant is a tort independent of the contract and therefore actionable? The answer would appear to be that an infant is liable in tort only if the wrongful act that he has done is one of a kind not contemplated by the contract.[5] If he hires a horse for riding, the act contemplated by the contract is riding, and he cannot be liable however immoderately he may ride; but on the other hand, the hire of a horse only for riding does not contemplate the act of jumping. The same test serves to distinguish two more recent cases. In *Fawcett v Smethurst*[6] an infant hired a car for the specific purpose of fetching his luggage from Cairn Ryan Station, and when he got to the latter place he drove further away to Ballantrae. It was held that he was not liable in tort for an accident that occurred during the further drive. In the words of Atkin J:

> Nothing that was done on that further journey made the defendant an independent tortfeasor ... The extended journey was of the same nature as the original one, and the defendant did no more than drive the car further than was intended.

But in *Ballett v Mingay*,[7] an action of detinue succeeded against an infant for the return of certain articles which he had borrowed from the respondent and which he had without authority lent to a friend. Lord Greene MR said:

> From the evidence it seems that, properly construed, the terms of the bailment of these articles to the defendant did not permit him to part with their possession at all. If it was the bargain that he might part with them, it was for him to establish that fact and he has failed to do so. On that basis the action of the defendant in parting with the goods fell outside the contract altogether, and that fact brings this case within *Burnard v Haggis*.[8]

1 *Levene v Brougham* (1909) 25 TLR 265.
2 *Jennings v Rundall* (1799) 8 Term Rep 335 at 336, per Lord Kenyon.
3 Above.
4 (1863) 14 CBNS 45.
5 This was the view of Pollock *Contracts* (12th edn, p 63). It was adopted by Kennedy LJ, in *R Leslie Ltd v Sheill* [1914] 3 KB 607 at 620, and confirmed by Atkin J in *Fawcett v Smethurst* (1914) 84 LJKB 473; and by the Court of Appeal in *Ballett v Mingay* [1943] KB 281, [1943] 1 All ER 143.
6 (1914) 84 LJKB 473.
7 [1943] KB 281, [1943] 1 All ER 143.
8 Ibid at 282-285 and 145, respectively.

Whether the act that the infant has done must be taken to be within the contemplation of the parties may perhaps depend upon the nature of the subject matter. In *Ballett v Mingay* this consisted of an amplifier and a microphone, articles that a lender would naturally expect a borrower to retain in his own possession, but the decision might have been different had the infant parted temporarily with a bicycle that he had hired from the plaintiff.

In *Ballett v Mingay* the transaction involved a bailment and it has already been seen that a bailment does not necessarily involve a contract.[9] In the case of a gratuitous loan of a chattel, it is clear that the lender has a tortious action in the event of refusal to return or failure to exercise reasonable care[10] and it would seem that since there is no contractual action, one who lends gratuitously to an infant can sue in such circumstances. If this is correct, it is not clear why one who lends for reward should be in a worse position than one who lends gratuitously.[11] It should be noted that gratuitous[12] loans of money are in a different position since historically refusal to return sounded in debt, rather than detinue or conversion and was therefore treated as contractual.

C THE EQUITABLE DOCTRINE OF RESTITUTION

We have just seen that at common law an infant is not liable in deceit if he induces another to contract with him by making some false representation, as for example that he has reached the age of majority. If, for instance, he obtains money or non-necessary goods from another by such a misrepresentation, he cannot be sued either on the express contract, or for money had and received, or, since the fraud is connected with the contract, in tort.[13] But since it should be obvious that 'infants are no more entitled than adults to gain benefits to themselves by fraud',[14] equity has developed a principle which requires benefits to be disgorged, if they are still in the possession of the fraudulent infant.

The limits of this doctrine of restitution are somewhat ill-defined.[15] There are three types of case to which it may be relevant.

Firstly, the infant obtains goods by fraud and remains in possession of them. Here there is no doubt that the doctrine applies and that an order for restitution will be made.[16] Secondly, the infant obtains goods by fraud but ceases to possess them. If the doctrine is limited to the restitution of the very goods obtained, it follows that it cannot be invoked in this case, for to make the infant liable to repay the value of the goods, or even to restore another article for which they have been exchanged, would in effect be to enforce a

9 Pp 94-96, above; Palmer *Bailment* (2nd edn) pp 26-31.

10 *Palmer* (2nd edn) pp 665-676.

11 Clearly contractual stipulations, which seek to put the lender in a better position, are on a different footing.

12 That is loans which contemplate simply the return of capital without payment of any interest.

13 *R Leslie Ltd v Sheill* [1914] 3 KB 607 at 612-613, per Lord Sumner.

