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ARTICLE

Agreements Forbidden by Law *vis-à-vis* Agreements to Defeat the Law: How Are They Different?

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Abstract

This article seeks to ascertain the difference between the agreements forbidden by law under section 24(a) and those intended to defeat the law under section 24(b) of the Malaysian *Contracts Act* 1950. Even though both subsections (a) and (b) cater to different types of illegality, the courts in Malaysia have often been applying them together without giving reasons why they do so. Their conjoined application prevails perhaps because there has been no convincing explanation of their differences, particularly when considered in the context of the common law doctrine of sham. This article attempts to fill that gap. The article suggests that 24(a) deals with the agreements that are expressly or impliedly forbidden by law, while 24(b) applies to sham contracts. This proposition is based on the analysis of the common law doctrine of sham and recent court decisions.

Introduction

Suppose a bank advances a loan to a borrower to partly finance the sale and purchase of land, not knowing that the borrower is not allowed by law to purchase the land.[1] After defaulting on the loan repayment, the borrower concedes that the sale and purchase agreement is illegal, only to be able to say that the loan agreement and related security documents are illegal, too, as their main purpose was to help him finance the illegal sale and purchase agreement. The illegality defence is invoked to deny the bank remedies for breach of contract or a restitutionary relief in case of illegality.[2] In situations like this, the court would first need to determine the validity of the sale and purchase agreement. If it is found to be illegal, the question then would be: what is the bank's culpability, if any, in financing such an illegal transaction? Are such loan agreements and related security documents tainted with the illegality of the sale and purchase agreement?

If the agreement is found to be expressly or impliedly forbidden by law, section 24(a) of the *Contracts Act* 1950 (Malaysia) would apply to render such an agreement void.[3] On the other

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[1]There have been many reported court cases, some of which will be discussed later in the article under the 'Commonality of Shamming Intention' heading, where the borrowers borrowed money to execute an illegal agreement (like the purchase of native land titles by non-natives).

[2]After the reception of the UK Supreme Court decision in *Patel v Mirza* [2016] UKSC 42 in Malaysia, it is unlikely that the illegality of the agreement would preclude the claimant from obtaining a restitutionary relief under section 66 of the Contracts Act 1950. That said, the claimant's entitlement to restitution in illegality cases is beyond the scope of this article. For more details, see the Court of Appeal (Malaysia) decision in *Public Bank Bhd v Ria Realiti Sdn Bhd* [2021] 3 CLJ 772.

[3]Contracts Act 1950, s 24(a) states: 'The consideration or object of an agreement is lawful, unless – (a) it is forbidden by a law.'

hand, if the agreement is *ex facie* (on the face of it) lawful but, nonetheless, is found to have been concluded to defeat the law, such an agreement would be void under section 24(b) of the same Act.[4] Even though both subsections (a) and (b) cater to different types of illegality, the courts in Malaysia have been applying them together without giving reasons why they do so.[5] Their conjoined application is perhaps due to the fact that, up to date, there has been no convincing explanation about their differences, particularly when considered in the context of the common law doctrine of sham.

This article puts forward a novel perspective by arguing that section 24(a) deals with agreements that are expressly or impliedly forbidden by law, whereas section 24(b) caters to agreements that are commonly referred to in common law jurisdictions as sham contracts.[6] The agreements that fall under subsection (a) are sufficiently discussed in the contract law literature and are less contentious. However, the problem often arises with subsection (b), as these agreements are *ex facie* legal. There is no law that expressly or even impliedly prohibits them. And yet, they could be declared void if they are found to have been concluded to defeat any law. So the question is how to know if the agreement was concluded to defeat the law. Here lies the key to this problem – by ascertaining the *contracting parties' intention*.

In agreements expressly or impliedly forbidden by law, the contracting parties' intention is irrelevant. What matters is the *legislative intent*. Sometimes the intention of the legislator is clearly spelled out by expressly stating that, for example, the sale and purchase of native land titles by non-natives is void as per provision in the *Land Ordinance (Sabah)* or *Malay Reservation Enactments*.[7] There are, however, situations where a statute does not explicitly say that the transaction is void, but only prescribes penalties for the conduct related to the transaction. Whether the statute's imposition of penalty for particular conduct implies the illegality of an agreement concluded in contravention of it would ultimately depend on the intention of the legislator, which the court would ascertain through proper statutory interpretation.

Unlike agreements forbidden by law, the contracting parties' intention in the agreements concluded to defeat the law is relevant. The loan agreement mentioned earlier is a good example. On its own, it is not forbidden by law, either expressly or impliedly. As such, there is no need to consider the application of section 24(a). But if evidence shows that the bank provided the loan to the borrower to pursue an illegal contract, it can be argued that the loan agreement was concluded in order to defeat the law, ie, to enable the illegal sale and purchase of native land titles. As a result, the loan agreement would be void due to illegality under section 24(b).

Having the agreement, which on its own appears to be legal, declared illegal is understandably contentious. It is understood that this may seriously curtail parties' ingenuity and freedom to conclude contracts in the way they believe will best serve their interest. Not every ingenuity and contract 'flexing' is sanctionable. This is why this article seeks to develop a framework that should help the court differentiate a contract that falls under subsections (b) from the one which would otherwise be acceptable. The crucial point to note here is the requirement of commonality/mutuality of the so-called 'shamming intention'. If the bank was not aware of the illegality, then the requirement would not have been fulfilled, and the loan agreement and related documents would be enforceable.

There seems to be evidence from recent court decisions dealing with the questions of illegality that they have begun to place more emphasis on the element of intention, particularly in the collateral contracts that are alleged to be tainted by the illegality found in the main agreements. In 2021, the Court of Appeal (Malaysia) delivered a landmark judicial decision in *Public Bank Bhd*

[4]ibid s 24(b) states: 'The consideration or object of an agreement is lawful, unless – (b) it is of such a nature that, if permitted, it would defeat any law'.

[5]See Syed Ahmad Alsagoff, *Principles of the Law of Contract in Malaysia* (LexisNexis 2003) 300.

