Subject Name: Contract Act
Topic Name: Illegal Agreements

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Introduction

The Contract Act makes a clear distinction between agreements that are merely void and those where the consideration or object is unlawful as well. "Section 23 delineates the scenarios where the consideration of an agreement becomes unlawful, rendering the agreement itself void, meaning it cannot be enforced by law."

Sections 25 to 30 elaborate on cases where the agreement is only void, even if the consideration isn't inherently unlawful.

An illegal agreement is one expressly prohibited by the law; however, a void agreement may not be prohibited outright, as "the law may simply stipulate that the courts will not uphold it if made."

Therefore, while every illegal contract is also void, a void contract isn't necessarily illegal. Nonetheless, the line distinguishing between them isn't always crystal clear.

Ramifications of Illegal and Void Contracts Under Contract Law

Main Transaction Void in Either Case

An essential similarity between an illegal contract and a void agreement lies in their enforceability—or rather, lack thereof. In both scenarios, the principal or primary agreement stands unenforceable.

No recourse can be sought under either type of agreement, and if goods or payments have been exchanged, they cannot be reclaimed.

No Action Under the Main Transaction

The guiding principle of public policy is encapsulated in the Latin maxim "ex dolo mala non oritur actio," meaning no action arises from a deceitful or wrongful act. No court will assist an individual who bases their claim on an immoral or illegal act. If the cause of action stems from an inherently wrongful or illegal deed, the court asserts that the party has no entitlement to legal assistance.

Consequently, a party engaging in an illegal contract forfeits the right to take legal action. For instance, an individual who secretly contracted to rent premises for a blasphemous gathering couldn't sue the landlord for breaching the contract once the true purpose was revealed. Similarly, money lent for illicit purposes becomes irrecoverable. Even a renewed promise to repay an illegal debt remains tainted by its illegality.

In such instances, the law maintains a stance of non-interference, leaving the parties to bear the consequences of their actions.

Furthermore, if a contract, though lawful at its inception, is executed unlawfully, recovery may be precluded. For instance, in a transportation contract where a lorry was overloaded, resulting in damage to the goods—a violation of the Road Traffic Act, 1988—the consignor was barred from seeking compensation. This ruling held despite the consignor's manager being aware of the overloading.

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Judicial Duty to Object to Unlawful Contracts

When a contract's unlawfulness is evident, it becomes the duty of the judge to raise an objection, irrespective of whether the parties themselves raise or waive it. Therefore, the court has the prerogative, even in the absence of specific pleadings, to assess whether the agreement in question is inherently immoral or unlawful.

Exceptions

1. Where the Contract is Still Executory

   In instances where the contract remains executory, meaning the illegal purpose has not been fulfilled, recovery of money paid or goods delivered under it might be possible. However, if the illegal purpose has been carried out or if enforcement of the illegal transaction is sought, no legal action can be maintained.

   For example, if a debtor executes a transfer to deceive creditors but repents before any deception occurs, they may recover the property. However, if the repentance stems from the failure of the illegal objective, recovery might not be allowed.

   The principle of locus poenitentiae, allowing repentance before the illegal purpose's substantial performance, is applicable in such cases.

2. Parties Not "in Pari Delicto"
   It's established that when parties are not equally at fault, the less guilty party may recover money paid or property transferred under the contract. This exception applies in scenarios where the contract is made illegal by a statute in the interest of a particular class of persons, where one party was induced by fraud or strong pressure, or where one party owes a fiduciary duty to the other.

   For instance, if a person is induced by fraud to make payments under an illegal contract, those payments may be recovered.

3. Recovery Possible Without Relying on Illegal Contract
   Transactions arising from agreements to perform illegal acts may still be valid and enforceable if they can stand independently from the illegal act. For example, in a case where property was leased out in violation of a statute, the plaintiff could recover possession without relying on the unlawful agreement.

4. Collateral Transactions
   The distinction between illegal and void agreements lies in their impact on collateral transactions, which are subsidiary to the main transaction. If the main transaction is illegal, any collateral transaction will also be tainted with illegality and the recovery may be barred.

   However, if the main transaction is merely void, its collateral transactions may remain enforceable.

   For instance, in a case where a partner entered into wagering transactions on behalf of the firm, the recovery was allowed as wagering was only void.



5. Severance

   Where an agreement is partly illegal, the court may enforce the legal part if it's severable from the illegal portion. This applies even if the parties were aware of the illegality.

   For instance, in a case where a lease included an unlawful condition to purchase certain goods, the court considered the lease valid by severing the unlawful aspect.

   Similarly, if only a portion of an agreement is unlawful, only that part will be deemed void, and the remainder may be enforced. For example, if a contract contains an illegal clause but also legal obligations, the legal obligations can still be enforced.