THE ILLEGALITY DEFENCE FOLLOWING

Patel v Mirza [2016] UKSC 42

Ronelp Marine Ltd & others v STX Offshore & Shipbuilding Co Ltd & another [2016] EWHC 2228 (Ch) at [36]:

"36 Counsel for STX argued that once the underlying factual disputes about how the Sideletter came into being had been resolved, the English law on illegality was "clear and well-known". This struck me as a bold submission in the light of the changes in the law even since the point was pleaded in the Commercial Court action. One only has to read the judgments in Patel v Mirza [2016] UKSC 42 to appreciate how accurate was the description by Prof Andrew Burrows in his "Restatement of the English Law Contract" (OUP, 2016) of the law of illegality as being "in a state of flux" (p.221), and the observation of Lord Neuberger (at paragraph [164]) that the different approaches adopted by members of the Supreme Court in recent cases had "left the law on the topic in the some disarray". That state has not been brought to an end by the decision that in the application of the doctrine of illegality regard must be had to the policy factors involved and to the nature and circumstances of the illegal conduct in determining whether the public interest in preserving the integrity of the judicial system should result in denial (on the grounds of illegality) of the relief claimed (see the judgment of Lord Toulson — with whom Baroness Hale, Lord Kerr, Lord Wilson and Lord Hodge agreed — paragraph [120]). Of course Patel v Mirza does render relatively clear and certain the law on illegality where a claimant has paid money to a defendant to carry out an illegal activity, and the illegal activity is not proceeded with. But that is not relevant to the dispute about the Zodiac Contracts: and the Supreme Court was clearly divided as to the extent to which the rule so articulated applied in other scenarios."

LEGAL PRINCIPLES PRE-PATEL

Illegality is a defence to all civil claims

"No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act" – per Lord Mansfield CJ in **Holman v Johnson (1775) 1 Cowp 341 at 343**

Insofar as justification was required for this it is provided by 2 underlying principles namely, (a) person should not be allowed to profit from his own wrongdoing and (b) the law should be consistent and not self-defeating in that what is condemned in one part of the law should not be given effect to or enforced in another part of the law.

Unfortunately in the application and development of the jurisprudence in relation to the defence of illegality sight was lost of this starting point and in particular the words: *"founds his cause of action upon".*

Confusion was introduced by the consideration of different aspects of illegality (e.g. legal contract to be performed illegally, legal contract to be performed illegally by one party with/without the knowledge of the other party, a contract that involved partial illegality etc). Some clarification being introduced by Lord Denning in **JM Allan (Merchandising) Limited v Cloke [1963] 2 QB 340 at 348** when he stated: *"active participation debars, but knowledge of itself does not".*

In **Tinsley v Milligan [1994] 1 AC 340**, the HL reverted back to the principles underlying the defence and found that a claim would be precluded where the claimant needs to rely on his own illegality to establish the claim save where the claimant has taken advantage of the locus poenitentiae (the opportunity of withdrawal) before the illegality was commissioned ("the Exception").

Whilst the reasoning of this decision (but not the result) was criticised, it did provide a reasoned and rule based approach to the application of the defence that was grounded in the originating principles. Further, with the benefit of the clarifications/modifications provided by the minority in **Patel,** is preferable to the "value judgment" approach laid down by the majority in **Patel**.

PATEL v MIRZA [2016] UKSC 42

Facts

C gave D £620,000 for D to use in betting on the movement of shares using inside information. The agreement was contrary to *s52 Criminal Justice Act 1993* and amounted to a conspiracy to commit an offence pursuant to this section. The betting never took place because the promised information never materialised. C claimed the return of the £620,000. D refused to repay the same and relied upon the defence of illegality.

Common Sense?

On what conceivable basis (however it is dressed up) could the position that C does not recover and D retains this sum be contemplated?

First Instance

Claim dismissed as the Judge found it was barred by illegality. The Judge applied **Tinsley** and concluded that in order to found his claim (whether in contract or restitution) Patel had to rely upon the illegal purpose of the agreement and the fact that that purpose was not fulfilled thereby giving rise to the right of repayment whether in contract or restitution.

Court of Appeal

Allowed the appeal. The majority allowed the appeal on the basis that whilst the Judge was correct to find that the claim was barred by illegality it ought to have been found that Patel fell within the Exception because the contract was never completed and the illegality discharged.

Gloster LJ allowed the appeal on the basis that she did not believe it was necessary for Patel to rely upon the illegal purpose of the agreement as all he needed to prove was that the sum had been paid for the purpose of betting on shares and that betting did not take place – it was irrelevant that the betting was intended to be with the benefit of "insider information".