[6]The word 'sham' is used as the agreements are intended by the parties to defeat the law (ie, to aid the borrowers in the execution of the illegal agreements). In the sections from 'The Commonality of Shamming Intention Requirement' onwards, this article will address the doctrine of sham and its applicability in Malaysia in more detail.

[7]The details are provided under the 'Commonality of Shamming Intention' heading.

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v Ria Realiti Sdn Bhd,[8] in which it made explicit reference to the party's absence of knowledge of illegality as one of the main factors that distinguished this case from the earlier Federal Court (Malaysia) decision in *Malayan Banking Bhd v Neway Development Sdn Bhd*,[9] in which both parties were fully aware of the illegality. As a result, despite a considerable similarity between the two cases, the agreement in *Ria Realiti* was found to be enforceable, whereas, in *Neway*, it was held to be illegal. This article examines these and other relevant judicial decisions to see how the element of intention influenced the court decisions on the issues of illegality.

The article begins by deliberating on the scope of section 24(a), particularly the role of the legislator's intention in agreements that are expressly or impliedly forbidden by law. It then sheds light on the agreements concluded to defeat the law, which are dealt with under section 24(b). As noted earlier, the courts seem to be content with the conjoined application of both subsections, whereas one of the central arguments of this article is that the two are different. Their differences are explained with reference to the parties' commonality of shamming intention required in agreements covered under section 24(b). In order to substantiate the claim that section 24(b) deals with sham contracts, the article examines the common law doctrine of sham and its elements as formulated by Lord Diplock in *Snook v London and West Riding Investment Ltd* (England and Wales),[10] together with the doctrine's limitations as noted in some recent court judgments.

Legislative Intent in Agreements Forbidden by Law

An agreement 'forbidden by a law' is illegal.[11] This is stated in section 24(a) of the Contracts Act 1950, and it includes agreements expressly forbidden by law. For example, section 17(1) of the Land Ordinance (Sabah) prohibits the sale of native land titles to non-natives. It states: 'All dealings in land between non-natives on the one hand and natives on the other hand are hereby expressly forbidden and no such dealings shall be valid or shall be recognised in any court of law…'[12] Likewise, section 15 of the *Moneylenders Act* 1951 (Malaysia) provides that 'no moneylending agreement … by an unlicensed moneylender shall be enforceable'.[13] As a result, both the sale of native land to a non-native and the loan by a non-licensed moneylender are void agreements under section 24(a) for being expressly forbidden by law.

Section 24(a) also encompasses agreements impliedly forbidden by law. For instance, if a licensed moneylender executes a moneylending agreement in any name other than the authorised name, they shall be guilty of an offence and liable to a fine according to section 8 of the Moneylenders Act 1951.[14] The penalty, by necessary extension, implies the illegality of the agreements having been made in contravention of section 8. This conclusion was reached by the Privy Council in an appeal from the Federal Court's (Malaysia) decision in *Menaka v Lum Kum Chum*.[15] In this case, the appellant signed loan documents in her name and not in the name of her licensed firm. The Privy Council cited with approval the rule stated by Parke B in *Cope v Rowlands* (England and Wales),[16] which provided the following:

[8][2021] 3 CLJ 772 (*Ria Realiti*).
[9][2017] 9 CLJ 401 (*Neway*).
[10][1967] 2 QB 786 (*Snook*). This is the leading case on common law sham doctrine and will be explained in detail later in the article under the 'Commonality of Shamming Intention Requirement' heading.
[11]The word 'law' refers to statutes and any other forms of law like Malaysian common law.
[12]Land Ordinance (Sabah Cap 68), s 17(1). See *Ria Realiti* [2021] 3 CLJ 772.
[13]Moneylenders Act 1951, s 15.
[14]Moneylenders Act 1951, s 8.
[15][1977] 1 MLJ 91 (*Menaka*).
[16](1836) 2 M&W 149.

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> It is perfectly settled, that where the contract which the plaintiff seeks to enforce … is expressly or by implication forbidden by the common law or statute law, no court will land its assistance to give it effect. *It is equally clear that a contract is void if prohibited by a statute, though the statute inflicts a penalty only, because such a penalty implies prohibition.*[17]

While a penalty may imply illegality, that is not always the case. Strictly speaking, the illegality by implication is a matter of statutory interpretation.[18] The court is required to determine if the legislator intended penalty provision to render the agreement, made in contravention of it, illegal. In *CIMB Bank Bhd v Gan Teow Hooi*,[19] the Court of Appeal (Malaysia) decided that a penalty prescribed under section 18(a) of the *Housing Development (Control and Licensing) Act* 1966 (Malaysia) for failing to obtain the required licence as a housing developer does not affect the validity of the construction agreements entered into by the non-licensed developer. The court relied on the following passage from the Supreme Court (Malaysia) decision in *Baca (M) Sdn Bhd v Tang Choong Kuan:*

> Not every breach of a statutory prohibition would render an agreement illegal or void though such breach may attract criminal penalty. The fundamental question is whether the Enactment means to prohibit the agreement. It is important that the courts should be slow to imply the statutory prohibition of agreements, and should do so only when the implication is clear. Whether an agreement is implicitly forbidden depends upon the construction of the statute, and for this purpose no one test is decisive.[20]

In some instances, a statute could explicitly say that a contract, the conclusion of which attracts a penalty, is nonetheless valid and enforceable. A good example is an Islamic financial contract found not to be in compliance with *Shari'ah* (Islamic law). While section 29(5) of the *Islamic Financial Services Act* 2013 (Malaysia) (IFSA) states that non-compliance with *Shari'ah* is an offence punishable with imprisonment for a term not exceeding eight years or with a fine not exceeding RM 25 million, or with both, section 281 of the same Act provides for the validity of contract found to be in contravention of *Shari'ah*,[21] stating: 'Except as otherwise provided in this Act, or in pursuance of any provision of this Act, no contract, agreement or arrangement, entered into in breach or contravention of any provision of this Act shall be void solely by reason of such breach or contravention.'[22]

The effect of *Shari'ah* non-compliance on the legality of Islamic financial contracts was considered by the court in the case of *Maybank Islamic Bhd v Golden Base Construction Sdn BhD*.[23] The defendants (borrowers)[24] submitted that the Islamic financial contract of *murabahah* (mark-up sale) concluded between them and the bank was illegal as it did not comply with the *Shari'ah* (Central Bank of Malaysia Guidelines on Murabahah).[25] The High Court (Malaysia) found merit in the defendants' argument and ordered the full trial, thereby dismissing the bank's claim for summary judgment. The Court of Appeal (Malaysia), however, reversed the decision in favour of the bank, clarifying that the non-*Shari'ah* compliance of the Islamic financial contracts, even if

[17]ibid 157 (emphasis added).

