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CIVIL LAW SECTION

REMEDIES IN CASE OF ILLEGALITY: TWENTY YEARS AND WHERE ARE WE?

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Fredericton, N.B.
August 10 -14, 2003

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INTRODUCTION

[1] Twenty years ago, in 1983, the Law Reform Commission of British Columbia issued a comprehensive report on the law relating to illegal transactions.[1] The report called for the enactment of an Illegal Transactions Act which would have substantially reformed the remedial aspects of this area of law, abolishing the common law remedial scheme and giving the courts a wide range of remedial powers in its stead. The details of this proposed statute will be discussed below.

[2] No legislative action was forthcoming. The Law Reform Commission itself was disbanded and its successor organization, the British Columbia Law Institute, was created in 1997 by incorporation under the Provincial Society Act. In 1998, it took up the 1983 report and, combining it with several other contract law initiatives, recommended the enactment of substantially similar provisions in a Contract Law Reform Act.[2] The purpose of that Act was both to consolidate provisions relating to contracts that currently are found in provisions of the Law and Equity Act and the Frustrated Contracts Act and to implement three reports of the Law Reform Commission which had not yet been acted upon by the legislature, including the Report on Illegal Transactions.[3]

[3] This Report of the Law Institute, like that of the Law Reform Commission, has also been neglected, in part, no doubt, because the reform of contract law appears a very mundane concern in a political environment in which serious economic challenges to the prosperity of the Province combine with deep ideological divisions. However, the genius of the British Columbia Law Reform Commission was always its ability to gain acceptance of its recommendations. Its projects tended to be incremental in the best sense of that word in that they adapted to the current legal system and made the best use of it. They were practical and had maximum effect for minimum change; they tended to be less ideologically driven than pragmatically influential. The tragedy of the Commission's history, one may speculate, may be found in the fact that being useful, it was not glamourous and not being glamourous may have ultimately led to the decision by government that in a world in which publicity counts, the Commission could no longer be useful.

[4] When the Report on Illegal Transactions was published, the Commission considered the alternative to reform. Particularly, it considered the suggestion that the courts could take care of the problem without legislation. The development in Canadian law of a discrete principle of unjust enrichment in the Supreme Court decision in *Deglman v. Guaranty Trust Co of Canada*,[4] elaborated and confirmed by that court in *Pettkus v. Becker*[5] in 1980 seemed to hold the promised key to a revision of some of the less

* My thanks to Ms. Jacqueline Leveille for her excellent research assistance in the preparation of this paper.

appealing aspects of the law governing illegal transactions. However, the Commission was not optimistic. It stated:

> We must state at the outset our conclusion that awaiting judicial reform is not a practical alternative. The process of judicial reform is, at best, haphazard. The elements leading to a pronounced change of judicial direction depend upon a happy coincidence of counsel, judges, facts and resources…Given that a proper case may emerge in which an argument may be advanced for a judicial reform, (and we know of no such case at present) there is no guarantee that the adoption of unjust enrichment as the guiding principle will necessarily result. The current law is well entrenched… [6]

[5] The purpose of this paper is to revisit this prediction of the Commission twenty years after it was written. After a consideration of the work of the Commission and its implications in light of later academic discussion, I will review a number of the most significant decisions in the area of illegal transactions over the past twenty years. The purpose of this review will be twofold: first, considering the now well established principle of unjust enrichment as a basic part of Canadian law, I will discuss whether the courts in analyzing illegal transactions appear to have made good use of the available tools; second, considering the much broader scope of the recommendations of the Commission, I will attempt to predict whether, had an illegal transactions statute in the terms envisaged by the Commission been available to the court, another result in these situations under consideration might have been possible. Finally, in light of this discussion, I will revisit the Commission's recommendations and discuss whether they are still needed and whether any minor alterations to them might now seem advantageous.

THE LAW OF ILLEGAL TRANSACTIONS

[6] When we refer to contract law as "private law" we do not, of course, mean that it is totally private. Indeed, if it were, it would hardly exist as "law" at all in the sense that laypeople, at least, commonly use the term. It is the fact that the private law of contract is nested within the public law of the state so that parties can take advantage of the enforcement mechanisms of the state (particularly as applied by the courts) that gives the promises made by parties to one another in commercial and like-commercial transactions their reliability. It is the decision of the state, expressed through both legislative and common law developments, that the ability of persons to make their own bargains needs to be protected and supported to ensure maximum economic growth, security and stability that gives contract and property law their force and their place in the recognized category of public "goods".

[7] For these reasons, it should hardly be surprising that when the private promises made by parties to a transaction conflict with a provision of the public law of the state or with a significant policy underlying that law, the availability of the courts to provide the necessary enforcement mechanisms should be in question.[7] The law of illegal transactions,[8] then, is concerned to define two things. First, when does a "private"

arrangement conflict with the law or policy of the state; and, second, what is the appropriate result if it does.

[8] The categories of illegal transactions are many and various. Most writers divide them into the broad general categories of contracts (or, somewhat more broadly, transactions) contrary to public policy and contracts contrary to statute.[9] But within that apparently simple division, much complexity lurks. For example, the contract may directly be prohibited by statue, or it may contravene a policy that the statute apparently supports, or it may be legal on its face but carried out in a way that offends a statute. As well, the categories of common law public policy are variously classified[10] and may change with changing conditions. For example, historically contracts for gaming have been held illegal.[11] However, confronted with the issue of enforcement of a gambling contract made in a jurisdiction in which it is legal, courts have determined that this rule now needs amendment and have proceeded to alter it.[12]

[9] In its Report, the Law Reform Commission of British Columbia surveyed in some detail the categories and classifications of substantive illegality.[13] It is not necessary to repeat its excellent analysis here. A somewhat less detailed, but also useful summary is found in Professor Waddams' book, The Law of Contracts.[14] Neither the British Columbia Law Reform Commission nor other proposed or enacted reforms of the law quarrel significantly with the categories of illegality or their legitimacy. As discussed above, the ability of the state to withhold its full panoply of enforcement mechanisms on the basis of a conflict with public policy is neither questioned nor in doubt and differences in classification do not seem to affect a common understanding of the principles of the substantive law.

[10] What is of concern to the Commission and to others is the consequence of that illegality. The "general rule" (as it is called by the Commission) combines two separate results of illegality.[15] The contract itself is held to be unenforceable by the court. As well, the court refuses to intervene to readjust the parties' rights. Thus, in the simplest case (discussed in the Commission's report), a highwayman who sues his partner for an accounting will not be allowed to maintain the action[16]; should a refusal to intervene leave one party in a better or worse position than fairness would seem to dictate, the courts will not intervene.

[11] The reasoning behind this blanket rule appears directly connected to the place the private law occupies in the general legal landscape, as discussed above. The use of the courts to enforce private bargains, of course, was not very old[17] when these consequences were discussed by Lord Mansfield in the leading decision of *Holman v. Johnson*.[18] That often-quoted case articulated the policy that the court would not lend its aid to a plaintiff who founded a cause of action upon an immoral or illegal act, but that this withholding of legal consequences was not intended to assist the either of the parties, each of whom would have to bear the losses as they had fallen.

[12] But while it may be a policy of law that private arrangements ought not to be encouraged when they conflict with public policies espoused either at common law or by statute, the rigid nature of the consequences attached to this conflict ignored separate policy considerations that might well arise in the application of those rules. While we commonly speak of a remedy as dictated by the cause of action (for example, that the remedy for breach of contract is expectancy damages), the law relating to remedies is itself a complex and highly nuanced system. Thus the general rule of contract damages is expanded by extensive analysis of what constitutes "expectancy" damages and when another measure of damages will be granted instead.

[13] This sophistication seemed to elude the courts in considering the result of an illegal transaction. Despite the varying circumstances that might give rise to illegality, some of which were undoubtedly more heinous than others, the blunt application of the general principle was mitigated only by very narrow and technical exceptions.[19] Where a plaintiff could show that she was not "in pari delicto" with the defendant,[20] either because she had substantially repented of a transaction that remained largely executory,[21] acted under a mistake of fact,[22] or because she was a member of the protected class sheltered by the policy which had been offended by the transaction,[23] the courts would not deny her relief. Another exception, perhaps the most technical, occurred where the plaintiff could frame his cause of action so that the illegal transaction did not need to be relied upon, but some other source of rights was found.[24] Similarly, if a court could use its "blue pencil" to strike out objectionable portions of a contract, the remainder, if sufficiently independent, could be enforced.[25]

[14] The other technique which courts employed to avoid the harsh consequences of the law was to interpret a statute in such a way that invalidity of the transaction in question was found not to be required by the policy of the statute. Only here did the courts engage in the kind of policy analysis that one might have expected to accompany the development of a remedial scheme. And the scope for analysis was further limited by the fact that a claim that a transaction is illegal because it violated the policy of a statute is only one of the multiple methods by which the taint of illegality may be incurred. In *St. John Shipping Corporation v. Joseph Rank Ltd.*,[26] Devlin J. developed what the Law Reform Commission referred to as a "rule of benevolent construction." When a contract was not expressly prohibited by statute, the court held, it should be slow to determine that the contract was illegal and unenforceable unless the statute contained a necessary implication to that effect.

