The legal consequences of illegality

Nicholas Pointon¹

“As any hapless law student attempting to grapple with the concept of illegality knows, it is almost impossible to ascertain or articulate principled rules from the authorities relating to the recovery of money or other assets paid or transferred under illegal contracts.”²

Abstract

Illegality is “notoriously knotty territory” for litigants and practitioners alike.³ In the absence of Parliamentary intervention⁴, an upcoming appeal to the Supreme Court in Patel v Mirza⁵ provides an opportunity for some much needed clarity, particularly in relation to the scope of the locus poenitentiae doctrine. This article will place Patel v Mirza into context within the wider topic of illegality before considering the questions to be resolved on the appeal itself.

History

The defence of illegality reflects the law’s refusal to lend its assistance to matters tainted by unlawful wrongdoing. In some narrow situations the very existence of the agreement will be prohibited and the act of entering into it unlawful. Far more often it is the object of the agreement which is illegal. In either event, the consequences of illegality are far from uniform.

History has seen a battle between the competing forces of public policy and the Victorian ideal of freedom of contract. The early nineteenth century saw the role of public policy reigned in as being “a very unruly horse”.⁶ Yet by the second half of the twentieth century the courts

¹ The author is a barrister practising from St John’s Chambers in Bristol and a Senior Associate Tutor of Law at the University of Bristol.
² Patel v Mirza [2014] EWCA Civ 1047; [2015] 2 WLR 405, per Gloster LJ at [47].
⁴ In 1999 the Law Commission recommended that legislation should be enacted which would give the courts a structured statutory discretion to decide the consequences of illegality on private law claims: see Illegal Transactions: The Effect of Illegality on Contracts and Trusts (1999) (Law Com No 154). In 2010 they published a further report which concluded that there was no longer any need for general legislation in the area (save in relation to trusts) because the existing law was amenable to common law development: see The Illegality Defence (2010) (Law Com No 320).
⁵ The Supreme Court granted permission to appeal on 15 December 2014.
⁶ Richardson v Mellish (1824) 2 Bing 229, per Burrough J at 252.
had indulged their interventionist streak in the guise of public policy once more. As Lord Denning MR observed, “with a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles.”

**Modern contraction of the doctrine**

The unruly horse has featured in a number of areas ancillary to the law of contract, in which the role to be played by illegality has been confined dramatically. Two very recent examples will suffice.

In *Hounga v Allen* [2014] UKSC 47; [2014] 1 WLR 2889 an employee who had been brought from Nigeria by her employer so as to enter the United Kingdom in breach of immigration control, to take up her employment illegally, was then dismissed by her employer. She brought a claim for unlawful race discrimination in relation to her dismissal. The Court of Appeal denied her entitlement to sue on the basis that upholding her claim would condone the illegality. The Supreme Court allowed her appeal, emphasizing that illegality works in different ways, depending on the context in which it arises.

In *Best v Chief Lands Registrar* [2015] EWCA Civ 17, the Court of Appeal held that a claim to be registered as proprietor of land as a result of adverse possession was not defeated simply because some of that adverse possession amounted to the commission of the criminal offence of squatting under s.144 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012.

**Forms of illegality**

**Agreements to commit a crime or civil wrong**

Agreements which have as their object the deliberate commission of a crime are not enforceable. So too an agreement to commit a civil wrong. Examples of unenforceable agreements include those to commit assault, publish libel, deceit or the perpetration of fraud on creditors or prospective shareholders.

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8 Levy v Yates (1838) 8 A & E 129.
9 Allen v Rescous (1677) 2 Lev 174.
10 Clay v Yates (1856) 1 H & N 73.
A particularly strong historical example of the doctrine is the notorious highwaymens’ case, *Everet v Williams* (1725), unreported but noted at (1893) 9 LQR 197. When invited to take an account between to highwaymen the court dismissed the claim as “scandalous and impertinent”, before ordering the arrest of the plaintiff’s solicitor and fining him.

**Agreements contrary to good morals**

It has often been said that contracts *contra bonos mores* are void, yet the only aspect of immorality to have been the subject matter of reported cases is sexual immorality. There are terrific old cases in which landlords have been prevented from recovering the rent because they knew that the premises were occupied by the kept mistress of a man in the habit of visiting her there, but time and morality have marched on such that a modern court is unlikely to reach the same result.