[18]See *Phoenix Insurance v Halvanon Insurance* [1988] QB 216, 268 (Kerr LJ) and *Yango Pastoral Co Pty Ltd v First Chicago Australia ltd* (1978) 139 CLR 410, 415 (Gibbs CJ).

[19][2012] 9 CLJ 1003.

[20][1986] CLJ (Rep) 64, 70.

[21]Islamic Financial Services Act 2013, ss 29(5) and 281.

[22]ibid.

[23][2019] 1 LNS 1785, [50]–[51] and [53]–[54] (Khadijah Idris J).

[24]The term 'borrowers' is used here for ease of reference. In a strict sense, the parties who obtained financing facilities from an Islamic bank are purchasers or partners and not borrowers, as the underlying Islamic financial contracts used by the parties are normally based on sale and partnership agreements.

[25]See Bank Negara Malaysia, 'Policy Document on *Murabahah*' (23 Dec 2013) <https://www.bnm.gov.my/documents/20124/938039/20131223_S_O_0001.pdf/> accessed 13 January 2023.

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established, and the supposed penalties imposed on the Islamic financial institution would not render the agreements illegal by virtue of section 281 of the IFSA.[26]

Coming back to the question of intention, it is submitted that the intention of the parties to an agreement found to be forbidden by law, expressly or impliedly, is irrelevant.[27] That is, whether the parties intended to break the law or whether they knew that the agreement was illegal does not affect, in one way or the other, the illegality of the agreement. The parties are presumed to know the law. This conclusion is supported by the court's decision in *Archbolds (Freightage) Ltd v S Spanglett Ltd* (England and Wales),[28] where Pearce LJ said: 'If a contract is expressly or by necessary implication forbidden by statute, or if it is *ex facie* illegal … the law will not help the plaintiffs in any way that is a direct or indirect enforcement of rights under the contract. *And for this purpose, both parties are presumed to know the law.*'[29] This sentiment was also echoed by the Privy Council in *Menaka,* in which the moneylending agreement was held to be illegal even though 'neither party was aware of the illegality at the time of making the loan transaction and the documents were prepared and executed on both sides in complete good faith.'[30]

In view of this strict illegality rule under section 24(a) with regards to agreements forbidden by law, which does not take into account parties' intention, one would assume that contracts concluded on the advice of learned legal counsels are less likely to fall into this category of illegality. The counsels are expected to exercise proper diligence, which includes conducting research on the subject matter of the contract before they advise their clients. The problem is more likely to occur with regard to contracts that have been allegedly tainted with the illegality of the agreement found to be expressly or impliedly forbidden by law. This is where the parties' intention becomes relevant to the finding of illegality under section 24(b).

Contracting Parties' Intention in Agreements to Defeat the Law

The question of illegality seems to be more litigious in situations when a contract is not expressly or impliedly forbidden by law as per section 24(a) of the Contracts Act 1950, and yet evidence indicates that the parties might have executed the contract in a particular way in order circumvent or defeat the law. The real objective of the contract is different from what the contract *ex facie* suggests. This type of contract is often referred to in the contract law literature as 'sham'.[31] The word 'sham' implies that something is not as it appears.[32] The outside shell acts as a disguise to cover the reality of the situation. Hence, the question is: are sham agreements illegal, and if so, under what law? The author submits that this type of illegality is captured under section 24(b) of the Contracts Act 1950, which states that an agreement is illegal when 'it is of such nature that, if permitted, it would defeat any law.'[33]

Illustration (i) in section 24 of the Contracts Act 1950 provides a useful guide as to the interpretation of section 24(b). It says:

[26]The Court of Appeal judgment was delivered in a verbal form on 6 January 2021.

[27]See See JW Carter, *Carter's Guide to Australian Contract Law* (Carter Publishing 2022) 515.

[28][1961] 1 QB 374.

[29]ibid 384 (emphasis added).

[30][1977] 1 MLJ 91, 94.

[31]For UK law, see Edwin Simpson & Miranda Stewart, 'Introduction: "Sham" Transactions', in Edwin Simpson & Miranda Stewart (eds), *Sham Transactions* (Oxford University Press 2013) 4. For Australian law, see Miranda Stewart, 'The Judicial Doctrine in Australia', in Edwin Simpson & Miranda Stewart (eds), *Sham Transactions* (Oxford University Press 2013) 51. For Canadian law, see Chris Sprysak, 'From Sham to Reality: Should a Wrong Be Taxed as a Wright?' (2010) 55 McGill Law Journal 123.

[32]While the word 'sham' is usually used in most common law jurisdictions, the other terms for sham, rarer in use though, are 'fiction' and 'simulation'. See N Stephan Kinsella, 'A Civil Law to Common Law Dictionary' (1994) 54 Louisiana Law Review 1265, 1292.

[33]Contracts Act 1950, s 24(b).

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> A's estate is sold for arrears of revenue under a written law, by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void, as it renders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law.[34]

The sale and purchase agreement between A and B would in normal circumstances be a permissible contract, but in this case becomes illegal as A and B have concluded it in order to circumvent the prohibition of A (defaulter) from purchasing the estate. In other words, it is a sham contract designed to defeat the law.

Deciding that an agreement, which *ex facie* is not forbidden by any law, is illegal is understandably contentious. It is often said that parties should be free to negotiate and structure their agreement in the way they feel works best for them. After all, that is the essence of the freedom of contract theory, which relies on the assumption that the contracting parties are in the best position to decide what works for them.[35] As Lord Tomlin, in *Commissioner of Inland Revenue v Duke of Westminster* (England and Wales),[36] famously said: 'every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be.'[37] It is not disputed that parties' ingenuity when contracting is not only allowed but necessary for the smooth functioning of business and commerce. The question, however, is: are there any limits to this ingenuity, and if so, what are they? The obvious answer to this question is that limitations do exist. For a start, parties' contracts and conduct must not be forbidden by law as per section 24(a). But, more germane to this context, the contracts which seemingly appear to comply with the law should not be executed with the intention to defeat the law as per section 24(b). If they are, then they, too, are illegal and void.