[15] In that particular case, a contract of carriage resulted in a ship being overloaded according to English statute. The statute itself provided for penalties for such overloading, but the level of penalty was such that the carrier would still be able to pay the fine and retain a significant profit on the transaction. The shippers withheld payment of the shipping charges and claimed that the carrier could not enforce the contract because it was illegal, contravening the statutory policy against overloading ships. Devlin J. held that in determining whether the contract was enforceable, it was necessary to consider the language, scope and purpose of the legislation. He found that this statute did

not contain any necessary implication that contracts which resulted in overloading should be held illegal.

[16] This policy analysis, however, is employed by the court at the first stage of its task: the stage that considers whether the transaction should be found illegal at all. Development of a similar method of analysis for the consequences of illegality would have made similar sense. One of the most notorious cases of the application of the consequences of illegal contracts makes the point. A statute prohibited the selling of ungraded apples. The statute was meant to protect the public. A farmer sold ungraded apples to another farmer who intended to grade the apples before marketing and who had the equipment to do so. However, the contract was declared unenforceable by the court and the purchaser was permitted to keep the apples without payment. None of the technical exceptions to the general principle was applicable.[27] The outright silliness of this decision has been the subject of comment, of course.[28] It is impossible to believe that such statutory violations should be treated in the same way as a contract to commit murder.

[17] The technical exceptions to which I earlier referred were no doubt efforts by courts to temper the harshness of the law in certain cases while retaining the blanket general rule. They responded to the innate sense of the judge in a particular case, that justice required that the contract be enforced or, at the least, that some adjustment of parties' losses should be made. As Professor Trackman expressed it,

> Implicit in these technical rules, however, is a reason for strict enforcement that is based upon belief, namely, that the transaction should be enforced for some further, but unexpressed moral reason. In such cases, differences in belief may lead to radically similar or different results.[29]

[18] The result was a law of illegal transactions that seemed stunted in growth, confined to nineteenth century technicalities and inadequate to meet the needs of either public or private law.

[19] As the law stood in 1983, then, there was a perceived need to divorce a finding of illegality from the automatic consequences of the general rule. Further, there was a need to persuade the courts to engage in policy analysis in determining which consequences were appropriate to the given situation.

THE COMMISSION'S RECOMMENDATIONS AND SUBSEQUENT COMMENTARY

[20] This problem was addressed by the Commission by recommending, first, that the general rule of unenforceability and non-intervention be affirmed, but then that all the methods for avoiding that rule which the courts had devised be abolished. These methods were replaced by a comprehensive list of remedial possibilities which included any remedy that might have been granted had the contract not been declared illegal.

Additionally, remedies of restitution, compensation, apportionment of loss, a declaration, vesting orders for property and an expanded severance power were specified.[30]

[21] A blueprint for the policy analysis which the courts had seemed unwilling to engage in was set out in a subsequent section. While the proposed section concluded with a power to examine "any other factor the court considers relevant", the Commission specifically commended to the attention of the court such matters as the public interest, factors involved in the relationship of the parties, knowledge of the parties, the stage of performance of the contract, substantial compliance with legislative requirements and the consequences of denying a remedy.[31]

[22] Arguably, the most important feature of the British Columbia proposal is the provision of a separate policy analysis for the consequences of illegality once the fact of illegality has been determined. The complete elimination of the previous legal exceptions[32] together with a broad list of remedies and a further indication that the court is expected to consider a broad range of policy factors when considering what remedy it should select should have had the effect of giving the courts a new start in the common law development of remedial aspects of illegal transaction cases.

[23] If for no other reason, such a "fresh start" can be justified by the addition to the law since *Holman v. Johnson*[33] of a general recognition that the policy of the law, as well as refusing to favour private arrangements that are immoral or illegal with the rights of enforcement afforded to other private agreements, also regards as abhorrent the enrichment of one party at the expense of another without juridical reason for the benefit being retained. The far-reaching effects of this development in the common law on reform of the law of illegal transactions were extensively discussed by Professor John McCamus in his article "Restitutionary Recovery of Benefits Conferred Under Contracts in Conflict with Statutory Policy – the New Golden Rule",[34] written only four years after the Law Reform Commission's work.

[24] In that article, Professor McCamus argued for a policy analysis like that directed toward the question of whether a contract was illegal in *St. John Shipping*[35] to also be directed toward the separate question of what relief should be given after a contract was declared illegal. He proposed that restitutionary claims under illegal agreements should be assessed in light of the purpose and structure of the statutory scheme or rule rendering the transaction unenforceable; that withholding restitutionary relief ought to require a finding of whether it was necessary that the policy of the law that benefits transferred under ineffective transactions be restored ought to be "suppressed" in order to give effect to the statutory scheme or rule of law creating the illegality. Professor McCamus further argued, perhaps less convincingly, that the current exceptions to the courts' non-intervention rule found in such doctrines as availability of relief to parties not in pari delicto provided the necessary doctrinal support for this advance being made by judicial decision.

[25] It is interesting that in most cases where a transaction is declared illegal, the chief objection today is likely to be that the general rule applied by the courts will result in a windfall benefit to the defendant.[36] Today, the retention of a benefit unfairly gained at the expense of another and retained with no legal justification is likely to appear as offensive to legal policy as many kinds of illegality of contract.[37] This competing policy claim for the application of the remedy of restitution makes it a strong contender as a primary remedy to be applied even in the face of a finding of illegality and may account for why "restitution" heads the list of the specific kinds of remedies that the proposed legislation would permit a court to grant. However, the proposal of the B.C. Law Reform Commission went much farther than that, permitting even a virtual enforcement of the contract.

[26] Restitutionary remedies also formed the backbone of the recommendations of the Ontario Law Reform Commission to deal with illegal contracts as discussed in a chapter of its "Report on Amendment of the Law of Contracts" released in 1987.[38] Unlike the earlier British Columbia report, however, the Ontario report confined the scope of the court's actions more rigidly to restitution or the award of compensation. The power advocated by the British Columbia report to allow any remedy that might have been granted had the contract not been illegal was absent as were many of the wide range of additional listed remedies.

[27] This approach was criticized by Professor Leon Trakman in his article "Porridge or Scrambled Eggs"[39] in which he noted that the common law, which the report criticized, was "largely preserved" thus retaining vast discretion for the judiciary in determining what is or is not illegal but curtailing their authority to create a new scheme of remedies by retaining also the remedial framework that currently exists with only modest additions.[40] In part, however, as Professor Trakman himself admitted, his objections to the report rested upon a belief that the report evidenced "debatable premises about the nature of the judicial role in private and public affairs, and [rested] upon a questionable faith in a common law approach, absent a comparable faith in the judges themselves."[41]

[28] The British Columbia approach, it is suggested, is less inconsistent. It is, despite its repudiation of the common law as built by the judiciary up to the time of the report in tackling the problem of the consequences of illegal contracts, an open invitation to the development of the common law founded upon a more modern policy approach. Professor Trakman, however, also objected to the Ontario report on the grounds that, like the New Zealand approach,

> The Report raises equity between the parties to a public interest…More traditional public interests, such as those relating to the "gravity of the violation committed by the parties" become mere abstractions, to be borne in mind as additional "factors" yet amorphous in themselves.[42]

[29] With respect, the suggestion that this commits the report to the "path of dubious dualism in dealing with this public/private distinction"[43] appears itself to be based upon a dualistic belief that the embedding of private law in the public regime does not serve

public ends and that the prevention of unjust enrichment arising out of private transactions should not equally be considered a public good. The British Columbia recommendations appear to give fair weight to what I would prefer to call multiple aspects of the public good.

[30] But notwithstanding the persuasive reasoning of the Commission and its consistency with the development of a strong legal policy in favour of restitution, legislative reform did not occur. Instead, the courts were left to carry on business as usual, influenced, it is true, by the developing law of unjust enrichment, but also tethered by the weight of judicial authority which had been unable to envisage any benefit to the public good arising out of a court's meddling in a private transaction once it had been declared illegal. To a discussion of some of the significant Canadian cases since the writing of the Law Reform Commission's report, this paper will now turn.

