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## ***Ex Turpi Causa: Reformation not Revolution***

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Seldom has an area of law been so afflicted with uncertainties and contradictions as the illegality defence and rarely have judicial opinions been so sharply divided as in the Supreme Court decision in *Patel v Mirza*. There nine Justices examined the issue of what the correct approach to the illegality defence is. Six of them endorsed the ‘range of factors’ approach whereas three condemned it. This paper defends the majority’s approach against the minority’s criticisms and argues that refinements have to be made to it in order to ameliorate the concern of uncertainty that may arise from its application.

Key words: *ex turpi causa*; illegality defence; public policies.

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### **INTRODUCTION**

The illegality defence is an important topic because first, it extends to civil claims in almost all branches of private law with different factual matrixes; and secondly, its application not only can cause disproportionately harsh consequences, but has produced unacceptable confusion and uncertainty. A panel of nine Justices was convened in *Patel v Mirza*<sup>1</sup> to resolve the issue of what the correct approach to the illegality defence is. It seems that the majority and the minority agreed on only two main points, the first of which is that the illegality defence – ‘no court will lend its aid to a man who founds his action upon an illegal or immoral act’<sup>2</sup> - is a rule of public policy, and the second is that judgment should be given for the claimant. There are stark differences between them on the question of how the illegality defence should be interpreted and applied. Lord Toulson delivered the leading judgment (with which Lady Hale, Lord Kerr, Lord Wilson and Lord Hodge agreed). He set out the range of factors approach (which was endorsed by Lord Neuberger in a separate judgement) which

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[2016] 3 WLR 399 (‘Patel’).

2 *Holman v Johnson* (1775) 1 Cowp 341 at 343 (Lord Mansfield).

requires the evaluation and balancing of considerations involving public policies and proportionality. This approach drew sharp rebuke from the minority (Lord Mance, Lord Clarke and Lord Sumption) who forcefully rejected it. Lord Sumption (with whom Lord Clarke agreed) affirmed the rule-based approach.

### THE LAW PRIOR TO *PATEL*

Lord Neuberger<sup>3</sup> observed that the law was uncertain because of the unsatisfactory reasoning of the majority in *Tinsley v Milligan*<sup>4</sup> and it was in disarray because of the different approaches to the illegality defence adopted by the Supreme Court in the three cases prior to *Patel*, i.e. *Hounga v Allen*<sup>5</sup>, *Les Laboratoires Servier v Apotex Inc*<sup>6</sup> and *Bilta (UK) Ltd v Nazir (No 2)*<sup>7</sup>.

The reasoning in *Tinsley* was criticised by the Law Commission.<sup>8</sup> The problem with the procedural reliance test in *Tinsley* is that it has no regard for the merits of the parties or the public policies underlying the illegality defence, and thus it could lead to arbitrary results.<sup>9</sup> In *Tinsley*, because the defendant contributed to the price of the house which she purchased with the claimant, the defendant was able to invoke the presumption of resulting trust, although they vested the house in the claimant's sole name in order to carry out a social security fraud. However, if the relationship of the parties had been that of a mother and daughter, and the house was vested in the latter's name, there would be a presumption of advancement in her favour. Thus, the mother's claim would be barred by the illegality defence as she had to rely on the illegality to rebut the presumption.<sup>10</sup> Further, there is uncertainty and confusion as to

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3 *Patel*, n 1 above at [164].

4 [1994] 1 AC 340 ('*Tinsley*').

5 [2014] 1 WLR 2889 ('*Hounga*').

6 [2015] AC 430 ('*Les Laboratoires*').

7 [2016] AC 1 ('*Bilta*').

8 The Law Commission, *The Illegality Defence: A Consultative Report* (LCCP 189) (2009). The Law Commission, *The Illegality Defence* (Law Com 320) (2010). See also *Nelson v Nelson* (1995) 184 CLR 538 at 595-613.

9 Law Com 320, *ibid*, at [2.13]-[2.15].

10 See also *Collier v Collier* [2002] EWCA 1095.

the meaning and application of ‘reliance’.<sup>11</sup> The Commission recommended that in deciding whether a claim should be barred by the illegality defence, regard should be had to its underlying policies.<sup>12</sup>

On the conflicting approaches adopted in the three Supreme Court decisions, they can be broadly characterised as the strict versus flexible approach. Under the strict approach, the illegality defence has to be strictly applied<sup>13</sup>; there is ‘no room for the exercise of any discretion by the court in favour of one party or the other’<sup>14</sup> and ‘is indiscriminate’<sup>15</sup> as it is ‘bound to confer capricious benefits on defendants some of whom have little to be said for them in the way of merits.’<sup>16</sup> The majority’s decision in *Les Laboratoires* exemplifies the strict approach. The flexible approach is supported by the majority’s reasoning in *Hounga*. Subsequently, in *Bilta*, Lord Toulson and Lord Hodge<sup>17</sup> endorsed the flexible approach, but Lord Sumption<sup>18</sup> rejected it and adopted the strict approach. Under the flexible approach, courts have to evaluate and balance competing public policies; ‘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 application of the defence would run counter?”’<sup>19</sup> These three decisions have been extensively analysed,<sup>20</sup> with opinions largely divided between those who support the strict approach and those who endorse the flexible approach.

