ILLEGALITY AND SEVERABILITY IN CONTRACTS[1]

INTRODUCTION

Illegal contracts are of particular interest to Victorians. The first recorded contracts made in Victoria were two carefully prepared deeds executed on the bank of a tributory of the River Yarra on 6th June, 1835, by which John Batman purchased from chiefs of the Doutta Galla tribe some 600,000 acres of land around Port Phillip Bay. One of these deeds provided that the vendors '*Give* Grant Enfeoff and confirm unto the said John Batman his heirs and assignees' a tract of land including the Melbourne district 'in consideration of Twenty Pair of Blankets, Thirty Tomahawks, One Hundred Knives, Fifty Pair of Scissors, Thirty Looking Glasses, Two Hundred Handkerchiefs, and one Hundred Pounds of Flour, and Six Shirts delivered to us by *John Batman*'. But as has so often happened, the simple aspirations of the parties to the contracts were frustrated by illegality. On 26th August, 1835 Governor Bourke in Sydney issued a proclamation declaring these and similar contracts void and the purchasers to be trespassers.[2] Batman, however, prospered and became famous as a founder of Melbourne.

Later in the century, title to much of the best land elsewhere in Victoria was obtained through land dummies by the use of contracts illegal under the Selection Acts.[3] On this foundation Victoria prospered.

With the subsequent great increase of legislative regulation in many spheres of activity, there is every reason to believe that the production of illegal contracts has continued as a growth area in Victoria as elsewhere.[4]

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1 This article is based on a paper of the same title delivered at the Western Australian Law Summer School in February 1976.

2 The deed for the purchase of the Geelong district and the proclamation are set out in C M H Clark, SELECT DOCUMENTS IN AUSTRALIAN HISTORY 1788-1850 (1968) 90-3. The original deeds are in the La Trobe Library and facsimiles are available from the State Library of Victoria.

3 M Kiddle, MEN OF YESTERDAY (1961) c 12.

4 The number of contracts affected by an element of illegality is likely to increase through the operation of s 45 of the Trade Practices Act 1974 (Cth) which provides in part:

APPROACH

This article deals first with the relationship between illegality and severability in contracts where the element of illegality produces what is usually called a 'void' contract or provision. Then it deals with that relationship where the element of illegality produces what is usually called an 'illegal' contract or provision. It concludes with some suggestions for law reform.

In dealing with void contracts and illegal contracts the article indicates briefly the legal concepts which those descriptions denote in this context. It is important to heed the warning of Windeyer J that:

> The words used do not matter if the actual legal result they are used to express be not in doubt or debate. But it has always seemed to me likely to lead to error, in matters such as this, to adopt first one of the familiar legal adjectives—'illegal', 'void', 'unenforceable', 'ineffectual', 'nugatory'—and then having given an act a label, to deduce from that its results in law. That is to invert the order of inquiry, and by so doing to beg the question, and allow linguistics to determine legal rights.[5]

VOID CONTRACTS OR PROVISIONS

The law which operates to render a contract or contractual provision void because of the presence of an element of illegality may be a principle of common law or the express or implied provision of a statute or other legislative instrument.

It is convenient to consider first the contracts and contractual provisions where it is a principle of common law which renders the contract or provision void because of the presence of an element of illegality. There are three elements of illegality which at common law produce void contracts. These are contractual provisions which are in

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(1) A contract in restraint of trade or commerce that was made before the commencement of this sub-section is unenforceable in so far as it confers rights or benefits or imposes duties or obligations on a corporation.

(2) A corporation shall not—

(a) make a contract or arrangement, or enter into an understanding, in restraint of trade or commerce; or

(b) give effect to a contract, arrangement or understanding to the extent that it is in restraint of trade or commerce, whether the contract or arrangement was made or the understanding was entered into before or after the commencement of this sub-section.

5 Brooks v Burns Philp Trustee Co Ltd (1969) 121 CLR 432, 458.

unreasonable restraint of trade, which oust the jurisdiction of the courts, or which tend to prejudice the status of marriage.[6]

It is the policy of the law that the courts will not enforce contracts or contractual provisions of this type but will leave the respective parties to decide whether or not they will comply with them. The approach of the law is the passive one of non-assistance to the parties. It does not go further and impose additional legal disadvantages so as to discourage people from making or carrying out such contracts or contractual provisions. The law treats them as inexpedient rather than unprincipled.[7] Thus if a person contracts to act in a way which unreasonably restrains his freedom to trade, the law will not enforce that promise against him. But if the contract contains a promise by the other party that he will pay this person a sum of money if he restrains his trade in the manner agreed, and the person does so, he may enforce the promise to pay the sum of money.[8]

While it is clear that a contract of the type now being considered is unenforceable, and while it is commonly referred to as being both void and unenforceable, the view has been expressed that such contracts are not void, in the sense of being entirely devoid of legal effect.[9] In this article, however, it is not necessary to investigate that question.

If a contract contains a contractual provision of the type now being considered, such as a promise in unreasonable restraint of trade, it is clear that that provision is unenforceable. The contract will usually contain a number of promises. Does the presence of the unenforceable promise cause the other promises to be unenforceable so that the whole contract is unenforceable? In other words when a court has decided that one or more promises is or are unenforceable, but that the remaining promises are inherently enforceable, will it treat the remaining promises as constituting a contract which is enforceable? This is the issue of severance. The authorities upon severance have fairly been described as 'a forest of decisions with their tangled undergrowth of dicta',[10] but broad principles have emerged from

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6 G Cheshire and C Fifoot, THE LAW OF CONTRACT (3d Australian ed 1974) 385.

7 Ibid.

8 Howard F Hudson Pty Ltd v Ronayne (1972) 126 CLR 449, 464-5; Brooks v Burns Philp Trustee Co Ltd (1969) 121 CLR 432, 464-7; McFarlane v Daniell (1938) 38 SR (NSW) 337, 347-8.

9 9 HALSBURY'S LAWS OF ENGLAND (4th ed) para 386 n 8; para 440 n 9.