COMMON LAW DEVELOPMENTS

[31] Without legislative direction to sweep away the rules of the past, the courts have, for the most part, dealt with illegality in traditional ways. The technical exceptions to the application of the general non-enforcement and non-interference policies have continued to be applied. While this has often allowed the more egregious results of these principles to be avoided, a consideration of the cases suggests that, in the words of Professor Trakman,

> Courts that are not statutorily authorized to grant a whole gamut of remedies in relation to illegal contracts usually are constrained to adopt another form of activism, often of a technical or fictional nature.[44]

[32] The willingness of courts to seek and apply such exceptions may support the view that the classical view of illegality is indeed crumbling and may ultimately be swept away by judicial change once the weight of the exceptions becomes too great for subsequent courts to rationalize. Certainly, at least one well regarded case has made that point[45] and has, in the area of contract contrary to statute, adopted radical principles reminiscent of the approach of the B.C. recommendations.

[33] However, as I will discuss, the consequences of that decision have been limited and, in contrast, several more recent decisions have illustrated what may be a return to remedial rigidity in the field. Moreover, decisions in the related areas of unenforceability and ultra vires have illustrated the difficulties in drawing lines between those areas of law and the concept of illegality. They point to the need for a reform of the law of illegality that will make the differences in categorization produce less inconsistent results.

A) Traditional views of the doctrine of illegality

i) The case law

[34] A classical application of the doctrines relating to illegal contracts is found in the 1998 Supreme Court of Canada decision in *Continental Bank Leasing Corporation v. Canada*.[46] The case involved a reassessment of Continental Bank Leasing on the grounds that its participation in a partnership was illegal and it was thus not entitled to the income tax treatment accorded to a partnership. The grounds of illegality were based upon a prohibition in the Bank Act[47] that prohibited a Bank from participating, directly or indirectly, in a partnership in Canada. Continental Bank Leasing was a wholly owned subsidiary of Continental Bank of Canada. Thus the Bank was acting in contravention of a direct statutory prohibition in being an investor in Leasing.

[35] Leasing's participation in the partnership was attacked on two principal grounds: first, that s. 34 of the Partnerships Act[48] of Ontario operated to dissolve the partnership; second, that Leasing's participation in the partnership was invalid because contrary to public policy expressed in the Bank Act. The court all agreed that the Bank's investment in Leasing did not of itself render the transaction invalid because of the specific provision of s. 20(1) of the Bank Act which expressly provided that a transaction was not invalid by reason only of acts of a Bank in contravention of the Act. This did not, however, dispose of the issue of whether the participation of Leasing in the partnership was illegal as contrary to the policy of the statute and whether, if it was illegal, that either dissolved the partnership or rendered the partnership contract invalid.

[36] The judges of the court disagreed on the conclusions. The Partnerships Act provided that a partnership was dissolved upon the happening of an event "that makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership". Bastarache and L'Heureux-Dube JJ. decided that the common law doctrine of illegality made it unlawful for Leasing to carry on the business in partnership. Bastarache J. accepted that the modern approach to determining whether a contract contrary to statutory policy is void depends upon the purpose and object of the prohibition. After considering these factors, he determined that "I conclude that it is contrary to public policy to allow the parties to the transaction to benefit from their deliberate breach of the prohibition set out in the Bank Act."[49] This finding, he further held, automatically attracted the operation of s. 34 of the Partnerships Act and rendered the partnership void from the beginning.

[37] The majority disagreed that s. 34 of the Partnerships Act was engaged by the illegality of the transaction. They made a highly technical distinction between the use of the term "illegal" in finding that a contract is contrary to public policy and the use of the term unlawful in such statutes as the Partnerships Act[50]. Having disposed of that objection and without citing the *St. John Shipping*[51] decision, but clearly following its mode of analysis, McLachlin J. determined that breach of the Bank Act did not render the partnership agreement unenforceable. She stated that to rule otherwise would be "to introduce uncertainty into the affairs of individuals and business". Furthermore,

> Section 20(1) thus supports the view that Parliament never intended breaches of the Bank Act to render bank transactions, including investments in other corporations, like Leasing, null and void. This supports the argument that

> Parliament intended to create an offence punishable by fines, not to invalidate otherwise lawful transaction.[52]

[38] The case, as already suggested, is by no means a surprising one. The court was able to use the benevolent interpretation test, buttressed, in this case, by the express words of the statute, to achieve a result that no doubt was unsatisfactory to the Canadian Customs and Revenue Agency but avoided creating serious commercial uncertainty. The worrisome aspect of the case is that to the minority the consequences of illegality appeared inescapable. Despite quoting from a decision which espoused a much more flexible approach to the results of illegality[53] (which I will discuss in detail below), the minority did not adopt that flexibility. Serious commercial consequences were avoided only by the majority's application of the traditional evasive tactic of benevolent interpretation when confronted with unacceptable results.

[39] Another case in which a court made good use of the benevolent construction principle was the decision of the Alberta Court of Appeal in *Love's Realty & Financial Services Ltd. v. Coronet Trust*.[54] In that case, Kearans J.A. upheld a contract for payment of commission which was entered into, but not performed, before the agent had completed the real estate licensing process as required by statute. The statute prohibited the bringing of an action for a commission where the real estate agent was not licensed at the time the services were rendered. The court held that the policy of the statute did not require a finding of invalidity of a listing contract entered into before the agent was licensed where the services were not performed until after the license was granted. In his judgment, Kearans J.A. commented unfavourably on the classical doctrines of illegality and relied upon the discussion of the law of the British Columbia Law Reform Commission.[55]

[40] The Supreme Court of Canada was also able to achieve a fair outcome by applying the traditional law in *Transamerica Life Insurance Co. of Canada v. Oldfield*.[56] In that case, an insured died when a condom containing cocaine which he had swallowed in the course of a smuggling operation burst in his stomach, causing heart failure. The named beneficiary of the policy was his estranged wife. The policy had been taken out as part of a separation agreement under which the deceased agreed to maintain life insurance until their two children became 18. The insurer argued for the existence of a general rule that the court will not aid in the enforcement of a life insurance policy when the insured dies accidentally as a result of her or his own crime.

[41] The authority cited for this proposition included the 1992 decision of the Supreme Court of Canada in *Brissette Estate v. Westbury Life Insurance Co*.[57] In that case, the husband had murdered his wife. The husband was the named insured. The court refused to interpret the policy so as to vest the proceeds of the insurance in the estate of the wife which would then have passed to the minor children. The court here distinguished *Brissette* on the grounds that in that case the court had found that any claim to the insurance had to be made through the husband whose illegal act disentitled him to receive

the funds. It was not to be interpreted so as to bar a claim by an innocent beneficiary independent of the criminal's rights.

[42] This decision maintains the traditional distinction between contracts illegal in their formation and contracts which are tainted by illegality in their performance and the different results which attach to each category. Contracts illegal in their formation are wholly unenforceable; thus had the insurance contract purported to insure the deceased while smuggling cocaine, no claim could have been advanced by anyone to the proceeds.[58] However, contracts which may be affected by illegality in their performance can be enforced by innocent parties in the appropriate circumstances.

[43] The court, again, took an inherently conservative approach but was able to achieve a fair result in so doing. It went on to consider whether the result in *Brissette*[59] and other cases in which the claim of equally innocent parties has to be made through the insured or his estate and is thus denied ought to be modified. The court acknowledged that the distinction was arbitrary and referred to proposals for a test that would balance the public policy issues as well as to legislative reform in England. However, despite commenting favourably on such initiatives, Major J. determined to "leave the question to be decided either by the legislature or in another case where the issue arises."[60]

[44] Other cases have embroiled themselves in the intricacies of the exceptions to the general principles of unenforceability and non-intervention. The results in these cases, which I shall discuss in some detail, highlight (I would suggest) the artificiality of those exceptions and the continuing difficulties in applying them.

[45] In *Ouston v. Zurowski*,[61] the plaintiffs sued to recover money which they had paid to the defendants as a part of an illegal pyramid scheme. The contract under which the money was paid was alleged to have contained a promise by the defendants to indemnify the plaintiffs against the risk of losing their money. The scheme came to an end when the newspaper ran an article on illegal pyramid operations. The defendants notified the plaintiffs in a telephone call that in light of the publicity, the "board" would not meet for the time being. The plaintiffs then apparently ceased any participation in the scheme and brought suit to recover their money.

[46] The British Columbia Court of Appeal held that the locus poenitentiae exception applied. To make this finding, the court concluded that the contract was not one which was so steeped in moral turpitude that a court would not discuss it; that the contract was terminated while it was still substantially unexecuted; and that the plaintiffs had shown adequate "repentance". While one may agree that a gambling contract is not, in today's moral judgment, deeply offensive, the court's findings on the other two matters appear problematic.

