



Illegality: a new mess for the old one?

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In March 2015 Nicholas presented a paper on the subject of illegality and the difficulties created by the locus poenitentiae principle which had, at that stage, recently been considered by the Court of Appeal in *Patel v Mirza*. Nicholas also discussed the approaches which the Supreme Court might have been expected to take when hearing the appeal from that decision. That paper can be read [here](#). Since then the Supreme Court has heard the appeal and on 20 July 2016 delivered judgment.



It is a landmark judgment, significant both for the sweeping changes it makes to the principle of illegality and for the sheer depth of legal analysis exhibited in both the majority and minority judgments. Its ramifications go far beyond the doctrine of illegality and raise fascinating questions about the creation and development of judge-made law itself, offering an unusual insight into the jurisprudential mindsets of several key Justices.

The decision

In *Bilta UK (Ltd) v Nazir (No 2)* [2016] AC 1, Lord Neuberger JSC said, at [15]:

“The proper approach to the defence of illegality needs to be addressed by this court (certainly with a panel of seven and conceivably with a panel of nine Justices) as soon as appropriately possible.”

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The appeal in *Patel v Mirza* provided that opportunity and was heard by a panel of nine. All nine Justices concurred in the outcome, dismissing Mirza's appeal from the decision of the Court of Appeal that he should give the money back to Patel. They were, however, fundamentally divided in the route to that conclusion.

Lord Toulson, with whom Lady Hale, Lord Kerr, Lord Wilson and Lord Hodge all agreed, presented the reasoning of the majority which supported a policy based approach by which a judge weighs various factors in determining whether enforcing a claim would be harmful to the integrity of the legal system.

Lords Mance, Clarke and Sumption presented a more orthodox rule-based view in the minority, eschewing the discretionary approach advocated by the majority and advocating a more principled analysis.

Lord Neuberger concurred with certain of the minority's views as to the utility of a restitutionary remedy in this particular case, but also expressed the view that, in broader circumstances, Lord Toulson's approach represented the most reliable and helpful guidance that is was possible to give.

The views expressed by the majority mark a radical change in the way in which the defence of illegality is to be applied. The "reliance test" embodied in *Tinsley v Milligan* [1994] 1 AC 340 was expressly rejected in favour of a wider analysis of public interest, within which certain factors fall to be considered. The minority's criticism of that approach is both forthright and persuasive, culminating in Lord Sumption's observation, at [265], that:

"We would be doing no service to the coherent development of the law if we simply substituted a new mess for the old one."

The new policy orientated approach

In *ParkingEye Ltd v Somerfield Stores Ltd* [2013] QB 840 Lord Toulson first advocated the approach which was later to form the basis of his judgment in *Patel v Mirza*, stating at [52] – [53]:

"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 case for reasons articulated by it."

This is not to suggest that a list of policy factors should become a complete substitute for the rules about illegality in the law of contract which the courts have developed, but rather that those rules are to be developed and applied with the degree of flexibility necessary to give proper effect to the underlying policy factors."

In 2013 Lord Toulson was in the minority in expressing his preference for such an approach. Since the decision in *ParkingEye v Somerfield*, and prior to the decision in *Patel v Mirza* itself, the Supreme Court had addressed the topic of illegality on three occasions. On the first occasion, in *Hounga v Allen* [2014] 1 WLR 2889, the Supreme Court held that a Nigerian national working illegally in the United Kingdom was not prevented from bringing claims for unfair dismissal on the basis that her employment was itself unlawful. On that occasion Lord Wilson sought to bring to the fore the relevance of policy considerations in the application of the defence of illegality, stating at [42]:

"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?'"

On the second occasion, in *Les Laboratoires Servier v Apotex Inc* [2015] AC 430, the Supreme Court considered the defence of illegality in the context of a claim to enforce a cross-undertaking in damages given in respect of an interlocutory injunction. Although considerations of policy were discussed at length in the Court of Appeal (notably in the judgment of Etherton LJ), the Supreme Court strongly reprimanded that approach and emphasized the importance of grounding analysis and application of the defence firmly in principle. Incidentally Lord Toulson himself sat in *Les Laboratoires Servier v Apotex* and delivered a judgment supportive of the approach taken by the Court of Appeal, albeit in the minority yet again on that occasion.

On the third occasion, in *Bilta (UK) Ltd v Nazir (No 2)* [2016] AC 1, the Supreme Court again considered the defence but this time in the context of claims between the participants of VAT fraud. The divergence of opinion, bubbling beneath the surface since *Hounga v Allen* and *Les Laboratoires Servier v Apotex*, became quite apparent and the battle lines were drawn. On the one hand, a more formal rule-based approach was championed and, on the other, a more flexible policy-based approach. It was against this backdrop that Lord Neuberger suggested that the matter ought to be addressed as soon as possible by a Court of seven or nine Justices, in order to resolve the clear divergence of views.

So it was that Lord Toulson came to deliver the first judgment in *Patel v Mirza* which, being in the clear majority, now represents the authoritative position.