10 Windeyer J in Brooks v Burns Philp Trustee Co Ltd (1969) 121 CLR 432, 453.

recent decisions which enable the woods to be seen without too much distraction from the trees.

It is suggested that there are two steps in deciding whether unenforceable promises will be severed and the remaining contractual provisions treated as constituting a valid contract. The first is to see whether severance is technically possible. If it is, the second step is to decide whether the intention should be imputed to the parties that, in the event of it transpiring that the provisions in question are unenforceable, the remaining provisions should operate as their contract.

TECHNICAL POSSIBILITY

Remainder a Workable Contract

It is obvious that there can be no severance if the remaining provisions would not operate as a complete and workable contract.[11]

Blue Pencil Principle

The courts will not go beyond the severance of particular words, expressions or provisions from the terms of a contract. This principle remains from an earlier and wider principle often called the 'blue pencil rule'. The blue pencil rule was once regarded as having a decisive role. The difference between the earlier view and the present prinicple is illustrated by the difference in approach between the Divisional Court and the Court of Appeal in *Attwood v Lamont*.[12] This difference was concisely expressed by Younger LJ in the Court of Appeal:[13]

> The learned judges of the Divisional Court, I think, took the view that such severance always was permissible when it could be effectively accomplished by the action of a blue pencil. I do not agree. The doctrine of severance has not, I think, gone further than to make it permissible in a case where the covenant is not really a single covenant but is in effect a combination of several distinct covenants. In that case and where the severance can be carried out without the addition or alteration of a word, it is permissible. But in that case only.

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11 See Bennett v Bennett [1952] 1 KB 249, 261 and Kelly v Kosuga (1959) 358 US 516, 521 both cited by the Privy Council in Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd [1975] AC 561, 578.

12 [1920] 3 KB 571.

13 Ibid at 593.

The present position is that there will be no severance unless this can be done by simply excluding particular words, expressions or provisions from the terms of the contract and without the addition or alteration of words or expressions.[14] Thus if a tailor contracted with his employer that within two years after leaving the employment he would not carry on any business whatsoever within a distance of one mile from the place of employment a court could not confine this promise to the business of a tailor so as to make it valid.[15] This test of the availability of severance is a negative test not a positive one. If it cannot be satisfied there can be no severance. If it can be satisfied it does not preclude severance although other tests may do so.

Not Change Meaning of Remainder

Particular words, expressions or provisions will not be severed from a contract if this would change the meaning of remaining words or expressions. In *Peters Ice Cream (Vic) Ltd v Todd* a shopkeeper agreed with his supplier that he would not 'sell, serve, supply or vend any other make of ice cream and/or kindred products or make any of same myself during the period this agreement is in force within a reasonable distance from my present place of business. . . .'[16] This was held to be void. Counsel for the company argued that the agreement should be severed and submitted, as a second alternative, that one way in which a severance could be effected was by striking out the words 'within a reasonable distance'. In rejecting that submission Little J said:[17]

> If the second alternative were adopted, the word 'from' would no longer be attached to the words 'reasonable distance' but simply to 'my present place of business'. The prohibition would be against sales 'from my present place of business'. The word 'from' would accordingly in the contract, as severed, be used in a sense different from that which it bears in the document as it now stands. If the parties had been asked to express their intentions in an expanded form, it would seem likely that they would have provided against the defendant selling 'at or within a reasonable distance from' the present place of business. Instead of the word 'at' they may have employed the expression 'in or on' as in *Peters American Delicacy Co. Ltd. v. Patricia's Chocolates and Candies Pty. Ltd.*

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14 Marquett v Walsh (1929) 29 SR (NSW) 298.

15 See Baker v Hedgecock (1888) 39 Ch D 520 and also Lindner v Murdock's Garage (1950) 83 CLR 628.

16 [1961] VR 485, 486.

17 Id at 492.

(1947), 77 C.L.R. 574. If, in an agreement expressed in either of those ways, severance were effected, what would remain would be a restraint on selling, serving, supplying or vending 'at' or 'in or on' the present place of business. Such a provision however is, in my opinion, narrower than a provision against selling, serving, supplying or vending 'from' my present place of business.

But in any event the argument appears not to take into account that, by the contract, the defendant also promises not to make ice-cream or kindred products. The language of that promise, equally with the words 'sell, serve, supply or vend', is, I think, plainly attached to the phrase 'within a reasonable distance from my present place of business'. It is, accordingly, a promise 'not to make ice-cream within a reasonable distance from the present place of business'. Excision of the words 'within a reasonable distance' would in this respect produce an ungrammatical and meaningless clause. To give any meaning (with those words deleted) to the promise not to make ice-cream, it would be necessary either to construe that promise as unlimited in area, i.e. ignore the words 'from my present place of business', or to do drastic surgery to the whole restraint provision so as to read the promise not to make ice-cream as one not to make it at the present place of business. . . . The second alternative involving, as it does, transposition an[d] addition of words, is not severance.

It follows that neither of the two methods of severance urged by . . . [counsel for the company] is open. 'I think it is still the law', said Lord Sterndale, M.R. in *Attwood v Lamont,* [1920] 3 K.B. 571, at p.577; [1920] All E.R. Rep. 55 at p.60, 'that a contract can be severed if the severed parts are independent of one another and can be severed without the severance affecting the meaning of the part remaining'.

