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**Draft Chapter  
on  
Illegality**

Black letter rules prepared by Professors M.J. Bonell, B. Fauvarque-Cosson,  
M. Fontaine, M. Furmston, R. Goode and R. Zimmermann

Comments prepared by Professor M. Furmston

# ILLEGALITY

## Article 1

### *Contracts contrary to fundamental principles*

**(1) A contract is illegal if, whether by its terms, performance or otherwise, it is contrary to principles widely accepted as fundamental in legal systems throughout the world.**

**(2) If only part of the contract is illegal under Article 1 the entire contract is illegal unless giving due consideration to all the circumstances of the case it is reasonable to hold otherwise.**

### *Comment*

All developed legal systems have rules treating some contracts as unacceptable because of their subject matter. A classic example would be a contract to pay X money in return for his murdering Y.

The content, terminology and conceptual structure of such rules vary widely. The present article is limited to principles which are very widely accepted across a wide range of states. Such acceptance may be shown by widespread acceptance of relevant international conventions but this is not essential.

Examples which are practically important in the context of international commercial contracts include corruption, money laundering, trading in goods at prices which can only be achieved by unacceptable labour practices and trafficking in people.

These principles are undoubtedly in a state of permanent evolution. What is acceptable in one generation becomes unacceptable in the next and vice versa. Some principles are universal; others are widely accepted in many parts of the world. If the contracting parties all come from an area where something is unacceptable, it should be treated as unacceptable even though a different view would be taken in other parts of the world.

National systems have another source of rules in statutory provisions which forbid particular contracts or require them to be made in a particular way. Unidroit has not created such rules as it has no legislature. Such mandatory rules are treated for the purpose of these principles by Article 1.4 and by Articles 99.3 and 99.4

### *Example 1*

Gray Boots is a major international manufacturer of sports shoes. It purchases large numbers of shoes from suppliers in Ruritania and Utopia. In both countries workers work 18 hour days in sweat shops for a pittance. This is contrary to an international convention which is widely accepted

Gray Boots has been accustomed to pay for the shoes a month after delivery. It has had an attack of conscience and is now refusing to pay its suppliers.

Such contracts are illegal.

*Example 2*

A is the owner of a large car showroom in Zenda, the capital of Ruritania. B, a Utopian national, agrees to buy 10 Rolls Royce cars to be delivered to St. Thomas, the capital of Utopia in one week for \$1,000,000. A stipulates for payment in advance. B pays in cash, using money which to A's knowledge is the product of drug smuggling. The contract is illegal.

*Example 3*

A engages X as a chauffeur at three times the normal rate for chauffeurs. There is a written contract of employment of a normal kind but it is understood that if called on X will kill any of A's business rivals. The contract of employment is ineffective.

Contracts can come into conflict with principles in a variety of ways.

- a. It may be a contract whose performance will violate a relevant principle as in Example 3.
- b. The contract may require one person not to act in circumstances where a relevant principle although not requiring action, disapproves of promises not to act.

*Example 4*

A is the Prime Minister of Ruritania and B is his chief of staff. B enters into a deal with X, who acts on behalf of Black Sky Television, the leading channel in Utopia under which X agrees for payments of \$10,000 not to report on Black Sky Television news of A's affair with a leading member of the opposition party in Ruritania. The contract is illegal.

- c. The contract may tend to encourage behaviour which is contrary to a relevant principle. For instance, A, Ruritanian businessman, agrees to pay B, a member of the Utopian legislature \$10,000 if a bill currently before the legislature becomes law.
- d. The contract is to do something in itself permissible but intended by one party as a preliminary to some act which compromises a relevant principle. For instance, A agrees to let a flat to a lady, B. B intends to use the flat for purposes of prostitution. The contract is illegal as regards B. The position of A depends on whether he knows or ought to know of B's purpose.
- e. The contract thus lawfully made has been illegally performed. For instance, A agrees to carry B's goods from X to Y by road. A carries the goods in an unlicensed vehicle. The purpose of the licensing scheme is to protect owners of goods. A cannot enforce the contract.