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11 Law Com 320, n 9 above.

12 The key ones are whether allowing the claim would undermine the purpose of the rule that prohibited the conduct, the connection between the illegality and the claim, the gravity of the parties’ conduct, and proportionality of denying the claim: LCCP 189, n 8 above at [3.142].

13 *Bilta*, n 7 above at [62] (Lord Sumption).

14 *Tinsley*, n 4 above at 355 (Lord Goff dissenting), endorsed in *Les Laboratoires*, n 6 above at [16] (Lord Sumption).

15 *Tinsley*, n 4 above at 364D-E (Lord Goff dissenting), endorsed in *Les Laboratoires*, n 6 above at [16] (Lord Sumption).

16 *Les Laboratoires*, n 6 above at [13] (Lord Sumption).

17 *Bilta*, n 7 above at [171]-[174].

18 *Ibid* at [62], [99]-[102].

19 *Hounga*, n 5 above at [42] (Lord Wilson).

20 JC Fisher, ‘The *ex turpi causa* principle in *Hounga* and *Servier*’ (2015) 78 MLR 854; E Lim, ‘Attribution and the Illegality Defence’ (2016) 79 MLR 476; N Strauss, ‘Ex Turpi Causa Oritur Actio?’ (2016) 132 LQR 236 at 248-256; E Lim, ‘Tensions in Private Law Judicial Decision-Making’ [2016] JBL 325; A Burrows, *Restatement of the English Law of Contract* (OUP, 2016) at 221-230.

The arguments in favour of the flexible approach are that it is not inconsistent with, let alone precluded by, *Tinsley*; after all, *Tinsley* did not address the issue of whether the illegality defence should still apply if doing so will not only fail to give effect to its underlying policies, but will be contrary to another rule of law; the flexible approach forms the basis of the ratio in *Hounga*, a binding authority; the flexible approach gives effect to the policies and rationales underlying the illegality defence; the strict approach will not necessarily lead to greater certainty and predictability than the flexible approach because of the problems with the reliance rule in *Tinsley*; and the strict approach can lead to injustice. The arguments in favour of the strict approach are that the flexible approach is contrary to *Tinsley* which precludes any weighing of policies; the flexible approach will not only result in uncertainty of the law, but it may run the risk of judicial legislation; and it is unclear what exactly the policies are and how they should be weighed and thus there might be errors when judges perform the balancing exercise.

Thus, because the law had been uncertain and in disarray, Lord Neuberger said that it was necessary to have an enlarged panel of the Supreme Court address the question of the correct approach to the illegality defence ‘as soon as appropriately possible.’<sup>21</sup> This opportunity came up in *Patel*.

## FACTS AND DECISION OF THE SUPREME COURT

The claimant, Mr Patel, paid £620,000 to Mr Mirza to place bets on RBS’s share prices using advance insider information, which contravened section 52 of the Criminal Justice Act 1993. But the insider information never became available and the betting did not take place. Patel sued Mirza for the return of the money. Mirza said that his claim was precluded by the illegality defence. The specific issue was whether Patel was entitled to restitution of £620,000. The broader and more important issue was how the illegality defence should be understood and applied not only in this case but other cases whether or not involving contractual illegality.

The High Court rejected Patel’s claim as he had to rely on his own illegality to establish the claim and the exception of *locus poenitentiae* did not apply as he had not voluntarily

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<sup>21</sup> *Bilta*, n 7 above at [15].

withdrawn from the illegality.<sup>22</sup> The Court of Appeal<sup>23</sup> unanimously allowed Patel's appeal but differed on the reasoning. The majority (Rimer and Vos LJJ) said that Patel was entitled to repayment as the contract remained wholly unexecuted and thus, whether Patel had voluntarily withdrawn did not matter.<sup>24</sup> But assuming it did, the majority agreed with the trial judge that his claim would be barred as he had relied on the illegal transaction in his pleadings.<sup>25</sup> Gloster LJ however said that what he pleaded was irrelevant as the illegality did not necessarily form part of his case.<sup>26</sup> More importantly, she examined the policy of the rule that was infringed and the public policies underlying the illegality defence, none of which she concluded barred the return of the money to Patel.<sup>27</sup> Mirza appealed to the Supreme Court.

### **The Correct Approach to the Illegality Defence – 'Range of Factors'**

Lord Toulson's 'range of factors' approach (with which five justices agreed) can be summed up in a series of propositions:<sup>28</sup>

1. The policy rationale of the illegality defence is to protect the integrity of the legal system ('Proposition 1').
2. In order to know whether allowing a claim that is tainted by illegality would undermine the integrity of the legal system, regard must be had to:
  - a. the underlying purpose of the law that has been infringed, such as that of the statutory provision that has been breached ('Proposition 2(a)');
  - b. any other relevant public policies which may be negated or undermined by denying the claim, such as those underlying another law that is applicable to the facts of the case ('Proposition 2(b)'); and

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<sup>22</sup> [2014] LLR 110 at [43] and [49].