The one area in which contracting remains impermissible is prostitution. No claim lies for the rent of premises knowingly let for prostitution, nor apparently for the hire of items to be deployed in furthering the same work.

**Agreements contrary to the public interest**

In *Les Laboratoires Servier v Apotex* [2014] UKSC 55; [2014] 3 WLR 1257 Lord Sumption JSC has rationalized all cases of ex turpi causa as being “concerned with claims founded on acts which are contrary to the public law of the state and engage the public interest” (at [25]). The paradigm case is a criminal offence, but Lord Sumption JSC also recognizes what he describes as “quasi-criminal” conduct, including cases of dishonesty or corruption.

**Consequences of illegality**

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12 Mallalieu v Hodgson (1851) 16 QB 689.
13 Begbie v Phosphate Sewage Co Limited (1876) 1 QBD 679.
14 Upfill v Wright [1911] 1 KB 506.
15 Girardy v Richardson (1793) 1 Esp 13.
16 Pearce v Brooks (1866) LR 1 Ex 213 (an agreement for the hire of an ornamental brougham of unusual design for use in the trade).
The consequences of illegality vary enormously. At one end of the scale the court might absolutely refuse to assist anyone implicated in the illegality. Alternatively it might permit money or property transferred under an illegal agreement to be recovered, or sever the illegal parts and enforce the remainder.

The starting point is the often cited dicta of Lord Mansfield in Holman v Johnson:

“The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but is founded in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may so say. The principle of public policy is this: ex dolo malo non oritur action. No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff’s own stating or otherwise, the cause of action appears to arise ex turpi causa, or the transgression of a positive law of this country, there the Court says he has no right to be assisted. It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally at fault, potior est conditio defendentis.”

A more modern statement of principle is found in Tinsley v Milligan [1994] 1 AC 340, in which it was held that a claimant to an interest in property is entitled to recover or establish it provided that in doing so he does not need to plead or rely on an illegality. Lord Browne-Wilkinson surveyed the authorities before stating, at 370:

“From these authorities the following propositions emerge: (1) property in chattels and land can pass under a contract which is illegal and therefore would have been unenforceable as a contract; (2) a plaintiff can at law enforce property rights so acquired provided that he does not need to rely on the illegal contract for any purpose other than providing the basis of his claim to a property right; (3) it is irrelevant that the illegality of the underlying agreement was either pleaded or emerged in evidence: if the plaintiff has acquired legal title under the illegal contract that is enough.”

The latest expression is that of Lord Sumption JSC in Les Laboratoires Servier v Apotex [2014] 3 WLR 1257, at [23]:

“But in general, although described as a defence, it is in reality a rule of judicial abstention. It means that rather than regulating the consequences of an illegal act (for example by restoring the parties to the status quo ante, in the same way as on the rescission of a contract) the courts withhold judicial remedies, leaving the loss to lie where it falls. This is so even in a contractual context, when the court is invited to

17 (1775) 1 Cowp 341, at 343.
determine the financial consequence of a contract’s voidness for illegality. The ex turpi causa principle precludes the judge from performing his ordinary adjudicative function in a case where that would lend the authority of the state to the enforcement of an illegal transaction or to the determination of the legal consequences of an illegal act.”

Locus poenitentiae and the need for repentance

When the contract for an illegal purpose has been performed, one party who has transferred property under that contract cannot usually set up the illegal purpose as a basis for its return. In Singh v Ali [1960] AC 167 Lord Denning put the principle as follows, at 176 – 177:

“There are many cases which show that when two persons agree together in a conspiracy to effect a fraudulent or illegal purpose - and one of them transfers property to the other in pursuance of the conspiracy - then, so soon as the contract is executed and the fraudulent or illegal purpose is achieved, the property (be it absolute or special) which has been transferred by the one to the other remains vested in the transferee, notwithstanding its illegal origin . . . The reason is because the transferor, having fully achieved his unworthy end, cannot be allowed to turn round and repudiate the means by which he did it - he cannot throw over the transfer, and the transferee, having obtained the property, can assert his title to it against all the world, not because he has any merit of his own, but because there is no one who can assert a better title to it. The court does not confiscate the property because of the illegality - it has no power to do so - so it says, in the words of Lord Eldon: ‘Let the estate lie where it falls;’ see Muckleston v. Brown (1801) 6 Ves. 52 , 69.”