Not all illegality in performance would make the contract illegal. So the contract of carriage would not become illegal because the lorry exceeds the speed limit. The key lies in the underlying purpose of the rule which has been broken.

Article 2  
*Effects of Illegality under Article 1*

- (1) **This Article applies to illegality under Article 1**
- (2) **Where each party knows, or ought to have known, of facts which make the contract illegal under Article 1, neither party has the right to exercise remedies under the contract.**
- (3) **Where one party neither knew nor ought to have known of facts which make the contracts illegal under Article 1 it has the right to exercise such remedies as in all the circumstances are reasonable.**

*Comment*

This article deals with the effects of the contract failing foul of Article 99.1. The basic rule is that neither party acquires any right to exercise remedies under the contract but this is subject to an important exception based on knowledge.

There will be situations where one party does not know key facts, which make the contract illegal. In example (d) above, the legal position should be different if the landlord neither knew nor ought to have known of the lady's purpose. In that situation he should have the normal rights of a landlord.

Even where both parties know or ought to know there may be cases where it is appropriate to grant a restitution remedy. This is dealt with by Article 99.5

*Example 5*

A is a major defence contractor in Ruritania. It is keen to sell numbers of its new Eurobomber airplane to the Utopian air force. It enters into an agreement with B, a senior officer of the Utopian Ministry of Defence to pay him a facilitation fee of 5% of the price paid for each aircraft. The Utopian air force orders 100 Eurobombers at \$100,000,000 each, deliverable at the rate of 20 a year starting on 1 January 2006. 30 Eurobombers have been delivered. B has been paid his fee in respect of the first 20 and Utopia has paid for 25 planes. The Peace Party came to power at the last Utopian election. They would be glad not to have to pay for any more planes. They have also discovered that the maximum speed of the planes is 1,000 km/hour and not 1,500 km/hour as had been claimed during the original negotiations.

In this case the fee offered is clearly so large that it must be a bribe. B cannot sue for the unpaid part of the bribe. There may be situations where B is so senior that his acts ought to be treated as those of the government but if not the Utopian government ought to be able to recover damages for defects in the planes delivered and to refuse to take any more.

*Example 6*

A, a national of Ruritania, runs a business whose main object is to provide prostitutes to work in brothels in Utopia. He procures girls by telling them that he will find jobs for them as waitresses or secretaries in Utopia. He has a contract

with the X bus company to drive the girls in buses from Zenda to St. Thomas. He does not tell X what his purpose is but X has good reason to suspect it. X is not entitled to payment. One of X's buses crashes on the journey owing to the negligence of the driver and some of the girls are injured. X is not liable to A for A's consequential financial loss.

### Article 3

#### *Contracts infringing mandatory rules*

**(1) A contract, whether by its terms, performance or otherwise, is also illegal if it infringes a mandatory rule applicable under Art. 1.4 under these Principles.**

**(2) If only part of the contract is illegal under Article 99.3 the remaining part is not illegal unless giving due consideration to all the circumstances of the case it is reasonable to hold otherwise.**

#### *Comment*

In domestic systems it is common to find contracts struck down by general principles and by specific prohibitions, usually statutory. These principles do not contain independent statutory prohibitions but the choice of the Unidroit principles should not be a means of sidestepping national rules which are applicable under Article 1.4.