<sup>23</sup> [2015] 2 WLR 405.

<sup>24</sup> Ibid at [45] and [116] and [118].

<sup>25</sup> Ibid at [20] and [102].

<sup>26</sup> Ibid at [78]-[93].

<sup>27</sup> Ibid at [65]-[76].

<sup>28</sup> *Patel*, n 1 above at [101], [107] and [120].

- c. the proportionality or otherwise of denying the claim, the relevant factors of which include how serious the conduct was, how central the conduct to the claim was, whether it was intentional, and whether there was a material disparity in the parties' respective wrongdoing ('Proposition 2(c)').

Lord Toulson approved the conclusion and reasoning of Gloster LJ which was identical to the range of factors approach in all material aspects.<sup>29</sup> First, Gloster LJ said that the purpose of section 52 is to prohibit insider dealing, i.e. the deliberate exploitation of insider information which may distort a regulated market. But it is not contrary to the policy or purpose of the law to order the defendant to return the money which the claimant paid to him for the purpose of making profit by misusing insider information which eventually did not materialise (Proposition 2(a)). Second, she said that to deny relief to the claimant would be contrary to another provision of the same statute which states that no contract shall be void or unenforceable merely because of s 52 (Proposition 2(b)). Finally, she said, among other reasons, that there was no causal connection between the illegal conduct (the agreement to engage insider dealing transaction) and the claim to have the money repaid, the claimant was not found to have known that taking advantage of inside information was illegal, and claimant was not trying to recover a benefit from his own wrongdoing (Proposition 2(c)). Thus, the illegality defence should not apply. The court ordered the defendant to return the money to the claimant.

Lord Neuberger who also endorsed the range of factors approach arrived at the same conclusion but by a different route. Instead of setting out the correct approach to the illegality defence (like Lord Toulson), he set forth the rule that a claimant is entitled to the return of his money which he paid to the defendant pursuant to an illegal transaction which was not proceeded with.<sup>30</sup> He said that this rule is consistent with authorities and policy and renders the law more certain.<sup>31</sup>

### **The Minority's 'Rule-Based' Approach**

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<sup>29</sup> Ibid at [115], [15]; n 4 above at 425-8.

<sup>30</sup> *Patel*, n 1 above at [146].

<sup>31</sup> Ibid.

The minority's 'rule-based approach', stated by Lord Sumption (with whom Lord Clarke agreed), can be summed up as follows:<sup>32</sup>

1. The illegality defence precludes courts from enforcing the legal rights of the claimant which are derived from or founded on the illegal act committed by him.
2. The policy rationale of the illegality defence is to avoid inconsistency in the law. There is inconsistency when a claimant is punished by the criminal court for his illegal act but a civil court allows recovery by the claimant by giving effect to his legal rights that are founded on the illegal act.
3. "Founded on the illegal act" refers to whether the claimant has to rely on the illegality in order to support his claim, which is known as the reliance test.
4. Exceptions: Because the illegality defence is applicable only when the parties are equally at fault in relation to the illegal act, there are two categories in which the law treats them as not being equally legally culpable:
  - a. the claimant's participation in the illegal act is treated as involuntary such as when it was procured by fraud, undue influence or duress on the defendant's part; and
  - b. where there is inconsistency with the law which renders the act illegal, the prime (but by no means sole) example of which is that the law is intended to protect persons such as the claimant from exploitation by persons such as the defendant.

Lord Sumption said that although the claimant had to and did rely on the illegal transaction in order to establish that there was no legal basis for the payment, he was entitled to relief as ordering the money that he paid to the defendant to be returned to him did not give effect to the illegality or a right derived it.<sup>33</sup> This is because restitution merely restored the parties to their original position as if they had not entered into the illegal transaction.<sup>34</sup> Likewise, Lord

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<sup>32</sup> Ibid at [233]-[234], [241]-[244].

<sup>33</sup> Ibid at [268].

<sup>34</sup> Ibid.



Mance said that relying on illegality in order to enforce an illegal contract or to gain a benefit from the illegal act is prohibited by the illegality defence.<sup>35</sup> But reliance for the purpose of restoring the parties to the status quo ante is permissible.<sup>36</sup> Thus, the minority's key reason for holding in favour of the claimant is that restitution was available. Lord Mance said this restitutionary concept underlies the doctrine of locus poenitentiae.<sup>37</sup> But he and Lord Sumption disapproved of its moral undertones and its subsequent, unduly narrow scope.<sup>38</sup> Lord Sumption said that the right to restitution should not depend on the moral quality of the claimant's withdrawal,<sup>39</sup> to him, the law is that 'restitution is available for so long as mutual restitution of benefits remains possible.'<sup>40</sup>

## CRITIQUE

### Range of Factors Approach: Criticisms

The two main criticisms levelled by the minority against the majority's range of factors approach are that it is 'entirely novel'<sup>41</sup> or 'revolutionary'<sup>42</sup>, and the exercise of judicial discretion involved in the weighing and balancing of different factors would result in unacceptable uncertainty.