14 *Nelson v Stocker* (1859) 4 De G & J 458, per Turner LJ at 464. Ativah has suggested that an extended meaning should be given to the word 'fraud' in this context: 22 MLR 273.

15 In practice plaintiffs will often prefer to rely on s 3 of the Minors' Contracts Act 1987, set out at p 489, above, but the Act does not replace the equitable jurisdiction.

16 *Clarke v Cobley* (1789) 2 Cox Eq Cas 173; *Lemprière v Lange* (1879) 12 ChD 675.

contract declared void by statute. The authorities would seem to establish that the doctrine is so limited. As A T Lawrence J said in *R Leslie Ltd v Sheill*,[17] 'if when the action is brought both the property and the proceeds are gone, I can see no ground upon which a Court of Equity could have founded its jurisdiction'. In the same case Lord Sumner stated the position as follows:

> I think that the whole current of decisions down to 1913, apart from dicta which are inconclusive, went to shew that, when an infant obtained an advantage by falsely stating himself to be of full age, the equity required him to restore his ill-gotten gains, or to release the party deceived from obligations or acts in law induced by the fraud,[18] but scrupulously stopped short of enforcing against him a contractual obligation, entered into while he was an infant, even by means of a fraud—Restitution stopped where repayment began.[19]

The reason why Lord Sumner confined this review of the law to the discussions prior to 1913 was that in that year Lush J held, in *Stocks v Wilson*,[20] that an infant who had obtained goods by misrepresenting his age and had later sold them was accountable for the proceeds of sale. It is extremely difficult to reconcile this decision either with the principles laid down by the Court of Appeal in *R Leslie Ltd v Sheill* or with what was decided in that case.[1] Lush J relied chiefly upon a decision in 1858 where the Lords Justices held, though with reluctance, that a loan obtained by an infant who had misrepresented his age was provable as a debt in his subsequent bankruptcy.[2] It is now admitted, however, that this decision merely expresses a rule of bankruptcy law, not a principle of general application relevant to such facts as arose in *Stocks v Wilson*.[3] Moreover, the question in the 1858 case was not whether the lender had a personal claim against the infant, but whether, in competition with other creditors, he could claim a share of the assets that had been surrendered to the trustee in bankruptcy.[4]

Thirdly, the infant obtains a loan of money by fraud. The contrast stressed by Lord Sumner between restitution and repayment necessarily excludes the doctrine in this case, for the very essence of a loan of money is that the borrower shall repay the equivalent amount, not that he shall restore the identical coins. Thus it was held in *Leslie Ltd v Sheill*[5] that an infant could not be compelled to restore a loan of £400 which he had obtained by a fraudulent misstatement of his age, for to do so would constitute in effect an enforcement of the contract, not an application of the doctrine of restitution. If, of course, the very coins or notes obtained by the infant were identifiable and if they were still in his possession, a highly improbable case, the doctrine could no doubt be invoked.

17 [1914] 3 KB 607 at 627.

18 If, for example, an infant, by fraudulently misrepresenting his age, induces his trustees to pay a sum of money to him and thus to commit a breach of trust, he cannot after he is of full age compel them to rectify the breach by paying the money over again: *Cory v Gertcken* (1816) 2 Madd 40.

19 [1914] 3 KB 607 at 618.

20 [1913] 2 KB 235.

1 But see Goff and Jones *The Law of Restitution* (3rd edn) pp 431-439. In *R Leslie Ltd v Sheill* the Court of Appeal refrained from expressing a definite opinion upon the decision of Lush J though Lord Sumner remarked that it was 'open to challenge': [1914] 3 KB at 619.

2 *Re King, ex p Unity Joint Stock Mutual Banking Association* (1858) 3 De G & J 63.

3 *R Leslie Ltd v Sheill* [1914] 3 KB 607 at 624, 628.

4 Ibid at 616.

5 Above.

2 Corporations

THE DOCTRINE OF *ULTRA VIRES*

It is essential, of course, that a contracting party should be a person recognised as such by the law. Persons in law, however, are not confined to individual men and women. If two or more persons form themselves into an association for the purpose of some concerted enterprise, as happens, for example, upon the formation of a club, a trade union, a partnership or a trading company, the association is in some cases regarded by the law as an independent person, ie as a legal entity called a 'corporation', separate from the men and women of whom it consists, but in other cases it is denied a separate personality and is called an unincorporated association. Whether an association falls into one class or the other depends upon whether it has been incorporated by the state.

