

THE LEGALITY OF AN ASSIGNMENT OF AN ILLEGAL HIRE PURCHASE AGREEMENT

Portland Holdings Ltd v. Cameo Motors Ltd [1966]
N.Z.L.R. 571, C.A.

This case is the latest of a number dealing with the interpretation of the Hire Purchase and Credit Sales Stabilization Regulations 1957 (Reprint S.R. 1967/192). The point considered, however, was a new one, that is, whether an assignment of a contract is to be treated as tainted with the illegality of the original contract.

The respondent, a motor vehicle dealer, entered into a hire-purchase agreement with a purchaser, hiring him a second-hand car on conditional sale terms with an option to purchase. This agreement was assigned by the respondent, on a form on the back of the hire-purchase agreement, to the appellant, a finance company. The respondent agreed, in clause 1 of the assignment, to pay the assignee "upon demand the 'total balance owing'" as shown in the schedule, or the balance thereof remaining unpaid. The hirer defaulted, and the appellant-assignee repossessed the wreck of the car and sold it for \$20, and then sued for the balance of the monies which the respondent agreed to pay under clause 1 of the assignment. The respondent claimed that since the original agreement was not in writing, it was illegal, because it contravened Regulation 3 of the Hire Purchase and Credit Sales Stabilization Regulations 1957. This Regulation provides that:—

Except as otherwise provided in these regulations, a person shall not dispose of any goods in pursuance of a hire purchase agreement or a credit sale agreement . . . unless the requirements specified in the First Schedule hereto are or have been satisfied in relation to that agreement.

The respondent argued that the agreement contravened Clause 1 of the First Schedule, which states that a hire-purchase agreement must be in writing, whereas in the present case several terms of the agreement were left blank, and filled in later. The respondent further claimed that the appellant's (assignee's) knowledge of the illegality had tainted the assignment, making it illegal and thus void under Regulation 10; and that therefore the appellant could not recover the balance of the monies the respondent had covenanted to pay.

In the Supreme Court, Richmond J. assumed that there was full knowledge on the part of the appellant (the assignee),¹ and he found that the assignment was tainted with the illegality, and gave judgment

1. [1965] N.Z.L.R. 109, 112 and 114.

for the respondent. This judgment was reversed in the Court of Appeal and the appellant recovered.

The main issue in the case was how much knowledge was required on the part of the assignee before the assignment became tainted with the illegality of the hire-purchase agreement, and whether in fact the assignee had such knowledge.

The two principal judgments in the Court of Appeal were delivered by Turner and McCarthy JJ., with North P. concurring in a short judgment. McCarthy J. held that knowledge of illegality in the original contract was not by itself sufficient to render the assignment so tainted with illegality as to defeat the rights of the assignee, who was not a party to the earlier contract. Something more was required in his Honour's view, that is, an intention to assist the illegality. The learned judge drew a distinction between those cases in which, it seemed to him, the court was enforcing an original contract which was concluded before the illegal contract², and the present case, where the contract of assignment was subsequent to the hire-purchase agreement. Although text-book statements refer to the possibility of a contract subsequent to the original one being tainted with its illegality, this, according to McCarthy J., applied only to contracts between the original contracting parties made to further the original illegality. The "determining factor" is the intention to further the illegality, which is to be shown by the assistance given by the appellant to the illegality. This, he held, was not shown in this case. Even if the appellant had known of the circumstances which constituted the illegality here, there was "no duty cast on him to be vigilant" (p.579). It would appear, then, that even if he suspected illegality, the appellant was under no obligation to investigate further, and ascertain conclusively whether the assigned contract was illegal. In *Cotton v. Central District Finance Corporation Ltd* [1965] N.Z.L.R. 992, North P. said (at 996):—

The Court will not enforce a contract which is expressly or impliedly prohibited by statute and . . . in this class of case the intent of the parties is wholly immaterial.

In *Cotton's* case a guarantee collateral to the original contract was being sued on, and therefore the above dictum was inapplicable in *Portland Holdings v. Cameo Motors*, because the independent covenant in the contract of assignment in that case was held to be valid. Even though the company knew something of the illegality, it did not know enough and did not actively assist in the illegality.

North P. took a different approach to that taken by McCarthy J. when considering the problem of what would render the assignment illegal. In his opinion, full knowledge of and intention to give effect to the antecedent contract was necessary. Nevertheless, he agreed that even if this was not the correct standard, sufficient knowledge had not been proved in the present case.

2. *Redmond v. Smith* (1844) 7 M. & G. 457; 135 E.R. 183; *Fisher v. Bridges* (1854) 3 El. & Bl. 643; 118 E.R. 1283; *Smith v. White* (1866) L.R. 1 Eq. 626.

