PATEL v MIRZA: A NEW APPROACH TO THE ILLEGALITY DEFENCE

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Abstract

In a landmark decision, a full bench of nine Justices of the United Kingdom Supreme Court in *Patel v Mirza* [2016] UKSC 42, [2017] AC 467 reviewed the proper approach to be taken by courts when confronted with a defence of illegality in private law claims. The claim in question was for the restitution of unjust enrichment arising out of a failed contract in which the claimant had paid a sum of money to the defendant pursuant to an illegal purpose that did not materialise. The Supreme Court unanimously allowed restitution, but there was a sharp difference in opinion on the proper approach to be adopted towards the illegality defence. A majority of the Supreme Court prescribed a new approach which the minority rejected. Whilst the new approach was formulated in the context of a claim for the restitution of unjust enrichment, it is arguable that the majority intended it to apply in all the other areas of private law involving the illegality defence. This paper seeks to examine how, if at all, the new approach has settled or clarified English law in the confused and confusing area of illegality.

Keywords: defence of illegality, recovery claims, rejection of rule-based approach, trio of considerations, proportionate response

1. Introduction

Illegality has the potential to provide a defence to civil claims of all sorts, whether relating to contract, property, tort or unjust enrichment, and in a wide variety of circumstances[23]. This paper does not seek or purport to answer the question what kind of illegality triggers the illegality defence. This question is best answered by reference to any standard contract law text-book, although there is no uniform categorisation of when the illegality defence is engaged. Suffice it to say that whilst it is tempting to think that any and all types of legal wrong or transgressions of public policy will engage the illegality defence, that is not the case.

[23] Per Lord Toulson in *Patel v Mirza* [2016] UKSC 42 at [2]

Before *Patel v Mirza*[24] courts adopted a rule-based approach i.e. generally, the courts would not assist any claimant but would do so in certain exceptional situations. This approach was widely criticised. Despite undertaking a review, the United Kingdom Law Commission, did not recommend any reform. Accordingly, the United Kingdom Supreme Court responded to these criticisms in *Patel v Mirza*, formulating a new open-textured, multi-factorial approach with emphasis on the need for a proportionate response.
The question that this paper seeks to analyse is whether the new approach is satisfactory, to see if it has brought or will bring any clarity to this law. This will be done by examining the illegality defence, the pre-*Patel v Mirza* approach towards the applicability of the defence, the criticisms of such approach, followed by a detailed analysis of the decision in *Patel v Mirza* itself, before critically analysing the new approach formulated by the United Kingdom Supreme Court.

2. The Illegality Defence

This defence, which has been adopted in Malaysia[25], has its foundation in Lord Mansfield CJ's oft-repeated *obiter dictum* in *Holman v Johnson*[26] (a claim in contract):

> The principle of public policy is this: *ex dolo malo non oritur actio.* No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the Court says he has no right to be assisted.

The words 'lend its aid' and 'no right to be assisted' suggest that courts will not, in any circumstances, grant any remedy to a plaintiff if his claim is grounded on illegality, and that this may be so whether, in connection to the particular illegality in question, such plaintiff seeks to enforce some unperformed obligations on the part of the defendant or whether the plaintiff seeks to recover any benefits thereby conferred on the defendant. In short, illegality, prima facie, provides an iron-clad defence to both enforcement claims and restitution claims.

[24] [2016] UKSC 42
[25] See, e.g., Contracts Act 1950 s 24: Every agreement of which the object or consideration is unlawful is void.
[26] (1775) 1 Cowp 341, 343

2.1. Public Policy Justifying the Illegality Defence

Lord Mansfied's dictum, supra, clearly indicates that public policy[27] underpins the illegality defence. At least three broad possible public policy considerations have been put forward to justify the illegality defence:

2.1.1. Maintaining the dignity of the courts

Atiyah identifies the policy to be 'the undesirability of jeopardising the dignity of the courts.[28] The illegality defence has been described as a rule of 'judicial abstention' that 'precludes the judge from performing his ordinary adjudicative function in a case where that would lend the authority of the state to the enforcement of an illegal transaction or to the determination of the legal consequences of an illegal act.'[29] Whilst it is easy to see that the dignity of the courts would be offended in allowing a remedy to a plaintiff, for example, in cases involving gross immorality[30] or commission of serious criminal offences[31], it is questionable whether the same is the case where the plaintiff's infringement is innocent[32] or if the infringement is merely of, say, some regulatory legislation.[33]

2.1.2. Deterrence

The idea is that the courts' refusal to grant a remedy will deter persons from entering into illegal transactions. This 'rests upon the rather dubious assumption that everyone knows the law and will take heed of its deterrent effect. Deterrence is also properly the function of the criminal law, not the civil law.'[34] Phillip Sheperd QC, counsel for Patel, pithily dismissed the deterrence argument during submissions before the UK Supreme Court, stating, 'The difficulty with the deterrence argument is: who is being deterred? The

[27] Public policy was famously described as an "unruly horse" by Burroughs J in *Richardson v Mellish* (1842) 2 Bing 229 at 252

[28] Atiyah, PS, *An Introduction to the Law of Contract*, (1995, 5th ed, Oxford: Clarendon Press

[29] Per Lord Sumption in *Les Laboratories Servier v Apotex Inc* [2014] UKSC 55 at [23]

[30] See, for example, illustrations (j) and (k) to the Malaysian Contracts Act 1950 s 24

[31] But, see the startling observations by Lord Sumption at [253] – [254] in *Patel v Mirza* [2016] UKSC 42: "The rational rule, which I would hold to be the law, is that restitution is available for so long as mutual restitution of benefits remains possible…I would also reject the dicta…to the effect that there may be some crimes so heinous that the courts will decline to award restitution in any circumstances."