While parties' intention or lack of knowledge of illegality is irrelevant under section 24(a), the same cannot be said for illegality under section 24(b). In fact, the parties' intention is a critical element of illegality in agreements concluded in contravention of section 24(b) (ie, sham agreements). Therefore, the court would need to determine if the contracting parties intended to defeat the law or at least were aware of the illegality. If they (or either one of them) were not, then the agreement is legal and enforceable. Pearce LJ in *Archbolds* cautioned that care should be exercised when considering if a collateral agreement (an agreement that is not expressly or impliedly forbidden by law) should be declared illegal. In this case, the *Road and Retail Traffic Act* 1933 (UK) provided that 'no person shall use a vehicle on a road for the carriage of goods … except under license'.[38] The plaintiff concluded a contract of carriage with the defendant, but unknown to the plaintiff, the defendant's van did not have the required licence type 'A'. When the goods were stolen from the van due to the defendant's negligence, the defendant claimed in his defence that the contract of carriage was illegal.

The court dismissed the defendant's contention and held that the statute did not forbid the contract of carriage. The statute merely 'regulated the means by which carrier should carry goods.' The contract of carriage was considered a 'collateral agreement' that was not within the ambit of the statutory prohibition. The plaintiff's absence of knowledge of illegality in the

[34]ibid s 24, illustration (i).

[35]It is also known as 'rational action theory'. This theory has been advocated by the neo-classical economists. See eg, N Gregory Mankiw, *Principles of Economics* (6th edn, South-Western Cengage Learning 2012) 7. For the critique of the theory, see Richard A Epstein, 'Behavioral Economics: Human Errors and Market Corrections' (2006) 73 University of Chicago Law Review 111. See also Alexandra Sims, 'Unfair Contract terms: A New Dawn in Australia and New Zealand' (2013) 39 Monash University Law Review 752.

[36][1936] AC 1.

[37][1936] AC 1, 19.

[38][1961] 1 QB 374, 385.

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collateral agreement was the main reason the court did not find it illegal.[39] On the contrary, had the plaintiff been aware that the defendant did not have the required licence to perform the contract of carriage, it is very likely that the contract of carriage, which in itself was not illegal, would have become illegal.

The requirement of intention to defeat the law or knowledge of illegality was also highlighted in the case of *Lim Kar Bee v Duofortis Properties (M) Sdn Bhd* (Malaysia).[40] With the help of tax advisors, the appellant devised a scheme to avoid the payment of estate duty. He did so by executing a sale and purchase agreement by which he first transferred four valuable pieces of land to a company and later executed a trust deed so that he could continue to manage the business-related activities associated with the lands. The company was a wholly owned subsidiary of a holding company that was in the exclusive ownership of the appellants' family members. It was obvious that the scheme was created so that the family members could transfer ownership over the lands after the appellant's passing without having to pay estate duty. It was admitted in the court that the scheme was intended for tax avoidance, which, the appellant's family argued, was not illegal.

The Supreme Court held that the sale and trust agreements were illegal not because they were forbidden by law under section 24(a) but rather because their purpose was 'to avoid paying estate duty'.[41] The main test, as stated by Peh Swee Chin SCJ, who delivered the judgment of the court, was: 'whether the primary purpose of the transaction was to avoid tax; if it is, it is an illegal purpose, ie of such nature that, if permitted, it would defeat the tax law in question, coming under sub-s (b) of s 24 of the Contracts Act 1950.'[42] To know if the agreements were genuinely intended to be what they *ex facie* appeared to be, or whether they are a sham intended to hide the illegal transaction, the court needed to determine the parties' intention. In this case, determination of the intention was easy as the parties professed that they executed the agreements as part of the tax avoidance scheme that happened to be illegal.[43] On the significance of intention to the finding of illegality, this is what the court said: 'evidence of such *intention to avoid paying estate duty*, as declared by the witnesses, *is highly relevant for the purpose of considering the question of illegality of contract.*'[44] Apart from considering witness testimony to ascertain the parties' intention, the court also considered 'the circumstances in the case, especially the documents designed and signed, to see whether they could be correlated to such evidence of intention.'[45]

Now that it has been established that the parties' intention is important in finding if an agreement concluded to defeat the law is illegal, the next question that needs to be answered is: do both the plaintiff and defendant must have the so-called 'shamming intention', or must they both be aware of the illegality? The answer to this question was provided by the Court of Appeal (UK) in *Snook v London and West Riding Investment Ltd,*[46] which is widely accepted as one of the most important court decisions on sham agreements. The decision of the court and principles deduced from it are deliberated below.

The Commonality of Shamming Intention Requirement

The Court of Appeal decision in *Snook* set the foundations for the modern doctrine of sham. The brief facts of the case are as follows. The plaintiff, Mr Snook, purchased a car from a car dealer. Most

[39]ibid 386 (Pearce LJ).
[40][1992] 2 MLJ 281.
[41]ibid 288.
[42]ibid 291.
[43]ibid 289.
[44]ibid 281 (emphasis added).
[45]ibid.
[46][1967] 2 QB 786.

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of the price was paid in cash. The balance was to be paid on hire and purchase terms with a finance company, TL. The plaintiff agreed to repay the agreed sum to TL in 12 monthly instalments. After three instalments had been paid, the plaintiff defaulted. He then applied to another finance company, AF, to refinance his debt. AF agreed and then asked the plaintiff to sign a letter addressed to TL, which stated that the plaintiff sold the car to AF and that, upon settlement of the outstanding amount with TL, the car would be completely owned by AF. All the while, however, the car was used by the plaintiff, and it was never in the possession of AF. AF then asked the plaintiff to sign a hire and purchase agreement with the defendant, London and West Riding Investment Ltd, a company for whom AF acted as an agent. In the meantime, AF sold the car to the defendant for a price that was never really paid nor was the car ever delivered to them. On record, however, the defendant became the sole owner of the car.

