

***The Illegality Defence after Patel v Mirza***  
**The Professor Jill Poole Memorial Lecture 2022**

**Aston University, 24 October 2022\***

## **1. Introduction**

Before I ever met Jill Poole, I was a great admirer of her Textbook and Casebook on Contract Law. Her infectious enthusiasm for contract law shone through those books and in her famous prefaces we glimpsed her dedication to her children, Becky and Alex, and her students. When I finally did meet her – she accepted my invitation to attend a conference on Contract Terms in Oxford in 2006 - it was a delight to see that she was just the person I had expected. Modest and unassuming, she loved contract law not at some high theoretical level but as a practical subject where the fun lies in exploring and understanding the detail of the rules and principles. In other words, like me, she was a doctrinal scholar or as one might otherwise put it she was dedicated to practical legal scholarship. When she died so tragically young in 2016, in my capacity as President of the Society of Legal Scholars, I attended her funeral – she had been a stalwart of the SLS Executive Committee for many years – and it was a deeply moving and yet uplifting occasion. I therefore consider it an honour and privilege to be asked to deliver the Jill Poole Memorial Lecture for 2022.

Illegality as a defence, which is the topic I have chosen for tonight’s lecture, includes contract law but extends beyond it to, for example, tort and unjust enrichment. Jill of course covered the contract aspects of it in her contract books but the leading case of *Patel v Mirza* came after her death so that, unfortunately, we are deprived of her views on it.

Prior to *Patel v Mirza*<sup>1</sup> the conventional approach to the illegality defence required the courts to apply various Latin maxims. So when I studied illegality as a student, I learned that much of the relevant law stemmed from the ideas that *ex turpi causa non oritur actio* (‘no action arises from a disgraceful cause’) and *in pari delicto potior est conditio defendentis* (‘where both parties are equally in the wrong the position of the defendant is the stronger’) and that there is a *locus poenitentiae* (‘time for repentance’). We were also taught that there was a reliance rule so that illegality would be a defence where the claimant had to rely on the illegality to establish or to plead its cause of action. In addition, in the context of contract, rules developed from the Latin maxims tended to draw distinctions between illegality in formation and illegality in performance. And in the realm of tort, illegality became linked with particular rules of causation. But there were also exceptions to these rules. The truth is that the common law in this area had become a nightmarish mess that was not only complex and unclear but also produced a mode of reasoning that did not appear to reflect the underlying issues that, standing back from the detail, one would have expected to be relevant.

Not surprisingly, therefore, there were calls for reform and this led to extensive work over several years by the Law Commission. I was the Law Commissioner in charge of this project in its early days. During my time it was thought that the common law had become so entrenched that the only way forward would be legislative reform and in the first consultation paper our provisional recommendation was for legislation to introduce a statutory discretion under which the traditional unsatisfactory rules would be swept away and the courts would be required to take into account various factors in deciding whether illegality should be a defence.<sup>2</sup> But subsequently in its report (widened to include tort as well as contract and trusts) and no doubt influenced by the lack of Governmental enthusiasm for legislative reform of this area of the common law, the Law Commission changed tack so that, while still favouring a range of factors approach, the strategy became one of largely calling on the courts to implement the necessary reform.<sup>3</sup>

There then followed a series of cases in the Supreme Court which revealed an underlying split of view between those Justices who thought that the existing rules were basically fine albeit needing some refinements and those who thought that the only satisfactory way forward was to abandon the conventional rules in favour of a policy-based or range of factors approach along the lines recommended by the Law Commission. So the scene was set for the show-down in the Supreme Court in *Patel v Mirza* heard by a panel of nine Justices.

Mr Patel, the claimant, paid sums totalling £620,000 to Mr Mirza, the defendant, pursuant to an agreement under which the defendant agreed to use the money to bet on the movement of shares using inside information. The use of inside information to deal in shares (as, for example, by betting on their movement) constitutes the offence of insider dealing contrary to s 52 of the Criminal Justice Act 1993. This was therefore a contract for the commission of a crime. In the event, the agreement could not be carried out because the expected inside information was not forthcoming. When that became clear, the claimant sought repayment of the £620,000 as restitution of an unjust enrichment. Applying the normal rules of unjust enrichment, the claimant would be entitled to restitution of the £620,000 because the money had been paid for a consideration that had totally failed ie the claimant had obtained nothing in return for his £620,000 and equally the defendant had obtained £620,000 for doing nothing. However, the defendant argued that the defence of illegality meant that the claim should fail so that he did not have to repay the money. The illegality defence succeeded before the trial judge applying the reliance rule that the claimant had to rely on the illegality to make out the claim but failed before the Court of Appeal who applied the *locus poenitentiae* doctrine. The defendant then appealed to the Supreme Court.

