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Taming the unruly horse! Contractual illegality and public policy: *Fitzgerald v FJ Leonhardt Pty Ltd*

Commentary on an appeal to be heard against a judgment of the Northern Territory Court of Appeal (given on 3 August 1995)

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Contracts - illegal and void - statutory illegality - contract to drill bores - drilling without statutory permits - whether contract rendered illegal by statute imposing penalties - whether a contract which is not forbidden by statute should be enforceable at the suit of a party that performs it illegally - whether such a contract contrary to public policy

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1. Introduction

{1} Certainty and consistency are necessary in every legal system. They enable citizens to regulate their affairs in the knowledge that their actions will have the protection of the law. Yet human affairs are so infinite in variety that some flexibility is needed to achieve justice in unusual situations. *Fitzgerald v FJ Leonhardt Pty Ltd* is a classic example of the balancing act required.

{2} FJ Leonhardt Pty Ltd (the "driller") sued for payment under a contract to drill for water. The contract had been performed without all the necessary permits. This was through no fault of the driller - he had complied with the requirements as implemented by the Water Authority at the time. While the contract was perfectly legal when formed, the question is whether it is to be rendered unenforceable because its performance unwittingly breached a statutory requirement of obtaining a prior permit. There is a line of authority which suggests that even where a contract is illegal as performed, it can nevertheless be enforced by the "innocent" party, i.e. the person not guilty of breaching the statute (*Holidaywise Koala Pty Ltd v Queenslodge Pty Ltd* [1977] VR 164; *TP Rich Investments Pty Ltd v Calderon* [1964] NSWR 709; *Anderson v Daniel* [1924] 1 KB 138; *Marles v Philip Trant & Sons Ltd* [1954] 1 QB 29). The present case is not covered by this line of authority, since both parties were held to be guilty of an offence.

{3} Since *St John Shipping Corporation v Joseph Rank Ltd* [1957] 1 QB 267 ("*St John Shipping*"), there has been an increasing tendency to treat the issue solely as one of statutory construction - did the legislature intend to render such contracts unenforceable because the manner of performance turned them into prohibited contracts? Unfortunately legislation seldom addresses this question directly. It prohibits **conduct** or **activity** (such as drilling without a permit), and provides a criminal penalty. Until recently it has usually been silent as to the enforceability (in a civil action) of any underlying contract. So, more often than not, the question is whether such an intention can be implied from the legislation.

{4} The relevant common law principle has a slightly different focus. It is sometimes expressed in the maxim *ex turpi causa non oritur actio* (an action does not arise from a disgraceful cause). In deciding whether a cause is *turpis*, courts use the yardstick of public policy. This principle is also often stated in more general terms - if it would be contrary to public policy to enforce the contract, the court will have nothing to do with it. Public policy is notoriously difficult to define with any precision. It has been described as an "unruly horse" (per Burrough J in *Richardson v Mellish* (1824) 2 Bing 229 at 252; 130 ER 294 at 303). As discussed later (at {40} and the following paragraphs), whether enforcing a contract will be contrary to public policy appears to depend on all the surrounding circumstances of a case. It can take account of the moral blameworthiness of the parties. It thus allows sufficient flexibility to do justice, but it does not promote certainty and consistency. On the other hand, compared with the difficulty in defining public policy, the rules of statutory interpretation are relatively well-defined and settled. In addition, once a statutory provision is interpreted so as to prohibit such a contract, the question might be settled once and for all. It is clear that this approach tends to better serve the need for certainty and consistency. The present case is an unusual situation which brings this balance into play.

{5} The High Court last considered public policy in a contractual setting in *A v Hayden (No 2)* (1984) 156 CLR 532. A contractual undertaking not to divulge the names of employees was held to be prejudicial to the administration of justice in circumstances where the police were

investigating the commission of certain criminal offences. The present case involves a statutory prohibition of conduct and raises less settled questions regarding the overlap between the implied statutory prohibition approach and the common law principle.

2. Factual background

{6} Fitzgerald (the "landowner") wanted to subdivide some of his land. Fresh water had to be available on the subdivision, so he contracted with the driller to drill several water bores. Leonhardt was licensed and registered under the *Water Act* 1992 (NT) ("the Act") and had some 24 years experience. He drilled seven bores. Three were successful in producing water. A dispute arose as to how much was owed. The driller eventually brought action against the landowner in the Local Court in Darwin for $24,540.

(i) Contractual terms and performance

{7} The exact terms of the contract were originally in dispute. Details are not important because the magistrate made findings on the evidence which were not attacked on appeal. But it is clear that the relationship between the parties deteriorated over the period of the contract. To some extent this might explain why the landowner has vigorously defended the action on the basis of illegality.

{8} The magistrate found that the contract was for the drilling of a minimum of 3 bores. Although the landowner originally intended to apply for 3 permits, initially only a single bore construction permit was issued by the authorities. This oversight was discovered some time after drilling started, and an oral request was made as a result of which two more permits were issued. It is not clear from the evidence which party made this oral request.