[32] See the discussion on the 'not *in pari delicto'* principle at paragraph 3 below

[33] In such situations courts have allowed plaintiffs to enforce agreements by focusing on the purpose of the legislation in question and whether there is a sufficiently close connection or link between the claim and the illegality. See, for example, *Shaw v Groom* [1970] 2 QB 504; *St John Shipping Corp v Joseph Rank Ltd* [1956] 3 All ER 683; *Hopewell Construction Co Ltd v Eastern & Oriental Hotel (1951) Sdn Bhd* [1988] 2 MLJ 621; *Ling Wah Press Sdn Bhd v Pustaka Utama Pelajaran Sdn Bhd* [1994] 3 CLJ 346.

[34] Ewan McKendrick, *Contract Law*, Palgrave, 11th edition (2015), page 269

defendant, if he succeeds will have been positively encouraged. So, deterrence as a policy is problematic.'[35]

2.1.3. Maintaining the integrity of the judicial system

Enonchong states that the policy is to protect 'the integrity of the judicial system by ensuring that the courts are not seen by law-abiding members of the community to be lending their assistance to claimants who have defied the law.'[36]

McLachlin J in the Canadian Supreme Court case of *Hall v Herbert*[37] further explains:

…to allow recovery in these cases would be to allow recovery for what is illegal. It would put the courts in the position of saying that the same conduct is legal, in the sense of being capable of rectification by the court, and illegal. It would, in short, introduce an inconsistency in the law…the law must aspire to be a unified institution, the parts of which – contract, tort, the criminal law – must be in essential harmony. For the courts to punish conduct with the one hand while rewarding it with the other, would be to "create an intolerable fissure in the law's conceptually seamless web…"…We thus see that the concern, put at its most fundamental, is with the integrity of the legal system.

2.2. A competing policy consideration

Clearly, a strict and absolute application of the illegality defence allows the defendant to escape all liability irrespective of the merits of the plaintiff's claim, and no matter how unmeritorious or reprehensible the conduct of the defendant may have been. As stated by Lord Goff in *Tinsley v Milligan*[38]:

[I]t is a principle of policy, whose application is indiscriminate and so can lead to unfair consequences as between the parties to the litigation. Moreover the principle allows no room for the exercise of any discretion by the court in favour of one party or the other.

Such 'an unforgiving and uncompromising'[39] doctrine is not only productive of injustice in some instances, it also runs counter to a competing public policy consideration of general application in law – that a person must not be allowed to gain from his own wrongdoing. As Lord Sumption stated in *Les Laboratoires Serviers and another v Apotex Inc and another*[40]:

[35] *Patel v Mirza* [2017] AC 467 at 473
[36] Enonchong, N, *Illegal Transactions* (1998) London: Lloyd's of London Press
[37] (1993) 101 DLR (4th) 129, 165
[38] [1994] 1 AC 340, 355
[39] *Stone & Rolls Ltd (in liquidation) v Moore Stephens (a firm)* [2009] UKHL 39, [2009] 1 AC 1391, per Lord Walker at [185]
[40] [2014] UKSC 55, [2015] AC 430 at [18]

The doctrine necessarily operates harshly in some cases, for it is relevant only to bar claims which would otherwise have succeeded. For this reason it is in the nature of things bound to confer capricious benefits on defendants some of whom have little to be said for them in the way of merits, legal or otherwise.

The law had therefore steered 'a middle course between two unacceptable positions': as succinctly highlighted by Bingham LJ in *Saunders v Edwards'*[41]:

On the one hand it is unacceptable that any court of law should aid or lend its authority to a party seeking to pursue or enforce an object or agreement which the law prohibits. On the other hand, it is unacceptable that the court should, on the first indication of unlawfulness affecting any aspect of a transaction, draw up its skirts and refuse all assistance to the plaintiff, no matter how serious his loss nor how disproportionate his loss to the unlawfulness of his conduct.

3. Pre-Patel v Mirza Approach

Having due regard to the conflicting public policy considerations in play, the courts developed a rule-based approach in determining the outcome of a claim tainted by illegality. Put simply, the rule-based approach involved the courts adopting a formulaic approach whereby the illegality defence would apply unless the plaintiff's claim fell within one or more of three broad exceptional categories of circumstances, outlined below, in which event the plaintiff would be granted a remedy notwithstanding the illegality.

3.1. Plaintiff not in pari delicto

This exception has its origins in Lord Mansfield CJ's *obiter dictum* that 'if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally in fault, [*in pari delicto*] *potior est conditio defendentis*'[42]. This means that in the case of mutual fault, the position of the defendant is the stronger one, so that the court will refuse to assist the plaintiff and let the loss lie where it falls. Conversely, therefore, if the plaintiff were not *in pari delicto* (i.e. is less at fault than the defendant for the illegality concerned) the plaintiff's claim would be allowed.[43] In Malaysia the not *in pari*

[41] [1987] 1 WLR 1116, 1134

[42] (1775) 1 Cowp 341, 343

[43] For examples of the operation of the not *in pari delicto* exception see *Oom v Bruce* (1810) 12 East 225; *Hughes v Liverpool Victoria Friendly Society* [1916] 2 KB 482; *Kiriri Cotton Co Ltd v Dewani* [1960] AC 192, PC; *Mohamed v Alaga & Co* [2000] 1 WLR 1815

delicto principle is said to be found in the words of the Contracts Act 1950, section 66.[44]