#### *Revolutionary?*

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35 Ibid at [199].

36 Ibid.

37 Ibid at [202]. Lord Toulson at [116] however saw no need to discuss the question of locus poenitentiae as he was able to address the questions raised in this appeal using the range of factors approach.

38 Ibid at [197], [202], [248], [252]-[253].

39 Ibid at [252]-[253].

40 Ibid at [253]. His obita statements suggest there is or should be no longer a role for locus poenitentiae (at least insofar as the doctrine holds that the claimant's withdrawal must be voluntary or penitent).

41 Ibid at [206] (Lord Mance).

42 Ibid at [261] (Lord Sumption).

The first criticism is misconceived, particularly or at least in relation to Propositions 1 and 2(a) and (b) of the range of factors approach, both of which are well-supported by authorities. In any event, the range of factors approach does not warrant the castigation from Lord Mance that it amounted to ‘tearing up the existing law and starting again.’<sup>43</sup>

On Proposition 1 of the range of factors approach, all of the justices including the minority cited and endorsed the celebrated judgment of McLachlin J in the Canadian Supreme Court decision in *Hall v Hebert*<sup>44</sup> where she held that ‘the basis of this power [i.e to allow the illegality defence], as I see it, lies in duty of courts to preserve the integrity of the legal system, and is exercisable *only* where this concern is in issue.’<sup>45</sup> She then said that this concern is in issue where allowing the claimant’s claim would permit him to profit from his illegal act or to evade a penalty prescribed by criminal law. She concluded by reiterating that the illegality defence is justified to prevent the integrity of the justice system from being compromised.<sup>46</sup> That is the policy rationale of the illegality defence, which was also endorsed by the Supreme Court in its earlier decisions<sup>47</sup>.

Lord Wilson clarified in *Hounga* that there are examples other than those stated by McLachlin J in which the concern for the integrity of the legal system would arise.<sup>48</sup> Further, as Lord Toulson pointed out, she qualified her statement that the claimant will not be allowed to profit from his wrongdoing by saying that the statement not only does not fully explain why some claims have been rejected, but may have the undesirable effect of tempting judges to focus on whether the claimant is ‘getting something’ out of the illegal act, rather than the more important question of whether permitting recovery for something which was illegal would result in inconsistency and disharmony in the law, and thus jeopardising the integrity of the legal system.<sup>49</sup>

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43 Ibid at [208].

44 [1993] 2 SCR 159.

45 Ibid, 169 (emphasis added).

46 Ibid, 178-9.

47 See eg, *Hounga*, n 5 above at [43]-[44] (Lord Wilson); *Les Laboratoires*, n 6 at [24] (Lord Sumption).

48 *Hounga*, ibid at [44].

Accordingly, in order to know whether there will be damage to the integrity of the legal system, one has to know whether there will be inconsistency in the law, and in order to know that, one has to examine whether allowing or denying the illegality defence will be inconsistent with: (a) the terms, purpose or policy of the law which has been infringed; and (b) the terms, purpose or policy of any other law which applies to the facts of the case. This mirrors Proposition 2(a) and 2(b) of the range of factors approach. If allowing the illegality defence would frustrate the purpose or policy of the law which has been infringed and/or frustrate the purpose or policy of another law, which although not infringed by the claimant, but which applies to the facts of the case, then there will be inconsistency and hence the integrity and coherence of the legal system would be undermined.

Equally importantly, not only do Propositions 2(a) and 2(b) of the range of factors approach flow from Proposition 1, but they are firmly grounded in authorities, i.e. in at least two recent Supreme Court and one Court of Appeal decisions.<sup>50</sup> Tellingly and crucially, the minority in *Patel v Mirza* did not disagree with the reasoning or result in these three decisions.

In *Hounga*,<sup>51</sup> where Lord Wilson delivered the judgment for the majority, the evaluation of public policies approach ‘unquestionably forms part of the ratio of the decision.’<sup>52</sup> Lord Wilson said that to allow the illegality defence might encourage illegal employment and even discrimination against persons in the position of the claimant with impunity.<sup>53</sup> Further, to allow the defence would be contrary to the policy against trafficking and in favour of the protection of the victims which underlie the Convention Against Trafficking Against Human

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49 *Patel*, n 1 above at [100].

50 Admittedly, there is one decision that seems inconsistent with the range of factors approach – *Les Laboratoires Servier*. But Lord Kerr clarified (at [131] of *Patel*) that in that decision, the court did not reject the evaluation of competing public policies. Although Lord Kerr is correct, it is apparent that Lord Sumption’s approach to the illegality defence is inconsistent with that of Lord Wilson in *Hounga*, as was recognised by Lord Sumption himself (at [226]). It would have been far clearer and simpler if the Supreme Court had simply declared that insofar as *Les Laboratoires* is inconsistent with the majority’s range of factors approach, it should not be followed.

51 *Hounga*, n 5 above at [42].

52 *Patel*, n 1 at [132] (Lord Kerr).

53 *Hounga*, n 5 above at [44].