The hire and purchase agreement between the plaintiff and defendant misleadingly stated (as the figures were fictitious) that the plaintiff purchased the car from the defendant for 800 pounds. It was specified that 500 was paid in cash when, in fact, nothing had been paid. The balance was agreed to be paid over two years in monthly instalments. When the plaintiff defaulted again, AF's men, acting on behalf of the defendant, seized the car and took it off. Shortly after, the car was resold for 575 pounds when its real market value at the time was estimated to be 775 pounds. AF then paid off the defendant 280 pounds and kept the balance of 295 pounds for themselves. The plaintiff sued for damages for the conversion of the car.

One of the issues raised before the trial court judge was whether the refinancing operation was, in fact, a loan. The court found that the loan agreement was dressed up to look like hire and purchase and, thus, the whole arrangement was a sham.[47] The judge concluded that the car was used as a security for the loan, but the parties disguised it as a hire and purchase transaction as the loan on the security of goods was prohibited under the *Bills of Sale Acts* (UK).[48]

On appeal, the Court of Appeal agreed that the refinancing arrangement was fictitious but disagreed on whether the defendant had the necessary 'shamming intention'. This is when Lord Diplock (concurred by Lord Russel) provided what will turn out to be the most famous judicial statement on sham, defining it as:

> acts done or documents executed by the parties to the "sham" which are *intended by them* to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual rights and obligations (if any) which *the parties* intend to create.[49]

However, immediately after this statement, the learned judge added the following condition:

> But one thing, I think is clear in legal principle, morality and the authorities … that for acts or documents to be a "sham", with whatever legal consequences follow from this, *all the parties* thereto must have *a common intention* that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a "shammer" affect the rights of a party whom he deceived. There is an express finding in this case that the defendants were not parties to the alleged "sham".[50]

Lord Diplock's statement suggests that an agreement would amount to a sham if the following two criteria are fulfilled: the agreement gives a false impression (ie, is misleading), and it was

[47] ibid 799.
[48] ibid.
[49] ibid 802 (emphasis added).
[50] ibid (emphasis added).

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intended by all parties to do so (ie, mutuality of shamming intention). Both criteria must be satisfied, and this is where the difficulty arises. Proving that the transaction is misleading is not as hard as proving that *all parties* to the transaction intended to deceive the court or the third party. The court in *Snook* had found that the transaction had a misleading appearance and that both the plaintiff and agents of the defendants were parties to the alleged deceit but, without the defendant's direct partaking in the deceit, there was no sham.[51] This decision shows that an artificial, fictitious transaction becomes a sham only when it has been coupled with the mutuality of shamming intention. In other words, it must be shown that both parties to the transaction have colluded to arrange their affairs in a way that would mislead (deceive) the court or third party.[52]

Shamming Intention

An interesting perspective as to what amounts to 'shamming' intention in the context of illegality under section 24 of the Contracts Act 1950 was offered by the High Court (Malaysia) and Court of Appeal (Malaysia) in their contrasting decisions in the case of *Pang Mun Chung & Anor v Cheong Huey Charn*.[53] The brief facts of the case are as follows. The plaintiff, a non-citizen, transferred the ownership of his property to the defendant, a citizen, through the sale and purchase agreement (SPA) in order to obtain a loan from Hong Leong Bank Berhad (the bank), which had an internal policy against giving loans to non-citizens. The defendant, with whom the plaintiff had a romantic relationship at the time, agreed to apply for the loan on behalf of the plaintiff, using the transferred property as security. The obtained loan was utilised and serviced by the plaintiff. When he defaulted, the bank initiated foreclosure proceedings, and the property was auctioned. The auction generated a considerable surplus sum (the surplus) which, the defendant claimed, belonged to her. The plaintiff contested the defendant's right over the surplus, arguing that she only held the property in trust for him. One of the issues raised before the court pertained to the authenticity of the SPA – in other words, whether the SPA was a sham contract intended to circumvent the law.

The High Court judge, S Nathan Balan, held that the SPA was a sham devised by both the plaintiff and defendant to mislead the bank. The finding was based on evidence that suggested that the SPA was concluded to circumvent the bank's internal policy of not giving loans to non-citizens. This conclusion, however, was later questioned by the Court of Appeal as the plaintiff had no 'shamming' intention. The SPA was concluded, according to the Court of Appeal, not to defeat the law but rather to comply with the bank's internal policy. Harmindar Singh Dhaliwal JCA, delivering the decision of the Court of Appeal, concluded: 'We are also not persuaded that there was a sinister motive on the part of the plaintiffs, as the learned judge seems to imply, for initiating and executing the sale transactions.'[54]

What about an argument that the parties must have surely intended to mislead the bank? Even if they did, is that the same as defeating the law? If misleading the bank is prohibited by law, then an agreement concluded with such an intention would fulfil the criteria of a sham. But the evidence, in this case, pointed to the conclusion that the SPA was concluded with the intention of circumventing the bank's internal policy, and the bank's policy is not the same as 'law'.[55] For the SPA to be

[51]Lord Denning dissented by saying: 'It was argued that the defendants are not to be affected by this sham transaction unless they were themselves parties to it. I cannot agree with this. Although the defendants were not parties to the sham, their agents were: and that is the end of it. Every principal is answerable for the conduct of his agent in the course of his agency.' [1967] 2 QB 786, 800.

[52]See ACL Davies, 'Sensible Thinking About Sham Transactions' (2009) 38 Industrial Law Journal 318.

[53][2018] 8 CLJ 663 (*Pang Mun Chung*). See also the High Court decision [2018] 1 CLJ 491.

[54][2018] 8 CLJ 663, 676.

[55]Federal Constitution (Malaysia), art 160 states that 'law includes written law, the common law as so far as it is in operation in the Federation or any part thereof, and any custom or usage having the force of law in the Federation or any part thereof.'

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considered illegal under section 24(b), it must have been concluded to defeat the law. Thus, if the purpose of the SPA was not to defeat the law, then the parties' intention could not have been described as 'shamming'.