3.2. Plaintiff not relying on the illegality

In *Bowmakers Ltd v Barnet Instruments Ltd*[45] the English Court of Appeal held to the effect that a plaintiff could successfully bring a claim for conversion in respect of goods let to the defendant under hire-purchase agreements tainted with illegality so long as the plaintiff did not have to rely on the illegality to establish his title to the property:

…a man's right to possess his own chattels will as a general rule be enforced against one who, without any claim of right, is detaining them, or has converted them to his own use, even though it may appear either from the pleadings, or in the course of the trial, that the chattels in question came into the defendant's possession by reason of an illegal contract between himself and the plaintiff, provided that the plaintiff does not seek, and is not forced, either to found his claim on the illegal contract or to plead its illegality in order to support his claim.[46]

In Malaysia, *Sajan Singh v Sardara Ali*[47], is authority for the proposition that a recovery claim will be allowed so long as the plaintiff does not rely on the illegality.

The majority decision of the House of Lords in *Tinsley v Milligan*[48] represents the high-water mark of the application of the no reliance principle, which extended its application to proprietary claims in equity. Milligan had contributed equally to the purchase price of a property which was put into Tinsley's sole name. Under trusts law, such a contribution gave rise to a rebuttable presumption of a resulting trust over a half share in the property in Milligan's favour. Tinsley sought to rebut this presumption by leading evidence of the illegal purpose of this transaction, which was known to both parties, and in which Milligan had participated, namely, to enable Tinsley to make false social security claims based on her (Tinsley's) registered ownership. The majority of the House of Lords held that Milligan's equitable proprietary right arose independently of the illegality. The source of her right was simply her contribution to the purchase price so that she did not have to rely on her own illegality in establishing her right. Accordingly, notwithstanding the maxim that

[44] *Ng Siew San v Menaka* [1973] 2 MLJ 154, FC affirmed in *Ng Siew San v Menaka* [1977] 1 MLJ 91, PC; *Ismail v Haji Taib* [1972] 1 MLJ 259, FC
[45] [1945] KB 65
[46] *ibid* at 71 per Du Parcq LJ
[47] [1960] 1 MLJ 52, PC
[48] [1994] 1 AC 340. See also *Malayan Banking Bhd v Neway Development Sdn Bhd & Ors* [2017] 5 MLJ 180, FC at [27] which is one of several Malaysian cases that cites *Tinsley v Milligan* with approval with regard to the no reliance principle

he who comes to equity must come with clean hands, the illegality defence failed, and Milligan was allowed to vindicate her equitable proprietary right.

3.3. The timely withdrawal or locus poenitentiae principle

This principle may be seen as an exception to the rule that a plaintiff may not rely on his own illegality. The rationale for this principle is to encourage parties to back out of an illegal purpose before it has been carried out. Basically, under this principle, a restitution claim would succeed if the plaintiff withdraws from the illegal purpose before any part of it had been carried out notwithstanding his reliance on his own illegality to explain how the property, the recovery of which he seeks, came to be in the defendant's name or possession[49].

Originally, the plaintiff also needed to show genuine repentance on his part[50]. However, this requirement was subsequently held to be unnecessary in *Tribe v Tribe*[51] where the plaintiff's withdrawal from the illegal purpose came about in purely fortuitous circumstances. Fully intending to defraud his creditors, the plaintiff transferred his shares in a company to his son (the defendant) so as to put them beyond the reach of his creditors. However, due to a change in circumstances over which he had no control, his need to defraud creditors disappeared. He then sought recovery of the shares. The defendant raised the rebuttable presumption of advancement to establish his title to the shares. The plaintiff sought to rely on the presumption of a resulting trust by pleading facts showing that his true intention was not to make a gift but to avoid the danger of losing his shares to creditors. The Court of Appeal held that he could lead evidence of the true purpose of the transfer, even though such purpose was fraudulent, to rebut the presumption of advancement as he had withdrawn from the transaction before any part of the illegal purpose had been carried into effect. With regard to the need for repentance, Millet LJ said[52]:

…genuine repentance is not required. Justice is not a reward for merit; restitution should not be confined to the penitent….voluntary withdrawal from an illegal transaction when it has ceased to be needed is sufficient.

In Malaysia, the withdrawal principle was recognised in *Palaniappa Chettiar v Arunasalam Chettiar*[53] although, on the facts, it did not apply as the illegal purpose had in fact been fully carried out thereby depriving the plaintiff any chance of timeous withdrawal.

[49] *Taylor v Bowers* (1876) 1 QBD 291; *Tribe v Tribe* [1996] Ch 107

[50] *Bigos v Boustead* [1951] 1 All ER 92 (where the plaintiff 'withdrew' not because he genuinely repented, but because the illegal purpose had been frustrated by external circumstances)

[51] [1996] Ch 107, [1995] 3 WLR 913

[52] *Ibid* at 938

[53] [1962] MLJ 143, PC

The Court of Appeal in *Tinsley v Milligan*[54] (Ralph Gibson LJ dissenting) after reviewing four English authorities[55] advocated the adoption of a flexible 'public conscience' test that addresses policy considerations rather than the rule-based approach when deciding whether or not grant relief to a plaintiff in cases of illegality:

These authorities seem to me to establish that when applying the "ex turpi causa" maxim in a case in which a defence of illegality has been raised, the court should keep in mind that the underlying principle is the so-called public conscience test. The court must weigh, or balance, the adverse consequences of granting relief against the adverse consequences of refusing relief. The ultimate decision calls for a value judgment.[56]

However, on appeal to the House of Lords[57], the public conscience test was unanimously rejected. In his minority judgment Lord Goff stated:

There is no trace of any such principle forming part of the decisions in any of the cases in question. It follows that…it was not open to the majority of the Court of Appeal to dismiss the appellant's claim on the basis of the public conscience test invoked by Nicholls L.J., or indeed on the basis of the flexible approach adopted by Lloyd L.J…[58]

Lord Browne-Wilkinson, in turn in his majority judgment said:

[T]he consequences of being a party to an illegal transaction cannot depend, as the majority in the Court of Appeal held, on such an imponderable factor as the extent to which the public conscience would be affronted by recognising rights created by illegal transactions.[59]

The House of Lords' decision in *Tinsley v Milligan* thus laid to rest the public conscience test, which Lord Goff regarded as being the same as exercising judicial discretion[60]. However, it is more than arguable that it has now been resurrected by *Patel v Mirza* albeit stated in a modified form.

3.4. Calls for Reform

The law on illegality, and the rule-based approach, in general, and *Tinsley v Milligan* and the 'no-reliance' principle, in particular, were never free from

[54] [1992] Ch 310
[55] *Saunders v. Edwards* [1987] 1 W.L.R. 1116; *Euro-Diam Ltd. v. Bathurst* [1990] 1 Q.B. 1; *Pitts v. Hunt* [1991] 1 Q.B. 24; *Howard v. Shirlstar Container Transport Ltd*. [1990] 1 W.L.R. 1292
[56] *Ibid* Per Nicholls LJ at 319-320
[57] *Tinsley v Milligan* [1994] 1 AC 340
[58] *Ibid* at 361
[59] *Ibid* at 369
[60] *Ibid* at 358

criticism.[61] The Law Commission of England and Wales described the effect of unlawful performance on parties' contractual rights as "very unclear" in its Consultative Report[62], and in the Court of Appeal in *Patel v Mirza* Gloster LJ observed as follows[63]:

As any hapless law student attempting to grapple with the concept of illegality knows, it is almost impossible to ascertain or articulate principled rules from the authorities relating to the recovery of money or other assets paid or transferred under illegal contracts. This court frankly recognised in *Tribe v Tribe* [1996] Ch 107 (per Nourse LJ, at p 121, and per Millett LJ, at p 135) that the authorities are irreconcilable.

With regard to the rule-based approach, it cannot be denied that, prima facie, legal rules promote certainty, consistency and predictability of the law, whilst judicial discretions tend to undermine these qualities. But, what if the legal rules themselves are complex, and uncertain and fluid in application as the Law Commission and Gloster LJ recognised? Or, what if a rule such as the no reliance principle, can lead to results that could be explicable on technical grounds, but does nothing to further the policy of the underlying legal prohibition?

Surely then, a strong argument can be made for replacing such rules with judicial discretion which gives judges the flexibility to come up with the most appropriate solution in the circumstances by having regard to all relevant policy considerations.

A brief analysis of *Tinsley v Millgan* suffices to show the inherent problems with the no reliance principle. In *Tinsley v Milligan* Lord Browne-Wilkinson explained the application of the reliance principle as follows[64]:

Where the presumption of resulting trust applies, the plaintiff does not have to rely on the illegality. If he proves that the property is vested in the defendant alone, but that the plaintiff provided part of the purchase money, or voluntarily transferred the property to the defendant, the plaintiff establishes his claim under a resulting trust unless either the contrary presumption of advancement displaces the presumption of resulting trust or the defendant leads evidence to rebut the presumption of resulting trust. Therefore, in cases where the presumption of advancement does not apply a plaintiff can establish his equitable interest in the property without relying in any on the underlying illegal transaction.

[61] For an excellent summary of the difficulty surrounding the law of illegality, please see Andrew Burrows, *Restatement of the English Law of Contract* (OUP 2016) pages 221--222
[62] 'The Illegality Defence: A Consultative Report (2009)' (Consultation Paper No. 189, para 3.27)
[63] [2015] Ch 271 at [47]
[64] [1993] 3 All ER 65 at 87, HL

On the facts, Tinsley was unable to rebut the presumption of resulting trust. The presumption of advancement did not apply in her favour as she and Millgan were not in any of the recognised categories of relationship giving rise to this presumption. She was also unable to lead any evidence to rebut the presumption of resulting trust.

But, if the presumption of advancement had applied in *Tinsley v Milligan*, it is unlikely that Milligan would have succeeded. As Lord Browne-Wilkinson explained[65]:

In such a case, unlike the case where the presumption of resulting trust applies, in order to establish any claim the plaintiff has himself to lead evidence sufficient to rebut the presumption of gift and in so doing will normally have to plead, and give evidence of, the underlying illegal purpose.

Three related points emerge clearly from these two passages. Firstly, the no reliance principle approach is uncertain in scope and effect. Secondly, application of the principle depends on how the plaintiff pleads his case. If 'correctly' pleaded, he succeeds without any consideration to whether the policy underlying the prohibition is advanced or stultified by allowing his claim. Thirdly, the outcome of cases involving apparent gifts in transactions tainted with illegality depends on the type of relationship between transferor and transferee. In short, the no reliance rule was short on principle.