{9} The chronology of events can be summarised in the following table:

Date	Event
9/10/92	Contract concluded
9/10/92	Landowner applied for permit(s?)
13/10/92	Water authority issued a single permit
15/10/92	Bore 1 drilled & constructed (successful, but not suitable for drinking)
16 and 17/10/92	Bore 2 drilled (unsuccessful)
18 and 19/10/92	Bore 4 drilled & constructed (successful, suitable for drinking)
21 to 23/10/92	Bore 5 drilled & constructed (successful, suitable for drinking)
24 and 25/10/92	Bore 3 drilled (unsuccessful)
27/10/92	Oral request - 2 more permits issued
27/10/92	Bore 6 drilled (unsuccessful)
28/10/92	Bore 7 drilled (unsuccessful)

{10} The magistrate found that all seven bores were drilled pursuant to the contract and with the knowledge and consent of the landowner. Had it not been for the illegality argument, he would have found for the driller in the sum of $22,315 for work done under the contract.

(ii) The illegality argument

{11} While the contract was legal when concluded, the landowner argued that it was performed in an illegal manner. This was because, apart from the first bore, permits were not issued for each bore **prior to** the drilling of that bore. This argument depended on the statutory provisions.

{12} The relevant parts of s 56(1) of the Act provide:

"A person shall not, unless authorised by or under this Act, cause, suffer or permit -
(a) a bore to be drilled, constructed, altered, plugged, back-filled or sealed-off; ...

Penalty:
For a first offence - $5,000.
For a second or subsequent offence - not less than $5,000 or more than $10,000."

{13} Section 57 gives the Controller power to grant a permit, and such permit may be subject to terms and conditions.

{14} A 'bore' is defined in s 4(1) to mean a " ...bore, hole, well, excavation or other opening ... which is or **could be used** for the purpose of intercepting, collecting, obtaining or using ground water ..." (my emphasis). On a literal interpretation of s 56(1) as read with this definition, it was argued that, at the time of drilling, even the bores which turned out to be unsuccessful **could be** used to obtain ground water, and thus required permits; and, to comply with the Act, these permits had to be issued before drilling commenced.

{15} The Power and Water Authority did not take this view. Realising that no-one could predict how many bores would be necessary to find suitable water, it instructed drillers that they did not need a permit to drill every bore before drilling commenced. For example, if a driller wanted to drill two successful bores, the Authority would issue two bore construction permits; it did not issue permits for "dud" bores.

{16} The term "construction" in relation to bores is used but not defined in the Act. The magistrate concluded that it referred to the process which follows the drilling, such as the forming of the bore with casing and lining. Once bore construction permits were issued, the Authority was quite happy for the driller to drill several bores until successful, and then to complete the construction of the successful bores under the permits issued. It expected each bore drilled, including unsuccessful bores, to be registered with the Authority shortly after the drilling had been completed - a requirement for all licensed drillers (AB 16-17).

{17} A senior officer in the Power and Water Authority gave evidence that, as far as the Authority was concerned, in this case:

- all relevant permits were applied for and given (presumably 3 permits for 3 successful bores); and
- the Authority had inspected the successful bores and it was happy with all aspects of the drilling; and
- all bores (successful and unsuccessful) had been registered shortly after the drilling (AB 16).

{18} On this evidence the justice of the case clearly lies with the driller. He appears to have made every attempt to comply with the Act as required by the Water Authority. As between the parties, there appears to be no justification for the landowner gaining the "windfall profit" of the bores without having to pay for them.

3. The judgments so far

{19} The case has been heard on three occasions: by a magistrate in the Local Court in Darwin; by Kearney J in the Northern Territory Supreme Court; and by a Full Court of the NT Court of Appeal.

(i) The magistrate

{20} The magistrate's reasoning was based on his construction of the statute. He held that the Act required a drilling permit or permits to be issued prior to the commencement of any drilling activity; and permits were required for all bores actually drilled (whether successful in finding water or not). Since drilling and construction of bores are two different activities,

the three "construction" permits authorised construction of the bores but did not authorise drilling at all. Furthermore the construction permits could authorise construction only if issued prior to the construction taking place. The following table summarises the magistrate's view of the status of work done.

Date	Event	Status of work done
13/10/92	Water authority issued a single construction permit	
15/10/92	Bore 1 drilled and constructed	Construction work authorised, drilling work unauthorised
16 and 17/10/92	Bore 2 drilled	No authorised work
18 and 19/10/92	Bore 4 drilled and constructed	No authorised work (construction work not authorised in advance)
21 to 23/10/92	Bore 5 drilled and constructed	No authorised work (construction work not authorised in advance)
24 and 25/10/92	Bore 3 drilled	No authorised work
27/10/92	Oral request 2 more construction permits issued	
27/10/92	Bore 6 drilled	No authorised work (no construction work done)
28/10/92	Bore 7 drilled	No authorised work (no construction work done)

{21} As a result of this reasoning, almost all the work carried out was held to be unauthorised and therefore illegal and unenforceable. The magistrate's order severed all such unauthorised work from the contract, and he made an award of $1,720.00 in respect of the remaining work.

(ii) The Supreme Court and Court of Appeal

{22} Kearney J in the Supreme Court and the majority in the Court of Appeal (Martin CJ and Thomas J) also treated the issue solely as a matter of statutory construction. But in construing the Act, they came to the opposite conclusion from that of the magistrate.

