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**Draft Chapter
on
Illegality**

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Article 1
Definition

A contract is illegal if the contract, or a substantial part of the contract, is contrary to principles widely accepted throughout the international community of states.

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.

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.

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. Ruritania has signed this convention but makes no effort to enforce it. Utopia has never signed. Representatives of Gray Boots take care not to visit Utopia or Ruritania but the price paid for the shoes is very low.

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.

It is thought that a contract of this kind is certainly illegal as regards Ruritania. It is arguable that it should be treated as illegal as regards Utopia if Utopia is one of only a few countries which have not adopted the convention.

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.

Article 2 *Application*

A contract may be illegal for the purposes of Article 1 either:

- a. Because it is a contract whose performance violates a relevant principle; or**
- b. Because the contract requires one party not to act in circumstances where a relevant principle although not requiring action, disapproves of promises not to act; or**
- c. Because the contract tends to encourage behaviour which is contrary to some relevant principle; or**
- d. Because the contract is to do something in itself permissible but intended by one party as a preliminary to some act which contravenes a relevant principle; or**
- e. Because the contract though lawfully made has been illegally performed.**

Comment

Contracts can come into conflict with principles in a variety of ways. This can most easily be explained by a series of simple examples taken from domestic law.

- a. A agrees to pay B \$10,000 if B will kill C.
- b. D agrees to pay E \$10,000 if E will not open a competing business. The relevant competition law imposes no duty on E to open the business but strikes down his promise not to.
- c. F agrees to pay G, a member of a state's legislature \$10,000 if a bill currently before the legislature becomes law.
- d. H agrees to let a flat to a lady J, who intends to use it for purposes of prostitution. Clearly the legal position will depend on whether H knows or ought to know of J's purpose. (See article 3)
- e. K agrees to carry L's goods from X to Y by road. He in fact carried the goods in a lorry which is not licensed for this purpose.

Example

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.

Article 3

Effects

(1) Where each party knows, or ought if it had behaved reasonably to have known, of facts which make the contract illegal, neither party has the right to enforce the contract.

(2) Where one party neither knew nor ought if it had behaved reasonably to have known of facts which make the contract illegal, it shall have such rights to enforcement or to damages as in all the circumstances are reasonable, paying due regards to the policies underlying the relevant principle.

(3) Where the illegality constitutes only part of the contract, it may be appropriate to award damages in respect of loss suffered even by the party who knew or ought to know of the illegality.

Comment

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 or 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 some remedies. The possibility of a restitution remedy is dealt with by Article 4.

Example 1

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. On the other hand it should probably be required to pay for the planes delivered but not yet paid for (perhaps with a deduction to reflect the inflated price because of the bribe).

Even if B is in effect the government, there should be such remedy as in all the circumstances is fair and reasonable. It would not usually be fair and reasonable to allow Utopia to keep the planes without paying for them.

Example 2

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. The injured girls can sue X. X is not liable to A for A's consequential financial loss.

Article 4 *Restitution*

Where money has been paid or property transferred in performance of a contract which is illegal, the normal rule shall be that the loss lies where it falls. However if this produces a result, which after taking into account the policies underlying the principle that have been contravened, is unfair and unreasonable then such restitution shall be ordered as is in the circumstances fair and reasonable.

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

A and B, who are lovers, live together in a house which has been bought with money provided by them equally. The house is registered only in A's name as this makes it easier for B to claim social security benefits from the government of Utopia. This continue for some years but then B repents and pays the government claims for repayment in full.

B should be able to recover her share of the house from A.