The presumption in such cases is that where the mandatory rule applies only to part of the contract, the rest of the contract will usually be valid (see example 7)

### Article 4

#### *Effects of contracts infringing mandatory rules*

**(1) This Article applies to contracts illegal under Article 3**

**(2) The effects of any infringement of a mandatory rule upon a contract are those expressly prescribed by that rule.**

**(3) Where the mandatory rule does not expressly prescribe the effects of an infringement upon a contract, the parties have the right to exercise such remedies as in all the circumstances are reasonable.**

**(4) In determining what is reasonable regard is to be had in particular to:**

- (a) the purpose of the rule which has been infringed;**
- (b) the category of persons for whose protection the rule exists;**
- (c) any sanction that may be imposed under the rule infringed;**

- (d) **the seriousness of the infringement;**
- (e) **whether the infringement was intentional; and**
- (f) **the closeness of the relationship between the infringement and the contract.**

*Comment*

National rules may prohibit a contract without going on to state the effects of the prohibition. In that case it will be necessary to consider what is reasonable taking into the factors set out in sub-article (4). It would be appropriate to take into account solutions arrived at by national case law.

*Example 7*

X, a Utopian company, enters into a contract with Y to erect a building in Ruritania. The contract contains a provision for dispute-settlement by arbitration which can only be initiated after the work has been completed. Ruritanian law has a mandatory provision that either party is entitled to have any dispute settled by neutral adjudication at any time during the contract. This provision prevails but does not affect the validity of the remainder of the contract.

*Example 8*

A, a Ruritanian merchant, contracts to sell 100 tons of coffee beans to B, a Utopian merchant, on 28 days credit. He delivers the coffee beans but B now refuses to pay on the ground that he does not have, as Utopian law requires, a license to buy coffee. Enquiry shows that the Utopian rule is in effect a tax on importers. A can recover the price.

*Example 9*

The facts are as in 2 but enquiry shows that the Utopian government has adopted a fair trade policy designed to make sure that Utopians only drink coffee imported from approved countries and that the licensing scheme is an essential part of this policy. A can not sue for the price though he may have a restitutionary remedy. In neither case could specific performance be obtained.

Article 5  
*Restitution*

**(1) Where there has been performance under an illegal contract, restitution is excluded unless that would lead to unreasonable results.**

**(2) Where restitution is granted it may take the form of return of property, the repayment of money, or payment of an allowances for property transferred or services supplied, whichever is appropriate.**

*Comment*

Many national systems have rules which deny restitutionary relief in relation to illegal contracts which have been performed. Although this result is defensible as discouraging the making of illegal contracts, it goes too far and should be subject to some exceptions and qualifications where a rigid rule produces an unacceptable result.

*Example*

In example 5 although the contract is illegal, it may be that it is not reasonable for Utopia to keep the 5 planes for which it has not paid. This would involve a careful examination of all the surrounding circumstances. It might be relevant, for example, that Utopia has been lamentably lax in the supervision of its purchasing officers or that B has been promoted to a new and even more senior position in Utopia.

# APPENDIX

## Principles of European Contract Law

### CHAPTER 15- ILLEGALITY

#### *Article 15:101: Contracts Contrary to Fundamental Principles*

A contract is of no effect to the extent that it is contrary to principles recognised as fundamental in the laws of the Member States of the European Union.

#### *Article 15:102: Contracts Infringing Mandatory Rules*

- (1) Where a contract infringes a mandatory rule of law applicable under Article 1:103 of these Principles, the effects of that infringement upon the contract are the effects, if any, expressly prescribed by that mandatory rule.
- (2) Where the mandatory rule does not expressly prescribe the effects of an infringement upon a contract, the contract may be declared to have full effect, to have some effect, to have no effect, or to be subject to modification.
- (3) A decision reached under paragraph (2) must be an appropriate and proportional response to the infringement, having regard to all relevant circumstances, including:
  - (a) the purpose of the rule which has been infringed;
  - (b) the category of persons for whose protection the rule exists;
  - (c) any sanction that may be imposed under the rule infringed;
  - (d) the seriousness of the infringement;
  - (e) whether the infringement was intentional; and
  - (f) the closeness of the relationship between the infringement and the contract.