{23} Kearney J held that the magistrate's interpretation of the requirements of the Act were "broadly correct" (AB 44). Illegality thus became the central issue. He found that the contract was not illegal as formed: nor was it expressly or impliedly prohibited because of the way it was performed (AB 73). In coming to this conclusion he referred to the indicia of a prohibited contract as set out in *Yango Pastoral Co Pty Ltd v First Chicago Bank Australia*

Ltd (1978) 139 CLR 410 ("*Yango*"). He felt that the Act provided a sufficient penalty for its breach; and that the contract was therefore enforceable.

{24} Martin CJ in the Court of Appeal also relied on *Yango* for the approach to be taken (AB 84). He held that the illegality did not go to the core or essence of the method of performance (*St John Shipping*) as there was nothing wrong with the way the drilling was done (AB 85). Looking at the provisions of the Act in detail, he concluded that the Act did not impliedly render the contract unenforceable (AB 91).

{25} Thomas J agreed with Kearney J that

"... having regard to all the proper indicia, the appellant is able to enforce the contract against the respondent in this case as their contract is not rendered void or unenforceable, either expressly or impliedly, by the Act." (AB 109).

{26} Angel J's dissenting judgment in the Court of Appeal was the only judgment which dealt with public policy as a possible alternative argument. He began by pointing out that performance of the contract entailed a breach of the statute (AB 95). His reasoning then proceeded as follows: In making his claim, the driller was compelled to disclose this prohibited conduct; it was the consideration for his claim. Since the prohibited conduct was not merely incidental to the contract or to its performance, the contractual claim had to fail (AB 95-96). The judge then "venture[ed] a little in to the thicket of the case-law", pointing out that some of the cases were difficult to reconcile. His comments on the case law will be dealt with below. Suffice to say that he came to the conclusion that the outcome would be the same whether using the implied statutory prohibition approach or the public policy approach, since it would be against public policy to enforce a contract which entailed a breach of a statute (AB 102).

{27} The Applicant's Summary of Argument for the appeal to the High Court appears to concede that the contract is not expressly or impliedly prohibited by the statute. It focuses attention on public policy. The main issues facing the High Court are (i) whether the common law public policy principle is still relevant in cases where conduct is prohibited by statute; and, if it is, (ii) how it should be applied in these situations, i.e. what factors ought to be taken into account?

4. Is public policy relevant?

{28} Of the five judgments, only Angel J's attempts to deal with public policy as a separate argument.

(i) Overlap between statute and common law

{29} The well-known case of *St John Shipping* is often regarded as authority for the proposition that in the case of "statutory" illegality, the result is solely a question of interpreting the statute. The master of a ship belonging to St John Shipping was convicted of overloading and fined the maximum amount under the relevant Act. Due to depreciation of the pound, the value of the fine was less than the extra freight earned by the overloading. Joseph Rank Ltd held a bill of lading on which some £18,893 was due. They withheld £2,295

(which was the amount to be earned by the extra illegal freight). When sued for the balance, they alleged that the contract was unenforceable because it had been performed in an illegal manner. Several extracts from Devlin J's judgment give the impression that he regarded the interpretation of the statute as the only relevant question. Amongst the most cited are:

"... whether it is the terms of the contract or the performance of it that is called in question, the test is just the same: is the contract, as made or as performed, a contract that is prohibited by the statute?" (at 284).

and, after citing Parke B in *Cope v Rowlands* (1836) 2 M&W 149 at 157: "Now this language - and the same sort of language is used in all the cases - shows that the question always is whether the statute meant to prohibit the contract which is sued upon." (at 285).

{30} It is clear from the judgment that these statements were only directed at clarifying the statutory interpretation approach. Devlin J did not exclude the operation of any common law principle based on public policy. Indeed, the court considered three main arguments (outlined by Devlin J at 282-283). Only the first was based on an interpretation of the statute (considered at 283-291). The second argument was based on the rule that one cannot enforce a contract if one is obliged to disclose an unlawful consideration in making the claim (considered at 291-292). The third argument was that the courts will not enforce "rights directly resulting to the person asserting them from the crime of that person" (at 292 *et seq*, citing the rule as expressed by Lord Atkin in *Beresford v Royal Insurance Co Ltd* [1938] AC 586 at 596).

{31} The latter two arguments are both variants of the public policy principle which has been recognised at least since the eighteenth century (see e.g. *Wetherell v Jones* (1832) 3 B & Ad 221; *Cleaver v Mutual Reserve Fund Life Association* (1892) 1 QB 147). It can be stated in general terms:

"The principle of public policy is this. ... No court will lend its aid to a man who founds his action upon an illegal and immoral act." (per Lord Mansfield in *Holman v Johnston* (1775) 1 Cowp 341 at 343; 98 ER 1120 at 1121).

{32} A statute which prohibits certain activity obviously takes precedence over this general public policy principle. If the statute prohibits the entering into or performance of certain contracts, either expressly or impliedly, then that must be the end of the matter. Public policy will have been rendered irrelevant. Statements which assert that the legislature is the supreme determinant of public policy are correct for this reason. (Such statements are also sometimes cited to support the slightly more contentious argument that public policy will not allow the enforcement of a contract if an offence is committed during its performance - see the discussion below at {55}-{61}.)