This point can also be substantiated by reference to the Court of Appeal (Malaysia) decision in *Chan Kay Siew v Choo Ban Hong*.[56] The plaintiff, in this case, obtained an interest-free loan from the defendants, who were the plaintiff's family members, on the understanding that the loan shall be repaid in full within a year. If the loan was not settled within a year, then an interest of 10% was to be paid for the unpaid amount of the loan. The loan was secured by two pieces of land, which the plaintiff charged in favour of the defendants. However, the memorandum of charge and memorandum of variation of charge (the agreement) did not contain any reference to the interest amount payable. In fact, in the section of the agreement where there is a reference to interest, the words 'not applicable' were inserted. While the agreement was silent on the interest payment, there was an additional letter signed by the plaintiff in which there is an admission that 10% interest is to be charged for the unpaid amount if the loan is not settled within a year. The issue that the court was asked to decide was whether the interest was payable or not.

One of the plaintiff's arguments before the court pertained to the alleged illegality of the charge agreement. It was argued that the arrangement was illegal as the parties deliberately chose to omit any reference to interest in it to evade payment of tax. If the interest was included in the agreement, the tax would have been payable. The High Court accepted the plaintiff's argument and held that the agreement was void due to illegality, which meant that the plaintiff did not need to pay any interest on the principal sum of the loan. However, on appeal before the Court of Appeal, the High Court's decision was reversed. The Court of Appeal noted that by not including a provision on interest in the charge agreement, the parties' intention was not to evade payment of tax *per se*, but rather they wanted to avoid payment of tax on income (in this case on interest) which was not yet received.[57] That, the court concluded, was lawful. In other words, the intention could not have been interpreted as 'shamming' when the parties' objective is not to defeat any law.

The intention was found to be shamming by the High Court (Malaysia) in the recent case of *Lai Sing Foo v Lee Kim Lin*,[58] in which the plaintiff and the second defendant concluded an agreement they referred to as 'Term Sheet'. In fact, the Term Sheet was a forward contract by which the shares of a company are publicly traded in an open market at a pre-determined future price. The agreement provided for the purchase of the shares from the third defendant and then a guaranteed buy-back of the same at a premium. Forward contracts are prohibited under various laws and regulations in Malaysia.[59] Adlin Abdul Majid JC described the Term Sheet as 'being an arrangement that falls foul of the Bursa Rules and the CMSA, is an agreement tainted with illegality. The Term Sheet is therefore unlawful and void, pursuant to section 24 of the Contracts Act 1950. The courts will not enforce contracts tainted with illegality'.[60] While the learned Judicial Commissioner did not deliberate on the parties' shamming intention with reference to the doctrine of sham and section 24(b), the facts and the decision provide enough basis for the author to draw the following conclusion. The Term Sheet was a forward contract in disguise intended to achieve a goal that is prohibited under the law. As such, the learned Judicial Commissioner correctly concluded that the agreement was illegal under section 24. The author would like to add, under section 24(b), to be more specific.

[56][2017] 6 CLJ 22.
[57]ibid 30–31 (Zaharah Ibrahim JCA).
[58][2022] 1 LNS 1917.
[59]See Capital Markets and Services Act 2007 (Malaysia), ss 175 and 176; Rules of Bursa Malaysia Securities, r 1.01.
[60][2022] 1 LNS 1917, [24].

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The Commonality of Shamming Intention

The need for 'commonality' of shamming intention for an agreement to be considered illegal, in particular under section 24(b), has been clearly demonstrated by the recent Court of Appeal (Malaysia) decision in *Public Bank Bhd v Ria Realiti Sdn Bhd*.[61] The court was asked to decide if the loan agreements and related security documents to part finance the purchase of 224 subleases and native land titles by a non-native company were tainted with illegality. The company argued that since the sale and purchase agreements of the native land titles by a non-native company were found to be illegal for being in contravention of sections 17 and 64 of the Land Ordinance (Sabah), the loans extended by the bank to the company for the purpose of the acquisition of those land titles were also illegal. In its submission, the company relied on an earlier Federal Court (Malaysia) decision in the case of *Malayan Banking Bhd v Neway Development Sdn Bhd*,[62] where the court held that the loan agreements were tainted with illegality that stemmed from the illegal acquisition of native land titles by a non-native through the sale and purchase agreements.

One of the main factors that distinguished *Ria Realiti* from *Neway* was the absence of shamming intention on the part of the bank.[63] In *Ria Realiti*, the bank had no knowledge of the sale and purchase agreement's illegality, while in *Neway*, the bank was fully aware of it. Ravintharan Paramaguru JCA, delivering the judgment of the Court of Appeal in *Rea Realiti*, made this clear when he said:

> The High Court in the instant case did not make any finding that the appellant as the financier had any actual knowledge of the alleged breach of ss. 17 and 64 of the Land Ordinance (Sabah) (Cap. 68). Douglas Primus J in the winding-up court also did not make any finding that the bank had any knowledge of the illegality.[64]

In *Neway*, however, Richard Malanjum CJSS, delivering the decision of the Federal Court, noted the following:

> And the appellant (the bank) could not be heard to say that it was a bona fide lender without any knowledge on the purpose of the term loan. It knew the purpose of the term loan and knew well that it was the fourth respondent who was the actual owner/purchaser of the native land using the native nominee in order to circumvent the prohibition of s. 17(1) of the SLO. Indeed, the appellant came to court with unclean hands.[65]

The decisions in *Ria Realiti* and *Neway* reinforce the argument put forward in this article, namely that for an agreement not expressly or impliedly forbidden by law to be illegal on the basis that it has been concluded to defeat the law, both parties must be *aware* of that sinister motive. In other words, they both must know of the illegality. Otherwise, knowledge of the illegality by only one party, as in the case of *Ria Realiti*, where the company knew and the bank did not know that the loan was being used for the illegal acquisition of native titles by non-natives, would not render the agreement illegal. Thus, without the 'commonality' of shamming intention, the agreement is not a sham.