The words, expressions or provisions severed may still be taken into account after severance for the light which they may throw on the meaning of words in the remaining provisions.[18]

Not Sever Part of Indivisible Promise

As indicated in the passage quoted above from the judgment of Younger LJ in *Attwood v Lamont,*[19] even though it might be otherwise open to the court to sever part of a promise, this will not be done if the promise is in substance a single and indivisible one. In that case the plaintiff had a business at Kidderminster with a number of departments. He followed a scheme by which the head of each department agreed to accept a restraint on trading in any business carried on by any of the departments. Thus the defendant, the head of the

18 T Lucas & Co Ltd v Mitchell [1974] Ch 129, 135.
19 [1920] 3 KB 571, 593.

tailoring department, agreed not to carry on the business of a tailor, dressmaker, general draper, milliner, hatter, haberdasher, gentlemen's, ladies' or children's outfitter at any place within a range of ten miles of Kidderminster. The defendant later carried on business as a tailor within the ten miles' limit. The restriction was unreasonably wide and the county court judge held that it could not be severed so as to apply to the tailoring business. The Divisional Court held that it could be severed in this way and granted an injunction against the defendant, restricted to the business of tailoring. The Court of Appeal held that the agreement should not be severed. Lord Sterndale MR said:[20]

> I think it is quite clear that this agreement was part of a scheme by which every head of a department was to be restrained from competition with the plaintiff even in the business of departments with which he had no connection and with the customers of which he was never brought into contact. If this be the true meaning of the agreement, it was, as it is described, an agreement not to trade in opposition and not an agreement to restrain the unfair use of secrets of knowledge of customers acquired by the servant in the employer's service. To effect this object the retention of the restraint to the business of all the departments is necessary, and I think that to strike out all but the tailoring department is not merely to remove one of several covenants, each directed to the legitimate object of preventing unfair competition, but to alter entirely the scope and intention of the agreement.

The decision in that case has been criticized as departing from the general stream of authority on severance. It has been suggested that it depended on a principle under which a court is less ready to sever a promise in restraint of trade in a contract between employer and employee than in a contract between a vendor and purchaser.[21] Although the courts take a more restricted view of what is a reasonable restraint in the case of an employee than in the case of a purchaser, on the question of severance there is no difference in approach.[22]

In other cases in situations similar in pattern to that in *Attwood v Lamont* severance has been allowed.[23] There are always difficulties in

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20 [1920] 3 KB 571, 579-580.

21 Ronbar Enterprises Ltd v Green [1954] 1 WLR 815, 820-1.

22 T Lucas & Co Ltd v Mitchell [1974] Ch 129.

23 Eg Goldsoll v Goldman [1915] 1 Ch 292; British Reinforced Concrete Engineering Co Ltd v Schelff [1921] 2 Ch 563; Marquett v Walsh (1929) 29 SR (NSW) 298; Scorer v Seymour Jones [1966] 1 WLR 1419; T Lucas & Co Ltd v Mitchell [1974] Ch 129.

drawing the line in matters of degree, such as whether a promise is in substance a single and indivisible one. Although the actual decision has been criticized, the principle stated in *Attwood v Lamont* is not in question.[24]

If promises in a contract, although separate in form, are so closely intertwined that they have no independent life of their own they can not be severed one from the other.[25]

If it is decided that severance is technically possible, attention moves to the next step of the decision.

IMPUTED INTENTION

In *Brooks v Burns Philp Trustee Co Ltd* Taylor J said:[26]

> It was suggested in argument that the effect which a void promise expressed in a contractual instrument will have on the rest of the contract will vary according to whether it is contained in a deed or in a simple contract. But the problem of severability is the same in either case; fundamentally the question is one of intention to be gathered from the instrument itself; *Fitzgerald v. Masters*[27] and *Whitlock v. Brew*.[28] There can, of course, be no doubt that if the parties to either a deed or simple contract were expressly to declare their intentions as to what consequences should follow upon the invalidation of a particular term effect would be given to the intention expressed provided, of course, the invalidation of the term meant merely that it was void. It may be that in the case of a simple contract the necessity for consideration may introduce an additional element to be taken into account (cf. *McFarlane v. Daniell*[29]) but, as will appear, this is a theoretical rather than a practical possibility and, speaking generally, the problems of what intentions should be imputed to the parties and how these should be resolved are common to both forms of instruments.

In *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* the Privy Council put the position in this way:[30]

> As Kitto J. remarked in *Brooks v. Burns Philp Trustee Co. Ltd.* (1969) 121 C.L.R. 432, 438: 'Questions of severability are often difficult.' The answer depends on the intention of the parties as

24 Eg it was applied in Peters Ice Cream (Vic) Ltd v Todd [1961] VR 485 and by the Court of Appeal in T Lucas & Co Ltd v Mitchell [1974] Ch 129.
25 Eg Stenhouse Australia Ltd v Phillips [1974] AC 391, 403.
26 (1969) 121 CLR 432, 442.
27 (1956) 95 CLR 420.
28 (1968) 118 CLR 445.
29 (1938) 38 SR (NSW) 337.
30 [1975] AC 561, 578.

> disclosed by the agreement into which they have entered; but generally, of course, they have not forseen that one or more of the provisions in their agreement will be unenforceable. Various tests have been formulated which might not in every case lead to the same result—e.g., is that which is unenforceable 'part of the main purport and substance' of the clause in which it appears? (*per* Lord Moulton in *Mason v. Provident Clothing and Supply Co. Ltd.* [1913] A.C. 724, 745); does the deletion 'alter entirely the scope and intention of the agreement?' (*per* Lord Sterndale M.R. in *Attwood v. Lamont* [1920] 3 K.B. 571, 580); does the deletion of the covenant in question 'leave the rest of the deed a reasonable arrangement between the parties?' (*per* Denning L.J. in *Bennett v. Bennett* [1952] 1 K.B. 249, 261); does what is left constitute an 'intelligible economic transaction in itself, . . . even though it furnished the occasion for' the unenforceable restraint? (*Kelly v. Kosuga* (1959) 358 U.S. 516, 521). But whatever test be applied the answer must, their Lordships think, be the same in this case.

In the second step of the decision upon severance the court inquires whether it is fair and reasonable to impute to the parties the intention that, in the event of the provisions in question being unenforceable, the remaining provisions should operate as their contract. Lord Radcliffe illustrated the intellectual process followed by courts in imputing to the parties an intention as to their respective rights and liabilities in the event of a contingency occurring which neither had expected or foreseen. He was considering the analysis of the principle of frustration of contract which is based on the existence of an implied term. He said:[31]

> [I]f the matter is to be approached by way of implied term, the solution of any particular case is not to be found by inquiring what the parties themselves would have agreed on had they been, as they were not, forewarned. It is not merely that no one can answer that hypothetical question: it is also that the decision must be given 'irrespective of the individuals concerned, their temperaments and failings, their interest and circumstances' (*Hirji Mulji v. Cheong Yue Steamship Co. Ltd.*[32]). The legal effect of frustration 'does not depend on their intention or their opinions, or even knowledge, as to the event'.[33] On the contrary, it seems that when the event occurs 'the meaning of the contract must be taken to be, not what the parties did intend (for they had neither thought nor intention regarding it), but that which the parties, as fair and reasonable men, would presumably have agreed upon

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31 Davis Contractors Ltd v Fareham Urban Dist Council [1956] AC 696, 728.
32 [1926] AC 497, 510.
33 Id at 509.