[47] In this case, the defendants had obtained enough participants in the scheme to receive their profits. The plaintiffs had made the full payment of all funds required of them. The plaintiffs had not yet obtained enough other participants to produce their

profit, but they had apparently approached some other persons, although perhaps not with great enthusiasm. This suggests that a significant part of the scheme, at least, had been carried out. Further, although the court refers to the plaintiffs' withdrawing from the scheme, it appears from the facts as related by the court that it was the defendant's decision to terminate the operation due to the publicity. However, the court found that the plaintiffs were unaware that the scheme was illegal and had been "suckered" by the defendants into believing that it was legal. The court's conclusions perhaps owe more to the moral sense that it would be unconscionable to allow the defendants to retain the plaintiffs' contributions than to the technical exception to the doctrine of illegality of contract on which the decision purports to rest.

[48] In contrast, the Alberta Provincial Court came to the opposite conclusion on facts which were very similar to those in *Ouston*.[62] In *Lefaivre v. Green*,[63] the plaintiffs were also suing for return of money they had paid to the defendant under an illegal pyramid scheme. As in *Ouston*, the defendant had been an instigator of the scheme and had received his windfall profit; the plaintiffs had paid all that was necessary. The scheme had come to an end when unfavourable publicity had caused the defendant to terminate the meetings of the "club". Two of the plaintiffs, like the plaintiffs in *Ouston*, had not yet finished the required recruiting necessary to obtain their own windfall. However, the court held that the scheme was too far into its operation for the plaintiffs to take advantage of the locus poenitentiae. The real distinction between the cases, it is suggested, is that in *Green*, the court apparently believed that the plaintiffs had good reason to believe the scheme was illegal. This ought, however, on traditional grounds to have made no difference as to the question of whether the contract had been substantially performed to the point where the locus poenitentiae was no longer available.[64]

[49] Another example of the use of a technical approach to permit flexibility in the situation of an illegal contract is the British Columbia Supreme Court decision in *Faraguna v. Storoz*.[65] Both plaintiff and defendant had cooperated in producing two sets of documents relating to a property sale. One set showed the purchase price substantially reduced and was intended to reduce liability for property transfer taxes. The court found both parties in pari delicto and refused to enforce the repayment claimed by the respondent based on the false documents. However, the court was willing to regard an agreement for sale entered into by the parties which had been intended to operate under both sets of documents as independent of the illegality and permitted the petitioners to recover the small amount owing under it plus interest and taxes accruing under that agreement.

[50] Without guidance as to the policy to be applied in considering whether a remedy may be appropriate, courts may also use the doctrines of illegality in ways that may rather reflect their personal opinions rather than rational policy conclusions. Such, it is suggested, was the nature of the decision of the Newfoundland Court of Appeal in *Bursey v. Bursey*.[66] As part of a separation agreement, the husband had received an indemnity from the wife for 50% of his potential liability for unpaid sales tax. There was some evidence that the husband had led the wife to believe that as long as she did not report the

fact that he was in default in required payments, she would not have to pay on the indemnity, although the contract was not expressed in those terms and the parties were both represented by counsel. The husband was reported by a third party and was ordered to pay approximately $54,000, half of which his solicitor demanded from the wife under their agreement.

[51] The court held that there was evidence to support a finding that the contract was made in furtherance of a scheme to evade tax. As well, it held that the wife was aware of the problem and the husband's illegal behaviour. Thus the contract was illegal and the court refused to intervene to enforce it. Because the wife was the defendant in the action, she was in the stronger position.

[52] The trial judge had held that the purpose of the agreement was to discourage the wife from reporting her husband's failure to pay the sales tax. The Court of Appeal found that there was some basis for this conclusion, but considered more broadly that the agreement was part of a scheme to evade the payment of tax. It is unclear how this agreement could be part of a scheme to evade tax. The illegal events had already occurred and the liability existed. The husband, having become aware that some years previously that he had apparently been mistaken in his tax liability, was, at the time the agreement was entered into, merely hoping that his default would be overlooked. That proved a false hope when he was subjected to an audit and the matter came to light.

[53] The assets which the husband owned and which were the subject of the division of property were obviously considerably less valuable if the potential sales tax liability should be imposed. The purpose of the indemnity would appear to have been, as argued by counsel, to ensure a fair division of the assets. While no doubt the effect would be to discourage the wife from reporting his default (if she were so minded), it seems highly unlikely that the husband would not realize that his wife's silence was unlikely to protect him fully. How the agreement could further a tax evasion scheme which had already been carried out seems puzzling. The agreement would appear rather an attempt to preserve the fairness of the settlement in case of reassessment. The courts' finding of illegality and their refusal to intervene almost certainly defeated this legitimate purpose.

ii) The effect of the recommendations of the British Columbia Law Reform Commission

[54] The advantages that would have accrued had the courts in deciding the cases discussed above been able to apply statutory provisions such as those recommended by the Report on Illegal Transactions seem fairly clear. Of course, it cannot be presumed that one can predict exactly how any given judge might apply a policy analysis in any given case. However, a brief review of the cases discussed suggests that the courts could have achieved the same results, but in a much more straightforward, consistent and simple fashion or might have been assisted in achieving a fair result by being directed to relevant factors by the statute.

[55] The "benevolent construction"[67] doctrine which was in effect applied by the majority in *Continental Bank*[68] and directly relied upon in *Love's Realty*[69] was preserved by the British Columbia recommendations. As formulated in the draft statute included in the later Proposals for a Contract Law Reform Act, the relevant section would have stated:

> A contract must not be considered an illegal contract by reason only that its formation, existence or performance contravenes an enactment or defeats its purpose unless the enactment, or the furtherance of that purpose, clearly so requires.[70]

[56] The existence of this section might have persuaded the minority in *Continental Bank*[71] to decide that the effect of s. 34 of the Partnerships Act was not engaged and provided a much more direct and less technical route by which the majority could have arrived at the same conclusion it reached. The statutory intention, clearly expressed in s. 20(1) of the Bank Act does not require transactions by banks made in violation of its provisions to be declared illegal; in fact, the entire tenor of the statute appears to be that commercial certainty (obviously at risk should contraventions of the Act render contracts unenforceable) is a primary purpose of the enactment. Thus, the contract not being illegal under this analysis, s. 34 of the Partnerships Act is not engaged. No distinction between "illegal" (as contrary to public policy) and "unlawful" (as contemplated in the Partnerships Act) need be made.

[57] Of course, given the conclusions of Bastarache and L'Heureux-Dube JJ. that it was highly objectionable that Leasing be able to take advantage of what was obviously a scheme to avoid the Bank Act and reduce tax, nothing in the recommendations would have compelled them to adopt another conclusion. However, it would, I suggest, have been more difficult to maintain that conclusion had a statute required the court to determine that the public policy of the Bank Act "clearly requires"[72] such transactions to be illegal.

[58] The cases discussed above that applied the traditional exceptions to the doctrine would have benefited even more greatly from the legislative scheme proposed in the Draft Act. The sections providing a wide range of remedy, including the ability to make any remedial order that could have been made had the contract not been illegal[73] would certainly have provided the flexibility for the court in *Oldfield*[74] to tackle the issue of payment under life insurance contracts when a crime has been committed on a broader basis and perform the policy analysis that remedial proposals discussed but not applied by the court favoured. The harsh, admittedly technical and arbitrary rule in *Brissette*[75] could have been eliminated at that stage rather than waiting for further jurisprudence. Neither in *Ouston*[76] nor in *Faraguna*[77] would the courts have had to engage in and, arguably, stretch the limits of the technical legal doctrines. Both could have been decided the same way using restitutionary remedies.

[59] Similarly, had the court in *Bursey*[78] been directed to apply a separate policy analysis to the consequences of illegality (assuming it would still have considered the agreement illegal), it would have been able to consider the effect of failure to enforce the agreement

on the terms of the separation agreement which, arguably, resulted in a windfall for the wife who was, at the time of the agreement, well aware of the husband's illegal conduct due to her involvement in his business and whose share of the matrimonial property had been increased by her taking advantage of the (up to that point) success of the husband in avoiding detection. There are some hints in the judgment that the wife's signature on the separation agreement may have been unfairly obtained, although, as already noted, she had been represented by independent counsel. That factor could also have been explicitly considered by the court and weighed together with the economic factors in determining a fair result.

B) The "bright light"

i) The case law

[60] The most promising development in the law of illegal transactions that has occurred since the work of the Law Reform Commission was a decision in the Federal Court of Appeal in the case of *Still v. M.N.R.*[79] In spirit, this case reflected the approach of the B.C. Commission by divorcing the analysis of what made a contract illegal from the analysis of what should be done about an illegal contract and applying a thorough policy analysis to that second question. The case is even more notable when one considers that the facts were not one on which an unjust enrichment claim could have been brought and that, therefore, developments in that area of the law were of no assistance to the Court.