Gloster LJ in effect started the "line of thought" that led to the majority decision in the Supreme Court. She stated that **Tinsley** did not lay down a rule of universal application in cases where there was reliance on illegality and there needed to be a consideration of whether or not allowing the claim would contravene the rules that created the illegality or public policy in general and whether or not denying the claim would be a proportionate response to the illegality in all the circumstances.

Commentary

Gloster LJ's reason for allowing the appeal i.e. there was no reliance on illegality was the correct approach as it was a straight forward application of the principles applicable to a claim in unjust enrichment and appreciated the fact that the unjust enrichment arose irrespective of whether or not there was illegality.

Supreme Court

Issue – Is a party to a contract tainted by illegality precluded from recovering money paid under the contract from the other party under the law of unjust enrichment?

Answer – *"A Claimant……who satisfies the ordinary requirements of a claim for unjust enrichment, should not be debarred from enforcing his claim by reason only of the fact that the money which he seeks to recover was paid for an unlawful purpose"* [121] – Cross-refer to the "Common Sense" Observation above.

Whilst the outcome of the appeal (i.e. the decision of the CA was upheld), there was a difference in approach as to the reasoning underlying the same being a difference in approach between "the value judgment/proportionate response" of the majority and the "rules based approach" of the minority.

The decision of the majority (5-4) is not founded on any previous authority or approach, disregards the originating principles of the doctrine and, in an area of law where there was a clamour for clarity and certainty of approach/principle, it has introduced a 3 stage value assessment to be conducted by the Court with no principles to govern how the assessment is to be undertaken.

To put the decision of the majority in context, the views of 3 of the 4 minority (in particular Lords Clarke, Mance and Sumption) should be considered. Their approach is founded on principle and does not involve a departure from the "reliance" approach set out in **Tinsley** but a "tidying up" or clarification of the same.

Lord Neuberger confined himself to a "Rule" specifically formulated by reference to the facts of the case but finding its genesis in **Tinsley –** a claimant is entitled to the return of his money when claim is not based on an illegal or immoral arrangement.

The Minority

- Determining the application of the doctrine by reference to considerations of public policy provides no clear guidance
- Need firm doctrinal foundations and limits
- The doctrine does not need to be re-written just understood
- The doctrine was designed to ensure that the Courts would not allow a person to profit from illegal conduct/contract and that an illegal contract would not be enforced.
- **Tinsley** should be re-cast – a claim will be precluded where the claimant is seeking by the claim to realise a profit from illegal conduct/pursuant to an illegal contract or is seeking to enforce an illegal contract.
- The Exception is "mis-cast" and actually explains the circumstances in which illegality will not preclude a claim – there should be no bar to the Courts restoring parties to the position that they would/should have been in prior to the illegal contract/conduct as this involves no reliance upon the illegal conduct or contract for profit

The Majority

Followed the approach of Gloster LJ and devised a 3 stage test to be considered in future cases:

1. Consider the underlying purpose of the prohibition, which has been transgressed?
2. Consider any other relevant public policy on which the denial of the claim may have an impact?
3. Would the denial of the claim be a proportionate response to the illegality bearing in mind that punishment is for the Criminal Courts?

Problems (apart from the fact that no grounding in authority or principle and there is no good reason to depart from the rules based approach advocated by the minority):

1. No guidance as to the approach to be adopted by the Court at each stage – e.g. under stage 1 – what should you consider? What outcome of the consideration will justify in proceeding to stage 2?

2. What “prohibition” are you to consider? Easy in a case where a criminal offence (e.g. as in **Patel**) has been considered but what about (as illustrated in **Singularis Holdings Limited (in official liquidation) v Daiwa Capital Markets Europe Limited [2017] EWHC 257 at [216] – [220].**

3. Alleged that claim in negligence defeated by illegality the illegality being (a) the breach of fiduciary duty by the director of the C in procuring the relevant payments and (b) his production of false documents in order to procure the payments. Court proceeded to consider what is the purpose behind a prohibition on a breach of fiduciary duty and relying on false documents!!!! [218]. The analysis that the Judge was forced to go through by virtue of this test demonstrates how the first stage does not comfortably fit in with all “illegal” conduct that the Court will be called upon to consider.

Summary

This is another poor decision from the Supreme Court that has actually managed to add to the uncertainty and confusion surrounding the doctrine of illegality and laid down an approach to be applied in future cases that is not fit for purpose. This is the more alarming in circumstances where the Minority had actually provided clarification and a way forward that was founded in authority and principle and was capable of application by reference to principle as opposed to value judgments.

MARK HARPER QC

5 May 2017