Beings to which the UK is a party.<sup>54</sup> In short, allowing the illegality defence would be inconsistent with the purpose or policy of the antidiscrimination statute (Proposition 2(a)) and the Convention (Proposition 2(b)).

Lord Wilson's approach was subsequently applied by Sales LJ (with whom McCombe LJ agreed) in *R (Best) v Chief Land Registrar* ('Best').<sup>55</sup> He held that to allow the illegality defence would be inconsistent with both the policy underlying section 144 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 which was infringed by the claimant (Proposition 2(a)), as well as that of the Land Registration Act 2002 which applied to the facts of the case (Proposition 2(b)).

In *Bilta*,<sup>56</sup> Lords Toulson and Hodge said that to allow the illegality defence in order to bar the company from suing its fraudulent director for breach of fiduciary duties would be contrary to the common law and sections 172(3) and 180(5) of the Companies Act (Proposition 2(a)). Lord Neuberger agreed with them on this point.<sup>57</sup> (Proposition 2(b) was not in issue as there was no countervailing public policy.) Moreover, as discussed earlier, Gloster LJ's analysis of the illegality defence substantially mirrored the range of factors approach.

With respect to Proposition 2(c) of the range of factors approach, although it is not as robustly grounded in authorities as Propositions 2(a) and 2(b), there are dicta that lend support to it which were referred to by Lord Toulson.<sup>58</sup> Further, the court in *Hounga, Best and ParkingEye Ltd v Somerfield Stores Ltd* ('ParkingEye')<sup>59</sup> did refer, albeit obiter, to the factors in Proposition 2(c) (such as seriousness of the illegality, its centrality to the claim, whether it was intentional, and the level of culpability between the parties). Tellingly, the minority in *Patel v Mirza* did not express disapproval of the reliance on those factors in those decisions.

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<sup>54</sup> Ibid at [51]-[52].

<sup>55</sup> [2015] 3 WLR 1505 at [51]-[61].

<sup>56</sup> *Bilta*, n 7 above at [130]. But note that Lord Sumption decided that case on the basis of attribution and he rejected Lord Toulson and Lord Hodge's policy-based reasoning: *Bilta*, n 7 above at [86], [99]-[102].

<sup>57</sup> Ibid at [20].

<sup>58</sup> *Patel*, n 1 above at [104]-[106].

<sup>59</sup> [2013] QB 840

Nevertheless, Proposition 2(c) is justified not so much by the dicta, but by Proposition 1. As Lord Toulson pointed out, ensuring that the criminal and civil courts act consistently is one way to protect the integrity of the legal system. Ensuring that the result is not disproportionate to the nature and seriousness of the wrongdoing is another. Indeed, while civil courts should not undermine the criminal courts by allowing the claimant to evade the penalty prescribed by the latter, the former should not impose disproportionate penalty. As he said, ‘[r]espect for the integrity of the justice system is not enhanced if it appears to produce results which are arbitrary, unjust or disproportionate.’<sup>60</sup>

However, the problem with Proposition 2(c) is that it is vulnerable to the criticism that Lord Goff in *Tinsley* made against the public conscience test – courts would be required to ‘weigh, or balance, the adverse consequences of respectively granting or refusing relief’<sup>61</sup> on a case by case basis – with which rest of the Appellate Committee agreed. Lord Goff’s dictum which was also raised by the minority in *Patel* was not repudiated by the majority, at least not expressly so. (What was disavowed was the reliance test in *Tinsley*.) Further, Proposition 2(c) is inconsistent with Lord Mansfield CJ’s dictum in *Holman v Johnson*<sup>62</sup> where he said that the illegality defence is not supposed to achieve justice for the parties; what is more, he recognised that the application of the defence would result in injustice to the claimant (‘contrary to the real justice’<sup>63</sup>).

Inconsistency with these influential dicta is not the only concern. Another concern is that the weighing of the consequences in deciding whether or not to grant relief entailed by Proposition 2(c) would lead to considerable uncertainty. This brings us to the second criticism levelled by the minority judges which is partially valid.

### *Uncertainty?*

Lord Sumption said: ‘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

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<sup>60</sup> *Patel*, n 1 above at [108].

<sup>61</sup> *Tinsley*, n 4 above at 358.

<sup>62</sup> n 2 at 343.

<sup>63</sup> *Ibid*.

leaves a great deal to a judge's visceral reaction to particular facts.... No one factor would ever be decisive as a matter of law, only in some cases on their particular facts.<sup>64</sup>

Lord Toulson gave three rebuttals to the uncertainty criticism: (1) the law as it stood was already fraught with uncertainties; (2) he was unaware of serious problems caused by the adoption of the flexible approach in other jurisdictions and (3) certainty is important when citizens engage in lawful activities but the same consideration does not apply in the same way to those who contemplate illegal activity.<sup>65</sup>