[61][2021] 3 CLJ 772.
[62][2017] 9 CLJ 401.
[63]There are other features that distinguished the two cases. For more details on those, see [2021] 3 CLJ 772, 788–792 (Ravintharan Paramaguru JCA).
[64][2021] 3 CLJ 772, 790.
[65][2017] 9 CLJ 401, 409 (emphasis added).

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Contractual Representation

The Court of Appeal in *Ria Realiti* made another interesting observation about whether the bank could have relied on the company's contractual representation that the sale and purchase agreement, which the bank was partly financing, was legal. Or was there a wider duty on the part of the bank to investigate its legality? In *Ria Realiti*, the company's contractual representation stated the following:

> the execution, delivery and performance of the facilities agreement and security documents by the borrower will not violate or contravene the provisions of: (i) any law, or regulation, or any order, or decree of any governmental authority, agency or court to whom any of them is subject.[66]

On that point, Ravintharan Paramaguru JCA, argued: 'The appellant as the financier was therefore perfectly entitled to rely on this contractual representation. Therefore, it was not incumbent on the appellant to investigate if any illegality attached to the underlying sale and purchase agreements.'[67]

In *Chang Yun Tai v HSBC Bank (M) Bhd*,[68] the Federal Court (Malaysia) was confronted with a similar issue, namely: 'Whether the respondents (banks) are under a duty to enquire and/or ensure that the SPA (sale and purchase agreements) are free from illegalities as a precondition to the end financing being granted.'[69] Zulkefli Makinudin FCJ, delivering the decision of the court, observed the following:

> It would be too onerous to require the respondent to investigate or enquire into a transaction or contract to which they are not a party. Banking business will be rendered impracticable and burdensome if this was so. In this regard the courts should not impose such a requirement that may impede the flow of commerce … We are of the view the respondent in the present case can also rely on the representation made by the appellants that the security documents are not in contravention of any law without further enquiry.[70]

Another way of interpreting the decisions in *Ria Rialiti* and *Chang Yun Tai* is that no shamming intention can be imputed to the bank if the borrower made a contractual representation that the loan agreement and related security documents are concluded in compliance with all the laws.

A Critique of the Commonality of Shamming Intention Requirement

As illegality is usually pleaded as a defence by the defendant who has a vested interest in having the agreement declared unenforceable (to avoid, for example, repaying the loan to the bank after having defaulted on it), the commonality of shamming intention, or rather the absence of it, helps the plaintiff prove that the agreement is not a sham and as such is enforceable. However, there have been situations, particularly those where there is a notable inequality of bargaining power between the parties, where the opposite happens, ie, where the defendant relies on the commonality of shamming intention requirement to keep the agreement enforceable. Good examples are tenancy and employment contracts, where inequality of bargaining power is most prevalent.[71] These contracts

[66][2021] 3 CLJ 772, 790.
[67]ibid.
[68][2011] 7 CLJ 909 (*Chang Yun Tai*).
[69]ibid 918.
[70]ibid 920–921.
[71]Other commercial contracts too are not immune to inequality of bargaining power. For example, in *Re Watson, Ex Parte Official Receiver in Bankruptcy* (1890) 25 QBD 27 (England and Wales), the inequality of barraging power between the bankrupt and financier is believed to have been a significant factor that led the court to decide that the hire and purchase agreement was a sham.

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are normally drafted by landlords and employers who, due to their dominant bargaining positions, are able to include contract terms that are inconsistent with the actual situation.[72]

For example, a landlord may deny a lessee protections to which he would otherwise be entitled by including a term that describes the lease as a licence agreement. Likewise, an employer may deny protections and benefits to an employee by having a term that describes the contract of service as a contract for service. It is obvious that the written terms in both situations are intended to defeat the law and mislead the court to believe that these contracts are not what they are in reality. They, nonetheless, do not fulfil the sham criteria under *Snook* as there is no mutuality of intent to collude. It would be hard to imagine that the lessee and employee would collude willingly to create sham terms to their own disadvantage.[73] The only reasonable explanation would be that they perhaps had no choice but to accept the terms or risk of not having the lease or employment. The inequality of barging power circumstance seems to be the only explanation. This is why the courts have begun to relax the *Snook* criteria of sham in situations where the parties' bargaining power is unequal.

In *AG Securities v Vaughan, Antoniades v Villiers*,[74] the House of Lords (UK) was asked to decide whether the contract in question was a lease or licence. If it was the lease, then the tenants would have been entitled to certain protections under the *Rent Act* 1977 (UK). In order to avoid the statutory duties, the landlord inserted a clause in the contract which denied the occupants the right of exclusive possession. By doing so, he thought that he had successfully predetermined the contract as a licence because exclusive possession is a requirement of a lease. Interestingly, the court interpreted the contract by considering 'the effect in law of the rights which they [the contracts] actually created.'[75] The clause denying exclusive possession was held to be a sham that was designed to give the appearance of a licence when in reality, the rights and duties that the contract actually created were that of a lease.

Similarly, in *Protectacoat Firthglow Ltd v Szilagyi*,[76] the Court of Appeal (UK) was asked to decide whether Mr Szilagyi's contract with Protectacoat was a contract of employment or self-employment. The contract contained terms that explicitly denied mutuality of obligations and allowed substitution. Protectacoat argued that the contract was not one of employment because the parties were not under obligation to offer work and service for the work. The substitution clause, Protectacoat argued, also suggested that the contract was one of self-employment, as an employment contract is built on personal relationships and does not permit substitution.[77] The Court of Appeal set aside the purported terms on the basis of sham, stating that they did not represent or describe the true relationship between the parties.[78]

Again, in *Autoclenz Ltd v Belcher and others*,[79] the Supreme Court (UK) set aside the purported written terms of the employment contracts between the company and claimants, twenty valeters who provided car-cleaning services for the company on the basis of a sham. In all these cases, the relevant factual circumstance (ie, inequality of bargaining power) seems to be the common factor that prompted the courts to set aside the impugned terms on the basis that they did not accurately reflect the reality of the situations. In other words, they were found to be shams.

[72]See Susan Bright, 'Avoiding Tenancy Legislation: Sham and Contracting Out Revisited' (2002) 61 Cambridge Law Journal 146. See also Douglas Brodie, 'The Autonomy of the Common Law of the Contract of Employment from the General Law of Contract', in Alan Bogg et al (eds), *The Contract of Employment* (Oxford University Press 2016) 131.