However there is an exception to the illegality defence which applies when the claimant withdraws from the transaction before the illegal purpose has been performed, in whole or in part. The exception is known as the locus poenitentiae doctrine. It is open to a party who has paid money or transferred property under an agreement with an illegal purpose to repudiate it, withdraw from the agreement and recover what he has paid or transferred: Taylor v Bowers (1876) 1 QBD 291. But once the agreement has been carried out, in part or in full, it is too late to withdraw: Kearley v Thomson (1890) 24 QBD 742.

John Gray’s Lawyers’ Latin (2002) explains the latin phrase as follows:

“ ‘a place of repentance’. Used in the law to denote a breathing space, a time before legal obligation operates; or during which the law affords an opportunity for change of mind.”

Lord Browne-Wilkinson also spoke in terms of repentance when briefly surveying the doctrine in Tinsley v Milligan, at 374.
The limits of the doctrine were explored by the Court of Appeal in *Patel v Mirza*, which had to consider whether the doctrine could still operate where the claimant withdraws not because he has a change of heart, but because the illegal purpose ceases to be possible as a result of actions beyond his control. In short, does the claimant need to repent at all?

**Patel v Mirza**

**The facts**

The facts can be stated simply. Chantrakant Patel paid £620,000 to Salman Mirza, upon Mirza's agreement to use the money to bet on the movement of RBS shares on the basis of inside information. In the event the inside information was not forthcoming and Patel brought a claim against Mirza for the repayment of the money. Mirza defended on the basis of a complicated explanation which denied any agreement to engage in insider dealing; he did not plead illegality.

**The decision at first instance**

David Donaldson QC (sitting as a Deputy High Court Judge) rejected Mirza's alternative explanation of the transaction but dismissed Patel's claim in any event, on the basis that his account of events meant that his case was founded upon an illegal agreement because it contravened the prohibition on insider dealing contained in Section 52 of the Criminal Justice Act 1993.

The Deputy Judge held that the position would have been different if Patel had withdrawn from the agreement before its implementation had become frustrated, but he did not. The Deputy Judge accepted that a claimant is not barred from recovery if he withdraws from the illegal contract before it is performed (the *locus poenitentiae* doctrine), but held that in this case Patel withdrew because the illegal purpose could no longer be performed and so could not rely on the doctrine.

**The decision of the Court of Appeal**

The Court of Appeal allowed Patel's appeal on the basis that he had withdrawn from the illegal agreement before it had been carried into effect. Judgments were reserved for some time as further enquiries were made of counsel, during which period Rimer LJ openly admits that his mind wavered on the correct approach (at [44]).
The key passage in the judgment of Rimer LJ reads as follows:

“I would regard as unattractive a distinction between cases (a) where the withdrawal is from an illegal agreement that is no longer needed for the purpose for which it was designed, and (b) where the withdrawal is from an illegal agreement that cannot be or is anyway not going to be performed. The drawing of any such distinction would, I consider, depend on holding that “genuine repentance” on the part of the withdrawer is required. I consider that if, as in Tribe v Tribe, voluntary withdrawal from an illegal agreement when it had ceased to be needed is sufficient to entitle the claimant to recover, it would be an odd distinction if a claimant were nevertheless not entitled to recover by relying on an illegal agreement that neither was performed nor could be performed. To recognize such a distinction would, I consider, require proof of a true sense of penitence, something that was not required or expected of the successful claimant in Tribe v Tribe.”

Gloster LJ took a different approach. She would have allowed the appeal on the first ground, on the basis that in her view Patel did not need to rely upon the agreement tainted by illegality at all when constructing his claim (at [80] et seq). She distinguishes between the agreement between Patel and Mirza, on the one hand, and the spread bet contract which Mirza was to enter into, on the other, emphasizing that only the latter was illegal.