[61] Ms Still was an American citizen who had married a Canadian and immigrated to Canada to be with her husband. She applied for permanent resident status and was assured by a document provided her by Immigration Canada that an exemption was available to her, provided all requirements were met. The document also contained an ambiguous clause which could have been interpreted to mean that she could now be employed in Canada without further steps. She did take employment as a housekeeper and worked for approximately five months before her permanent residence status was granted. One month later, she was laid off and applied for unemployment benefits. She was denied these benefits on the ground that her contract of employment was illegal because contrary to the Immigration Act and that her employment therefore did not constitute insurable employment under the employment insurance legislation.

[62] The question of whether or not Ms Still's employment contract was illegal was abundantly clear. This was not a situation in which the court could rely upon a saving provision of a statute or upon the benevolent interpretation test. Subsection 18(1) of the Immigration Regulations of 1978 was quoted by the court as providing that "no person, other than a Canadian citizen or permanent resident, shall engage in or continue in employment in Canada."[80] The court held that this prohibition went to the formation of the contract and that, under the classical doctrine of illegality, her contract was void ab initio.

[63] After commenting unfavourably on the classical position and noting the inconsistency in the development and application of exceptions to it, Robertson J.A. formulated what was, in effect, a new answer to the question of what consequences a finding of illegality should bring with it. He stated the test as follows:

> In my opinion, the doctrine of statutory illegality in the federal context is better served by the following principle (not rule): where a contract is expressly or impliedly prohibited by statute, a court may refuse to grant relief to a party when, in all of the circumstances of the case, including the objects and purposes of the statutory prohibition, it would be contrary to public policy, reflected in the relief claimed, to do so.[81]

[64] He proceeded to apply this test by analyzing two dimensions of public policy that might outweigh the applicant's right to unemployment insurance benefits: the principle that a person should not benefit from her or his own wrong; and the desirability of preserving the purposes or objects of the statutes involved. Having reviewed these factors, he found that Ms Still's good faith was a crucial element. Further, he noted that under the Immigration Act, a penalty could only be imposed on Ms Still if she knowingly broke the law; yet the result of a finding that she was disentitled to employment insurance benefits imposed, de facto, a very harsh penalty. After concluding his analysis, Robertson J.A. allowed Ms Still's appeal.

ii) The effect of the Law Reform Commission recommendations

[65] The *Still*[82] decision has been regarded with considerable approval.[83] As already noted, its approach was highly consistent with that of the Report. Indeed, the mechanism of policy analysis that Robertson J.A. employed might serve as a model to courts should the draft legislation ever be enacted. It appears likely that the work of the Commission was influential in tailoring the court's approach, although it is not expressly credited in the judgment with that effect.[84] However, the work was cited to the court and, it is suggested, the parallel in fundamental approach is too great to be ignored.

[66] However, the *Still*[85] decision, despite receiving approbation, has not yet heralded any radical change in the law of illegal contracts.[86] This is hardly surprising since, as the Law Reform Commission itself noted in the quotation with which this paper opened, the development of the common law depends on that "happy coincidence of counsel, judges, facts and resources".[87] That occurred in *Still*. But to work a pervasive change in the common law will require more similar cases in which the *Still* approach is adopted. In one significant Court of Appeal decision which will be discussed in some detail later, the *Still* approach might have proved highly illuminating.[88] However, it was not considered by the court at all.

C) "Like" cases and their connections to the doctrine of illegality

[67] Professor McCamus noted in his paper that cases of ultra vires and of unenforceability due to failure of formalities are closely allied to illegal contracts.[89]

Where a claim of ultra vires is advanced, the claimant is arguing that the actor is exceeding its authority as limited by statute or documents produced under statute; in the case of unenforceability, again a policy of the law regarding the necessity for certain formalities to be entered into has been transgressed. Yet cases in neither of these categories, for all their apparent similarities to many claims of statutory illegality, have been subjected to the same treatment as contracts held simply illegal. While elaborate explanations for the differences exist,[90] the fact remains that both claims of ultra vires and of unenforceability due to failure of formality concern agreements formed in contradiction to statutory policy. The substantive arguments for according them different treatment appear poor.

i) Recent case law – Ultra Vires

[68] In *Communities Economic Development Fund* v. *Canadian Pickles Corp.*,[91] a statutory corporation was held to have made a loan that was ultra vires its statutory limits. The corporation was incorporated to assist businesses in communities that were remote and isolated; the loan in question was made to Canadian Pickles Corp., which was operating in a community located 20 kilometers north of Winnipeg. The result of a finding of ultra vires was that the loan was void. From a practical perspective, this finding did not harm the lender in its claim directly against the borrower: the loan was for $150,000 and the corporation had virtually non-existent assets. However, the Supreme Court of Canada also held that the invalidity of the loan made recovery on the guarantee given by a shareholder of the corporation impossible. The court rejected a claim for "monies had and received" on the basis that the guarantor had received no funds; it further held that the guarantee, which made the guarantors liable as principal debtors, did not apply to the situation in which the loan was ultra vires. On the strict interpretation of the contract, the court held, the action failed.

[69] This decision was roundly criticized by John Swan in his comment "The 'Void' Contract; Ultra Vires and Illegality".[92] Professor Swan pointed out that where courts have found loans made contrary to a provision of statute, the trend has been to use the benevolent interpretation test and to uphold the validity of the contract. In suggesting that the treatment by the Supreme Court of ultra vires loans was anomalous, he made the point that

> It would, I think, be possible to argue that courts might be expected to have more problems with making illegal contracts … enforceable than with permitting a corporation to recover on an ultra vires loan. Illegal contracts have always had an aura of criminality and wrongdoing about them that has frequently made enforcement difficult…An aura of criminality cannot as easily be felt when a loan is merely ultra vires. In this sense, cases like those I have mentioned are very strong authority for the enforcement of the loan.[93]

[70] His view, as well, was that since the court should have found the corporation liable to repay the loan, the guarantee as well should have been enforced. The technical analysis

of the language of the guarantee ignored, in Professor Swan's judgment, the clear and reasonable commercial intentions of the parties.[94]

ii) Ultra Vires contracts and the B.C. Law Reform Commission

[71] It has been observed that ultra vires contracts are an endangered species; most general corporate statutes now give a corporation the capacity and powers of a natural person.[95] However, statutory corporations and various other corporations not formed under the general business corporation statutes may, as this case showed, still be subject to the doctrine. The arguments for treating an ultra vires contract the same way as an illegal contract appear, as Professor Swan argues, very strong.

[72] The recommendations of the Law Reform Commission, as put into draft legislation by the draft Contract Law Reform Act, would arguably include ultra vires contracts within the definition of "illegal contracts". The remedial system of the Act, including the preservation of the benevolent interpretation rule cited above, would then be applicable to such contracts. The draft Act defines "illegal contract" as

> A contract that in its formation, existence or performance, is null, void, illegal, unlawful, invalid, unenforceable, or otherwise ineffective, or in respect of which no action or proceeding may be brought, by reason of an enactment or of a rule of equity or common law respecting contracts that are contrary to public policy.[96]

[73] The definition is followed by several exceptions, none of which would apply to ultra vires contracts.[97]

[74] On its face, an ultra vires contract is "void" by reason of a rule of common law. That rule of common law invalidates contracts made beyond the power and capacity of a corporation based upon the theory that the powers of corporate entities should be confined to only those objects and powers expressly entrusted to them.[98] It might be argued, to the contrary, that the closing words of the definition quoted (respecting contracts that are contrary to public policy) do not necessarily apply to include contracts invalidated by the doctrine of ultra vires. However, I suggest that the words are broad enough to include them should a court accept that the differences in treatment with illegal contracts and the inflexibility of the ultra vires rules would make such inclusion desirable. For greater certainty, an amendment specifically extending the statute to ultra vires transactions might be made.

iii) The case law – contracts not meeting formality requirements

[75] One may contrast the stringent treatment of ultra vires contracts – exceeding even the rigidity of the law of illegal transactions – with the more generous treatment of contracts which fail statutory requirements of formality. The recent decision of the New Brunswick Court of Appeal in *Safeway Shouldering Ltd. v. Nackawic (Town)*[99] is instructive.

[76] Under the mistaken belief that he had been awarded a contract by the town for shouldering some 5 km. of highway, Mr. Fox, the owner of Safeway Shouldering, proceeded to carry out the work. When he submitted an invoice, he was refused payment. The defence raised was that s.5 of the Municipalities Act[100] rendered unenforceable any contract with a municipality which was not under seal and signed by the mayor or clerk. Mr. Fox had acted on the basis of what he believed to be an oral contract only. He claimed restitutionary recovery.