The Supreme Court unanimously dismissed the appeal – that is, the defence of illegality failed - but for different reasoning than that of the Court of Appeal. By a majority of 6-3, the Supreme Court favoured a new policy-based approach to the illegality defence which drew on the work of the Law Commission. Lord Toulson (who had been Chair of the Law Commission for part of the time that the illegality project was ongoing) gave the leading judgment with whom Lady Hale, Lord Kerr, Lord Wilson, and Lord Hodge agreed (as did Lord Neuberger albeit with some differences). In contrast, Lords Sumption, Mance and Clarke favoured retaining the traditional rules, with some tweaking, and, rather ironically, given the state of the common law, feared that the new approach would create unacceptable uncertainty.

Lord Toulson explained that, at a high level of generality, a court in deciding on the defence of illegality should seek to avoid inconsistency in the law, thereby maintaining the integrity of the legal system,<sup>4</sup> and that a “trio of necessary considerations” should be taken into account in achieving that high level goal. These were, first, the purpose of the illegality in question; second, any conflicting relevant policies; and third, the need to avoid a result that was disproportionate. In deciding on whether the result was disproportionate, a number of factors might be relevant including the seriousness of the illegal conduct, its centrality to the claim, whether the conduct was intentional and whether there was a marked disparity in the blameworthiness of the parties’ conduct.

In Lord Toulson’s words:<sup>5</sup>

‘[O]ne 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.'

With that by way of introduction, I want to go on to explore how the defence of illegality is operating in the courts today and, in particular, how Lord Toulson's approach in *Patel v Mirza* has subsequently been interpreted and applied in the courts. In doing so, I shall be referring to two important Supreme Court cases that were heard before I joined the court and in relation to which I therefore had no input. They were heard within a short time of each other and the judgments were plainly crafted to provide further clarity to the practical application of Lord Toulson's approach. These cases were *Grondona v Stoffel & Co*<sup>6</sup> and *Henderson v Dorset Healthcare University NHS Foundation Trust*.<sup>7</sup> In the former, the illegality defence failed. In the latter, it succeeded.

## **2. *Grondona v Stoffel & Co***

This was a professional negligence claim, brought in contract and tort, against a firm of solicitors retained to carry out conveyancing. Ms Grondona had participated with a Mr Mitchell in a mortgage fraud whereby, inter alia, a lender (Birmingham Midshires) had been deceived into lending money for the purchase of a lease of a flat by Grondona from Mitchell. By the negligence of the solicitors, the lease of the flat was not registered in Grondona's name. In her claim for negligence against them, it was not in dispute that, if there were no defence of illegality, the claim would succeed entitling Grondona to damages of £78,000 plus interest. But the solicitors argued that the illegal conduct of Grondona – she and Mitchell were guilty of conspiracy to commit a mortgage fraud – meant that there was a defence of illegality to her claim. It was held by the Supreme Court, upholding the decision of the lower courts, that, applying *Patel v Mirza*, illegality was not here a defence.

The leading judgment was given by Lord Lloyd-Jones (with whom Lord Reed, Lord Hodge, Lady Black and Lady Arden agreed). He sought to apply Lord Toulson's trio of considerations. In doing so, four particularly important points may be said to emerge from his judgment.

First, at a high level, the goal in applying the illegality defence is to avoid inconsistency within the legal system.

Secondly, the identification and assessment of the relevant policies in play normally falls within the competence of judges to carry out without the need for expert evidence.

Thirdly, that process of identifying and assessing the relevant policies should be flexible and should not become too mechanistic.

Fourthly, one may not need to move on to consider proportionality where it is clear from the first two of Lord Toulson's trio of consideration, ie stages (a) and (b), that the defence of illegality should not be allowed.