Turner J. distinguished the *Fisher v. Bridges* type of case (supra) on the same grounds as McCarthy J. and went on to quote, and agree with, the law stated in *Halsbury* that "an agreement . . . cannot be enforced if it is entered into for the purpose of carrying out an illegal transaction." (8 *Halsbury's Laws of England*, 3rd ed., 128). The learned judge maintained that this meant that it was some future illegal action that must be contemplated.

Admittedly, in *Portland Holdings v. Cameo Motors* the illegality occurred before the assignment, but it is submitted that the purpose of assignment was to carry out and assist in the performance of an illegal transaction—the sale of the car. It appears to be a somewhat subtle distinction to separate the two contracts (that is, the original contract and the assignment). The car was, technically, sold before the assignment but, it is reasonable to assume, with the knowledge that the agreement would be assigned. The assignment, therefore, contributed to the illegality in spite of its being subsequent to it, because reliance on its execution encouraged the parties to enter into the illegal contract. Consequently, it is submitted that it was not totally correct to say "nothing illegal was enabled or encouraged by the transaction of the assignment" (Turner J., at 582). While the assignment did not encourage any future act, reliance on it did nevertheless encourage the parties to enter into the original contract. The car would probably not have been sold in the first place without the knowledge that a finance company would provide credit facilities and that the contract would be assigned to it.

Previous decisions on the Regulations were not very helpful to the Court of Appeal because of the novelty of the point raised. The Regulations had, however, been considered in several other cases, the latest being the decision of the Court of Appeal in *Cotton v. Central District Finance Corporation* [1965] N.Z.L.R. 992. In this case, the appellant, a car dealer, financed his car sales through the respondent finance company and assigned the benefit of amounts owing to him (on hire-purchase agreements for cars) to the respondent—a similar arrangement to that in *Portland Holdings v. Cameo Motors*. The appellant, the assignor, guaranteed the amount owing under each agreement to the respondent, the assignee, and, several purchasers having defaulted, the respondent sued under those guarantees. The appellant's defence was that the hire-purchase agreements were illegal because they were not fully in writing, as terms were added after the agreement had been signed. The court held that this defence was a valid one. In *Portland Holdings v. Cameo Motors*, however, although *Cotton's* case was not questioned, it was not directly in point. Although in both cases the hire-purchase agreement was held to be illegal and void, there is a distinction on the facts. In *Cotton's* case the finance company (the assignee) brought an action against the dealer (the assignor) based on guarantees the dealer gave. These were guarantees of the purchasers' performance of the hire-purchase agreements. The dealer was able to rely on the illegality, and hence invalidity, of the hire-purchase agreements that he had guaranteed because the rights of a creditor against

a guarantor are defeated if the debtor is not liable under the main contract. The dealer in *Cotton's* case, therefore, escaped liability. In *Portland Holdings v. Cameo Motors*, on the other hand, the assignment included an independent covenant by the dealer (the assignor) to pay the due balance on demand by the finance company (the assignee). The finance company therefore did not have to base its claim on the main contract between the dealer (assignor) and the purchaser, and the dealer was liable.³

Assignment was also relevant in *Luhrs v. Baird Investments Ltd* [1958] N.Z.L.R. 663, though in a different way.⁴ In that case, an illegal hire-purchase agreement was assigned by a dealer to a finance company, an innocent party, who sued the hirer on his default. It was held by the Supreme Court that an agreement contravening the Regulations was no more valid in the hands of the innocent assignee than in the hands of the assignor. The assignee finance company in that case was suing the debtor (the purchaser), and hence his rights against the debtor were subject to the equities available to the debtor against the assignor. Since he was actually suing on the illegal hire-purchase agreement, he was not entitled to recover. In *Portland Holdings v. Cameo Motors*, however, the situation was totally different—the assignee was suing the assignor under a covenant in the contract of assignment, and did not rely on the original agreement. Thus the point of his taking subject to the equities available to the debtor against the assignor did not arise.

In the present case, the purpose of the Regulations was referred to by Turner J. to support his reasoning, that promotion or encouragement of the prohibited act was required in any contract before that could be tainted with illegality. In his opinion, their purpose was to prevent the disposition of the car. Although it is true that one aim of the Regulations was to prevent this, and that the car had already been disposed of, it nevertheless is a rather narrow view of the purpose of the Regulations. Turner J. himself in *Motor Mart Ltd v. Webb* [1958] N.Z.L.R. 773, 778 stated that the purpose of the Regulations was to restrict banking credit and reduce the "quantity of currency in circulation". A similar statement was made by Richmond J. in *Official Assignee v. Provident Life Assurance Co. Ltd* [1962] N.Z.L.R. 166, 169. The requirement that the agreement be in writing was designed to ensure that the sale of the car was conducted within the Regulations, by making all the details easily available for reference. In this way the main object of restricting credit would be easier to achieve.