[77] The court had no difficulty in determining that the Town had been enriched by Mr. Fox's work and that his company had been correspondingly deprived. The major argument in the case was whether the legislative purpose of the statute should be a factor in determining whether there was any juristic reason why the Town should not be required to restore the benefit received by paying appropriately for it. The court held that the purpose of the legislation might be relevant. In this case, it further held that permitting restitutionary claim of Safeway would not substantially undermine the purpose of this section of the Municipal Act and recovery was granted to Safeway.

iv) The recommendations of the Law Reform Commission

[78] The case illustrates the application of the law of unjust enrichment in a case in which a contract is unenforceable because lacking a required formality. As such, it is unremarkable. The cases on illegality of contract are not referred to or discussed and the matter is treated as a wholly separate issue.

[79] However, the approach of the court would, I suggest, be consistent with the treatment of illegal contracts under the proposed draft Act. Under that Act, despite a claim that the contract is illegal, the court would have to engage in a very similar analysis. The result would be that an illegal contract could be treated in very much the same way as one unenforceable because of a failure to meet formal requirements. This consistency is to be applauded.

[80] The proposed draft Act expressly excludes from its operations "a contract that is unenforceable by reason only of its not being in writing or signed by the party to be charged, or that party's agent".[101] This exclusion is framed in words that appear to be directed specifically towards requirements of the Statute of Frauds or, in British Columbia, those remnants of the Statute of Frauds yet preserved by the Law and Equity Act.[102] The rationale for this exclusion is said, by the British Columbia Law Institute,[103] to be a wish to preserve the functions performed by this statute which had already been the subject of an earlier report by the Law Reform Commission.[104] The reforms implemented after that report was published provided, in the revisions currently found in the Law and Equity Act, a full range of remedial possibilities to the court. It was not necessary, therefore, to bring contracts unenforceable for this reason within the statute.

[81] Two matters might be considered if the draft provisions on Illegal Transactions were to be adopted. First, as the *Safeway*[105] case illustrates, the development of the law relating

to contracts unenforceable for want of formality is very consistent with the treatment of illegal contracts recommended by the new proposals. The wording of the B.C. recommendation, however, does not clearly indicate whether a case such as *Safeway* would fall within the exclusion or not. It does not appear that it was intended to do so. Second, in jurisdictions in which extensive reforms to the equivalent of the Statute of Frauds have not been enacted, inclusion of cases unenforceable for want of formality within the legislation should be seriously considered.

D) Retrograde steps

i) Contracts for illegal interest and the doctrine of severance

[82] The amendment to the Criminal Code in 1981[106] which added s. 347 prohibiting the contracting for or receipt of interest in excess of 60% per annum triggered a new wave of interest in remedies for illegal transactions. At the time the British Columbia Law Reform Commission's Report on Illegal Transactions was published, the implications of this section for commercial law had only begun to be realized. In *Mira Design Co. Ltd. v. Seascape Holdings*,[107] a decision cited by the Commission on the first page of its report, the court had been confronted with the first instance of a sophisticated borrower resisting repayment of an important commercial obligation on the basis that the contract violated s. 347 of the Criminal Code and was therefore illegal.

[83] Numerous cases in the civil courts alleging similar claims have followed. It is well beyond the scope of this paper to review all, or even a significant number, of them. Section 347 itself has been characterized for its effect on commercial transactions as a "deeply problematic law".[108] The Uniform Law Conference of Canada has a separate project dealing with reform of the section and a paper written by the author is available on its website, citing the most recent developments in the jurisprudence considering the section in a commercial context.[109]

[84] The remedial aspects of the cases are also dealt with in that paper. However, because they constitute a significant modern development, to a large degree postdating the work of the Commission, some attention will be given to them and to recent developments on the remedial front.

[85] As early as *Mira Design*,[110] the court identified severance as an appropriate remedy for the commercial transaction in which some element of the contract either provided for or caused the lender to receive a criminal rate. The conditions for the application of severance were enumerated in the leading decision of the Ontario Court of Appeal, *William E. Thomson Associates Inc. v. Carpenter*.[111] The court made severance conditional upon a finding that the objectionable part of the agreement could be readily excised; and whether public policy favoured severance. That second condition involved the court in a policy analysis which included a review of the bargaining power of the parties, whether or not they intended to break the law and whether the consequences of a

refusal to sever would result in unjust enrichment. In the vast majority of cases, severance has been granted.

[86] The method of severance has generally been the traditional "blue pencil" test. Repeating traditional objections of the common law courts to remaking the parties' bargain, courts have generally performed severance by either striking out a particular provision that triggered the criminal rate (such as a bonus[112] or, in the case of *Mira Design*,[113] an inflation of the principal of the loan) or by striking out the whole of the provisions for compensation for the transaction.[114]

[87] In *Transport North American Express Inc. v. New Solutions Financial Corp.*,[115] the trial judge called into question the necessity for using the mechanism of the "blue pencil". He criticized the procedure as "a relic of a bygone era" in which attitudes "towards the interpretation and enforcement of contracts was more rigid than is the case at the present time."[116] His solution was to apply a concept of "notional severance" in which none of the provisions of the agreement was actually struck out but in which the provision which created the problem was read down such that the amount recoverable under it was limited to the amount that would, together with other charges for the loan characterized as interest, result in compensation falling within the legal rate.

[88] The Ontario Court of Appeal found that this solution was inconsistent with precedent.[117] The court reviewed the "blue pencil" test and held that it was a figurative way of expressing the court's willingness to sever covenants which, whether technically separated by the agreement or combined, are in effect a combination of several distinct covenants, some of which could be carried out legally and independently from the others. Rosenberg J.A., for the majority, stated that

> Understood in this way, I do not think that the existing test for severance is so artificial that it cannot be applied in a way that will produce principled, understandable and predictable results.[118]

[89] For the time being, this decision appears to have put a limit on the creative development of the doctrine of severance by the courts. The decision is under appeal to the Supreme Court of Canada. As well, the British Columbia Court of Appeal has recently held that where the question is not the enforceability of a contract to receive illegal interest, but an allegation that the lender has received a payment in excess of the criminal rate (a contravention of s. 347(1)(b) rather than s. 347(1)(a)), the court may allow claims by the lender up to the 60% limit.[119]

ii) Severance and the recommendations of the Law Reform Commission

[90] The Law Reform Commission subscribed to the view that the "blue pencil" test was unduly formulistic and rigid. It rejected the view that severing in this method altered only the words of the contract rather than its obligations. It suggested a broader severance power in which courts would sever, not by identifying phrases and words that could be struck out, but by identifying obligations which the court could hold to be not binding,

while still holding the other obligations of the contract to be enforceable.[120] While it was thought that this method would remove the overly formalistic aspects of the "blue pencil" test, the Commission rejected giving the court a blanket power to rewrite the contract as it saw fit.[121]

[91] It is unclear whether the Law Reform Commission's formulation of the severance test would permit the "notional severance" approach adopted by Cullity J. in *New Solutions*.[122] In that case, compensation for the loan was payable under a number of provisions, including interest, fees and a royalty. The fees and royalty payments alone amounted to approximately 30% per annum. The interest was stipulated to be 4% per month, calculated daily and payable monthly. That, in itself, produces an effective annual rate of 60.10%. It was this interest provision that the court proposed to "read down", reducing it to a rate that, combined with the other fees and charges, would not exceed 60%. Even if a court is empowered to divide the contract terms into discrete obligations, rather than looking for an easily excisable sentence or phrase, it seems arguable that the provision for 4% per month is a single obligation. In this case, the recommendations of the Law Reform Commission might not be effective to allow the solution proposed by the trial judge.

[92] Whether or not such creativity should be encouraged is a difficult question. In this case, the approach of Cullity J. would have the effect of giving the parties a closer approximation of what they bargained for than would severance of the whole of the interest obligation. This is because, whatever the various heads of compensation contained in the agreement, they were all about the payment of money and the parties' negotiated conclusions as to how much was a fair return for the loan. While 60% per annum is not nearly as high as the parties agreed to, it is much closer to it than is 30% per annum, the result of traditional severance.

[93] But it may be that cases under s. 347 are unique because the policy of the section and whether it should operate at all to interfere in sophisticated lending transactions is very much the subject of scholarly debate.[123] As one who favours the amendment of the section to reduce or exclude its application to commercial loans, I appreciate that my approval of the efforts of Cullity J. to reduce the influence of the section on the transaction may be motivated more by my views of the policy of this particular section than by a general sense that such interference with contractual obligations is warranted. It may be that amendments to s. 347 should be treated as a topic of their own.

[94] Additionally, it might be argued the power under the proposed amendments to allow a court to give effect remedies for breach of contract as if the contract were not illegal might, in the proper case, be extended to require the borrower to repay the whole of the compensation. I think this is unlikely. To do so would be to require the commission of a criminal offence (receipt of interest in excess of 60%). The powers of the court as proposed, however broad, would surely never be extended to that degree.

iii) A retrograde step in consequences of statutory illegality: *Top Line Industries v. International Paper*[124]

[95] In this case, the British Columbia Court of Appeal employed a traditional and narrow analysis of the law of illegal contracts to exclude recovery of a landlord of use and occupational rent.

