ILLEGAL TRANSACTIONS:
THE EFFECT OF ILLEGALITY ON CONTRACTS AND TRUSTS

A Consultation Paper
THE LAW COMMISSION

ILLEGAL TRANSACTIONS: THE EFFECT OF ILLEGALITY ON CONTRACTS AND TRUSTS

CONTENTS

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1-1.24</td>
<td>1</td>
</tr>
<tr>
<td>1.1-1.11</td>
<td>1</td>
</tr>
<tr>
<td>1.6</td>
<td>3</td>
</tr>
<tr>
<td>1.7-1.11</td>
<td>3</td>
</tr>
<tr>
<td>1.12-1.15</td>
<td>7</td>
</tr>
<tr>
<td>1.16-1.17</td>
<td>8</td>
</tr>
<tr>
<td>1.18-1.21</td>
<td>9</td>
</tr>
<tr>
<td>1.22-1.23</td>
<td>10</td>
</tr>
<tr>
<td>1.24</td>
<td>10</td>
</tr>
<tr>
<td>2.1-2.78</td>
<td>11</td>
</tr>
<tr>
<td>2.2-2.31</td>
<td>11</td>
</tr>
<tr>
<td>2.3-2.19</td>
<td>12</td>
</tr>
<tr>
<td>2.20-2.31</td>
<td>21</td>
</tr>
<tr>
<td>2.20-2.23</td>
<td>21</td>
</tr>
<tr>
<td>2.24-2.28</td>
<td>24</td>
</tr>
<tr>
<td>2.29-2.31</td>
<td>26</td>
</tr>
<tr>
<td>2.32-2.56</td>
<td>27</td>
</tr>
</tbody>
</table>

PART I: INTRODUCTION

1. THE SCOPE OF THIS PROJECT

(1) Transactions which involve the commission of a legal wrong

(2) Transactions which are otherwise contrary to public policy

2. AN OVERVIEW OF THE AIM OF THIS PROJECT

3. STRUCTURE OF THE PAPER

4. AN OVERVIEW OF OUR PROVISIONAL PROPOSALS

5. COMPATIBILITY OF OUR PROVISIONAL PROPOSALS WITH THE EUROPEAN CONVENTION ON HUMAN RIGHTS

6. ACKNOWLEDGEMENTS

PART II: THE EFFECT OF ILLEGALITY I: CONTRACTS

1. THE ENFORCEMENT OF CONTRACTUAL OBLIGATIONS

(1) Contracts rendered unenforceable by statute

(2) Contracts rendered unenforceable at common law

(a) Contracts to commit a legal wrong or carry out conduct which is otherwise contrary to public policy

(b) Where one or both parties enter into the contract for the purpose of furthering the commission of a legal wrong or carrying out conduct which is otherwise contrary to public policy

(c) Where one or both parties commits a legal wrong or acts in a manner which is otherwise contrary to public policy in the course of performing the contract

2. THE REVERSAL OF UNJUST ENRICHMENT
Illegality as a defence to restitutionary claims

(a) Failure of consideration
(b) Mistake
(c) Duress
(d) Vulnerability

Illegality as a restitutionary cause of action: the doctrine of locus poenitentiae

3. THE RECOGNITION OF CONTRACTUALLY TRANSFERRED OR CREATED PROPERTY RIGHTS

(1) Title may pass under an illegal contract
(2) The recovery of property in which a limited interest has been created under an illegal contract - the reliance principle
(3) Exceptions

4. THREE OTHER ISSUES

(1) Damages for a different cause of action
(2) Severance
(3) Linked contracts may be tainted by illegality

PART III: THE EFFECT OF ILLEGALITY II: TRUSTS

1. THE GENERAL SCOPE OF THIS PART

2. “APPARENT GIFTS” AND RESULTING TRUSTS

(1) Where a resulting trust is unenforceable because its existence can only be shown by “relying” on illegality: the “reliance principle”

(a) The reliance principle
(b) The withdrawal exception
(c) The application of the principles illustrated

(2) Where a resulting trust will not arise, or will be unenforceable, for some reason other than the reliance principle

(a) A resulting trust will not arise, or will be unenforceable, where the turpitude of the beneficiary is gross
(b) A resulting trust will not arise, or will be unenforceable, where statute expressly or impliedly so provides

3. EXPRESS TRUSTS AND RESULTING TRUSTS ARISING ON FAILURE OF EXPRESS TRUSTS

(1) Express trusts which are invalid (or “void”) for illegality

(a) Express trusts which fall within this category
(b) The implications of an express trust or condition being “invalid”
   (i) The ordinary proprietary consequences of a decision that an express trust or condition is “void”
(ii) Does the reliance principle have any role to play in the event that an express trust or condition is void for illegality?