> Independent juristic personality can only be conferred upon an association according to English law, by some act on the part of the State, represented either by the Crown in the exercise of its prerogative rights, or by the sovereign power of Parliament.[6]

An unincorporated association, such as a club, is not a competent contracting party. If a contract is made on its behalf no individual member can be sued upon it except the person who actually made it and any other members who authorised him to do so.[7]

The main classification of corporations is into aggregate and sole. A corporation aggregate is a body of several persons united together into one society which, since it may be maintained by a constant succession of members, has the capacity of perpetual existence. Examples are the mayor and corporation of a city and a trading company incorporated under the Companies Act 1985. A corporation sole consists of a single person occupying a particular office and each and several of the persons in perpetuity who succeed him in that office, such as a bishop or the vicar of a parish.

> The law therefore has wisely ordained that the parson, *quatenus* parson, shall never die, by making him and his successors a corporation. By which means all the original rights of the parsonage are preserved entire to the successor; for the present incumbent and his predecessor who lived seven centuries ago are in law one and the same person; and what was given to the one was given to the other also.[8]

The consent of the Crown, thus necessary to the creation of a corporation, may either be express or implied. It is express in the case of chartered and statutory corporations. The Crown has a prerogative right to incorporate any number of persons by charter, and it is to this method that some of the older trading companies such as the Hudson's Bay Company and the P&O Steam Navigation Company, owe their existence. Incorporation by statute may take two forms. The members of an association, whether united for trade or for some other purpose, may form themselves into a corporation by obtaining a special Act of

6 Stephen's *Commentaries* (21st edn) vol II, p 558. See also Pickering 31 MLR 481.
7 *Bradley Egg Farm Ltd v Clifford* [1943] 2 All ER 378. For a critique of the law, see Keeler 34 MLR 61.
8 Blackstone's *Commentaries* vol I, p 470.

Parliament; or alternatively, if united for trading purposes and if not less than seven in number, they may comply with the general conditions laid down in the Companies Act 1985, and obtain registration as a limited liability company. The consent of the Crown to incorporation is implied in the case both of common law and of prescriptive corporations. An example of the former is an ecclesiastical corporation sole such as a bishop or a parson. A prescriptive corporation is a body of persons which has been treated as a corporation from time immemorial but which cannot produce a charter of incorporation. The existence of a charter is presumed by the law, and such a body enjoys the same rights as a chartered company.

The doctrine of *ultra vires* stated that a statutory corporation could exercise only those powers which are expressly or implicitly conferred by the statute itself. It did not apply to corporations created by charter. In the words of Bowen LJ:

> At common law a corporation created by the King's charter has prima facie the power to do with its property all such acts as an ordinary person can do, and to bind itself to such contracts as an ordinary person can bind himself to.[9]

A trading company, for instance, incorporated under the Companies Act is required to have articles of association (which regulate matters of internal administration), and also a memorandum of association. The memorandum is the charter which defines the statutory creature by stating the objects of its existence, the scope of its operations and the extent of its powers. A company so created should pursue only those objects set out in the memorandum. Its area of corporate activity is thereby restricted, so that if, for instance, it is authorised to run tramways, it should not run omnibuses. It may exercise and only exercise the powers set out in the memorandum and such powers as are reasonably incidental to or consequential upon the operations that it is authorised to perform. In the middle of the nineteenth century it was held the transactions which went outside the scope of the powers conferred by the memorandum was *ultra vires* and void.[10] The *locus classicus* was *Ashbury Railway Carriage Co v Riche*:[11]

> The objects of the appellant company, as stated in the memorandum of association, were 'to make, sell or lend on hire, railway carriages and waggons, and all kinds of railway plant, fittings, machinery and rolling stock; to carry on the business of mechanical engineers and general contractors; to purchase, lease and sell mines, minerals, land and buildings; to purchase and sell as merchants, timber, coal, metals and other materials, and to buy and sell any such materials on commission or as agents'.
>
> The directors agreed to assign to a Belgian company a concession which they had bought for the construction of a railway in Belgium.

It was held that this agreement, since it related to the construction of a railway, a subject matter not included in the memorandum, was *ultra vires*, and that not even the subsequent assent of the whole body of shareholders could make it

9 *Baroness Wenlock v River Dee Co* (1877) 36 ChD 674, note at 685. *Institution of Mechanical Engineers v Cane and Westminster Corpn* [1961] AC 696 at 724-725, [1960] 3 All ER 715 at 728-729, per Lord Denning; Hudson 28 Solicitor 7.

10 *A-G v Great Eastern Rly Co* (1880) 5 App Cas 473 at 478. For a fuller account, see Gower *Modern Company Law* (6th edn) pp 201-221. Under ss 4, 5, 6 of Companies Act 1985 there is a limited power to change the objects. See Davies 90 LQR 79.