The depth of analysis, both historical and contemporary, domestic and comparative, underscores the importance of this seminal judgment. The change effected by this judgment cannot be overstated. For Lord Mance, it introduces *“not only a new era but entirely novel dimensions into any issue of illegality”*². Whereas the law to date had developed a complex and often conflicting body of rules, presumptions, maxims and latin phrases, Lord Toulson has replaced the lot with a unifying enquiry as to whether the enforcement of a claim would be harmful to the integrity of the legal system. The test developed in the course of that lengthy judgment is summarized at [120] as follows:

“The essential rationale of the illegality doctrine is that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system (or, possibly, certain aspects of public morality, the boundaries of which have never been made entirely clear and which do not arise for consideration in this case). In assessing whether the public interest would be harmed in that way, it is necessary a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim, b) to consider any other relevant public policy on which the denial of the claim may have an impact and c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts. Within that framework, various factors may be relevant, but it would be a mistake to suggest that the court is free to decide a case in an undisciplined way. The public interest is best served by a principled and transparent assessment of the considerations identified, rather by than the application of a formal approach capable of producing results which may appear arbitrary, unjust or disproportionate.”

In an area so vexed with competing doctrinal analysis, the perspective of leading academics was inevitably (and rightly) going to feature prominently. Mr Patel’s legal team included none other than Professor Graham Virgo. But it was Professor Andrew Burrows’ recent *Restatement of the English Law of Contract* (OUP, 2016) which was to bear citation on so many occasions that it might have been simpler to annex the text in full. The crux of his contribution to this area of law lies in pages 229-230 of that superb work, in which Professor Burrows identifies eight factors to which the court might have regard when deciding whether or not to deny enforcement of a claim for illegality. They 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;

² *Patel v Mirza*, per Lord Mance at [206].

- (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 conduct that is illegal or contrary to public policy;*
- (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.”*

Lord Toulson described that list as helpful but not exhaustive, adding that:

“Potentially relevant factors include the seriousness of the conduct, its centrality to the contract, whether it was intentional and whether there was marked disparity in the parties’ respective culpability.”

The scope for legitimate divergence in the application of such factors, and for the injection (conscious or otherwise) of subjective impressions and predilections of the tribunal, is readily apparent from that statement. Undoubtedly the breadth of circumstances in which the defence of illegality can and has appeared makes such an untrammelled approach appealing, but at what cost? To describe this approach as “wooly” would be derisory and unfair, but it undoubtedly raises questions as to how those many and varied factors will come to be applied; questions which will likely induce litigation in the belief by both sides that at least some of these factors support their position.

The minority view

Lords Mance, Clarke and Sumption strongly disagree with the *“wholesale abandonment of a clear cut test”*³ proposed by the majority. Lord Sumption stated his criticism of the majority view most clearly at [262(iv)]:⁴

³ *Patel v Mirza*, per Lord Mance at [207].

⁴ With which Lord Clarke expressly agreed at [216].

“The ‘range of factors’ test discards any requirement for an analytical connection between the illegality and the claim, by making the nature of the connection simply one factor in a broader evaluation of individual cases and offering no guidance as to what sort of connection might be relevant. I have already observed that the reliance test is the narrowest test available. If it is no longer to be decisive, the possibility is opened up of an altogether wider ambit for the illegality principle, extending to cases where the relevant connection was remote or non-existent but other factors not necessarily involving any connection at all, were thought to be compelling.”

For all three minority Justices, the crucial objection to the approach of the majority was that it is *“far too vague and potentially far too wide to serve as the basis on which a person may be denied his legal rights.”*⁵ Thus the minority reason from the premise that unless and until the defence of illegality is made out, the claimant against whom the defence is asserted is seeking to enforce his legal rights. The defence is therefore a method by which the law denies him those legal rights or, more accurately, denies him the assistance of the court in their enforcement, and as such should be carefully and predictable circumscribed.

Different approaches to the same ideal?

For the obvious disagreement between the majority and minority judgments, each reasons from the premise that the objective of the doctrine of illegality should be to preserve the integrity of the legal system. The difference comes in the methods advocated to achieve that ideal. The majority say that it is best achieved by entrusting a judge to address the question of policy directly, considering a number of factors defined at a level of generality capable of encompassing the wide variety of circumstances in which the defence can become engaged. The minority say that this is a recipe for further inconsistency, unpredictability and arbitrariness. Instead judges should be tasked with applying rules and principles, mindful that any curtailment of the enforcement of legal claims on the basis of illegality should be carefully circumscribed and based on principled analysis.