Applying this approach to the facts, Lord Lloyd Jones considered that allowing the defence would not seriously deter mortgage fraud. On the other hand, denying the defence would undermine the good reasons why the law imposes duties of care on solicitors, would tend to increase the prospect of reducing mortgage fraud, would on the facts help to protect other victims of fraud (ie the lenders who could pursue Grondona if she succeeded in recovering compensation) and would recognise that Grondona had a valid property interest (that could be registered). It was also thought relevant that what Grondona was here seeking was compensation for loss not profit from wrongdoing.

Given that the policies clearly favoured denying the defence, there was no need to go on to consider proportionality. But if one did so, to allow the defence would be a disproportionate response because the illegality was not at all central to the negligence of the solicitors or, put another way, the negligence of the solicitors was conceptually entirely separate from the illegality.

The defence of illegality was therefore held to be inapplicable and the claim for professional negligence succeeded.

### **3. *Henderson v Dorset Healthcare Foundation Trust***

The claimant stabbed her mother to death while suffering a psychotic episode. She was convicted of manslaughter by reason of diminished responsibility. The defendant health authority admitted negligence in failing to have the claimant returned to hospital. The claimant brought an action in the tort of negligence against the health authority in which she claimed as damages the loss she had suffered consequent on having killed her mother, which included damages for her loss of liberty and the loss of her share of her mother's estate by reason of the Forfeiture Act 1982. The sole issue was whether the defendant had a defence of illegality to the claim for negligence. The Supreme Court held that it did have that defence.

In contrast to *Stoffel*, a complication in this case in applying *Patel v Mirza* – and it was for this reason that a panel of seven Justices heard the case - was that there was a previous decision of the House of Lords in *Gray v Thames Trains Ltd*<sup>8</sup> which, on somewhat similar facts, had allowed the defence of illegality. Although the negligence in that case had been very different – it concerned negligence in relation to a train accident in which the claimant had suffered PTSD – the essential similarity was that, as a consequence of the negligence, the claimant had killed someone and had been convicted of manslaughter, by reason of diminished responsibility, for that death.

The leading judgment in *Henderson* was given by Lord Hamblen (with whom Lord Reed, Lord Hodge, Lady Black, Lord Lloyd-Jones, Lady Arden and Lord Kitchin agreed). In relation to the application of *Patel v Mirza* Lord Hamblen made a number of important points. I here mention six of them.

(i) Although this was implicit in *Stoffel*, he explicitly stated<sup>9</sup> that the policy-based approach of *Patel v Mirza* applies across civil law and is not confined to claims in unjust enrichment or contract. It applies as in *Stoffel* and in this case to torts but also to claims based on property law.

(ii) As was also made clear in *Stoffel*, Lord Hamblen was of the view that usually evidence as to the policy considerations would be unnecessary.<sup>10</sup>

(iii) He clarified that the consideration of policies at stages (a) and (b) requires one to consider all the relevant policies in favour of applying the defence (ie denying the claim) at (a) and then all the relevant policies for denying the defence (ie allowing the claim) at (b).<sup>11</sup>

(iv) As was said in *Stoffel*, Lord Hamblen was of the view that, where the balancing of policy considerations comes down clearly against applying the defence of illegality, there is no need to go on to consider proportionality.<sup>12</sup>

(v) Lord Hamblen made clear that *Patel v Mirza* was concerned with what can be labelled common law illegality and not statutory illegality.<sup>13</sup> I will return to this point later.

(vi) As regards precedent, the adoption of the new policy-based approach in *Patel v Mirza* did not wipe away existing precedent.<sup>14</sup> *Patel v Mirza* did not represent 'year zero'. The exercise was one of checking whether past precedents were '*Patel*-compliant'.<sup>15</sup>

Applying all this to the case at hand, Lord Hamblen identified a number of policies supporting denial of the claim (ie that the defence of illegality should apply). These included avoiding inconsistency in the legal system (ie while recognising diminished responsibility, criminal law treated the defendant as guilty of, and hence responsible for, the death), the close connection between the crime and the claim, and the general deterrence of crimes. The policies going the other way – such as upholding duties of care and providing compensation to the victims of torts – were plainly outweighed by the former policies. As the policies favoured allowing the defence, one needed to move on to the third stage, and here the denial of the claim would not be disproportionate taking into account, for example, the centrality of the conduct to the claim and the criminal guilt of the defendant in that she knew what she was doing and that it was legally and morally wrong. Applying the approach in *Patel v Mirza*, therefore, that the defence of illegality should succeed.