11 (1875) LR 7 HL 653.

binding. Therefore, an action brought by the Belgian company to recover damages for breach of the contract necessarily failed.

The *ultra vires* doctrine has long been criticised. Although in theory it operates to protect shareholders against use of the company's funds for unauthorised purposes, this protection is largely illusory because of the common practice of drafting the objects clause in very broad and general terms. On the other hand the doctrine can operate as a trap for those who do business with the company since it is quite unrealistic to expect them to read the memorandum of association to discover the company's authorised purposes. It is not surprising therefore that both the Cohen Committee in 1945[12] and the Jenkins Committee in 1962[13] recommended substantial amendment of the doctrine.

The European Communities Act 1972, section 9(1) made substantial changes in the doctrine.[14] Further changes were made in the Companies Act 1989 as a result of a DTI consultative document following a Report by Dr Prentice. Section 108 of the Companies Act 1989 inserts new sections 35, 35A and 35B into the Companies Act 1985. This provides that:

A company's capacity not limited by its memorandum

35 (1) The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum.

(2) A member of a company may bring proceedings to restrain the doing of an act which but for subsection (1) would be beyond the company's capacity; but no such proceedings shall lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company.

(3) It remains the duty of the directors to observe any limitations on their powers flowing from the company's memorandum; and action by the directors which but for subsection (1) would be beyond the company's capacity may also be ratified by the company by special resolution. A resolution ratifying such action shall not affect any liability incurred by the directors or any other person; relief from any such liability must be agreed to separately by special resolution.

(4) The operation of this section is restricted by section 30B(1) of the Charities Act 1960 and section 112(2) of the Companies Act 1989 in relation to companies which are charities; and section 322A below (invalidity of certain transactions to which directors or their associates are parties) has effect notwithstanding this section.

Power of directors to bind the company

35A (1) In favour of a person dealing with a company in good faith, the power of the board of directors to bind the company, or authorise others to do so, shall be deemed to be free of any limitation under the company's constitution.

(2) For this purpose–

(a) a person 'deals with' a company if he is a party to any transaction or other act to which the company is a party;

(b) a person shall not be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution; and

(c) a person shall be presumed to have acted in good faith unless the contrary is proved.

12 Cmd 6659, para 12. Hornwitz 62 LQR 60.
13 Cmnd 1249, paras 35/42.
14 Prentice 89 LQR 518. Farrar and Powles 36 MLR 270.

(3) The references above to limitations on the directors' powers under the company's constitution include limitations deriving–
  (a) from a resolution of the company in general meeting or a meeting of any class of shareholders, or
  (b) from any agreement between the members of the company or of any class of shareholders.

(4) Subsection (1) does not affect any right of a member of the company to bring proceedings to restrain the doing of an act which is beyond the powers of the directors; but no such proceedings shall lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company.

(5) Nor does that subsection affect any liability incurred by the directors, or any other person, by reason of the directors exceeding their powers.

(6) The operation of this section is restricted by section 30B(1) of the Charities Act 1960 and section 112(3) of the Companies Act 1989 in relation to companies which are charities; and section 322A below (invalidity of certain transactions to which directors or their associates are parties) has effect notwithstanding this section.

No duty to enquire as to capacity of company or authority of directors

35B (1) A party to a transaction with a company is not bound to enquire as to whether it is permitted by the company's memorandum or as to any limitation on the powers of the board of directors to bind the company or authorise others to do so.

(2) In Schedule 21 to the Companies Act 1985 (effect of registration of companies not formed under that Act), in paragraph 6 (general application of provisions of Act), after sub-paragraph (5) insert–
  '(6) Where by virtue of sub-paragraph (4) or (5) a company does not have power to alter a provision, it does not have power to ratify acts of the directors in contravention of the provision.'

(3) In Schedule 22 to the Companies Act 1985 (provisions applying to unregistered companies), in the entries relating to Part I, in the first column for 'section 35' substitute 'sections 35 to 35B'.

The effect of this is to make the *ultra vires* doctrine a rule relating to the internal management of the company. Third parties dealing with the company will no longer be under any obligation to check the company's capacity and there will be no question of a contract made by the company being invalid because it is outside the purpose of the company as defined in the memorandum. Nevertheless, as a matter of internal management, if the directors do things which they are not entitled to do under the memorandum, a shareholder if he acts in time may be able to restrain them by injunction and the company itself will in principle have an action against the directors for acting outside their powers.