Not surprisingly the no reliance principle came in for strong academic criticism[66]. English Courts expressed disquiet even as they applied it[67]. The principle fared no better in other common law jurisdictions. For example, in Australia, the High Court in *Nelson v Nelson*[68] rejected the no reliance principle as the test of enforceability. Dawson J described this principle as wholly unjustifiable on any policy ground[69]. Toohey J highlighted that for the outcome of a particular case 'to be determined by the procedural aspects of a claim for relief is at odds with the broad considerations necessarily involved in questions of public policy'[70].

And in the Canadian Federal Court of Appeal, Robertson JA spoke of the difficulty with the exceptions to the classical model of the illegality defence as arising from "the legal manoeuvering that must take place to arrive at what is

[65] *ibid*
[66] See generally Berg [1993] JBL 513; Cohen [1994] LMCLQ 163; Enonchong (1994) 14 OJLS 295; Goo (1994) 45 NILQ
[67] See, for example, comments of Robert Walker LJ in *Lowson v Coombs* [1999] Ch 373 at 385, and Nourse LJ in *Silverwood v Silverwood* (1997) 74 P & CR 453 at 458-459
[68] (1995) 132 ALR 133
[69] *Ibid* at 166
[70] *Nelson v Nelson* (1995) 184 CLR 538 at 597

considered a just result"[71] and expressed the view that since the doctrine of illegality rested on public policy considerations "it is only appropriate to identify those public policy considerations which outweigh" the plaintiff's *prima facie* right to relief.[72]

Following *Tinsley v Milligan* the Law Commission of England and Wales included the illegality defence in the Sixth Programme of Law Reform (1995). Its first consultation paper, in 1999[73], recommended statutory reform by replacing the existing 'technical and complex rules' by a general judicial discretion[74] by way of statutory reform along the lines of the New Zealand Illegal Contracts Act 1970[75]. The second consultation paper, in 2009 noted the success of the New Zealand Act[76]. However, in its final confirmatory report, in 2010[77], the Law Commission concluded that although there were serious problems relating to the effect of illegality[78], the law of contract and unjust enrichment should continue to be developed by the courts. With regard to trusts law, statutory reform was recommended along the lines of a draft bill[79], but no legislation has been forthcoming.

With no reform forthcoming, English courts continued to grapple with the proper approach to the illegality defence. A discernible trend emerged. It favoured a flexible approach of applying judicial discretion after consideration of a range of factors and identifying the relevant competing policy considerations with a view to protecting the integrity of the legal system, rather than a strict rule based approach.[80]
In *Les Laboratoires Servier v Apotex Inc*[81] Etherton LJ described both counsel's rule based approach as "too dogmatic and inflexible"[82] and instead chose to follow the Law Commission's recommended approach:

that the illegality defence should be allowed where its application can be firmly justified by one or more of the following policies underlying its existence:

[71] *Still v Minister of National Revenue* (1997) 154 DLR (4th) 22 at para 24
[72] *Ibid* at para 49
[73] 'Illegal Transactions: The Effect of Illegality on Contracts and Trusts' (Consultation Paper No. 154)
[74] *Ibid* at para 1.19
[75] This section provides that the court may grant to any party to an illegal contract "such relief by way of restitution, compensation, variation of the contract, validation of the contract in whole or part or for any particular purposes, or otherwise howsoever as the court in its discretion thinks just."
[76] 'The Illegality Defence: A Consultative Report' (Consultation Paper No. 189), para 3.81
[77] 'The Illegality Report' (Law Com No 320)
[78] *Ibid* paras 3.50 – 3.60. Broadly speaking these were complexity, uncertainty, arbitrariness and lack of transparency.
[79] Trusts (Concealment of Interests) Bill. See 'The Illegality Defence (HC 412, 2010), App A
[80] See *Gray v Thames Trains Ltd and another* [2009] 1 AC 1339, HL; *Stone & Rolls Ltd (in liquidation) v Moore Stephens (a firm)* [2009] 1 AC 1391, HL
[81] [2012] EWCA Civ 593
[82] *Ibid* at [63]

furthering the purpose of the rule which the illegal conduct has infringed; consistency; the Claimant should not profit from his or her own wrong; deterrence; and maintaining the integrity of the legal system.[83]

Similarly, Toulson LJ advocated in *ParkingEye Ltd v Somerfield Stores Ltd*[84] that:

Rather than having over-complex rules which are indiscriminate in theory but less so in practice, it is better and more honest that the court should look openly at the underlying policy factors and reach a balanced judgment in each for reasons articulated by it.[85]

This trend continued in *Hounga v Allen*[86] where Lord Wilson in the leading judgment said:

The defence of illegality rests on the foundation of public policy…So it is necessary, first, to ask 'What is the aspect of public policy which founds the defence?' and, second, to ask 'But is there another aspect of public policy to which the application of the defence would run counter?

However, this trend suffered a setback when *Apotex* went on appeal to the UK Supreme Court.[87] Whilst the Court of Appeal's decision was unanimously upheld, the majority (Lord Sumption with whom Lord Neuberger and Lord Clarke agreed, and Lord Mance) reached the decision by not following Etherton LJ's approach. Lord Toulson[88], however, refused to criticise Etherton LJ's approach, pointing out that the Supreme Court itself had taken a similar approach in *Hounga v Allen*.