{33} On the other hand, if the statute prohibits conduct but is held not to have expressly or impliedly prohibited the contract, it is submitted that the general principle of common law will still apply. In the absence of a code which replaces the common law, or an exclusion of the common law principle, a statute merely supplements the common law. Perhaps it was a little unfortunate that Devlin J's judgment in *St John Shipping* did not highlight the different bases of each of the questions he considered. Martin CJ, Kearney and Thomas JJ all appear to assume that statutory interpretation is the sole issue.

(ii) The *Yango* approach

{34} The correct approach is that taken in *Yango*. There the court was dealing with the question whether a mortgage loan was unenforceable as a result of breaching a general prohibition on conducting a banking business without a licence. It involved illegality at the time of making the contract (whereas we are concerned with illegality because of the method of performance). Mason J (with whom Aickin J agreed) and Jacobs J clearly asked three separate questions. (Gibbs ACJ's judgment was not quite so clear in this respect).

{35} The first column of the following table shows the questions asked by Mason J. The second column rephrases the questions slightly for cases where the issue is illegality because of the method of performance.

Illegality as made	Illegality as performed
Does the Act expressly prohibit the contract as made? (Mason J at 424)	Does the Act expressly prohibit the contract because of the way it was performed?
If not, then does the Act by implication, that is by way of necessary inference, prohibit the contract as made? (Mason J at 425)	If not, then does the Act by implication, that is by way of necessary inference, prohibit the contract because of the way it was performed?
If not, then, as a matter of public policy, will the court allow the plaintiff to enforce the contract? (Mason J at 427)	If not, then, as a matter of public policy, will the court allow the plaintiff to enforce the contract?

(iii) Angel J's analysis of the case law

{36} Angel J tries to reconcile some of the statements in this area. He refers first to some Australian cases which follow *St John Shipping* and treat the matter solely as a question of statutory interpretation. (He mentions *Hayes v Cable* [1961] NSWR 610, and *Doug Rea Enterprises Pty Ltd v Hymix Australia Pty Ltd* [1987] 2 QR 495). He points out that on the basis of these authorities the parties' knowledge of the prohibition is irrelevant (AB 97). But he goes on to identify a number of cases in which the state of mind of the parties and other surrounding circumstances have been held to play a crucial role (*Fire and All Risks Insurance Co Ltd v Powell* [1966] VR 513; *Frank Davies Pty Ltd v Container Haulage Group Pty Ltd (No 1)* (1989) 98 FLR 289; *Corumo Holdings Ltd & Ors v C Itoh Ltd & Ors* (1990) 3 ACSR 438 (affirmed in (1991) 24 NSWLR 370); and *PT Ltd and Another v Maradona Pty Ltd and Ors* (1991-1992) 25 NSWLR 643). These cases all appear to move from the question whether the relevant statute prohibits the contract **as made**, to the question whether the contracts are contrary to public policy. He cites dicta in *Yango* which seem to support this view (per Mason J at 423, 424 and 427; and per Jacobs J at 432; cited at AB 99-101), but does not acknowledge that *Yango* was a case where the contract was alleged to be illegal as made.

{37} On these authorities Angel J concludes that:

"On the present state of the more recent authorities the question whether a contract is expressly or impliedly prohibited by statute would appear to be answerable according to whether the statutory prohibition, as a matter of statutory interpretation, prohibits the contract **as made**, irrespective of its mode of performance, lawful or unlawful. If the performance is unlawful, and the contract **as made** is not prohibited, the question then is whether as a matter of public policy the contract should nevertheless be enforced." (AB 102, my emphasis).

{38} It is submitted that Angel J is correct in identifying the public policy rule as being relevant. But he is incorrect is suggesting that, in the case of illegality as a result of the method of performance, the public policy issue follows the question whether the statute prohibits the contract **as made**. In the case of illegality as a result of the method of performance, we are almost always talking about a situation where the contract is NOT illegal as made. On Angel J's analysis, because the contract is not illegal as made, an interpretation of the statute becomes irrelevant and the only issue is whether public policy prevents enforcement. This effectively ignores the approach taken in *St John Shipping* that the statute must be construed to see whether it prohibits the contract **as performed**. The judgments cited by Angel J are not carefully considered on this point; if they are to be interpreted as authority for Angel J's conclusion on the law (quoted above), it is submitted they must be wrong.

{39} All three questions identified above need to be asked. It can never be solely a matter of statutory interpretation, unless the statute excludes the common law rule. The next issue is how the public policy principle should be applied in cases where there is a statutory prohibition of conduct.

5. How should public policy be applied?

{40} The difficulty with public policy has been mentioned already. While it introduces great flexibility, it leads to uncertainty. When Burrough J described it as an "unruly horse", he went on to say "and when once you get astride it you never know where it will carry you." (*Richardson v Mellish* (1824) 2 Bing 229 at 252; 130 ER 294 at 303). In cases where a statute has prohibited certain conduct, how might the public policy principle be applied in a way which encourages more certainty? Some of the alternatives will be discussed.