> if, having such possibility in view, they had made express provision as to their several rights and liabilities in the event of its occurrence' (*Dahl v. Nelson*,[34] *per* Lord Watson).
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> By this time it might seem that the parties themselves have become so far disembodied spirits that their actual persons should be allowed to rest in peace. In their place their rises the figure of the fair and reasonable man. And the spokesman of the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is and must be the court itself.

Various tests have been propounded for application by the court in arriving at its conclusion on this aspect of its decision. Some of these tests are referred to in the passage quoted above from the reasons of the Privy Council in *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd*.[35] It is clear that tests which have been useful in particular cases may be unsatisfactory and lead to different results in other cases.[36]

What emerges strongly from the recent cases is that the answer ultimately depends on the intention imputed to the parties in the light of the terms of their contract and the surrounding circumstances at the time of contracting which are relevant to its interpretation. It is suggested that the various tests which have been propounded are no more than indicators of intention to be taken into account by the court in deciding what intention to impute to the parties. In some cases there may be only one indicator and it may point strongly in the direction of an intention that there be severance or in the opposite direction. In other cases there may be indicators pointing in both directions on this question of intention. In these cases a court in reaching a conclusion upon the intention to be imputed will be greatly influenced by the prevailing weight of the indicators pointing in the respective directions.

In *Brew v Whitlock* (No 2)[37] the Full Court of the Supreme Court of Victoria (Winneke CJ, Little and Gowans JJ), in a case where a provision in a contract was too uncertain to take effect, considered the principles of severance applicable under the modern law.[38] The court said:[39]

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34 (1881) 6 App Cas 38.

35 [1975] AC 561, 578; see text at note 30 supra.

36 See Kitto J in Brooks v Burns Philp Trustee Co Ltd (1969) 121 CLR 432, 438.

37 [1967] VR 803, affirmed on appeal (1968) 118 CLR 445.

38 For another instructive example of the application of the modern principles see David Jones Ltd v Lunn (1969) 91 WN (NSW) 468.

39 [1967] VR at 805-6.

> [I]t is desirable to advert to the principles governing severability. They seem to be the subject of a good deal of confusion, as appears from the discussions by the textbook writers on the subject. . . .[40] In the main the subject has been discussed in relation to the illegality of contractual provisions or their avoidance on the ground of conflict with public policy. But in spite of the submission that the tests of severability are different in such cases from those applicable in cases of uncertain provisions, we have been unable to be satisfied as to why that should be so. The view that tests are the same in all such cases appears to be adopted in *Pollock on Contracts,* 13th ed., p.340, where it is said: 'There is no special rule as to agreements alleged to be in restraint of trade, and severability is in every case a matter of construction.'

The court then considered four cases where the severability of an uncertain provision in a contract had been discussed and continued:[41]

> These authorities on severability in cases concerning uncertainty in a part of a contract point to the test as being the intention of the parties as to whether the operation of the contract apart from the impugned part was to be conditional on the efficacy of that part, or whether it was to take effect notwithstanding the failure of that part. That intention is to be ascertained from the construction of the contract as a whole. The process of construction will have regard to such considerations as the independence in form of the impugned part, any interdependence of that part in form or operation with the rest, the effect that severance would have on the operation or meaning of what is left, the nature of the subject-matter dealt with in the part and its relative importance in the setting of the whole bargain, whether the impugned part is one of several promises supported by different considerations or by a common consideration, or whether it is part of a single consideration supporting a promise or promises or whether it is one of several considerations, and, if so, whether it is a material or important part of the total consideration or merely subordinate.
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> The considerations to which resort is had for the purpose of construction are not necessarily of the same force and effect, e.g. dependence in form or interdependence of operation or meaning would operate as a bar to severance, but independence in those respects may not be decisive in favour of severability. In the process of construction for the purpose of ascertaining the intention, in the case of a written contract intended to be the final

40 See G Cheshire & C Fifoot, THE LAW OF CONTRACT (4th ed) 324-7; Anson PRINCIPLES OF THE ENGLISH LAW OF CONTRACT (22nd ed) 355-60; POLLOCK ON CONTRACTS (12th ed) 333; SALMOND AND WILLIAMS ON CONTRACT (2nd ed) 356-60; G Treitel, LAW OF CONTRACT (1962) 311-9; 38 HALSBURY'S LAWS OF ENGLAND (3d ed) 50-3.

41 [1967] VR at 807-8.

> and complete respository of the parties' intentions, the material to which resort can primarily be made consists of the content of the written instrument (see *Heisler v. Anglo Dal Ltd.*, [1954] 1 W.L.R. 1273, at pp. 1279-80), and the surrounding circumstances cannot be used except for the purpose of explaining the contract (see Cussen, J., in *Cooper & Sons v. Neilson and Maxwell Ltd.*, [1919] V.L.R. 66, at p. 77; 25 A.L.R. 36, at p. 44).

Later the court, having held the provision to be inseverable said:[42]

> It may appear curious that incompleteness and consequent uncertainty in one of several promises, which is given by one party for the benefit of and probably at the instance of the other, should enable the party furnishing the uncertain promise to contend that his other promises are void and ineffective. But if the uncertain promise which has been exacted constitutes such an important part of the total bargain that to eliminate it would alter the nature of the bargain as a whole, it is difficult to see how the fact that it was inserted at the instance of and for the benefit of the promisee can save the remainder from invalidity. . . .
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> It seems to us that once the conclusion is reached that the invalid promise is so material and important a provision in the whole bargain that there should be inferred an intention not to make a contract which would operate without it, but to make a contract which is conditional upon the operation of that promise, then it must be treated as forming with the other valid promises an indivisible whole which cannot be taken to pieces without altering its nature, and as not being capable of elimination without changing the kind of the contract.