As to the second ground of appeal, her reasoning continued to differ from that of Rimer and Vos LJJ, focusing instead on the policy implications which underlie the illegality defence. In paragraphs 65 – 67 she cogently argues that the statutory provisions prohibiting insider dealing do not require that the investor loses all rights to the return of money if the transaction never takes place. She notes that Section 63(2) of the Criminal Justice Act 1993 itself holds that no contract shall be void or unenforceable by reason only of Section 52 (the prohibition on insider dealing), and states:

“In circumstances where the actual securities contract entered into on the basis of illegal insider information is not void or unenforceable… it is hard to see on what possible basis the public policy behind the rule against insider trading requires the anterior contract or arrangement for the deposit of Mr Patel's funds with Mr Mirza, as Mr Patel's agent, to be struck down as unenforceable, so as to deny Mr Patel recovery of the moneys he paid over…”

Finally, on the need for repentance Gloster LJ agreed with Rimer and Vos LJJ as follows (at [96]):

“I agree with the views of Rimer LJ (as expressed at para 45 of his judgment), and those of Vos LJ (as expressed at para 113 of his judgment) that the entitlement to recover under the locus poenitentiae doctrine cannot depend upon some

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18 At [69].
questionable analysis of the reasons why the illegal transaction did not proceed, or upon the vague and subjective concept of genuine "repentance" or "withdrawal", prior to the time at which the illegal agreement no longer is, or appears to be, capable of performance."

Previous authority

**Berg v Sadler and Moore**

In *Berg v Sadler and Moore* [1937] 2 KB 158, Scott LJ put the point in this way (at 167):

“If dishonest people pay money for a dishonest purpose, and then, by good fortune the offence which they designed to commit is not committed, are they entitled in this court to come and ask for recovery of the money? In my opinion they are not. It would be a bad example if this court were to entertain an action by a man for money dishonestly paid for the purpose of committing an offence against the criminal law, and he were allowed to claim from the court an order that the money should be repaid."

One might be forgiven for thinking that is an answer to the problem. Yet in *Patel v Mirza* Rimer LJ cited that passage before distinguishing it on the basis that the claimant fraudster had attempted the fraud but was found out (at [28]). This suggests that the claimant's motives for desisting in their wrongdoing are relevant – it is one thing to stop because you want to, but quite another to stop because you are caught.

**Bigos v Bousted**

In *Bigos v Bousted* [1951] 1 All ER 92 the plaintiff and defendant agreed that the former would provide £150 in Italian currency to the latter’s wife and daughter when they arrived in Italy, in exchange for which the latter promised to repay the former in sterling in England. The plaintiff gave the defendant security in the form of a share certificate. The agreement contravened the *Exchange Control Act 1947*. The wife and daughter went to Italy but the plaintiff failed to provide them with the Italian money and they returned to England empty handed.

The plaintiff sued for £150 and the defendant counterclaimed for the return of the share certificate. The plaintiff abandoned the claim but the counterclaim proceeded, before being dismissed on the ground of illegality.
Pritchard J drew a distinction in the authorities between “repentance cases” and “frustration cases”. He said, at 100:

“If a particular case may be held to fall within the category of repentance cases, I think the law is that the court will help a person who repents, provided his repentance comes before the illegal purpose has been substantially performed.”

In Patel v Mirza Rimer LJ distinguished Bigos v Bousted on the basis that in Patel the illegal purpose became “impossible of performance by force of a change in circumstances beyond the control of either of the parties to the illegal contract” (at [31]).

**Tribe v Tribe**

In Tribe v Tribe [1996] Ch 107 the plaintiff was the lessee of two shops occupied by his company for the purposes of its business. The landlords intimated large claims for dilapidations. The plaintiff feared that he might need to have recourse to his shareholding in the company to satisfy their claims. To avoid that risk he transferred his shares to his son (the defendant), to hold them as his nominee and to return them on demand. The purpose of the scheme was to convince the landlords that the plaintiff did not own the shares and was not a worthy defendant.

The dispute with the landlords was resolved without needing to apprise them of the disposition of the shares, but next came the dispute with the son. Since the transfer to the son triggered the presumption of advancement, the plaintiff needed to rebut that presumption in order to get his shares back. This he could do only by relying upon his dishonest agreement with the son.