(i) The legislature's intention

{41} If the statute is held to prohibit contracts because of their method of performance, it has been noted that this is the end of the matter - the common law principle is subordinate to the statutory prohibition. By the same token it can be argued that if the statute does **not** expressly or impliedly prohibit contracts, then the legislature must be happy for such contracts to be enforced; so public policy should support the legislature's intention, and courts should enforce the contract. If accepted, this argument would have the same effect as treating the matter solely as a question of statutory construction, because public policy would always follow the conclusion reached in interpreting the statute. This would clearly encourage a greater degree of certainty and consistency.

{42} There are two difficulties with this approach. One is based on logic; the other is whether it permits enough flexibility to do justice.

{43} The logical flaw is obvious. Just because the legislature has not expressly or impliedly prohibited such contracts does not mean that their enforcement would be welcomed. This logic would be valid only if there were two states: prohibition or acceptability. In reality, where the legislature's view is not to be gathered from the statute, the more likely state is 'undecided'. The logic is a little like assuming that if only 40% of the members vote for a resolution at the annual general meeting of a company, it has been defeated, when in fact only

25% would have voted against it. The abstentions may well be important. If the 'undecided' state is not to be countenanced, the legislature is assumed to have a view by default, i.e. if nothing to the contrary can be gathered from the statute, it is assumed that the contract is acceptable.

{44} Champions of the cause of certainty might suggest that this approach is justifiable - that in the absence of a clear statutory intention, punishment should be left to the criminal law. But one can always think of an unusual set of facts which would stretch the acceptability of such a rule. Take as an example a statute similar to the one involved in the present case, but with the onus on the driller to obtain permits. Assume that the court's first decision, based on facts similar to those in the present case, is that there is no express or implied intention in the statute to affect contracts between drillers and landowners. A scenario arises in which a driller enters into a contract to drill 30 bores for a new mine. The contract is legal as formed, but, unknown to the mine owner, some time after entering into it the driller decides that he can save money by not bothering to apply for permits. As a result of drilling the bores, the water table in the area is severely depleted. Animals die, and the livelihood of the surrounding community is seriously threatened. If the driller had applied for permits, this consequence could have been avoided by the imposition of certain conditions. Enforcing the contract would seem to be encouraging such offenders since they will still be able to reap the benefits of their offensive conduct.

{45} On the other hand, if the first decision had been that the statute did intend to render unenforceable any contract performed without a proper permit, then even innocent drillers (like FJ Leonhardt Pty Ltd), who made every attempt to comply with the statute, would be unable to enforce contracts, and landowners would benefit from the windfall profit.

{46} It must be desirable that the judicial system have sufficient flexibility to deal with cases differently depending on factors such as the state of mind of the parties, the type of conduct which has been prohibited, the seriousness of the transgression of the statute and the consequences of performance of the contract.

(ii) The legislature's intention regarding each contract

{47} The inflexibility of the rule suggested above is predicated on a 'once only' interpretation of the statute, i.e. that it does or does not prohibit such contracts. Perhaps inflexibility could be ameliorated by taking a slightly different approach in interpreting the statute. One possibility is to differentiate between different types of contract.

{48} In interpreting the statute in *St John Shipping*, Devlin J said:

"Two questions are involved. The first - and the one which hitherto has usually settled the matter - is: does the statute mean to prohibit contracts at all? But if this be answered in the affirmative, then one must ask: does this contract belong to the class which the statute intends to prohibit? For example, a person is forbidden by statute from using an unlicensed vehicle on the highway. If one asks oneself whether there is in such an enactment an implied prohibition of all contracts for the use of unlicensed vehicles, the answer may well be that there is, and that contracts of hire would be unenforceable. But if one asks oneself whether there is an implied prohibition of contracts for the carriage of goods by unlicensed vehicles or for the repairing of unlicensed vehicles or for the garaging of unlicensed vehicles, the answer may well be different. The answer might be that collateral contracts of this sort are not within the ambit of the statute." (at 287).

{49} Devlin J appeared to have in mind differentiating between types of contract. When faced with a bore drilling contract which has been performed without a permit, we may well be able to differentiate it from bore constructing contracts, or bore capping contracts. This might effectively narrow the focus of the statutory provision, (and thus the common law principle if it is to follow the answer given in the statute). But this does not deal with the problem of unusual individual circumstances within the offending category of contract.

{50} Can the argument be extended so as to treat each contract (of the same type) as different, depending on its unique facts? This would require construing the statute in each case to see whether it impliedly prohibited **that particular contract** in the circumstances in which it was performed. Some of the judgments in this case indicate just such a flexible approach in interpreting the statute. Kearney J appeared to regard the lack of "fraudulent or immoral purpose", the minor nature of the transgression and the administrative practice of the water authority as relevant indicia in considering whether the contract as performed was impliedly prohibited (AB 67 in the context of the statements following at 68). Confusingly, he also appears to raise the *ex turpi causa* principle in the middle of his consideration of the statute (AB 68). Following some of the statements made by Miles CJ in *Ross v Ratcliff* (1988) 91 FLR 66 (a case involving similar facts), Thomas J also felt that both the minor nature of the transgression (AB 111-112) and the administrative practice of the water authority were relevant indicia to be taken into account (AB 113). It should be noted that "the minor nature of the transgression" as used here seems to have included the parties' state of mind.