[73]See Davies (n 52).

[74][1990] 1 AC 417 (*Antoniades*).

[75]ibid 431 (Lord Fox).

[76][2009] EWCA Civ 98.

[77]See eg, *Express and Echo Publications Ltd v Tanton* [1999] ICR 693. A limited power of substitution, however, may be permitted by some employment contracts as indicated in *MacFarlane v Glasgow CC* [2001] IRLR 7.

[78][2009] EWCA Civ 98, [55] (Smith LJ).

[79][2011] UKSC 41 (*Autoclenz*).

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It is clear that in the examples above, the motive for the sham agreements was to avoid the statutory duties the landlords and employers would otherwise have. Therefore, rather than considering these agreements as those intended to defeat the law under section 24(b) of the Contracts Act 1950, they could be considered as agreements impliedly forbidden by law under section 24(a) of the Act, in which case the shamming intention on the part of the parties becomes irrelevant. Instead, the relevant statutory provisions would need to be interpreted in light of the purpose behind passing the statute to see if the purported agreements or their terms are forbidden. This well-established statutory interpretation rule advocates the interpretation of a statute or any of its provisions in the context of the statute's wider purpose.[80]

For example, in *Antoniades* the court could have applied the purposive interpretation rule to the relevant provisions in the Rent Act 1977 to conclude that the clause in the lease contract that denied the lessees the exclusive possession was a sham, as it contravened the intent of the Rent Act. Likewise, in *Autoclenz*, the decision on sham could have been justified by the finding that the written employment contracts were concluded so that the company may avoid certain obligations which otherwise would have been imposed on it by *the National Minimum Wage Regulations* 1999 and *Working Time Regulations* 1998 if the claimants were considered as 'workers'. The purposive interpretation of the relevant provisions of the Regulations would have shown that they had been enacted precisely to provide protections and benefits to individuals like claimants (ie, workers).

Many commentators have suggested that the misleading or fraudulent nature of a transaction or document should, on its own, be sufficient justification for the finding of sham in situations where the interests of justice so require (such as in situations involving inequality of bargaining power).[81] They argued that the mutuality of shamming intention should not be required to justify the court's intervention.[82] This requirement, according to them, has significantly narrowed the scope of the doctrine's practical utility.[83] In some situations, it may have even rendered the entire concept of sham redundant.[84]

In line with these criticisms, it has been said that the courts in the United States[85] and South Africa[86] have been applying a broader concept of sham that is both flexible and receptive to the relevant factual circumstances. They have also been willing to construe the written terms of contracts with reference to the purpose of the relevant statutory provisions (eg, legislative intent). As a result, the doctrine of sham remains to be viewed as a doctrine of wide utility in these jurisdictions. The courts in other common law jurisdictions, such as Australia[87] and Canada[88], have been quite content with the *Snook* restrictive formulation of sham. They occasionally made some inroads into the idea of a wider doctrine of sham but eventually returned to *Snook*.

The *Snook* formulation of sham has also been regularly cited by the courts in Malaysia, but the way the concept is interpreted and applied suggests that the broader formulation of sham has begun to gain greater support among judges and jurists. For instance, in *Kuppusamy v Anggamah & Anor,*[89] the High Court held that the tenancy agreement between the subtenant and the chief tenant

[80]The purposive statutory interpretation has been lucidly discussed by Philip P Frickey, 'Structuring Purposive Statutory Interpretation: An American Perspective' (2006) 80 Australian Law Journal 849.

[81]See eg, Simpson & Stewart, 'Introduction: "Sham" Transactions' (n 31) 9.

[82]ibid.

[83]See Justice Sizan Glazebrook's discussion of the doctrine in New Zealand's context in *Official Assignee v Wilson* [2007] NZCA 122; [2008] 3 NZLR 45.

[84]See Natalie Lee, 'The Concept of Sham: A Fiction or Reality' (1996) 47 Northern Ireland Legal Quarterly 377, 384.

[85]See Joshua D Blank & Nancy Staudt, 'Sham Transactions in the United States', in Edwin Simpson & Miranda Stewart (eds), *Sham Transactions* (Oxford University Press 2013) 68.

[86]See Andrew Hutchinson & Dale Hutchinson, 'Simulated Transactions and the Fraus Logis Doctrine' (2014) 131 The South African Law Journal 69.

[87]See Stewart, 'The Judicial Doctrine in Australia' (n 31) 51.

[88]See Sprysak (n 31).

[89][1992] 1 MLJ 602 (*Kuppusamy*).

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was unenforceable as it was concluded to deprive the landlord of rightfully repossessing the disputed property, which was subject to the *Control of Rent Act* 1966 (Malaysia).[90] The court seemingly cited *Snook* with approval but then decided that the agreement was illegal as it contravened section 20(1)(a) of the Control of Rent Act. So, the mutuality of shamming intention requirement was irrelevant here, given that the agreement was impliedly forbidden by law. In other words, the court only considered the legislative intent.

Conclusion

This article sought to achieve two main objectives. The first was to demonstrate that agreements forbidden by law under section 24(a) are different from the agreements to defeat the law under section 24(b) of the Contracts Act 1950. The difference can only be fully appreciated if subsection (b) is considered in light of the common law doctrine of sham. This brings us to the second main objective of the article, which is how to know if the agreement in question is a sham. This decision should not be taken lightly because the types of agreements that would mostly be considered under this category of illegality are those that are *ex facie* legal. It is only after the agreements are scrutinised more closely, specifically with reference to the contracting parties' intention, that it becomes obvious that they, too, are illegal as the parties have concluded them to defeat the law. The key emphasis here is on the requirement of 'commonality of shamming intention'. It must be proven that all parties to the contract must have intended (or colluded) to circumvent the law. Future research could discuss the illegality doctrine with reference to agreements found to be fraudulent under section 24(c), those involving injury to the person or property of another under section 24(d), and agreements that the court regards as immoral or opposed to public policy under section 24(e) of the Contracts Act 1950.

[90]ibid 620.

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