3 Persons mentally disordered, and drunkards

A MENTAL DISORDER[15]

The word 'lunatic' has been used since at least the sixteenth century to describe a person who becomes insane after birth, but it was discarded by the legislature

15 Fridman 79 LQR 502 at 509-516. Hudson 35 Can Bar Rev 205, 37 Can Bar Rev 497, 25 Conv (NS) 319.

in 1930 in favour of 'person of unsound mind',[16] a term that was not statutorily defined. This in turn has been replaced by 'person mentally disordered' or more shortly 'mental patient', and mental disorder is exhaustively defined.[17] This definition relates to the treatment and care of mental patients and to the administration of their property, but it does not affect the question of their contractual capacity. This remains subject to the rules formulated by the courts.

If a genuine consent were necessary to the formation of every agreement it would follow that a mental patient could not make a valid contract. Here as elsewhere, however, the necessity of interpreting conduct by its effect upon reasonable persons has forbidden so simple a proposition. The law on the subject has varied, but the modern rules are clear.

The first question in all cases is whether the party at the time of contracting was suffering from such a degree of mental disability that he was incapable of understanding the nature of the contract.[18] If so, the contract is not void but voidable at the mental patient's option, provided that his mental disability was known or ought to have been known by the other contracting party.[19] The burden of proving this knowledge lies upon the person mentally disordered.[20] If, however, the contract was made by him during a lucid interval, it is binding upon him notwithstanding that his disability was known to the other party.

Again, it is immaterial that the mental disability is known to the other party, if necessaries are supplied to a person mentally disordered or to his wife, suitable to the position in life in which he moves, for in this case an implied obligation arises to pay for them out of his property.[1] The obligation does not arise unless it was the intention of the person supplying the necessaries that he should be repaid. He must intend, not to play the role of a benefactor, but to constitute himself a creditor.[2]

As regards the supply of necessary goods, this obligation to pay is converted by the Sale of Goods Act 1979 into a statutory obligation to pay a reasonable price. Section 3(2) provides that:

> Where necessaries are sold and delivered to a person who by reason of mental incapacity or drunkenness is incompetent to contract, he must pay a reasonable price for them.

Jurisdiction to manage the property and affairs of a mental patient is now conferred by Part VII of the Mental Health Act 1983 upon 'the judge', ie certain nominated judges of the Chancery Division and also the master and deputy master of the Court of Protection. The jurisdiction is exercisable when the judge is satisfied that a person is incapable by reason of mental disability of managing his property and affairs,[4] and it is of the widest

16 Mental Treatment Act 1930.
17 Mental Health Act 1983, s 1.
18 *Boughton v Knight* (1873) LR 3 PD 64 at 72.
19 *Molton v Camroux* (1848) 2 Exch 487; affd 4 Exch 17; *Imperial Loan Co v Stone* [1892] 1 QB 599. *York Glass Co Ltd v Jubb* (1925) 134 LT 36. *Hart v O'Connor* [1985] AC 1000, [1985] 2 All ER 880.
20 *Molton v Camroux*, above.
1 *Hall v Warren*, (1804) 9 Ves 605. *Selby v Jackson* (1844) 6 Beav 192.
2 *Re Rhodes* (1890) 44 ChD 94; *Read v Legard* (1851) 6 Exch 636.
3 *Re Rhodes*, above.
4 The former procedure under which after a formal inquiry ('inquisition'), a person could be declared to be of unsound mind ('lunatic so found'), and a person appointed (the 'committee') to manage his person and property has been abolished: Mental Health Act 1959, s 149(2).

nature. It includes the power to make contracts for the benefit of the patient and also to carry out a contract already made by him.[5]

B DRUNKENNESS

It is generally said, both by judges[6] and by textbook writers, that the contractual capacity of a drunken person is the same as that of one who is mentally afflicted, but the decisions are few and not too satisfactory. The effect of *Gore v Gibson*,[7] as qualified by *Matthews v Baxter*,[8] would seem to be that if A, when he contracts with B, is in such a state of drunkenness as not to know what he is doing, and if this fact is appreciated by B, then the contract is voidable at the instance of A. It may, for instance, be ratified by him when he regains sobriety. It would appear, therefore, that a contract with a person so seriously afflicted must always be voidable, for unlike the case of insanity it is almost inconceivable that the extent of his intoxication can be unknown to the other party.

A drunken person to whom necessaries are sold and delivered is under the same liability to pay a reasonable price for them as is an infant or an insane person.[9]

5 Mental Health Act 1983, s 96(1)(h); cf *Baldwyn v Smith* [1900] 1 Ch 588.
6 *Molton v Camroux* (1848) 2 Exch 487.
7 (1845) 13 M & W 623.
8 (1873) LR 8 Exch 132.
9 Sale of Goods Act 1979, s 3.