For an understanding of the present law it is important to recognize that it is the result of extensive development. Some of the decisions represent earlier stages of development and cannot be regarded as applications or expositions of the law as it is today. Generally speaking, the earlier the decision, the more remote will its reasons tend to be, from the principles now applied.

In 1948 in *The Severance of Illegality in Contract*[43] and later in *Severance and Public Policy—An addendum*[44] NS Marsh traced the development of this area of law. He argued that:[45]

> [T]he rules governing the severance of illegality in contract had, largely owing to a failure to appreciate their historical origin, become excessively obscure and artificial. The alleged distinction

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42 [1967] VR at 812-3.
43 (1948) 64 LQR 230 and 347.
44 (1953) 69 LQR 111.
45 Ibid.

> between severance of the consideration and severance of promises was doubted, and it was suggested that, both as regards illegality of part of the consideration and illegality of one of two or more promises in a contract, the tests of severance were: (a) would the parties have agreed to enforce the legal part of the contract on its own and (b) was the illegality in question immoral or otherwise so clearly against public policy as to taint the whole transaction?

Leaving aside the requirements which are relevant to the decision as to whether severance is technically possible, the law has developed so that it is now the 'test (a)' advocated by Marsh which is applied to decide whether a void provision may be severed. This means that once it is decided that severance is technically possible, the decision whether there should be severance now involves issues of substance, reasonableness and justice in an area often dominated in the past by issues of form, terminology and technicality. There is, of course, no limit to the factors which may be treated by the courts in particular cases as indicators of an imputed intention. Factors which are relevant to the decision whether severance is technically possible may also be relevant to the decision upon imputed intention. The essence of the inquiries made under many of the tests propounded and applied in the past continue to be made, though usually in somewhat less technical language.

An inquiry often made in the cases, is whether the covenant or some of the covenants which would remain are dependent on or independent of the unenforceable covenant which it is sought to sever. The terminology in which the inquiry has been described has had a tendency towards a narrow technical approach to an inquiry which under the present law is the substantial inquiry relevant to the imputed intention. Much of the learning on covenants and on whether they are dependent or independent is both ancient and technical. However the essential inquiry which is made is usually quite central to the imputation of intention. As was said by Kitto J:[46]

> Questions of severability are often difficult, and tests that have been formulated as useful in particular classes of cases are not always satisfactory for cases of other kinds; but in some cases—and I think this is one—the intended reciprocity of obligation between promises is sufficiently clear to necessitate an inference that the legal validity of each promise is a condition of the operation of the other.

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46 Brooks v Burns Philp Trustee Co Ltd (1969) 121 CLR 432, 438.

Earlier he had referred to the respective promises of the parties as ' . . . intended to be the obverse and reverse of the one coin, to operate reciprocally or not at all.'[47]

There have been many statements to the effect that while there may be severance between promises where one is affected by illegality there can be no severance where part of the consideration is affected by the element of illegality. This has been a difficult distinction to follow because, under the modern law of contract, usually all the promises of one party constitute the consideration for all promises of the other party. This distinction was criticized by Jordon CJ in *McFarlane v Daniell* who pointed out that, in any event, the suggested inability to sever did not apply where the effect of the element of illegality was to make part of the consideration void as distinct from illegal.[48]

The issue which depends on an inquiry whether an intention to sever should be imputed, has often been approached as though it were an inquiry into adequacy of consideration. The approach was to see whether the fact that a promise of one party was unenforceable led to the failure of a substantial part of the consideration for the promises of the other party.[49] The essence of this inquiry is relevant to the continued existence of the 'reciprocity of obligation between promises'. It tends to be distracting to conduct this investigation in terms of consideration and involves giving the word 'consideration' a special meaning.[50] If the element of illegality causes substantial unenforceability in the promises of one party a court would usually decide that in view of this substantial loss of reciprocal balance between the promises of the respective parties it should not impute an intention to sever. It is helpful neither to clear thought nor to the process of decision to state this in terms usually associated with the technical rules of consideration.

If it were proper to concentrate on the adequacy of consideration there would be good cause to treat deeds, which do not require consideration, differently from simple contracts, which do. True, if through the element of illegality all the promises of a party to a simple contract are unenforceable, the contract is invalid through lack of consideration. But the same practical result would be reached in that case through the court imputing an intention against sever-

47 Ibid. See also per Windeyer J at 463-465.

48 (1938) 38 SR (NSW) 337, 347. See also Dillon v Nash [1950] VLR 293.

49 Some of the cases which approached the question in this way are discussed in O'Loughlin v O'Loughlin [1958] VR 649.

50 Brooks v Burns Philp Trustee Co Ltd (1969) 121 CLR 432, 463-4.

ability. For these reasons Taylor J in *Brooks v Burns Philp Trustee Co Ltd*[51] regarded the difference in this respect between deeds and simple contracts as theoretical rather than practical.

The present author believes that the law has been greatly improved by its development to the stage where a court's decision upon severance depends, in a case where severance is technically possible, on the imputation of an intention to the parties. Although this is often a difficult task for the court, both the court and the parties know what the issue is and what factors are relevant to that issue. Instead of the court entering a maze of technicalities in the hope that it will find an outlet providing a just solution, it makes a direct approach to find whether a just solution is available. Where part of a contract is void, one of the parties will usually be harmed if the whole contract is treated as unenforceable. On the other hand if the void part is severed and the remaining part enforced as a contract, one of the parties will receive less than he bargained for and less than he provided his promises for. The law has been concerned to adopt a general solution which is likely to provide a balance between the parties which is as just as is possible in the circumstances. The principle of imputing an intention to the parties regarding severance enables the court to sever the unenforceable part and enforce the remainder where this will not impose a serious disadvantage on the party who loses the benefit of the unenforceable part.