[96] The purported lease in question was entered into innocently by the landlord and tenant but was a lease for an unsubdivided piece of land for a term of more than three years in contravention of s. 73 of the Land Titles Act. The purpose of this section is to protect the integrity of the subdivision process by making illegal arrangements to lease unsubdivided land, an obvious method of evading the process. As in *Still*,[125] the court probably had little choice but to declare the lease tainted with illegality. More problematic, and, indeed, the subject of substantial controversy, was the holding that not only was the lease, as a conveyance of property invalid but that no personal rights could be created under the document either. Notwithstanding the principle of benevolent interpretation, the contract was also held to be void.[126]

[97] After this decision, the landlord applied to the court to receive rent paid by the tenant during the proceedings into court pending the outcome of the case on the basis of an implied contract for reasonable rent. The court denied the claim. It held that because the lease was illegal, the only basis for implying a contract for the payment of rent was the impugned lease. Thus no independent claim for rent, without relying on the illegal contract, could be found. The court quoted with approval a statement of law from the 1869 decision of *Taylor v. Chester*[127] the court held that it ought not to assist the landlord by enforcing an obligation arising out of an illegal contract.

iv) *Top Line*[128] and the recommendations for reform of the British Columbia Report

[98] Had the court in *Top Line* followed the approach laid out in *Still v. M.N.R.*[129] or had the proposed Contract Law Reform Act been in force, the decision might have been very different. The fact that the lease was illegal, even if requiring a holding of illegality of the contract, would not have dictated denial of the final remedy. The tenant, by being allowed to continue occupation without paying rent had been unjustly enriched; the landlord, correspondingly deprived. Further, while the policy of the statute might require such arrangements to be terminated, it appears (analogously to the reasoning in *Still*) an excessive penalty to impose on a party innocent of the illegality and far beyond what is necessary to maintain the integrity of the statutory policy.

[99] The need for reform is more clearly highlighted by the closing comments of Newberry J.A., writing for the court. She stated, "I emphasize in closing that neither trespass nor unjust enrichment was pleaded or argued in this case by the Landlord."[130] This suggests that the result may have turned on the technicalities of the pleadings. Trespass might have given the landlord an independent right allowing it to found its claim without reference to the illegal transaction. This is one of the less admirable

exceptions to the classical doctrine.[131] Whether the court would have allowed an unjust enrichment claim, we cannot guess. Its apparent belief that a claim for use and occupation rent was not closely allied to a claim for unjust enrichment raises some doubt about this matter.[132] Surely legislation should release the courts from such rigid application of the already-discredited classical doctrines.

CONCLUSIONS

[100] I suggest that this review of the law substantiates that the prediction of the British Columbia Law Reform Commission made twenty years ago that the law of remedies in cases of illegality would not likely be reshaped by the common law has proved correct.

While there are encouraging signs, we are yet a very long way from a rationalization and reform of the law along more modern lines. The very nature of the common law, with its reliance on finding the appropriate case to make an incremental change, has left the matter in substantial confusion. Technicalities abound. Further, while one court may signal a willingness to take a courageous step forward, that willingness may not be emulated by others. Legislation would appear to be the only realistic solution.

[101] I suggest further that the review of selected cases undertaken above does validate the approach and decisions recommended by the Commission, on the whole. The recommendations would enshrine the approach of the *Still*[133] decision which, as noted, as been favourably received; problems left unsolved by *Oldfield*[134] and *Brissette*[135] would be solved; cases in which the limits of the technical exceptions have had to be stretched to accomplish the court's view of a just result would be solvable on a principled and rational basis.

[102] Recent developments do suggest that several of the Commission's recommendations be revisited and reviewed. Particularly, the issue of whether the language should be clarified to clearly include ultra vires contracts should be considered. As well, cases in which a contract is unenforceable because of formal deficiencies might usefully be brought within the provisions, particularly in jurisdictions in which the Statute of Frauds has not been substantially reformed. In B.C., this provision should be clarified to ensure that other statutory requirements imposing formal requirements on contracts fall within the legislation.

[103] Finally, it is suggested that unless amendments to s. 347 are undertaken, a statute dealing with illegal contracts might include specific provisions to deal with the special circumstances of commercial loans which violate this section. I have elsewhere suggested parallel Federal and provincial legislation limiting the civil consequences of a violation of s. 347 where the loan is for a commercial purpose and where no prosecution under the section has been authorized by the Attorney-General, as required for criminal prosecution under the section.[136] This might be the appropriate place to put such a limit. Alternatively, a special severance rule might be included to permit a court to enforce payment under a contract for illegal interest up to the 60% limit.

[104] The law as it has developed since 1983 would still seem to present a strong case for legislative reform. In conclusion, I can do no better than to quote again the words of the British Columbia Law Reform Commission:

> The current law does not necessarily discourage suits on illegal contracts. It merely makes them more complex. Moreover, subsequent glosses on the general rule deflect the courts from considering questions such as whether the effect of the contract is contrary to pubic policy and whether the plaintiff is a culpable wrongdoer to technical question of pleading…of substantive law…of philosophy…or of construction…The merits of the case are secondary considerations, at best. Moreover, even were the ambit of the exceptions to the general rule certain, the nature of the process is objectionable. It is preferable that the issues involved in granting or denying relief be reviewed objectively and forthrightly.[137]

[105] Enactment of remedial legislation appears to remain the best hope to achieve that goal.

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1 Report on Illegal Transactions, British Columbia Law Reform Commission, LRC 69, November 1983. Hereafter, cited as "the Report".

2 Proposals for a Contract Law Reform Act, British Columbia Law Institute, September 1998.

3 Also proposed for implementation were the Commission's Reports on Covenants in Restraint of Trade and Deeds and Seals. See *supra*, note 2, p.1

4 [1954] 3 D.L.R. 785 (S.C.C.).

5 [1980] 2 S.C.R. 834.

6 *Supra*, note 1, at p. 53.

7 The most frequently quoted formulation of this policy is found in *Holman v. Johnson* (1775) 1 Cowp. 341, 98 E.R. 1120.

8 The Report, *supra*, note 1, determined that its recommendations for reform ought to be somewhat broader than contracts alone and include transactions transferring property and trusts as well as all analogous arrangements. They thus referred to their report as dealing with illegal transactions, rather than simply contracts. The Report of the Law Institute, *supra*, note 2, expanded the definition of "contract" to include those transactions. In this paper, I will adopt the definition of the Law Institute and use "contract" and "transaction" interchangeably.

9 This division, at least, seems to be accepted by both courts and commentators. See the Report, supra, note 2, at p. 9 – 21.

10 Professor Waddams in **The Law of Contracts**, 4th ed., Canada Law Book, 1999 notes at para. 565 that one writer divides them into nine categories, another into twenty-two.

11 The earliest English statute expressing disapproval of gaming may have been the Gaming Act of 1388. See discussion in *Boardwalk*, *infra*, note 11.

12 *Boardwalk Regency Corp. v. Maalouf* (1992), 6 O.R. (3d) 737 (C.A.) is an example.

13 *Supra*, note 1, p. 9 – 38.

14 *Supra*, *note 9*, Chapter 15.

15 Discussed in the Report, *supra*, note 1, at p. 4 – 8 under the heading The General Rule. In this paper, I will also refer to these principles as the "general rule".

16 *Everet v. Williams* (1893) 9 L.Q. Rev. 197. Discussed by the Commission at p. 5 of the Report, *supra*, note 1.

17 It will be remembered that contract actions was somewhat of a late-developer. See A. Simpson, A **History of the Common Law of Contract**.

18 *Supra*, note 7.

19 See the discussion of the Commission in its Report, *supra*, note 1, at p. 30 – 38.

20 *Ibid., p*. 30 – 31.