If the Court of Appeal is correct in interpreting the authorities as

3. The obtaining of an indemnity rather than a guarantee may be the better course for finance companies wanting to safeguard their rights. Such an indemnity would, like the covenant in *Portland Holdings*, be independent of the original agreement and not affected by the illegality—*Goulston Discount Co. Ltd v. Clark* [1966] 3 W.L.R. 1280. The covenant in *Portland Holdings* is the safest provision of all, since loss did not have to be proved before recovery (merely that there was an unpaid balance). The indemnity in *Goulston Discount's* case required that loss be shown.
4. It also dealt with the possibility of raising an estoppel against those who conspire to deceive a finance company as to the true facts of a transaction.

it did in *Portland Holdings v. Cameo Motors* and in formulating the principle that knowledge of and assistance to the illegality is necessary before a contract will be tainted with that illegality, this could lead to some avoidance—as opposed to actual contravention—of the Regulations. Thus, dealers may with impunity defy the Regulations, intentionally or unintentionally, and finance companies do not have to pay any close attention to the legality of agreements assigned to them. Admittedly, paying such close attention would be a major task.

According to the interpretation of McCarthy J. of the principle, even if a finance company knew the original contract was illegal in some respects, the assignment of that contract would not be illegal, if the finance company had not assisted the illegality. Furthermore, it is not likely that a finance company would give such assistance since what is assigned is a finalised agreement—the company does nothing capable of being called “assistance”, for example, omitting relevant details from the contract: all it does is have the completed contract assigned to it. According to the decision in *Portland Holdings v. Cameo Motors*, even if it is perfectly obvious that the contract being assigned is illegal, the assignment is legal and can be enforced against the dealer, even though the original contract is unenforceable against the purchaser.

This could prevent a contravention of the Regulations as they stand, but even though the Regulations seem to be aimed more at the situation where the assignee or assignor is suing the debtor rather than where the assignee is suing the assignor, it nevertheless is a similar operation to those prohibited by Regulation 8(b). This Regulation states:—

8. A person shall not . . .

(b) Enter into any transaction or make any contract or arrangement, whether orally or in writing, for the purpose of or having the effect of, in any way, whether directly or indirectly, defeating, evading, avoiding, or preventing the operation of these regulations in any respect.

It does not, even indirectly, prevent the Regulations operating in this particular case, but it could in future cases “facilitate or assist the type of transaction which the regulations aimed to prohibit” ([1966] N.Z.L.R. 571, 578—though McCarthy J. thought such a result would not occur). The Regulations aim to prevent, *inter alia*, those transactions which allow an excessive length of time to pay and thus those not showing the time and other details on them. If a finance company could not enforce an assignment of an illegal contract against a dealer, it would be able to pressure the dealer into making sure the contract was not illegal although admittedly it would be difficult for the finance company to investigate all its contracts. In view of the fact that under this decision a finance company can enforce such an assignment, albeit only against the dealer—perhaps financially a less substantial person than the debtor in this situation—there is less incentive to pay much

attention to the illegality of the contract. Although it could be said that it is not the concern of individual finance companies to assist the working of the Regulations, this does not mean that they should be allowed to hide contraventions of them. Moreover, the existence of this type of arrangement would not be rare: *Portland Holdings v. Cameo Motors* was itself a "test case" (McCarthy J. at 573), there being a number of similar cases pending.

Turner J. in *Cotton v. Central District Finance Corporation* (*supra*, at 998) said:—

Merits *inter partes* can have little weight when public policy has declared transactions to be illegal, for in such cases the interests of the State must transcend private rights.

The court's decision in *Portland Holdings v. Cameo Motors*, if it is submitted, could lead to the opposite result. The interests of the state in regulating the amount of currency in circulation and thereby generally regulating the economy could be transcended by private rights, if assignments of illegal hire-purchase agreements are allowed to remain unscathed. This may, perhaps, indirectly, lead to other illegal agreements. If merits *inter partes* are irrelevant, the major consideration of the purpose of the Regulations should be given the greatest weight. To ensure that it is, a tightening of Regulation 8(b), in order to cover the situation of an assignment of an illegal contract, should be investigated. Further regulations could perhaps also be made to clarify the duties of finance companies in assisting the operation of the Regulations.

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