An advantage of this development is that the same principle applies whether severance is being considered of a portion of what is, in form, one promise from the rest of the contract;[52] or of one or more promises from the rest of the contract; or, as in *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd*[53] of one contract from a larger commercial transaction of which it is a part. It also means that the process of deciding whether the remaining part of a contract should be enforced is similar, when part is unenforceable through an element of illegality, to the process followed when part is unenforceable for uncertainty or other cause.

It is generally assumed that in cases where a statute or other legislative instrument expressly or impliedly makes a contractual provision

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51 (1969) 121 CLR 432, 442.

52 This is the question to be considered in imputing intention rather than considering whether there is an intention that the portion be severable from the rest of the promise. Tuit v Australian Mutual Provident Society [1975] 1 NSWLR 158, 169.

53 [1975] AC 561.

void the same principles of severance apply as where a contractual provision is made void at common law because of the presence of an element of illegality.[54] There is little authority on cases where a statute has made a contractual provision void as distinct from illegal. However in principle the position must be the same whether the provision is made void, as distinct from illegal, by common law or by statute.[55]

ILLEGAL CONTRACTS OR PROVISIONS

As with void contracts or provisions, the law which renders a contract or provision illegal may be a principle of common law or it may be the express or implied provision of a statute or other legislative instrument. It is the policy of the law, not only to render such contracts or contractual provisions unenforceable in court, but further to impose additional legal disadvantages so as to discourage people from making or carrying out such agreements. It may be said that it treats them as unprincipled.

The main question is whether the law will allow any severance at all of contractual provisions of this type. If the law allows severance of particular types of contractual provisions which are illegal, the principles to be applied in deciding whether severance is technically possible and whether the intention to sever should be imputed to the parties are the same as where the contractual provision is merely void.[56] The basic questions to be considered, therefore, are whether the law will allow severance of contractual provisions that are illegal, and if so, in what types of cases.

The elements of illegality which at common law produce illegal contracts are contractual provisions

—to commit a common law or statutory crime or tort or a fraud on a third party;

—which are sexually immoral;

—which prejudice public safety;

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54 G Cheshire and C Fifoot, supra note 6 at 453.

55 See id at 350-8 for a discussion of contracts rendered void by statute but not illegal. See also Minister for Lands (New South Wales) v King (1916) 22 CLR 193.

56 See Tierney v Kingsley Distributors Pty Ltd [1967] QSR 604; Thomas Brown & Sons Ltd v Fazal Deen (1962) 108 CLR 391; and Niemann v Smedley [1973] VR 769. The latter two cases are discussed infra, see text accompanying notes 69 and 73 respectively.

57 This adopts the categories set out in G Cheshire and C Fifoot, supra note 6 at 385.

—which prejudice the administration of justice;
—which tend to corruption in public life; and
—to defraud the revenue.[57]

Contracts or contractual provisions are illegal if they are prohibited by statute or other legislative instrument. A contract or contractual provision is prohibited if a statute expressly or impliedly prohibits its being made. If performed in a way which is prohibited by statute, rights arising under the contract in respect of that performance may be treated as though they arose under an illegal contract.[58]

An illegal contract is unenforceable but, as with a void contract, doubts have been expressed whether it is entirely devoid of legal effect.[59] This question need not be pursued in this article.

It is mentioned above that when a contract is illegal, the law not only refuses to enforce it but imposes additional legal disadvantages to discourage the making or performance of such contracts. For example, money paid or property transferred may not be recoverable and a collateral contract made to secure performance of the illegal contract may not be enforceable. Opinions differ on whether another disadvantage is the refusal to sever a contractual provision which is illegal.

It is said in HALSBURY'S LAWS OF ENGLAND that '[A]s a general rule, severance is probably not possible where the objectionable parts of the contract involve illegality and not merely void promises.'[60] In Cheshire and Fifoot's THE LAW OF CONTRACT in discussing severance it is said:[61]

> It should be noticed at once that this is not allowed in the case of the contracts . . . which are illegal at common law as being contrary to public policy.
>
> 'If one of the promises to do an act which is either in itself a criminal offence or *contra bonos mores* the court will regard the whole contract as void.'[62]
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> On principle the same is true of contracts prohibited by statute, and there is clear authority to that effect,[63] but in at least one case, *Kearney v. Whitehaven Colliery Co.*[64] the principle seems to have been ignored.

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58 See id at 359-81.
59 9 HALSBURY'S LAWS OF ENGLAND (4th ed) para 434.
60 Id at para 430.
61 G Cheshire and C Fifoot, THE LAW OF CONTRACT (8th English ed 1972) 382.
62 Bennett v Bennett [1952] 1 KB 249, 253-4.
63 Hopkins v Prescott (1847) 4 CB 578; Ritchie v Smith (1848) 6 CB 462.
64 [1893] 1 QB 700.

On the other hand in Australia authority establishes that it is possible to sever contractual provisions which are illegal.[65]

In *McFarlane v Daniell* Jordan CJ drew attention to the fact that:[66]

> There are cases which appear to decide that if the illegality takes the form of an agreement to qualify illegally promises which, apart from any such illegal qualification, are valid and legal, the illegal agreement for qualification may be regarded as severable from the promises, which may then be enforced as if they were unqualified by the illegal term.

He referred to English cases, including *Kearney v Whitehaven Colliery Co*[67] mentioned in the passage quoted above from Cheshire and Fifoot's THE LAW OF CONTRACT.[68]

The issue arose squarely before the High Court in *Thomas Brown and Sons Ltd v Fazal Deen.*[69] In 1943 Deen deposited a safe containing gold and gems with a company to hold them in safe custody at its premises until he required them. At that time a regulation of the National Security (Exchange Control) Regulations required every person who had gold in his possession or control to deliver it to the the Commonwealth Bank within a month after it came into his possession. In 1959 Deen made a demand on the company for the safe, the gold and the gems but they were not returned. Deen commenced an action which included a claim for damages for breach of the contract of bailment. Deen obtained judgment and the company appealed to the High Court. The company argued that the contract was to hold the gold beyond the month and was therefore illegal. It argued that the contract was not severable because if any part of a contract is illegal public policy will not allow any part of the contract to be enforced. The Court (Kitto, Windeyer and Owen JJ) rejected this argument. It said:[70]

> The terms of the bailment required the company to hold the gold, along with the gems and the safe, in safe custody until such time as the plaintiff required them to be redelivered to him and, while apart from the provisions of the regulations he could no

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65 In New Zealand in Keeton v Graham [1964] NZLR 99, 105-7 Tompkins J treated severability as available in the case of a contractual provision assumed to be illegal through statutory prohibition. See also Smith v Matheson [1945] NZLR 291. The position in New Zealand is now covered by legislation which is discussed below; see pp 22-23 infra.