The first rebuttal is persuasive: this is evident in the way the reliance test was applied in *Tinsley* and subsequent cases.<sup>66</sup> Lords Toulson and Kerr pointed out that there has been considerable confusion on what reliance meant, what it is that needs to be relied, and the degree of reliance required.<sup>67</sup> Equally or more important, the test has been applied in a procedural and mechanical sense with no regard for the policy rationales of the illegality defence; this problem is exemplified in *Tinsley* and the cases following it.<sup>68</sup> Further, the fact that the judges in the Court of Appeal in *Patel* expressed different views on whether there was reliance on the illegality by the claimant exemplifies the difficulties and hence uncertainty caused by the reliance test. Unsurprisingly, Lord Toulson held that the reliance rule in *Tinsley* should no longer be followed.<sup>69</sup>

It might be said however that the range of factors approach has merely replaced the existing uncertainties with another or different level of uncertainty. Whether the reliance test in the rule-based approach generates less uncertainty than the range of factors approach (as asserted by Lord Sumption and implied by Lord Mance) can only be determined empirically. As to which approach is the lesser of two evils, only time will tell. For now, there is persuasive empirical evidence (as evinced in the Law Commission's two consultation papers and final report<sup>70</sup>) that the reliance test has generated unacceptable uncertainty, but not so (or at least, not yet) with regards to the range of factors approach. Further, although it might be said that

<sup>64</sup> *Patel*, n 1 at [263].

<sup>65</sup> *Ibid* at [113].

<sup>66</sup> *Ibid* at [17]-[24].

<sup>67</sup> *Ibid* at [4]-[8]; [134], [138].

<sup>68</sup> *Ibid* at [24].

<sup>69</sup> *Ibid* at [110].

<sup>70</sup> The Law Commission, *Illegal Transactions: The Effect of Illegality on Contracts and Trust Law* (1999), Consultation Paper No 154 (CP 154); LCCP 189, n 8; Law Com 320, n 8 above.

reforms ought to be pursued by Parliament and not the courts, Lord Toulson<sup>71</sup> noted the Law Commission's findings<sup>72</sup> that because of the difficulties of statutory reform, judicial reform is more appropriate.

Lord Toulson's second rebuttal seems weak. As Lord Mance said, the foreign authorities in support of the range of factors approach are 'slender'<sup>73</sup> and the court was presented with no evidence that there have been no problems with the flexible approach adopted in other jurisdictions.

Lord Toulson's third rebuttal does not distinguish the different kinds and extent of illegality and whether it was intentional when he said that 'people contemplating unlawful activity'<sup>74</sup> should not expect the same level of certainty as that which is accorded to people who engage in lawful conduct. For example, a claimant who paid money to a defendant to commit theft or murder cannot expect certainty in the law with regards to the outcome of their conduct or at least cannot be entitled to the same level of certainty as those who engage in reputable behaviour. But it is different where the purpose of the act is legal but one of the parties may have unwittingly infringed the law in the course of performance; there, parties are entitled to certainty in the law. Further, as Lord Neuberger said, innocent third parties are entitled to certainty as the decision whether to allow the illegal defence would affect them.<sup>75</sup>

Thus, only the first of Lord Toulson's three rebuttals to the minority's objection is persuasive. While the range of factors approach does not deserve the condemnation that the minority heaped on it, it is clearly not unproblematic. In light of Proposition 2(c)'s inconsistency with the dicta in *Tinsley* and *Holman* and in view of the uncertainty and unpredictability that its application might cause, it is suggested that the Supreme Court could consider doing two things at the next appropriate opportunity. First, it could consider expressly rejecting or

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71 *Patel*, n 1 above at [25].

72 These difficulties include but are not limited to the fact that courts still have to "go through the difficult process of statutory interpretation in order to establish whether the legislature had impliedly provided that the claim is unenforceable", and the definitions and scope of the proposed legislative discretion are unclear: LCCP 189, n 8 above at [3.109]-[3.122].

73 *Ibid* at [207].

74 *Ibid* at [113].

75 *Ibid* at [158].

qualifying the dicta.<sup>76</sup> Secondly, the Supreme Court could consider making refinements to the range of factors approach.

### **Range of Factors Approach: Refinements**

The range of factors approach, as articulated by Lord Toulson, gives judges significant discretion to accord the weight that they deem fit to each of the three sub-propositions in Proposition 2 (i.e 2(a), 2(b) and 2(c)). However, it is suggested that the Court could consider clarifying that Propositions 2(a) and (b) are the controlling factors and Proposition 2(c) is subordinated to Proposition 2(a) and (b), to which primacy has to be accorded. If the application of Propositions 2(a) and (b) can resolve the question of whether the illegality defence should be allowed, it is not necessary to proceed to apply Proposition 2(c).

For example, as demonstrated by the reasoning of Lord Wilson in *Hounga*, Gloster LJ in the Court of Appeal and the majority in *Best*, the application of Propositions of 2(a) and (b) would have already resolved the question of whether to allow the illegality defence. It was unnecessary to proceed to and consider Proposition 2(c) (although the courts in those cases did so). Further, Lords Toulson and Hodge in *Bilta* rejected the application of the illegality defence solely on the basis of Proposition 2(a). Propositions 2(b) and (c) were not relevant.