(2) Express trusts which are valid, notwithstanding illegality

(a) Express trusts which fall within this category
   (i) Express trusts created for an "illegal consideration"
   (ii) Express trusts created to facilitate fraud on a third party

(b) The implications of an express trust being not invalid but "unenforceable"

4. CONSTRUCTIVE TRUSTS GIVING EFFECT TO INTENTIONS

(1) Common intention constructive trusts

(2) Trusts (including "secret trusts") imposed on persons who receive property on the faith of an undertaking to hold for another

(3) The constructive trust arising from a specifically enforceable contract

(4) The constructive trust in Re Rose which gives effect to incomplete transfers

PART IV: THE EFFECT OF ILLEGALITY III: THE REJECTION OF THE "PUBLIC CONSCIENCE" TEST

PART V: THE CASE FOR LEGISLATIVE REFORM

1. COMPLEXITY

2. INJUSTICE

3. UNCERTAINTY

4. UNLIKELYHOOD OF JUDICIAL REFORM

5. CONCLUSION

PART VI: SHOULD ANY DOCTRINE OF ILLEGALITY BE MAINTAINED?

1. UPHOLDING THE DIGNITY OF THE COURTS

2. THE PLAINTIFF SHOULD NOT PROFIT FROM HIS OR HER OWN WRONGDOING

3. DETERRENCE

4. PUNISHMENT

5. CONCLUSION

PART VII: OPTIONS FOR REFORM I: CONTRACTS

1. OUR PROVISIONALLY PREFERRED BASIC APPROACH TO REFORMING ILLEGALITY: DISCRETION RATHER THAN STRICT RULES
(1) The enforcement of contractual obligations
   \[\text{Paragraphs}: 7.5-7.16\]  \[\text{Page}: 93\]
   \begin{enumerate}
   \item Contracts which involve the commission of a legal wrong
     \[\text{Paragraphs}: 7.5-7.12\]  \[\text{Page}: 93\]
   \item Contracts which are otherwise contrary to public policy
     \[\text{Paragraphs}: 7.13-7.16\]  \[\text{Page}: 96\]
   \end{enumerate}
(2) The reversal of unjust enrichment (where a contract is unenforceable for illegality)
   \[\text{Paragraphs}: 7.17-7.22\]  \[\text{Page}: 98\]
(3) The recognition of contractually transferred or created property rights
   \[\text{Paragraphs}: 7.23-7.26\]  \[\text{Page}: 100\]

2. STRUCTURING THE DISCRETION
   \[\text{Paragraphs}: 7.27-7.43\]  \[\text{Page}: 102\]
   \begin{enumerate}
   \item The seriousness of the illegality
     \[\text{Paragraphs}: 7.29-7.32\]  \[\text{Page}: 102\]
   \item The knowledge and intention of the plaintiff
     \[\text{Paragraphs}: 7.33-7.37\]  \[\text{Page}: 103\]
   \item Whether denying relief will act as a deterrent
     \[\text{Paragraphs}: 7.38\]  \[\text{Page}: 105\]
   \item Whether denying relief will further the purpose of the rule which renders the contract illegal
     \[\text{Paragraphs}: 7.39-7.40\]  \[\text{Page}: 105\]
   \item Whether denying relief is proportionate to the illegality involved
     \[\text{Paragraphs}: 7.41-7.42\]  \[\text{Page}: 106\]
   \end{enumerate}

3. WHAT SHOULD BE THE STARTING POINT OF THE PROVISIONALLY PROPOSED DISCRETION?
   \[\text{Paragraphs}: 7.44-7.57\]  \[\text{Page}: 107\]

4. ILLEGALITY AS A RESTITUTIONARY CAUSE OF ACTION: THE DOCTRINE OF \textit{LOCUS POENITENTIAE}
   \[\text{Paragraphs}: 7.58-7.69\]  \[\text{Page}: 111\]

5. THE SCOPE OF THE PROVISIONALLY PROPOSED DISCRETION
   \[\text{Paragraphs}: 7.70-7.72\]  \[\text{Page}: 115\]

6. GIVING THE COURTS A DISCRETION TO GO BEYOND TREATING ILLEGALITY AS A DEFENCE TO STANDARD RIGHTS AND REMEDIES
   \[\text{Paragraphs}: 7.73-7.87\]  \[\text{Page}: 116\]

7. SHOULD THE COURT BE GIVEN A DISCRETION IN CONTRACTUAL DISPUTES INVOLVING ILLEGALITY TO MAKE AN AWARD ON TERMS THAT THE PLAINTIFF MAKES A PAYMENT OR TRANSFERS PROPERTY TO A PERSON WHO IS NOT A PARTY TO THE ILLEGAL CONTRACT?
   \[\text{Paragraphs}: 7.88-7.93\]  \[\text{Page}: 122\]

8. THE INTERACTION OF THE PROVISIONALLY PROPOSED DISCRETION AND STATUTORY PROVISIONS WHICH DEAL WITH THE EFFECTS OF ILLEGALITY
   \[\text{Paragraphs}: 7.94-7.102\]  \[\text{Page}: 124\]