66 (1938) 38 SR (NSW) 337, 346-7.

67 [1893] 1 QB 700.

68 See note 61 supra.

69 (1962) 108 CLR 391.

70 Ibid at 410-11.

> doubt have demanded their return at any time, the purpose common to both parties was that the company should hold them for an indefinite period and not part with them except to the plaintiff. So far as the gold was concerned, the performance of that agreement would, and in fact it did, contravene the regulations but it does not follow that the bailment of the gems and of the safe was tainted by illegality. If the terms of the bailment relating to the gold were severable from those relating to the gems and the safe the bailment of the latter chattels would be lawful. The test of severability was stated by Jordan C.J. in *McFarlane v. Daniell.*[71] 'If the elimination of the invalid promises changes the extent only but not the kind of contract, the valid promises are severable: *Putsman v. Taylor.*'[72] Applying that test, it is clear that the plaintiff's rights of action in respect of the gems and the safe would not be answered by a defence of illegality based upon a breach of the *National Security (Exchange Control) Regulations* since the contractual obligation upon the company as to the return of the plaintiff's property on demand applied to every part of the property deposited whether demanded together with the rest of it or separately. In the case of the gold, however, the plaintiff could not succeed if he was obliged to rely upon the illegal transaction to establish his case.

The Court held that Deen was obliged to rely upon the illegal transaction. He recovered damages in respect of the safe and the gems but not in respect of the gold. The Court proceeded on the basis that it was dealing with a deposit under a contract of bailment and not with a gratuitous bailment. There was no argument that if severance were available it was not technically possible. Where the contract is not in writing but is partly oral and partly implied it would seem that severance would be technically possible unless the promise to be severed was 'one and indivisible' with one or more of the remaining promises. The Court did not discuss the cases which indicate that there can be no severance of an illegal contractual provision. But the issue having been raised, the Court decided to sever. The decision stands as the first step in the development of principles to govern the severance of illegal contractual provisions.

The principle of the High Court decision was applied by the Full Court of the Supreme Court of Victoria (Winneke CJ, Little and Anderson JJ) in *Niemann v Smedley.*[73] A share acquisition agreement included a provision which, contrary to section 56 of the *Companies Act* 1961 (Vic), contained a promise by a company to finance the

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71 (1938) 38 SR (NSW) 337.
72 [1927] 1 KB 637, 640-1.
73 [1973] VR 769.

subscription for its shares. The court held that the section made the provision illegal. After discussing general principles of severability of clauses void for uncertainty, the court said:[74]

> An illegal term as distinct from one merely void, may raise different considerations for if it is of a kind involving a serious element of moral turpitude or is obviously inimical to the interest of the community so as to offend almost any concept of public policy it will so infect the rest of the contract that the courts will refuse to give any recognition at all to the contract, e.g. a promise to commit a burglary or to defraud the revenue or one *contra bonos mores*. But such class of cases apart, where the illegality has no such taint, the other terms will stand if the illegal portion can be severed: *vide Cheshire and Fifoot, Law of Contract,* 2nd Aust. ed,. pp. 500-5; *Anson's Law of Contract,* 21st ed., pp. 333-4.

The court referred to *Thomas Brown & Sons Ltd v Fazal Deen* and continued:[75]

> In the present case the offending term is, as a matter of language, verbally separate from the remainder of the agreement and it is capable of removal by a blue pencil without affecting the meaning of the part remaining. The material matter, we think, is whether elimination of that term would basically alter the true nature of the contract or involve the formation of a new and different contract. In our opinion, it would not do so. . . .
>
> In our opinion, accordingly the term by which the company agreed to finance the transaction was severable from the rest of the agreement which remains valid.

The present position in Australian law is that for the purpose of deciding whether severance is available for illegal contractual provisions, a distinction is drawn between what might be called first degree and second degree illegality. It seems necessary for there to be a differentiation between illegal contractual provisions whose illegal element may be a trifling infraction of a minor regulation and those whose illegal element is a grave crime. As Jordan CJ said:[76]

> It can hardly be imagined that a Court would enforce a promise, however inherently valid and however severable, if contained in a contract one of the terms of which provided for assassination.

Marsh, in the articles mentioned above,[77] suggested that the test should be whether or not the illegality in question is immoral or otherwise so clearly against public policy as to taint the whole transaction.

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74 Id at 778.
75 Id at 779.
76 McFarlane v Daniell (1938) 38 SR (NSW) 337, 346.
77 See notes 43 and 44 supra.

Australian law is developing along those lines. It will need to produce principles to determine whether an illegal contractual provision suffers from first degree illegality which makes severance unavailable or from second degree illegality which leaves severance available.

REFORM OF THE LAW

The need for reform of the law in this area has long been recognized. In 1953 Gresson J said:[78]

> If the cases on severance in relation to covenants in restraint of trade are examined, it will be found that some general rules have been formulated and, in particular, rules which might be considered applicable to this case, i.e., that the promises must be separate and independent and that the substituted character of the contract must not be altered. The worth and efficacy of these alleged rules is much criticised in *Cheshire and Fifoot on Law of Contract,* 2nd Ed., pp. 284-287; and the conclusion come to that 'the . . . rules . . . provide no workable test' (*ibid.,* 286) and that 'we are left with no guiding principle' (*ibid.,* 286). The discussion concludes with this passage on p. 287:
>
> The truth is that the Courts have felt a certain embarrassment in the application of the doctrine of severance. They have had misgivings with regard to its object, its scope, indeed its wisdom. They have, no doubt, felt that there is something repugnant in being asked to pull the chestnuts out of the fire for the parties by carving out of a void contract the maximum that it might lawfully have contained. The inevitable result is confusion and chaos in this branch of the law.
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> The learned author of *Salmond and Williams on Contracts,* 2nd Ed., 360, takes much the same view when he says:
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> > In truth the rules as to severance stand in much need of an authoritative reconsideration and restatement.

