



Miles and Dowler, *A Guide to Business Law 21st edition*

Study Aid – Chapter summaries

Chapter summary – ch 14 – illegality

1. The object of a contract is its purpose. An essential requirement for a valid contract is that its objects must be legal. Sometimes contracts are made illegal either by statute law or common law.
2. **Contracts illegal by statute.** A court will not allow a plaintiff to base a claim on a contract that is illegal under statute.

Where a statute prohibits the formation of a contract, that contract is usually void: *Re Mahmoud & Ispahani* and *Buckland v Massey*.

Where a statute only prohibits the performance of a contract, the contract may still be enforceable. It depends upon the intention of the statute. Was the law meant to prohibit the entire contract or regulate or control some aspect of the contract? (See *Ashmore Benson v Dawson* and *Yango Pastoral v First Chicago*.)

3. **Contracts void under statute law.** Sometimes a statute declares certain contracts void rather than illegal. In such case, the contract is void and does not create any legal rights or obligations. An example is s 56 of the *Unlawful Gambling Act 1998* (NSW) which states that any gambling or wagering agreement has no effect and neither party can maintain any court action in respect of the recovery of money.
4. **Contracts illegal at common law.** Contracts that are illegal at common law generally involve some unacceptable conduct contrary to the interests of the public. Usually, such contracts are void. Some examples of these types of contracts include agreements:
 - to commit a crime or a tort;
 - that promote public corruption;
 - that prejudice the security of the country; or
 - that promote sexual immorality.
5. **Contracts void at common law.** Some contracts have been treated by the common law as being void because of some social or economic reasons. Some examples include contracts that:
 - prejudice marriage;
 - exclude court jurisdiction; or



- unreasonably restrain trade.
6. Contracts in restraint of trade are contracts that prevent or restrict a person working for themselves or others and deprive the public of the person's skills and expertise for a period of time.
 7. Prima facie a contract in unreasonable restraint of trade is void at common law. Therefore a contract that is deemed by the courts to constitute a "reasonable restraint" may be permitted: see *Nordenfelt's case*.
 8. Restraint of trade clauses are commonly found in contracts for the sale/purchase of a business, employment agreements, partnership deeds and manufacturer/retailer agreements.
 9. In a contract for the sale of a business that includes a component for goodwill, the courts will allow a reasonable restraint of trade clause if it is not against public policy and is in the interest of the parties.
 10. What is reasonable depends upon the:
 - type of business sold;
 - duration of the restraint;
 - area of restraint;
 - amount of consideration involved; and
 - wording of the restraint; ie is it too wide or uncertain? (See *Arnott's Ltd v Bourke*.)
 11. In *Nordenfelt's case*, there were two restraints. The court held that the restriction on Nordenfelt working in a similar gun-making business for 25 years was reasonable but the restraint that he could not work in any business likely to compete was unreasonable. In *Peters (WA) v Petersville*, the court decided a restraint of 15 years in a contract for the sale of an ice-cream business was too long and therefore unreasonable and it was not enforceable.
 12. In employment contracts, restraints may be imposed on employees to regulate their conduct during employment: see *Hivac v Park Royal Scientific Instruments*.
 13. However, courts are usually reluctant to enforce restraints in employment agreements due to presumed unequal bargaining power between employers/employees: see *Schroeder Music Publishing Co Ltd v Macaulay*.
 14. In employment contracts, restraints may be imposed for the period *after* termination of employment. This may be allowed by the courts where the employer can show their legitimate business interests need protection.
 15. Some examples of restraints include the protection of:



- trade secrets (*Mettrnas v Courtney-Smith*);
 - sensitive information;
 - formulas and/or processes (*Forster v Suggett*); and
 - confidential information/customer lists: *Gilford Motors v Horne*.
16. Despite having legitimate reasons for the restraints on employees, the law requires that any restraint must be “reasonable” and no wider than necessary to protect the interests claimed.
 17. Where the purpose of such restraint is simply to prevent competition from the former employee it will not be allowed: see *Attwood v Lamont*.
 18. A restraint may not be enforceable unless proven that the offending conduct is covered by the wording of the restraint: see *Arnott's v Bourke*.
 19. A restraint of trade may be invalid due to uncertainty.
 20. A restraint of trade clause may (in some situations) be severed (removed) from a contract to enable the remainder of the agreement to be enforced: see *Nordenfelt v Maxim Nordenfelt*. If this is not possible, the entire contract may be void.
 21. Some lawyers avoid the consequences of a restraint being void by using what are called “ladder clauses” comprising of a vertical list of restraints each of which is less restrictive. This enables the court to select the most reasonable rather than avoid the whole contract: see *Rentokil Pty Ltd v Lee*, *Hanna v OAMPS Insurance Brokers Ltd* and *Hitech Contracting Ltd v Lynn*.
 22. Section 4(1) of the *Restraints of Trade Act 1976* (NSW) allows the Supreme Court to deal with complaints about contracts in restraint of trade. The court can make such orders as it thinks fit in respect of any restraint of trade clause. The main consideration for the court is the matter of public policy. The court may invalidate the whole contract or read down the restraint to such extent that it is not against public policy: see *Woolworths v Olson*.
 23. The *Industrial Relations Act 1996* (NSW) allows the review of unfair employment contracts by the Industrial Relations Commission.