9. MISCELLANEOUS ISSUES
   \[\text{Paragraphs}: 7.103-7.106\]  \[\text{Page}: 128\]
   \begin{enumerate}
   \item Severance
     \[\text{Paragraphs}: 7.103\]  \[\text{Page}: 128\]
   \item Tainting
     \[\text{Paragraphs}: 7.104\]  \[\text{Page}: 128\]
   \item Changes in the law
     \[\text{Paragraphs}: 7.105-7.106\]  \[\text{Page}: 129\]
   \end{enumerate}

10. THE EFFECT OF OUR PROVISIONAL PROPOSALS
    \[\text{Paragraphs}: 7.107-7.116\]  \[\text{Page}: 130\]
    \begin{enumerate}
    \item How our provisional proposals might have operated in relation to some past cases
      \[\text{Paragraphs}: 7.108-7.113\]  \[\text{Page}: 130\]
    \item How our provisional proposals might apply to hypothetical examples
      \[\text{Paragraphs}: 7.114-7.116\]  \[\text{Page}: 132\]
11. GENERAL QUESTION ON DISCRETIONARY APPROACH

PART VIII: OPTIONS FOR REFORM II: TRUSTS

1. ABANDONING THE RELIANCE PRINCIPLE

(1) The difficulties with the reliance principle
   (a) The lack of convincing rationale and the arbitrariness of the principle
   (b) The uncertainties of the reliance principle
   (c) Conclusion

(2) Options for reform, if the reliance principle is abandoned

2. A DISCRETIONARY MODEL FOR ILLEGAL TRUSTS

(1) What do we mean by an “illegal trust”?
   (a) Trusts which are “illegal trusts” (that is, our proposed “definition” of illegal trusts)
      (i) Trusts which it is legally wrongful to create or to impose
      (ii) Trusts which are created to facilitate a fraud, or which arise out of a transaction or arrangement with that purpose
      (iii) Trusts which are created in order to facilitate some other legal wrong, or which arise out of a transaction or arrangement with that purpose
      (iv) Trusts which are created in return for an “illegal consideration”
      (v) Trusts which expressly or necessarily require trustees to commit a legal wrong or which tend or are intended to do so
      (vi) Trusts which expressly or necessarily require a beneficiary to commit a legal wrong or which tend or are intended to do so
      (vii) Trusts which are otherwise contrary to public policy at common law
   (b) Trusts which are not “illegal trusts”
      (i) A trust which neither expressly nor necessarily requires a trustee to perform an illegal act nor tends nor is intended to do so does not become an “illegal trust” where the trustee in fact performs such an act
      (ii) A trust which neither expressly nor necessarily requires a beneficiary to perform an illegal act nor tends nor is intended to induce such an act does not become an “illegal trust” where the beneficiary purports to satisfy a condition by performing such an act
      (iii) A trust where the trust property is used to achieve some fraudulent or other illegal purpose is not an “illegal trust” where the intention to use the trust property for that purpose was formed only after the date on which the trust was created or arose
<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.42-8.43</td>
<td>147</td>
</tr>
<tr>
<td>8.44-8.50</td>
<td>147</td>
</tr>
<tr>
<td>8.51-8.63</td>
<td>149</td>
</tr>
<tr>
<td>8.53</td>
<td>150</td>
</tr>
<tr>
<td>8.54-8.56</td>
<td>150</td>
</tr>
<tr>
<td>8.57-8.58</td>
<td>151</td>
</tr>
<tr>
<td>8.59</td>
<td>151</td>
</tr>
<tr>
<td>8.60-8.62</td>
<td>152</td>
</tr>
<tr>
<td>8.64-8.74</td>
<td>153</td>
</tr>
<tr>
<td>8.64-8.71</td>
<td>153</td>
</tr>
<tr>
<td>8.72-8.74</td>
<td>155</td>
</tr>
<tr>
<td>8.75-8.82</td>
<td>156</td>
</tr>
<tr>
<td>8.75-8.79</td>
<td>156</td>
</tr>
<tr>
<td>8.80-8.82</td>
<td>158</td>
</tr>
<tr>
<td>8.83-8.85</td>
<td>158</td>
</tr>
<tr>
<td>8.86-8.88</td>
<td>159</td>
</tr>
<tr>
<td>8.89-8.91</td>
<td>160</td>
</tr>
<tr>
<td>8.92-8.115</td>
<td>161</td>
</tr>
<tr>
<td>8.96-8.100</td>
<td>162</td>
</tr>
</tbody>
</table>
(b) The effect of dispositions by trustees occurring before a court order and the recipient's title and liability

(c) The effect of dispositions by beneficiaries to “third parties” occurring before a court order

(11) Severance

3. THE EFFECT OF OUR PROVISIONALLY PROPOSED DISCRETION

4. ILLEGAL TRANSACTIONS THAT ARE NEITHER CONTRACTS NOR TRUSTS

PART IX: SUMMARY OF PROVISIONAL RECOMMENDATIONS AND CONSULTATION ISSUES