This divergence of opinion represents two extremes of a balancing act which has been undertaken in every common law jurisdiction for as long as legal memory. Historically the extremes were more polarized still, with the Lord Chancellor dispensing equity in accordance with the size of his foot while the courts of common law took a strict characteristically line in the application of legal rules. The question strikes down to the ultimate level of how much trust and confidence we have in judges exercising their discretion consistently and correctly, free from subjective instincts or predilections which, by their natural diversity, will tend towards

⁵ *Patel v Mirza*, per Lord Clarke at [217].

inconsistency and error. Lord Sumption touches upon this point at [240] when he discusses the case of *Cross v Kirkby* [2000] EWCA Civ 426. In that case a hunt saboteur started a fight with a hunt follower and lost. He sued the hunt follower in respect of his injuries. The hunt follower's defence turned on whether or not he had used excessive force in defending himself. Beldam LJ held that he had not, but went on to say that even if he had, the saboteur's injuries were "inextricably linked" with the fact that he had started the fight, such that his claim was barred by illegality. As Lord Sumption observed, "*The case illustrates the tendency of any test broader than the reliance test to denigrate into a question of instinctive judicial preference for one party over another.*"

The notion that a party might be denied the assistance of the Court in the enforcement of their legal rights as a result of the manner in which a particular judge has balanced a "*widely spread mélange of ingredients*"⁶ does not inspire confidence. Given that appellate courts are notoriously loathe to revisit the exercise of a discretion vested in the trial judge, the scope for review of such balancing acts is likely to be slim. Parties are therefore faced with something of a gamble. Alongside each of the factors listed by Professor Burrows and adopted by Lord Toulson, together with any others that might appeal beyond that non-exhaustive list, sits perhaps the most important factor of them all: the judge him or herself. It is nonsense to deny that judges, like any other person, possess differing views about culpability, blameworthiness, responsibility, morality and almost any other measure of 'badness'. Judges are inclined, for the most part, to consciously rid such factors of any influence over their judgments, but realistically it is impossible for any judge short of a Dworkinian Hercules to do so.

Arguably the simple vesting of a discretion, however well structured by a list of relevant factors, ought to be a last resort, applied only where it is not possible to tailor rules to the myriad of potential circumstance without creating the sorts of problems which have plagued the law of illegality. Is it possible to create such rules here? The minority plainly think so, although their solution evidently has its limits beyond the circumstances of this particular case. The notion of restitution restoring the status quo ante prior to any illegality (e.g. by restoring the parties to the position prior to any illegal contract) is obviously desirable where it can be achieved, but becomes strictly impossible whenever the illegal venture has generated a profit or loss. In those circumstances, short of an Australian style power to divest the parties of any profit to the advantage of the public purse⁷, a decision must be made as to where that profit or loss lies.

In reality that problem might be overstated. For example, even where a profit has been generated it would be possible to recognize a restitutionary right in the payor to receive what he paid in, leaving any profit to be attacked by use of legislation such as the Proceeds of Crime Act

⁶ *Patel v Mirza*, per Lord Mance at [206].

⁷ See *Nelson v Nelson* [1995] HCA 25, (1995) 184 CLR 538.

2002. Equally, where the venture sustains a loss it would be possible to recognize a restitutionary right in the payor to recoup what remains, the shortfall being the cost to him of engaging in this wrongdoing in the first place. This approach to the treatment of profits is consistent with the notion that it is no purpose of the civil law to punish wrongdoing, but that is not to say that the civil law should ignore the propensity of its rules to incentivize or discourage certain behavior. In other areas of the civil law we have seen the Supreme Court rely strongly on the power of the civil law to deter undesirable conduct. For example in the context of the receipt of bribes or secret commissions by fiduciaries the courts have cited that deterrent effect in support of the availability of a proprietary remedy for a principal: see *FHR European Ventures v Mankarious* [2014] UKSC 45; [2015] AC 250; *AG for Hong Kong v Reid* [1994] 1 AC 324, per Lord Templeman. Perhaps ironically, it was Lord Neuberger in *FHR* who gave the judgment of the Court which restored the availability of that proprietary remedy, departing from his own earlier decision in the Court of Appeal in *Sinclair v Versailles* [2011] EWCA Civ 347. His Lordship noted at length how undesirable bribery was and how the imposition of a proprietary remedy could serve to deter such unpalatable behavior. Yet in *Patel v Mirza* Lord Neuberger simply notes, at [184] that “*it is for the criminal law, not the civil law, to penalize a party or parties for entering into and/or performing a contract with an illegal component.*” If anything this ironically illustrates the ability of judges to cogently emphasise a given factor in one case while discarding it in the next, or even to cause that factor to militate in one direction in one case only to perform a volte face in another.

Conclusion

Curiously the approach advocated by the majority in *Patel v Mirza* was not one contended for by either party to that appeal. Nevertheless, the fact that a panel of nine justices had, at Lord Neuberger’s suggestion, convened to hear this appeal suggested that something seismic might be afoot. The majority have given what is probably the most important judgment which the law of illegality has ever seen. The minority have given one of the strongest dissents of recent times. Only once the courts have had an opportunity to apply this new factor-based analysis will we know whether we have simply replaced the old mess with a new one. In the meantime, practitioners can expect to see illegality arguments running to trial in far more circumstances, optimistic that the most important factor of all will exercise his or her newfound discretion in their client’s favour.

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