#### *Article 15:103: Partial Ineffectiveness*

- (1) If only part of a contract is rendered ineffective under Articles 15:101 or 15:102, the remaining part continues in effect unless, giving due consideration to all the circumstances of the case, it is unreasonable to uphold it.
- (2) Articles 15:104 and 15:105 apply, with appropriate adaptations, to a case of partial ineffectiveness.

#### *Article 15:104: Restitution*

- (1) When a contract is rendered ineffective under Articles 15:101 or 15:102, either party may claim restitution of whatever that party has supplied under the contract, provided that, where appropriate, concurrent restitution is made of whatever has been received.
- (2) When considering whether to grant restitution under paragraph (1), and what concurrent restitution, if any, would be appropriate, regard must be had to the factors referred to in Article 15:102(3).
- (3) An award of restitution may be refused to a party who knew or ought to have known of the reason for the ineffectiveness.
- (4) If restitution cannot be made in kind for any reason, a reasonable sum must be paid for what has been received.

*Article 15:105: Damages*

- (1) A party to a contract which is rendered ineffective under Articles 15:101 or 15:102 may recover from the other party damages putting the first party as nearly as possible into the same position as if the contract had not been concluded, provided that the other party knew or ought to have known of the reason for the ineffectiveness.
- (2) When considering whether to award damages under paragraph (1), regard must be had to the factors referred to in Article 15:102(3).
- (3) An award of damages may be refused where the first party knew or ought to have known of the reason for the ineffectiveness.

**Restatement, Second, Contracts**

CHAPTER 8 - UNENFORCEABILITY ON GROUNDS OF PUBLIC POLICY

TOPIC 1. UNENFORCEABILITY IN GENERAL

§ 178 (*When a Term Is Unenforceable on Grounds of Public Policy*)

- (1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.
- (2) In weighing the interest in the enforcement of a term, account is taken of
  - (a) the parties' justified expectations,
  - (b) any forfeiture that would result if enforcement were denied, and
  - (c) any special public interest in the enforcement of the particular term.
- (3) In weighing a public policy against enforcement of a term, account is taken of
  - (a) the strength of that policy as manifested by legislation or judicial decisions,
  - (b) the likelihood that a refusal to enforce the term will further that policy,
  - (c) the seriousness of any misconduct involved and the extent to which it was deliberate, and
  - (d) the directness of the connection between that misconduct and the term.

[...]

§ 184 (*When Rest of Agreement Is Enforceable*)

- (1) If less than all of an agreement is unenforceable under the rule stated in § 178, a court may nevertheless enforce the rest of the agreement in favor of a party who did not engage in serious misconduct if the performance as to which the agreement is unenforceable is not an essential part of the agreed exchange.
- (2) A court may treat only part of a term as unenforceable under the rule stated in Subsection (1) if the party who seeks to enforce the term obtained it in good faith and in accordance with reasonable standards of fair dealing.

[...]

## TOPIC 5. RESTITUTION

§ 197 (*Restitution Generally Unavailable*)

Except as stated in §§ 198 and 199, a party has no claim in restitution for performance that he has rendered under or in return for a promise that is unenforceable on grounds of public policy unless denial of restitution would cause disproportionate forfeiture.

§ 198 (*Restitution in Favor of Party who Is Excusably Ignorant or Is Not Equally in the Wrong*)

A party has a claim in restitution for performance that he has rendered under or in return for a promise that is unenforceable on grounds of public policy if

- (a) he was excusably ignorant of the facts or of legislation of a minor character, in the absence of which the promise would be enforceable, or
- (b) he was not equally in the wrong with the promisor.

§ 199 (*Restitution Where Party Withdraws or Situation Is Contrary to Public Interest*)

A party has a claim in restitution for performance that he has rendered under or in return for a promise that is unenforceable on grounds of public policy if he did not engage in serious misconduct and

- (a) he withdraws from the transaction before the improper purpose has been achieved, or
- (b) allowance of the claim would put an end to a continuing situation that is contrary to the public interest.