However, if no determinate outcome can be achieved by the application of Propositions 2(a) and (b), then Proposition 2(c) can be applied but no more than is necessary to give effect to Proposition 1 (i.e. protect the integrity of the legal system) and to dispose of the case. This might happen, for example, in three types of cases, the first and second of which concern statutory provisions and the third common law.

The first is that if allowing the illegality defence will give effect to the purpose of the legal provision that has been infringed (Proposition 2(a)) but contrary to the purpose or policy of another applicable legal provision (Proposition 2(b)). In this case, the court would have to consider Proposition 2(c) and the final decision to allow or reject the illegality defence must give effect to Proposition 1, which will be the overriding consideration.

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<sup>76</sup> One reply to the dicta was already given by Sir Robin Jacob (with whom Toulson LJ and Laws LJ agreed) in *ParkingEye*, n 60 above at [39]: ‘Proportionality as I see it is something rather different [from the exercise of judicial discretion inherent in the public conscience test]. It involves the assessment of how far refusal of the remedy furthers one or more of the specific policies underlying the defence of illegality.’



The second example is where only Proposition 2(a) but not Proposition 2(b) applies because there is no other relevant policy underlying a legal provision other than that in Proposition 2(a). Assume that allowing the illegality defence is consistent with the purpose of a statutory provision that has been infringed (Proposition 2(a)). But the claimant's illegal act was involuntary (because it was, for example, induced by fraud, duress or undue influence).<sup>77</sup> In this example, the court would have to consider Proposition 2(c). It ought to reject the illegality defence.

However, assume the claimant's conduct was not involuntary and it does not qualify for any statutory or equitable exceptions (if they exist). Nor is the claimant within the class of persons that is protected by the statute. In this case, if on a proper construction, the statutory provision requires that relief be denied to the claimant, courts have no choice but to comply with the statute.<sup>78</sup> They should not have any discretion to consider Proposition 2(c) even if it would be disproportionate to refuse the relief because, for instance, the claimant's illegal act was trivial or the claimant was far less culpable than the defendant. As mentioned earlier, Proposition 2(c) should be subordinated to Propositions 2(a) and (b). To put it differently, disregarding the terms or purpose of an applicable statutory provision which the claimant has breached (Proposition 2(a)) by rejecting the illegality defence in order to satisfy a judge's perceived sense of disproportionateness or unfairness caused by the denial of the claim would cause far greater damage to the integrity of the legal system. But where a contract involving illegal conduct is not void on a proper construction of the statutory provision that has been infringed (Proposition 2(a)), nor is it barred by the policies of other applicable laws (Proposition 2(b)), the illegality defence should be rejected. It is unnecessary to consider Proposition 2(c).

The third example concerns breach of a common law rule that is often generic and widely applicable. There is nothing in the purpose or policy of the law that has been infringed (Proposition 2(a)) – for instance, the common law rules regulating formation and performance of contract – that will shed light on the issue of whether to allow or deny the

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<sup>77</sup> See eg, *Burrows v Rhodes* [1899] 1 QB 816.

<sup>78</sup> See eg, *Anderson Ltd v Daniel* [1924] 1 KB 138. Devlin J said in *St John Shipping Corp v Joseph Rank Ltd* [1957] 1 QB 267 that the claim in *Anderson* failed because the contract was prohibited by the statute. By contrast, in *St John's Shipping*, Devlin J said that a proper construction of the statute did not bar relief for the claimant.

illegality defence on the specific facts of the case. An example can be found in *ParkingEye*<sup>79</sup>. There the claimant sued for repudiatory breach. The defendant raised the illegality defence on the basis that the claimant intended to commit deception in the performance of the contract. As Proposition 2(a) is not determinative, courts have to consider Proposition 2(c) which the Court of Appeal did in *ParkingEye*.<sup>80</sup>

In sum, because the application of Proposition 2(c) has the potential to give rise to considerable uncertainty and even arbitrariness, the benefit of the above suggested refinements is to provide greater structure to the range of factors approach by restraining the court's exercise of discretion through the specification of the relationship between each of the three sub-propositions and in particular the circumstances under which Proposition 2(c) can be considered.

### **Rule-Based Approach: Criticisms**

According to Lord Sumption's rule-based approach, the law on illegality defence is characterised as one that is based on a relatively clear rule with limited exceptions. The policies underlying the law on illegality defence are its rationales which must not be confused with the rule itself; thus judges are required to interpret and apply the rule and not the policies.<sup>81</sup>

The question then is that in light of the uncertainties and arbitrariness surrounding the reliance test<sup>82</sup> which is the linchpin of the rule-based approach, should courts (i) continue to strain the application of the rule in order to ensure that there is no grave injustice or serious error in each case; (ii) create more exceptions to the rule; or (iii) replace the rule-based approach with the range of factors approach? The Law Commission considered all three approaches but only endorsed the third one.<sup>83</sup> The Commission noted that under the first and second approaches, needlessly and endlessly complex case law has been generated; so have

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<sup>79</sup> n 60 above.