In *Bilta (UK) Ltd v Nazir (No. 2)*[89] the proper approach to illegality was not determinative of the outcome. Nevertheless, sharp differences of opinion were expressed on this matter. Lord Sumption advocated a rule-based approach, while Lord Toulson and Lord Hodge advocated the more open-textured flexible approach. Lord Neuberger thus expressed the view that the proper approach to the defence of illegality needed to be addressed as soon as appropriately possible.[90]

The opportunity for review arose in *Patel v Mirza*.

[83] *Ibid* at [66]
[84] [2013] QB 840
[85] *Ibid* at [52]
[86] [2014] UKSC 47
[87] *Les Laboratoires Servier v Apotex Inc* [2014] UKSC 55
[88] *Ibid* at [62]
[89] [2015] UKSC 23
[90] *Ibid* at [15]

4. Patel V Mirza and The New Approach

The claimant (Patel) transferred £620,000 to the defendant (Mirza) under a scheme for Mirza to use the money to bet on share price movements based on inside information that Mirza expected to obtain. The scheme amounted to a conspiracy to commit the crime of insider dealing under section 52 of the Criminal Justice Act 1993. The insider information did not materialize, and the intended betting did not take place. Mirza failed to return the money to Patel, who then brought an action for its recovery based *inter alia* on unjust enrichment, arguing that the purpose or basis for transferring the money had failed totally. To establish his claim, Patel had to plead the facts surrounding the transfer, which clearly showed his active involvement in the conspiracy. Mirza raised the illegality defence.

The High Court[91] held that Patel's claim was unenforceable. In dismissing the claim, the trial judge held that, firstly, on the facts, the reliance principle of *Tinsley v Milligan* applied, and, secondly, the *locus poenitentiae* principle did not apply because Patel had not voluntarily withdrawn from the illegal scheme.

Patel's appeal was unanimously allowed by the Court of Appeal.[92] The majority (Rimer and Vos LJJ) adopted the classical rule-based approach. Whilst agreeing with the trial judge that the reliance principle did apply, their view was that the *locus poenitentiae* exception to the reliance principle applied. Gloster LJ's reasoning for allowing the appeal was different. She adopted the flexible multi-factorial public policy considerations judicial discretion approach.

Mirza's appeal to the Supreme Court was unanimously dismissed by the *coram* of nine Justices. However, their approaches were starkly dissimilar. Interestingly, both parties agreed that the rule-based approach should apply.

Nevertheless, five of the Justices (Lord Toulson, who delivered the main judgment, with whom Baroness Hale, Lord Kerr, Lord Wilson and Lord Hodge agreed) rejected the rule-based approach, and adopted the flexible multi-factorial public policy considerations approach. In particular, the majority held that the no reliance principle of *Bowmakers Ltd v Barnet Instruments Ltd* and *Tinsley v Milligan* should no longer be good law, and that there was no need to refer to the *locus poenitentiae* doctrine in deciding the outcome. Their decision was based on the public policies involved and proportionality. They concluded that this was not an exceptional case where public interest required the dismissal of Patel's claim.

Three of the Justices (Lord Mance, Lord Clarke and Lord Sumption) rejected the majority's flexible approach, and opted to base their decision on the rule-based

[91] *Patel v Mirza* [2013] EWHC 1892 (Ch)
[92] *Patel v Mirza* [2014] EWCA Civ 1047; [2015] Ch 217

approach. They regarded the reliance principle as the starting point for prima facie rejecting Patel's claim but held that the *locus poenitentiae* doctrine, albeit in an expanded form, applied in Patel's favour.

Lord Neuberger also took a rule-based approach (albeit different from that of the other three Justices) in allowing Patel's claim, but recognised Lord Toulson's approach as being appropriate in some circumstances.

What emerges clearly, though, from the decision is that all the Justices agreed that, in general, illegality is not a defence to restitution of unjust enrichment claims.

4.1. The Majority Reasoning: the trio of considerations

Before formulating the new approach, Lord Toulson undertook a very lengthy review of the existing rules derived from case law relating to illegality, in particular the reliance principle and *Tinsley v Milligan*, to conclude that the state of the law was unsatisfactory, that there was a need for a change of approach[93] and then went on to draw heavily from Professor Andrew Burrows' *Restatement of the English Law of Contract* (2016, 2nd ed, OUP)[94] in formulating the new approach. In doing so Lord Toulson first identified the key question to be whether allowing a restitution claim tainted with illegality would 'damage the integrity of the legal system' and not 'whether the plaintiff is "getting something" out of the wrongdoing'.[95] He then rejected the rule-based approach, and set out what the majority considered to be the proper approach in answering this question[96]:

It is not a matter which can be determined mechanistically. So how is the court to determine the matter if not by some mechanistic process?...one cannot judge whether allowing a claim which is in some way tainted by illegality would be contrary to the public interest, because it would be harmful to the integrity of the legal system, without (a) considering the underlying purpose of the prohibition which has been transgressed, (b) considering conversely any other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and (c) keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality…That trio of necessary considerations can be found in the case law.

On the question of whether it would be disproportionate to refuse relief to which, but for the illegality, the plaintiff would be entitled, Lord Toulson

[93] *Patel v Mirza* [2016] UKSC 42 at [17] – [81]
[94] *Ibid* at [82] – [94]
[95] *Ibid* at [100]
[96] *Ibid* at [101]

referred to the eight factors suggested by Burrows in his *Restatement of the English Law of Contract* (2016, OUP) at pp 229-230 as potentially relevant.[97]

Lord Toulson concluded his approach by emphasizing that[98]:

The public interest is best served by a principled and transparent assessment of the considerations identified, rather than by the application of a formal approach capable of producing results which may appear arbitrary, unjust or disproportionate.