The courts themselves in developing the principle of imputed intention expounded in cases such as *Brooks v Burns Philp Trustee Co Ltd*[79] and *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd*[80] and the principle applied in *Thomas Brown and Sons Ltd v Fazal Deen*[81] and *Neimann v Smedley*[82] have made a significant contribution to the rationalization and improvement of the law. Indeed the development of the law in this area is a good example of law

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78 Snell v Potter [1953] NZLR 696, 715-6.
79 (1969) 121 CLR 432.
80 [1975] AC 561.
81 (1962) 108 CLR 391.
82 [1973] VR 769.

reform through the normal processes of the common law. The unsatisfactory state of the law was demonstrated by an academic lawyer who traced its origins, compared its solutions with those of other legal systems and suggested principles as appropriate for our system.[83] The courts in their decisions have since moved the law to a position close to the principles which he proposed. It is worth reflecting that if this area of law had been codified thirty years ago, to correspond with the rules then accepted, this evolutionary development would not have taken place.

New Zealand, by its *Illegal Contracts Act* 1970, has made statutory amendments to the law of illegality some of which affect the position of severance. Under section 7 a court may in the case of an illegal contract grant such relief by way of restitution, compensation, variation of the contract, validation of the contract in whole or in part or for any particular purpose or otherwise, as the court in its discretion thinks just. In considering whether to grant this relief the court is to have regard to the conduct of the parties, the object of and penalty provided by any relevant enactment which has been breached and such other matters as it thinks proper. It is not to grant relief if it considers that to do so would not be in the public interest. The width of discretion conferred is illustrated by *Slobbe v Combined Taxis Co-operative Society Ltd*[84] and *R D Bull Ltd v Broadlands Rentals Ltd.*[85] When section 7 is read together with the definition of illegal contracts in section 3, it is evident that the court has been given wide discretionary powers to sever illegal provisions with or without modifications and with or without compensation.

Section 8 of the Act provides:[86]

> (1) Where any provision of any contract constitutes an unreasonable restraint of trade, the Court may—
>
> (a) Delete the provision and give effect to the contract as so amended; or
>
> (b) So modify the provision that at the time the contract was entered into the provision as modified would have been reasonable, and give effect to the contract as so modified; or
>
> (c) Where the deletion or modification of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand, decline to enforce the contract.

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83 See note 61 supra.
84 [1973] 2 NZLR 651 (Note).
85 [1975] 1 NZLR 304.
86 Illegal Contracts Act 1970 (NZ).

> (2) The Court may modify a provision under paragraph (b) of sub-section (1) of this section, notwithstanding that the modification cannot be effected by the deletion of words from the provision.

Thus the Act greatly extends the scope of severance.

The Act and the report on which it was based were strongly criticized by MP Furmiston in an article in the New Zealand Universities Law Review, *The Illegal Contracts Act 1970—An English View.*[87] He said that it appeared that the motivation was 'that the situation is such that any change, however ill-considered, must be for the better',[88] and suggested that it was 'an example of the "aspirin" syndrome—treatment of the symptom without diagnosis of the disease'.[89] He added that[90]

> It is debatable whether it is a wise policy of law reform to replace moderately firm and clear rules by a largely unfettered discretion. It is true that such a course has an attraction that it makes the law much easier to state (though often more difficult to apply). . . .

He also referred to the constitutional dangers of conferring wide discretions on judges.

Time will show how the New Zealand reform works in practice.

Furmiston's remarks certainly raise a caution about the dangers of 'instant' law reform in difficult areas of law. In important respects recent decisions have greatly improved the law considered both from the aspect of rationality and justice. Still one hesitates to leave further reform in this area to the chance and time involved in having the appropriate issues come before the appropriate courts. Contracts, whether illegal or not, belong to those who make them. It is well to remember the comments of Devlin J in *St John Shipping Corp v Joseph Rank Ltd*:[91]

> It may be questionable . . . whether public policy is well served by driving from the seat of judgment everyone who has been guilty of a minor transgression. Commercial men who have unwittingly offended against one of a multiplicity of regulations may nevertheless feel that they have not thereby forfeited all right to justice, and may go elsewhere for it if courts of law will not give it to them. In the last resort they will, if necessary, set up their

87 (1972) NZUL Rev 151.
88 Ibid.
89 Id at 152.
90 Id at 161.
91 [1957] 1 QB 267, 288-9.

> own machinery for dealing with their own disputes in the way that those whom the law puts beyond the pale, such as gamblers, have done.

I suggest that careful consideration should be given to the possibility of amending the law regarding illegal contracts so as to have it conform more with the expectations of the community, particularly the commercial community. This country now has a national Law Reform Commission and similar bodies in each state and the Australian Capital Territory which are moving towards co-ordinated activity in law reform.[92]

I think it desirable that the whole area of illegality in contract be referred to and investigated thoroughly by one of these commissions or bodies, that it recommend the areas in which there is a need for statutory amendment of the law and recommend the amendments. Areas where the present common law principles operate satisfactorily would need no change. It would be essential that the tentative views of the body responsible for the investigation and recommendations be made available to and thoroughly discussed with the legal profession and the commercial community. Its final recommendations could form the basis of uniform legislation throughout Australia. Amongst aspects of severance which ought to be considered in this investigation would be the availability of severance and the principles of severance for illegal provisions; the need for the present technical requirements for severance; and the possibility of the payment of compensation upon severance.

R E McGARVIE*

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92 See the Annual Report 1975 of the Australian Law Reform Commission 13-36, 48-52.

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