{51} If Kearney and Thomas JJ were prepared to take account of these factors in making their decision, then presumably they might have been prepared to hold otherwise if any of these factors had been different. The result might be this: the legislature impliedly prohibits the driller from recovering in the mine scenario outlined above, and also in the case of a shipper who consistently overloads their ship to an extent that is dangerous; but does not impliedly prohibit the driller from recovering when faced with facts similar to the present case, nor the shipper who only marginally overloads on a few occasions. And in each case public policy should follow this legislative intention.

{52} While this result may be eminently reasonable, it does not really involve an interpretation of the statute. It is an *ex post facto* reconstruction of legislative policy, based on an interpretation of the purpose of the statute, and the court's view of how the legislature might have wanted to achieve that purpose given the individual circumstances before the court.

{53} Greig & Davis (*The Law of Contract*, 1987, Law Book Company Ltd at 1117-1118) criticise the development of the implied statutory illegality approach as being fictional, and welcome more recent decisions which are slow to imply such an intention (at 1120-1123). It would be all the more fictional to reconstruct a legislative intention based on factors such as the state of mind and degree of transgression when neither are mentioned in the Act. "A court should not hold that any contract or class of contracts is prohibited by statute unless there is a clear implication, or 'necessary inference,' as Parke B (2 M&W 159) put it, that the statute so intended." (Devlin J, *St John Shipping* at 288). This approach would be a guess at legislative policy rather than a necessary inference.

{54} In addition to being an artificial approach, it effectively re-introduces a flexible policy test through the back door. Determining legislative policy would import the same degree of uncertainty as the common law public policy principle.

(iii) The seriousness of the offence

{55} In the present case Angel J felt that if the legislature expressly prohibited the conduct (drilling without a permit), then public policy must *ipso facto* render the contract unenforceable as well (at AB 103). This is because the supreme arbiter of public policy is the legislature. (He cites Cardozo J in *Messersmith v American Fidelity Co* (1921) 19 AmLR (Ann) 876 at 877 where he said "The public policy of this state, when the legislature acts, is what the legislature says it shall be."). Angel J purports to base this conclusion on the legislature's prohibition of conduct rather than the creation of an offence.

{56} In *St John Shipping* Devlin J refers to a similar argument based on the traditional common law rule thus:

"... I take the law from the dictum in *Beresford v Royal Insurance Co Ltd* [1938] AC 586 ... that was adopted and applied by Lord Atkin [at 596]: 'no system of jurisprudence can with reason include amongst the rights which it enforces rights directly resulting to the person asserting them from the crime of that person.' I observe in the first place that in the Court of Appeal in the same case Lord Wright [1937] 2 KB 197 at 220 doubted whether this principle applied to all statutory offences. His doubt was referred to by Denning LJ in *Marles v Philip Trant & Sons*, [1954] 1 QB 29 at 37 ... This distinction is much to the point here. The Act of 1932 imposes a penalty which is itself designed to deprive the offender of the benefits of his crime. It would be a curious thing if the operation could be performed twice - once by the criminal law and then again by the civil. It would be curious, too, if in a case in which the magistrate had thought fit to impose only a nominal fine, their decision could, in effect, be overridden in a civil action. But the question whether the rule applies to statutory offences is an important one which I do not wish to decide in the present case. ..." (at 292).

{57} Devlin J went on to decide the issue on another basis (which is discussed below at {65}-{66}). Does it follow that public policy cannot allow enforcement of the contract because it involves the commission of an offence? Does the rule apply to all prohibited conduct (as suggested by Angel J), or only to serious offences?

{58} Apart from the obiter comments cited by Devlin J in the above quotation, *Yango* must be authority for rejecting this proposition as an absolute. In holding that public policy did not render the contract unenforceable, Mason J said:

"The weighing of considerations of public policy in this case and the decision in favour of enforcing the contract is influenced by the form of the particular legislation. ... There is much to be said for the view that once a statutory penalty has been provided for an offence the rule of the common law in determining the legal consequences of commission of the offence is thereby diminished - see my judgment in *Jackson v. Harrison* (1978) 138 CLR 438, at p 452 . See also the suggestions that the principle cannot apply to all statutory offences (*Beresford v. Royal Insurance Co. Ltd* in the Court of Appeal (1937) 2 KB 197, at p 220 , per Lord Wright; *Marles v. Philip Trant & Sons Ltd*. (1954) 1 QB 29, at p 37 , per Denning L.J., and that it would be a curious thing if the offender is to be punished twice, civilly as well as criminally (*St. John Shipping Corporation v. Joseph Rank Ltd*. (1957) 1 QB 267, at p 292 , per Devlin J.). The main considerations from which the principle ex turpi causa arose can be seen in the reluctance of the courts to be instrumental in offering an inducement to crime or removing a restraint to crime: *Beresford's Case* (1938) AC, at pp 586, 599 ; *Amicable Society v. Bolland* (*Fauntleroy's Case*) (1830) 4 Bligh (NS) 194, at p 211 (5 ER 70, at p 76))." (at 429).