<sup>80</sup> Ibid at [32]-[35], [38]-[40], [53], [61], [68], [69], [71]-[73].

<sup>81</sup> *Patel*, n 1 above at [261].

<sup>82</sup> n 8-11, 68-70 above.

<sup>83</sup> LCCP 189, n 8 above at [3.53]-[3.55].

been the technical distinctions, largely because of the confusion surrounding the reliance test. So, one should either modify or replace the reliance test with something else. But because Lord Sumption would have it neither way, the application of his rule-based approach is destined to repeat the same problems and even engender new ones. Unsurprisingly, the third approach was preferred by the Commission because given that the illegality defence is a judge-made rule that is specifically based on public policies which may vary in different situations, the most appropriate and effective way to implement the rule is to identify and give effect to its underlying policies, instead of mechanically applying the letter of the rule with no regard for its policy rationales.

The problem of the approach of having a rule followed by exceptions is also evidenced in Lord Clarke's endorsement of Lord Neuberger's formulation of the rule: a claimant is entitled to the return of the money that he has paid to the defendant under a contract to carry out an illegal act but the act is not carried out due to matters beyond the parties' control ('the Rule').<sup>84</sup> Lord Clarke praised the Rule as it is not only consistent with authority and policy, but 'renders the outcome in cases of contracts involving illegality and the maxim *ex turpi causa non oritur actio* relatively clear and uncertain.'<sup>85</sup> He said that the Rule does not require the balancing of any public policies as 'it simply applies the principles derived from the authorities to the facts of the case.'<sup>86</sup>

However, Lord Clarke has overstated the certainty and clarity of the Rule and underestimated the complexities that may arise which may not be captured by the Rule or its exceptions<sup>87</sup>. To put it differently, the Rule is not able to provide a clear and fair answer unless one examines the public policies underlying the illegality defence.

Take two examples mentioned by Lord Neuberger. First, the Rule, in itself, is not able to provide clear guidance where, for instance, the purpose and formation of the contract are not illegal, but while performing the contract, the defendant would have to commit, of which both parties are well-aware, an illegal but incidental and trivial act such as parking on a

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<sup>84</sup> *Patel*, n 1 above at [146].

<sup>85</sup> *Ibid* at [210].

<sup>86</sup> *Ibid* at [212].

<sup>87</sup> Lord Neuberger said at [162] there are two possible exceptions to the Rule: (a) the rule should not be applied where the defendant falls within the class of persons that is protected by the statute and (b) the claimant should be entitled to no or only partial recovery where the defendant was unaware of the illegality and in particular if he had altered his position.

double red line.<sup>88</sup> If the defendant breaches the contract by refusing to perform, it is not apparent from the rule (or its exceptions) whether the claimant is entitled to damages. Or if the claimant has fulfilled the terms of the contract but had to park on a double red line, it is not manifest from the rule whether the defendant has to pay the claimant. On the former, Lord Neuberger said that the public policy of consistency would require courts to deny damages to the claimant. On the latter, Lord Neuberger said that the claimant is entitled to be paid in full for his performance albeit committing the trivial and incidental illegal act. But no reason was given by him. The only sensible justification requires examination of the public policies under the range of factors approach: in order to protect the integrity of the legal system, whether allowing the claimant's claim would be inconsistent with the terms or purpose of the law that has been infringed and whether it would be disproportionate to deny him relief.

Second, the Rule is not able to provide clear and authoritative answer 'where the nature of the criminal activity was more serious and/or more central to the activity involved, where the illegal activity was expressly included in the contract, or where one of the parties did not know or intend that the activity in question to be carried out was illegal but the other did, or where the proceedings arose out of the fact that such a contract had only been partly performed.'<sup>89</sup> Further, it is not possible to lay down a clear and definitive rule that would cover the second example and any other future examples. Thus, although Lord Neuberger said that the application of the Rule would resolve and dispose of this case, he endorsed Lord Toulson's range of factors approach because of the considerable permutations and complexities that have arisen and could continue to arise from cases involving contractual illegality that are not contemplated by the Rule.<sup>90</sup>

## CONCLUSION

The minority's rule-based approach 'has failed to deliver on what some have claimed to be its principal virtue viz ease of application and predictability of outcome.'<sup>91</sup> Admittedly, the range

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<sup>88</sup> *Patel*, n 1 above at [178].

<sup>89</sup> *Ibid* at [179] (Lord Neuberger).

<sup>90</sup> *Ibid* at [180]-[182].

<sup>91</sup> *Ibid* at [134] (Lord Kerr).

of factors approach is not strictly necessary for the resolution of the specific issue in this case and the disposal of the appeal (as demonstrated by Lord Neuberger's Rule and in particular Lord Mance and Lord Clarke's reasoning). However, because the law was in 'disarray',<sup>92</sup> the majority was correct to have set the record straight by authoritatively pronouncing on what the correct approach to the illegality defence is. This approach has been shown to be well-supported by authorities, and, if refinements suggested in this article are made, is likely to result in significantly less uncertainty than the minority's rule-based approach.

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<sup>92</sup> Ibid at [164] (Lord Neuberger).