Furthermore, this policy-based analysis was consistent with the decision and most of the reasoning of the House of Lords in *Gray*, albeit that there had there been no consideration of proportionality by their Lordships. This meant that *Gray* was 'Patel-compliant' and should be followed in this case.

It should be realised that the facts of *Henderson* and *Gray* may be considered somewhat exceptional. In *Patel v Mirza* the tenor of the majority judgments was that, at least in restitution of unjust enrichment cases - because one is seeking to restore the pre-illegality position rather than to enforce a contractual obligation upholding an illegal position - there is a very strong argument for applying normal civil law rules unaffected by illegality and leaving the criminal law to deal with the criminality involved. The same may be said of claims in tort and this derives support from *Stoffel*. But *Henderson* and *Gray* show that there are limits to that approach.

Taken together, *Stoffel* and *Henderson* in the Supreme Court have served to clarify and indeed simplify the application of the trio of considerations laid down in *Patel v Mirza*. With the overall aim of avoiding inconsistency, one must identify and weigh the relevant policies for and against the illegality defence and then, if the former outweigh the latter (ie the policies favour allowing the defence), one must go on to consider whether allowing the defence would be a disproportionate response.

Having said all that, in the light of these two cases, I do have some lingering concerns as to whether the attempt made in *Patel v Mirza* to structure the analysis through a trio of considerations is to be preferred to an approach which would have allowed the courts, more freely, to consider and articulate a range of factors in arriving at their decision. There is some danger of the courts being unnecessarily strait-jacketed into a mechanical approach when it may have been preferable to have permitted the courts to consider all relevant factors and to articulate those considered important in applying or rejecting the illegality defence in the particular case. Not least because of the requirement, as far as possible, to respect precedent, I doubt whether courts needed the structure provided by the trio of considerations in order to marshal the relevant factors. This links to the further point that, rather than viewing the overall aim as being to avoid inconsistency in the legal system, one might regard that policy as merely one of the relevant policies in play which will more obviously have a central role to play in some cases than in others. Similarly, proportionality might have been best treated as one relevant factor to be considered because, again, it may have greater resonance in some cases than others.

It is important to add that the new policy-based approach should ensure that, in contrast to the old unsatisfactory rules, new rules on the illegality defence can in time be formulated that are fit for purpose and reflect sound underlying policies. Those new rules need to be sufficiently flexible to

allow the relevant policy factors to be taken into account but also, so far as possible, should be consistent with past decisions.

#### 4. Statutory illegality and common law illegality

A further point made by Lord Hamblen in the *Henderson* case is that *Patel v Mirza* was concerned with what he referred to, as 'common law illegality rather than statutory illegality'.<sup>16</sup> He continued, 'Where the effects of the illegality are dealt with by statute then the statute should be applied.' And as Lord Toulson said in *Patel*, 'The courts must obviously abide by the terms of any statute.'<sup>17</sup>

This relationship between statutory and common law illegality is not straightforward. However, it must be stressed that it is in no sense a new issue created by *Patel v Mirza*.

What can cause initial confusion is that the terms common law and statutory illegality are not here referring to the source of the illegality but to its effects on the claim in question. In most cases, at least those involving crimes, the source of the illegality is statutory. That is, the crime is laid down in statute rather than by common law. Indeed, that is true of *Patel v Mirza* itself whether one regards the relevant crime as the statutory offence of insider dealing or the statutory offence of conspiracy to commit insider dealing (the common law offence of conspiracy having been made a statutory offence under the Criminal Law Act 1977). With statutory illegality, one is concerned with applying whatever the statute lays down, expressly or impliedly, as to the effects of the illegality. This is determined by ordinary statutory interpretation. Common law illegality is applied where the effects of the illegality have not been laid down, expressly or impliedly, in the statute (ie the statute has not dealt with the effects of the illegality). With common law illegality, one is concerned to determine the effects of the illegality at common law and this is where *Patel v Mirza* applies.