{59} It is submitted that it would make public policy a blunt tool indeed if it were bound to regard contracts which involved the smallest criminal offence or prohibited conduct as unenforceable. The difficult question is how to distinguish between different categories of prohibited conduct while maintaining certainty.

{60} In *Electric Acceptance Pty Ltd v Doug Thorley Caravans (Aust) Pty Ltd* [1981] VR 799, Brooking J considered this issue. He was faced with an agreement to charge a commission in

breach of the *Hire-Purchase Act* 1959 (Vic). He rejected as too narrow the statement in *Pollock on Contracts*, (13 ed) at 262 that the common law rule only applies to agreements to commit a crime or indictable offence. He refers to the suggestion in *Chitty on Contracts, General Principles*, (24 ed) at para 906 that the rule does not apply to "lesser legislative offences". He suggests that the exception might be in respect of "minor statutory offences which do not involve obloquy". But in the end he refrains from deciding the issue on the basis that, if there is such a restriction on the general rule, the case he was considering lay outside it (at 810-812).

{61} It would serve certainty and consistency well if the public policy principle was limited to an identifiable categorisation such as "crimes and indictable offences". But if the rule is to apply automatically to all such offences, and not apply in the case of lesser offences, it will still be inflexible and lead to injustice. For example, it would mean that in the mine scenario described above, the court would have to enforce the contract. It is submitted that a better approach would be to treat the nature of the offence as one of the factors to be taken into account in determining the enforceability of the contract. A compromise which might encourage certainty would be to have a rebuttable presumption that it is against public policy to enforce a contract which involves the commission of a crime or indictable offence; and to have no such presumption in the case of all other lesser offences.

(iv) The degree of transgression

{62} If it is decided that the type of offence created by the statute is serious enough to warrant public policy's scrutiny, the next question must inevitably be the degree of transgression. In *St John Shipping* Devlin J mentioned the absurd consequences of holding that the statute impliedly prohibited contracts which involved even the smallest transgression of the statute: "A shipowner who accidentally overloads by a fraction of an inch will not be able to recover from any of the shippers or consignees a penny of the freight." (at 281). The same concern arises when considering public policy. How does one distinguish minor and major transgressions of the statutory prohibition with certainty?

{63} It is submitted that there is no easy way - it is merely one of the criteria which public policy will have to take into account. One of the indicators of the degree of transgression would be the state of mind of the parties. If they deliberately intend to flout the statute, the imperative for public policy to refuse to entertain the contract would naturally be higher.

(v) The relationship between contract and conduct

{64} After dealing with the statute, Devlin J considered two other arguments in *St John Shipping*. They were both variations of the public policy principle; and each focussed on the relationship between the contract and the prohibited conduct. The first was expressed in a number of ways, but appeared to be that one cannot succeed in a claim if, in making out the claim, one is obliged to disclose illegal conduct, i.e. the consideration for which one is making a claim cannot be unlawful (at 291). Devlin J disposed of this argument by holding that it was not necessary for St John Shipping to disclose the illegality in making out their claim.

{65} The second public policy issue was whether one could enforce rights under a contract when a statutory offence had been committed during its performance (discussed above at {55}-{61}). He declined to decide the issue directly, but held instead that the contractual

rights being enforced did not 'directly result' from the offence (at 292-293). He was thus able to conclude that the rule did not apply to the facts in *St John Shipping*.

{66} Clearly the relationship between the contract and the prohibited conduct is important; it is more likely to be against public policy to enforce a contract which is "closely related" to prohibited conduct. How can this relationship be expressed in a way that reduces uncertainty? Phrases describing activity as "merely incidental", "going to the core or essence", or "central to the contract" all involve value judgments which are difficult to quantify. But once again there appears to be no better solution.

(vi) Public policy's purpose

{67} In deciding how the public policy principle should be applied, the purpose of the principle should be kept in mind. After reaffirming the principle that a person should not have recourse to a court to claim a benefit from his crime, Lord Atkin said:

"No doubt the rule pays regard to the fact that to hold otherwise would in some cases offer an inducement to crime or remove a restraint to crime, and that its effect is to act as a deterrent to crime." (*Beresford v Royal Insurance Co Ltd* (1938) AC 586 at 598-599).

{68} Application of the public policy principle needs to be flexible enough to take account of this purpose. In cases like the present one where the parties made every effort to comply with the law, treating the contract as unenforceable will have no deterrent effect. It will merely encourage disrespect for the law. It might also encourage unscrupulous landowners to 'forget' the permit, in the hope that they will gain a windfall profit when the innocent driller is prevented from recovering the contract price.

{69} Public policy also needs to take account of other imperatives.

"The suggested application of the principle often involves a conflict between competing common law policies. In Beresford's Case (1938) AC, at p 603 Lord Macmillan identified the conflict between the principle that no court ought to assist a criminal to derive benefit from his crime and the principle that contracts deliberately undertaken by persons of full age ought to be enforced." (*Yango* per Mason J at 428).

{70} For these reasons, it becomes apparent that in implementing the public policy principle there are some areas where certainty and consistency will be very hard to find. The court will need to be able to look at all the surrounding circumstances at the time of the action to see how the purpose of the public policy principle is best served.