[21] *Ibid*., p. 22 – 24.
[22] *Ibid*., p. 24 – 25.
[23] *Ibid*., p. 31 – 32.
[24] *Ibid*., p. 32 – 34.
[25] *Ibid*., p. 34 – 37.
[26] [1957] 1 Q.B. 267. Discussed in the Report at p. 12 – 15.
[27] *Kingshott v. Brunskill*, [1953] O.W.N. 133 (C.A.).
[28] Professor Waddams comments, op. cit., at paragraph 572, "It is hard to see what public policy is served by this decision. A technical, trivial and innocent breach of statute results in a substantial enrichment."
[29] Leon E. Trakman, *Porridge or Scrambled Eggs*? (1988) 14 CBLJ 75, at p. 89.
[30] Report, *supra*, note 1, at p. 86 – 87. In the draft statute prepared by the Law Institute, *supra*, note 2, almost identical provisions were proposed for s. 18 and s. 19.
[31] Report, *ibid*., at p. 87; draft legislation, *ibid*., s. 20.
[32] Whether or not the legislation should provide a "clean slate" by eliminating the exceptions or not was a subject of much debate. See Report, *ibid*., at p. 57 – 59. The Commission's decision to preserve the general rule, subject to the new scheme for relief, is discussed at p. 80 – 82.
[33] *Supra*, note 7.
[34] (1987), 25 Osgoode Hall Law Journal 787.
[35] *Supra*, note 26.
[36] See the decisions in *Ouston v. Zurowski* and in *Faraguna v. Storoz*, cited *infra* at notes.
[37] A brief summary of the law of unjust enrichment in Canada and its application in illegal contract situations can be found in Professor Ziegel's comment, *Criminal Usury, Class Actions and Unjust Enrichment in Canada*, (2002) 18 Journal of Contract Law 121.
[38] Ontario Law Reform Commission, *Report on Amendment of the Law of Contract*, 1987, Chapter 11.
[39] *Supra*, note 29.
[40] *Ibid*., at p. 76 – 77.
[41] *Ibid*., at p. 77 – 78.
[42] *Ibid*., at p. 92.
[43] *Ibid*.
[44] *Ibid*., at p. 80.
[45] *Still v. M.N.R.*, [1998] 1 F.C. 549 (C.A.), at paragraph 42 relying on the decision of the Alberta Court of Appeal in *Love's Realty & Fin. Services Ltd. v. Coronet Trust*, [1989] 3 W.W.R. 623 at p. 629.
[46] [1998] 2 S.C.R. 298.
[47] R.S.C. 1985, c. B-1, s. 174.
[48] As cited by the court, then R.S.O. 1980, c. 370.
[49] *Supra*, note 46, at paragraph 92.
[50] *Ibid*., at paragraphs 114 – 117.
[51] *Supra*, note 26.
[52] *Supra*, note 46, at paragraph 119.
[53] *Still*, *supra*, note 45. Cited in the decision of Bastarache J. at paragraph 67.
[54] [1989]A.J. No. 241
[55] The Ontario Court of Appeal has also followed the benevolent construction approach in its decision in *Reliable Life Insurance Co. v. M.H. Ingle & Associates* [2002] O.J. No. 1382.
[56] [2002] SCC 22.
[57] [1992] 3 S.C.R. 87.
[58] This hypothetical was discussed by the court at paragraph 59.
[59] *Supra*, note 57.
[60] *Supra*, note 56 at paragraph 67.
[61] (1985), 63 B.C.L.R. 89; [1985] B.C.J. No. 2181 (C.A.).
[62] *Ibid*..
[63] [2002] A.J. No. 362.
[64] *Ouston*, *supra*, note 61, was followed by the Alberta court in *Dancovich v. Rast*, [2002] A.J. No. 1276 which was another pyramid scheme resulting in litigation.
[65] [1993] B.C.J. No. 2114 (S.C.).
[66] [1999] N.J. No. 149.
[67] Termed a "benevolent rule of construction" by the Law Reform Commission, Report, *supra*, note 1, at p. 68.
[68] *Supra*, note 46.
[69] *Supra*, note 54.

[70] *Supra*, note 2, p. 9, s. 17.
[71] *Supra*, note 46.
[72] *Supra*, note 70.
[73] *Supra*, note 2, p. 10, s. 19(1)(g).
[74] *Supra*, note 56.
[75] *Supra*, note 57.
[76] *Supra*, note 61.
[77] *Supra*, note 65.
[78] Supra, note 66.
[79] *Supra*, note 45.
[80] As cited by the court, Immigration Regulations, 1978, SOR/78-172, ss. 18(1) as am. by SOR/89-80, s. 1), 20(1), (3).
[81] *Supra*, note 45, at paragraph 48.
[82] *Ibid*.
[83] Professor Waddams, op. cit., at paragraph 563 cites the decision with approval. In *Continental Leasing*, *supra*, note 46, Bastarache J. seemed to accept the extension approved by Robertson J.A. and his formulation of the modern rule.
[84] Robertson J.A. cited the Report at paragraph 12 of his judgment to support the proposition that "Law reform agencies have been quick to conclude that the law of illegality is in an unsatisfactory state."
[85] *Supra*, note 45.
[86] *Still* was cited in *Reliable Life Insurance*, *supra*, note, 55 but not for its approach to analysis of the appropriate result of illegality. Indeed, courts seem to have ignored that aspect of the case, except for the comments in *Continental Bank Leasing*, supra note 46 in which, again, it was not applied.
[87] *Supra*, note 6.
[88] *Top Line Industries v. International Paper Industries*, [2000] BCCA 23.
[89] *Supra*, note 34 at p.
[90] In *Continental Bank Leasing*, *supra*, note 46, Bastarache elaborated upon the differences in the foundational principles of illegality and ultra vires, the one limiting the capacity of an entity, the other limiting its right to participate in certain activities. While this is no doubt technically accurate, the public policy basis of both doctrines suggests that they are more similar than this analysis would care to admit.
[91] [1991] 3 S.C.R. 388.
[92] (1992), 21 CBLJ 115.
[93] *Ibid*., at p. 118.
[94] *Ibid*., *at p.* 124 – 125.
[95] As noted by Iacabucci J. in his extensive review of the law of ultra vires in *Canadian Pickles Corp*., *supra* note 91.
[96] *Supra*, note 2, p. 8, s. 15.
[97] The exceptions included contracts invalid for failure to register, failure to act within a limitation period, failure to be evidenced in writing where required, violation of perpetuities laws, found to be in restraint of trade or avoided by frustration.
[98] The rule was intended to be for the protection of creditors against having the assets of the corporation dissipated in unauthorized transactions. See the discussion of Bastarache J. cited *supra*, note 90 and Iacabucci J., supra, note 91.
[99] (2001), 196 D.L.R. (4th) 659 (N.B.C.A.).
[100] R.S.N.B. 1973, c. M-22.
[101] *Supra*, note 2, p. 9, s. 15(3).
[102] R.S.B.C. 1996, c. 53.
[103] *Supra*, note 2, at p. 15. See also the original Report, *supra*, *note* 1 at p. 72.
[104] Report on the Statute of Frauds, Law Reform Commission of British Columbia, LRC 33, 1977.
[105] *Supra*, note 99.
[106] An Act to Amend the Small Loans Act and to Provide for its Repeal and to Amend the Criminal Code, S.C. 1980-81-82-83, c. 43.
[107] [1982] 4 W.W.R. 97 (B.C.S.C.).
[108] As characterized by the Supreme Court of Canada in *Garland v. Consumers Gas Co*., [1998] 3 S.C.R. 112 at p. 143.
[109] *Section 347 of the Criminal Code: "A Deeply Problematic Law*"; see also the paper by the author *What's to be Done with S. 347*?, forthcoming in the Canadian Business Law Journal.
[110] *Supra*, note 107.

[111] (1989), 61 D.L.R. (4th) 1 (Ont. C.A.)
[112] See *Milani v. Banks* (1997), 32 O.R. (3d) 557.
[113] *Supra*, note 107.
[114] See *Terracan Capital Corp. v. Pine Projects Ltd.* (1993), 100 D.L.R. (4th) 431.
[115] (2001), 200 D.L.R. (4th) 560 (Ont. Sup. Ct.).
[116] *Ibid*., at p. 571 and 573.
[117] [2002] O.J. No. 2335 (C.A.)
[118] *Ibid*., at paragraph 29.
[119] *Boyd v. International Utility Structures Inc*. [2002] BCCA 438.
[120] *Supra*, note 1 at p. 34 – 37.
[121] *Ibid.*, at p. 77 – 78.
[122] *Supra*, note 115.
[123] See for example, Ziegel, The Overdue Repeal of Section 347 of the Criminal Code (1999) 31 CBLJ 173.
[124] *Supra*, note 88.
[125] *Supra*, note 45.
[126] (1996), 20 B.C.L.R. (3d) 41 (C.A.)
[127] (1869), L.R. 4 Q.B. 309.
[128] *Supra*, note 88.
[129] Supra, note 45.
[130] *Ibid*., at paragraph 18.
[131] See the Report, *supra*, note 1 at p. 32 – 34. At p. 34, the Commission commented, "Insofar as the exception may be used to prevent unjust enrichment, it is an exceptionally blunt instrument. It does so without regard to the justness or unjustness of the enrichment."
[132] See the comments of McCamus on this issue, *supra*, note 34, at p.
[133] *Supra*, note 45.
[134] *Supra*, note 56.
[135] *Supra*, note 57.
[136] *Supra*, note 109.
[137] *Supra*, note 1, at p. 52.