Where the source of the illegality is statutory, one must first therefore consider whether the effects of the illegality are dealt with, expressly or impliedly, in the statute. Where the statute does not deal, expressly or impliedly, with the effects on the claim in question one must go on to consider common law illegality and *Patel v Mirza*. Perhaps the best known case where a statutory illegality defence succeeded was *Re Mahmoud and Ispahani*.<sup>18</sup> Here a wartime order, made by delegated legislation, prohibited the purchase or sale of linseed oil without a licence from the Food Controller. The claimant (who had a licence) contracted to sell linseed oil to the defendant, who did not have a licence, although the claimant was told by the defendant that he did have a licence. The defendant refused to accept the oil but the claimant's action for damages for non-acceptance failed because the contract was prohibited by the legislation and was therefore, by necessary implication, unenforceable by either party. The statute therefore comprehensively dealt with the effects of the illegality and there was no role for common law illegality.

The decision of the Privy Council in *Energizer Supermarket Ltd v Holiday Snacks Ltd*<sup>19</sup> is a useful illustration of a post-*Patel* case that exemplifies this relationship between statutory illegality and common law illegality. A principal issue in the case was whether an equitable easement allowing a gas pipeline to run under the land of the defendant, in favour of the claimant, was unenforceable by the claimant because of illegality in that no licence for the pipeline had been obtained by the claimant (or its predecessors in title) contrary to the Petroleum Act in Trinidad and Tobago. It was held that there was no illegality defence, whether statutory or common law.

There was no statutory illegality defence because, in contrast to *Re Mahmoud and Ispahani*, the relevant statute, the Petroleum Act, on its proper interpretation, did not prohibit the granting of the easement and did not impliedly render the easement unenforceable.

Turning to common law illegality (on the basis that the statute had not ousted the common law ie it had not precluded unenforceability at common law) then, applying *Patel v Mirza*, as clarified in *Stoffel and Henderson*, the policies, in favour of the illegality defence, were clearly outweighed by the policies favouring denying the illegality defence.

## 5. Conclusion

Illegality as a defence raises many fascinating issues. In this lecture in memory of Jill Poole, I have touched on the relationship between common law and statutory illegality but I have principally been concerned to explain and evaluate the decisions of the Supreme Court in *Stoffel and Henderson*, which have simplified and clarified the new approach to illegality laid down in *Patel v Mirza*.

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<sup>1</sup> [2016] UKSC 42, [2017] AC 467.

<sup>2</sup> Law Commission Consultation Paper No 154 *Illegal Transactions* (1999).

<sup>3</sup> Law Commission Consultation Paper No 189, *The Illegality Defence* (2009); Law Commission Report No 320, *The Illegality Defence* (2010).

<sup>4</sup> This was Justice McLachlin's phrase in her influential judgment in the Supreme Court of Canada in *Hall v Hebert* [1993] 2 SCR 159. This is the same idea as not 'stultifying the law' which was the language used by Lord Radcliffe in *Boissevain v Weil* [1950] AC 327, HL.

<sup>5</sup> [2016] UKSC 42, [2017] AC 467, at [101].

<sup>6</sup> [2020] UKSC 42, [2021] AC 540.

<sup>7</sup> [2020] UKSC 43, [2021] AC 563.

<sup>8</sup> [2009] UKHL 33, [2009] AC 1339.

<sup>9</sup> [2020] UKSC 43, [2021] AC 56, at [76].

<sup>10</sup> *Ibid* at [115].

<sup>11</sup> *Ibid* at [116]-[122].

<sup>12</sup> *Ibid* at [123].

<sup>13</sup> *Ibid* at [74]-[75].

<sup>14</sup> *Ibid* at [77]-[78]. A useful analogy might be drawn with the recognition of the law of unjust enrichment in *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548. It is not suggested that that decision at a stroke wiped away all the decisions in past cases based on the rejected 'implied contract' approach to restitution. Rather, after that decision, the courts should strive to arrive at the same decisions as bound them before but applying an unjust enrichment analysis.

<sup>15</sup> *Ibid* at [145].

<sup>16</sup> *Ibid* at [74].

<sup>17</sup> [2016] UKSC 42, [2017] AC 467, at [109].

<sup>18</sup> [1921] 2 KB 716, CA.

<sup>19</sup> [2022] UKPC 16.