In allowing Patel's claim, Lord Toulson concluded[99]:

A claimant, such as Mr Patel, 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. There may be rare cases where for some particular reason the enforcement of such a claim might be regarded as undermining the integrity of the justice system, but there are no such circumstances in this case.

Lord Kerr, in addition to agreeing[100] with Lord Toulson, delivered a concurring judgment rejecting the rule-based approach[101].

5. Critical Analysis of The New Approach

5.1. Is it really a new approach?

It is easy to overlook a very important observation by Lord Toulson that the 'trio of necessary considerations can be found in the case law.'[102] The point being made appears to be that no new ground was being broken. In other words, this was not a revolutionary change in approach. Rather, it was some kind of refining and structuring of the existing law. With regard to the range of factors to be considered on the issue of proportionality, Lord Sumption observed that they too could be found in the case law.[103]

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[97] *Ibid* at [107]. The factors identified by Burrows are (a) how seriously illegal or contrary to public policy the conduct was; (b) whether the party seeking enforcement knew of, or intended, the conduct; (c) how central to the contract or its performance the conduct was; (d) how serious a sanction the denial of enforcement is for the party seeking enforcement; (e) whether denying enforcement will further the purpose of the rule which the conduct has infringed; (f) whether denying enforcement will act as a deterrent to the conduct; (g) whether denying enforcement will ensure that the party seeking enforcement does not profit from the conduct; (h) whether denying enforcement will avoid inconsistency in the law thereby maintaining the integrity of the legal system.

[98] *Ibid* at]120]

[99] *Ibid* at [121]

[100] *Ibid* at [124], [142] – [143]

[101] *Ibid* at [133] – [134]

[102] *Ibid* at [101]

[103] *Ibid* at [260]

5.2. Does the new approach promote certainty?

How are courts to apply the trio of considerations to any given case? Given the very broad high-level generality of the identified considerations, it is not surprising that the Supreme Court could give little or no assistance on this question.

Public policy continues to be the underpinning of the law in this area, but what does public policy even mean? How are the courts supposed to accurately identify its contents in a particular case? And given that public policy, whatever it may mean, is not immutable, is it not possible that two cases with similar facts may have different outcomes as the public policy may have mutated in the meantime? Would not that then lead to incoherence, complexity and apparent arbitrariness, the very evils that the rejected rule-based approach was said to have engendered? If so, what is the need to do away with the rule-based approach, developed painstakingly over 250 years since *Holman v Johnson*?

It is therefore not surprising that the minority held very strong opposing views to the new approach. Lord Sumption had this to say about the new approach at various stages of his judgment:

With the arguable exception of (a) and (d) all of the considerations identified by Professor Burrows have been influential factors in the development of the rules of law comprised in the illegality principle as it stands today.[104]

…it would be wrong to transform the policy factors which have gone into the development of the current rules, into factors influencing an essentially discretionary decision about whether those rules should be applied…Perhaps most important of all, justice can be achieved without taking this revolutionary step.[105]

An evaluative test dependent on the perceived relevance and relative weight to be accorded in each individual case to a large number of incommensurate factors leaves a great deal to a judge's visceral reaction to particular fact. Questions such as how illegal is illegality would admit of no predictable answer, even if the responses of different judges were entirely uniform…Far from resolving the uncertainties created by recent differences of judicial opinion, the range of factors test would open a new era in this part of the law. A new body of jurisprudence would be gradually built up…[106]

[104] *Ibid* at [260]
[105] *Ibid* at [261]
[106] *Ibid* at [263]

The new approach is far too vague and potentially far too wide to serve as the basis on which a person may be denied his legal rights. It converts a legal principle into an exercise of judicial discretion, in the process exhibiting all the vices of "complexity, uncertainty, arbitrariness and lack of transparency" which Lord Toulson JSC attributes to the present law…We would be doing no service to the coherent development of the law if we simply substituted a new mess for the old one.[107]

Lord Mance[108] and Lord Clarke[109] expressed corresponding views in opposing and criticising the new approach.

Lord Toulson did attempt to answer these criticisms in his judgment.[110] His first retort, simply put, was that so was the existing law which he said was doctrinally riven with uncertainties. His second was that there is no evidence of uncertainty in those jurisdictions (New Zealand and the USA) that had adopted a relatively flexible approach to illegality. And his third was that whilst commercial transactions need certainty of the law, the same considerations do not apply to people contemplating unlawful activity. In such cases discovering where the public interest lay was more important.

On his third response, Lord Toulson found support from Lord Kerr who said:[111]

Certainty or predictability of outcome may be a laudable aim for those who seek the law's resolution of genuine, honest disputes. It is not a premium to which those engaged in disreputable conduct can claim automatic entitlement.

However, be that as it may, Lord Toulson's and Lord Kerr's argument does not take into account the plight of legal advisers who need certainty and predictability in advising clients who have engaged in such conduct and who now seek to recover benefits conferred.

Burrows[112] acknowledges that a flexible approach produces less certainty than clear and acceptable rules. However, he too argues that the law on illegality has always been uncertain notwithstanding the rule-based approach. He sees the new approach as rendering certainty through the greater transparency in the reasoning of the courts required by it. Burrows[113], however, disagrees with the majority view[114] that the law should not be too concerned with certainty when dealing with plaintiffs who have engaged in unlawful activities.