{71} It is submitted that it is desirable for the judicial system to have sufficient flexibility to take into account such factors as the state of mind of the parties, the seriousness of the offence, the degree of transgression of the statute and the consequences of performance of the contract; and that despite the uncertainty involved, public policy is the only instrument sharp enough to be able to achieve this effectively. In *A v Hayden (No 2)* (1984) 156 CLR 532, Mason J cited the statement by Pollock LCB in *Egerton v Brownlow* ((1853) 4 HLC 1; 10 ER 359) that:

"... it may be that Judges are no better able to discern what is for the public good than other experienced and enlightened members of the community; but that is no reason for their refusing to entertain the question, and declining to decide upon it. (p.151 (E.R. p.419))."

Mason J continued "Notwithstanding the criticism of these remarks ... I find them compelling."

6. Other arguments

{72} Although the appeal is not based on these grounds, there are several other interesting points worth noting.

{73} The magistrate held that the "construction permits" did not authorise drilling. While it is no doubt true that the Act contemplates drilling and constructing as being two different activities, the relevant question is whether there was **authority** to drill and/or construct. From the evidence of the water authority official, it is clear that the intention in giving a "construction permit" was to authorise both drilling and constructing (see AB 25). The magistrate should have found that both these activities were authorised by the permits granted. This was one of the arguments made to Kearney J (AB 37), but unfortunately he did not deal with it.

{74} The analysis of the effect of the later granting of two permits leaves a lot to be desired. In public law it may make sense to say that an official who has power to grant a permit cannot later ratify an offence by granting a permit with retroactive effect. But in civil law the doctrine of repentance is recognised (see *Clegg v Wilson* (1932) 32 SR (NSW) 109) although its scope is unclear (see e.g. the discussion in Carter & Harland, *Contract Law in Australia*, 3 ed (1996) at paras1715-1718, and authorities cited). Here the landowner intended to comply with the water authority's requirements by applying for 3 permits, but only one was issued. Once the omission was discovered, there was an attempt to remedy the situation. It is arguable that, as soon as two further permits were applied for and given, this reinstated the right to enforce any consideration for the performance covered by the permits. To put it another way, although an offence had been committed when the **prohibited activity** took place (drilling without a permit), any implied prohibition against enforcement of **the contract** fell away when the permits were subsequently issued. There is certainly scope for a deeper analysis of the law in respect of the overlapping concepts of repentance and attempted rectification of illegality.

{75} The matter could also have been argued from a number of other interesting angles.

- Both Kearney J in the Supreme Court and Thomas J in the Court of Appeal found that the onus of applying for the permits was on the landowner (AB 67 and 108 respectively). This would mean that the parties were not in equal guilt, and the *in pari delicto* principle would not be a bar to a claim on the basis of unjust enrichment.
- An alternative argument might also have been made out on the basis of estoppel (although this would require a re-examination of the conventional view that estoppel cannot suppress a defence based on illegality).
- The roles of mistake or ignorance of the law in a civil action might have been re-examined.
- The opportunity might have been taken to reassess the use of the collateral contract doctrine in these situations.

{76} As the matter developed, however, none of these arguments received consideration. Unjust enrichment was noted as a ground of appeal to the Supreme Court, but the issue was

not fully addressed during the appeal. In view of Kearney J's decision that the contract was enforceable he found it unnecessary to deal with unjust enrichment as a basis for the claim (AB 73).

7. Conclusion

{77} Where prohibited activity takes place during the performance of a contract which is not itself expressly or impliedly prohibited by the statute, the question whether the contract is unenforceable in the light of public policy must still be relevant. In applying the public policy test, courts should seek ways of increasing certainty and consistency.

{78} To regard such contracts as always enforceable (because they are not prohibited by the statute) is illogical and too inflexible to be a satisfactory solution. To interpret the legislative intention so as to take account of all individual circumstances in each case is artificial and as equally uncertain as the public policy test.

{79} It would be bizarre if public policy required that major multi-million dollar contracts were unenforceable as a result of the commission of minor offences (such as parking or speeding offences) during their performance. The seriousness of the type of conduct prohibited, and the degree of the actual transgression in each case, must be relevant factors. Other than restricting the public policy rule to a category like "crimes and indictable offences", there is no easy way of ensuring certainty and consistency in applying these criteria.

{80} Testing the closeness of the relationship between the contract and the prohibited conduct is also problematic. Policy is unlikely to require that 'merely incidental' activity should render a contract unenforceable. A suitable *prima facie* test of whether activity is merely incidental to a claim on a contract is to ask whether it is strictly necessary to disclose the unlawful activity in making out the claim.

{81} The competing dictates of public policy require both that contracts freely entered into should be enforced, and that the courts should not assist someone in gaining a benefit from their own illegal or immoral act. The tension between these two requirements means that simple and certain lines cannot be drawn. The purpose of the public policy approach needs to be kept in mind when making decisions about the enforceability of contracts.

{82} The ultimate policy issue for the High Court is whether the desire for certainty and consistency outweighs the desire to achieve justice in unusual situations. With respect it is submitted that it does not. Public policy may well be an unruly horse. But if it is left out of the team, the coach may never arrive. Courts must harness it and ensure that it pulls in the right direction.

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