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[107] *Ibid* at [265]
[108] *Ibid at* [192], [204] – [208]
[109] *Ibid* at [216] – [219]
[110] *Ibid* at [113]
[111] *Ibid* at [137]
[112] Andrew Burrows, *Illegality after Patel v Mirza*, Current Legal Problems (2017) 70 (1): 55
[113] *Ibid*
[114] *Patel v Mirza* [2016] UKSC 42 at [113] per Lord Toulson, and at [137] per Lord Kerr

Virgo[115], on the other hand, agrees with Lord Sumption's view that the majority's approach was far too vague and wide. He points that the majority did not explain how the trio of considerations and the other range of relevant factors were applied on the facts of *Patel v Mirza* itself. Thus, the majority did not identify any reasons why they considered insider dealing as criminal, or how this was relevant to deciding how the illegality defence could or could not apply. Similarly, no policies which could be said to be adversely affected were identified, and the issue of proportionality of the law's response was not expressly addressed. He fears that the law may have gone a full circle in the development of the law, and reverted to a test similar to the previously discredited public conscience test. Virgo[116] continues to endorse a rule-based approach that generally rejects claims where the plaintiff is tainted with illegality but allows principled exceptions.

Murphy[117] whilst acknowledging that the majority approach is controversial in that it represents a departure from the usual common law method of reasoning-up by adopting a reasoning-down method, makes two arguments in support of *Patel v Mirza*. Firstly, he argues that illegality was one area where the reasoning-up approach had failed to produce a coherent set of rules, so that the majority's attempt to produce a coherent framework represents an improvement. Secondly, he points out that the common law itself has at times adopted a similar open-textured approach without disastrous consequences, an example being the approach adopted by courts when dealing with questions of abusing the process of the Court.

5.3. Proportionality

Whatever might be the shortcomings of the new approach, the explicit emphasis on, and the need for proportionality, is to be lauded. This is not to say that proportionality was previously never a consideration. Cases decided under the not *in pari delicto* and the *locus poenitentiae* exceptions show how the courts grappled with this consideration. Apart from legitimising overt considerations of proportionality, the new approach allows a balance between a knee-jerk moralistic rejection of otherwise meritorious claims and a mindless application of the no reliance principle in allowing claims despite the plaintiff having been involved in serious unlawful conduct.

[115] Graham Virgo, *Patel v Mirza: one step forward and two steps back*, Trusts & Trustees (2016) 22 (10): 1090. Interestingly, Virgo appeared with Philip Shepherd QC as counsel for Patel at the UK Supreme Court.
[116] *Ibid*
[117] Emer Murphy, *The ex turpi causa defence in claims against professionals*, Journal of Professional Negligence (2016) 4 PN 241-245

5.4. Scope of the new approach

It is not entirely clear whether the new approach applies across the board to all causes of action. As Murphy[118] points out *Patel v Mirza* was a claim for restitution of unjust enrichment in the context of a failed contract, so that much of what was said in the Supreme Court could be regarded as *obiter*. This is reinforced by the fact that Lord Toulson relied heavily on Burrows' *Restatement of the English Law of Contract* in formulating the new approach. Further, the Supreme Court itself sent out a mixed message on this as there are also references in the judgments to the approach applying to contracts only.[119] An English High Court judgement[120] has doubted whether the new approach applies even to contractual disputes involving disputes other than failed contracts. However, very recently, the English Court of Appeal[121] approved of the application of the new approach in a claim by liquidators against a bank to recover negligently paid monies. It held that an appellate court should not interfere with a first instance application of the *Patel v Mirza* test merely because it would have taken a different view. To bar the company's claim would undermine the carefully calibrated *Quincecare* duty[122] and would not be a proportionate response, particularly where the bank's breaches were so extensive and the fraud so obvious.

5.5. The status of locus poenitentiae

The status of the *locus poenitentiae* principle is now unclear. Whilst the no reliance principle of *Tinsley v Milligan* was rejected by the majority, only Lord Toulson made any reference to the *locus poenitentiae* principle, and that was simply to regard it as irrelevant[123]. However, the principle is often seen as an exception to the reliance principle, and as such would seem inconsistent with the trio of considerations approach. It will, however, probably be a relevant factor to be considered in deciding the proportionality of the court's response although it will no longer be regarded as the main reason why a claim may be allowed.

6. Conclusion

Patel v Mirza has clearly resolved the disagreement in English courts as to the proper approach to be adopted towards the illegality defence, but, perhaps, no more than that.

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[118] *Ibid*

[119] *Patel v Mirza* [2016] 42 at [164] – [165] per Lord Neuberger.

[120] *Ronelp Marine Ltd v STX Offshore & Shipbuilding Co Ltd* [2016] EWHC 2228 (Ch), unreported (7 September 2016)

[121] *Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd* [2018] EWCA Civ 84

[122] I.e. the duty of care described in *Barclays Bank Plc v Quincecare Ltd* [1992] 4 All E.R. 363

[123] *Patel v Mirza* [2016] 42 at [116]

Whether application of the trio of considerations coupled with the range of factors approach will successfully bring about clarity remains to be seen as these are early days. The common law tradition is to look to case law for guidance as to how any rule, test or approach is applied in factual situations. A seemingly good approach may prove difficult to apply, at least until a new body of coherent case law is built up, pending which legal advisers and their clients who need certainty and predictability will face difficulties. There is no assurance that the new body of case law on illegality will prove to be any less complex or uncertain than the rule-based approach.

Whether Malaysian courts will take the lead of *Patel v Mirza* also remains to be seen. As at the date of writing, there are no reported Malaysian cases referring to *Patel v Mirza*.