The plaintiff succeeded. Since the share transfer had never been showed to the landlords, the illegal purpose had not been carried into effect in any way. Nourse LJ said this, at 121:

“Nor is it any objection to the plaintiff’s right to recover the shares that he did not demand their return until after the danger had passed and it was no longer necessary to conceal the transfer from his creditors. All that matters is that no deception was practised on them.”

Millett LJ said this, at 135:

“But I would hold that genuine repentance is not required. Justice is not a reward for merit; restitution should not be confined to the penitent. I would also hold that voluntary withdrawal from an illegal transaction when it has ceased to be needed is sufficient.”

Nourse and Millett LJJ did not quite adopt the same reasoning. Otton LJ simply agreed with both, though with which line of reasoning he did not deign to disclose.
Analysis

The difficulty can put in a nutshell as follows. Is it the objective fact that the agreement has not entered performance, or the claimant’s subjective motivations in withdrawing prior to performance, which are decisive? The question engages issues of morality, policy and deeper enquiries about the proper role to be performed by the law of contract in deterring undesirable conduct.

A powerful argument in favour of Patel is the fact that he was not seeking to acquire any benefit by the contract, but simply to secure the return of the money which he had laid out. Accordingly, the imposition of an illegality defence would not merely prevent him from obtaining a benefit from wrongful conduct, but actually punish him by keeping him out of pocket. Conversely, upholding an illegality defence would leave Mirza, almost certainly the more culpable of the two, in possession of the fortune and therefore gaining from his own illegality. The same concern evidently weighed heavily with Lord Atkinson, giving the decision of the Privy Council in Chetty v Servai (1908) LR 35 Ind App 98, though it strikes awkwardly against the general principle that illegality does not impede the claimant for the defendant’s sake, but rather upon the policy that the court will not assist the claimant: see Holman v Johnson above.

During argument in the Court of Appeal the example was put to counsel of a claimant who had made a large payment to a hit man to murder X. The question was whether if, before the murder was committed, X had died of natural causes, would the court allow the claimant to recover his money? Gloster LJ sidesteps this awkward example on the basis that this would be a case of “extreme moral turpitude”, of a different kind to that in issue in Patel v Mirza. Yet that gives rise to the question, where is the line to be drawn between cases of modest and extreme moral turpitude, and is it possible (let alone helpful) for the law to create differing levels of illegality? In Tinsley v Milligan Lord Goff posited the case of terrorist or armed robbers before stating, at 362:

“It may be said that these are extreme cases; but I find it difficult to see how, in this context at least, it is possible to distinguish between degrees of iniquity.”

In Patel v Mirza Gloster LJ simply states, at [75]:

“Given the seriousness of the intended crime of murder, there is every public policy justification in such a case to deny recovery. In the present case there is no such public policy justification.”

19 The point is made very fully by Gloster LJ at [70].
That is at least open to challenge. Financial crime can prove to be extremely harmful, especially when engaged in on a large scale. Is the law to draw a line based on the sums involved, and if so, what is the going rate for “extreme moral turpitude”?

The House of Lords have explained that the policy considerations associated with illegality are context-sensitive and operate differently in each situation. The Law Commission have expressly approved of the modern flexibility exhibited in the key decisions intervening between their 1999 and 2010 reports, to such an extent that the latter report resiled from the previous recommendation that Parliament ought to legislate here. One might therefore have expected the Supreme Court to continue in this vein, reducing illegality more to a policy consideration than a principle in its own right.

However, in its most recent decision on the topic the Supreme Court made clear that the defence of illegality is a rule of law rather than a mere discretionary power. In Les Laboratoires Servier v Apotex [2014] UKSC 55; [2015] 1 All ER 671, judicial attempts to introduce a public conscience test (as envisaged by the Law Commission’s 2009 report) were strongly disapproved of. The High Court and Court of Appeal had both indulged in value judgments about how badly the claimant had behaved and how much weight was to be attached to that. The Supreme Court strongly disapproved of such a discretionary approach.

Lord Sumption JSC, within whom Lord Neuberger PSC and Lord Clarke JSC agreed, said at [13]:

“...two features of this area of law have been characteristic of it from the outset. First, it is a rule of law and not a mere discretionary power. Secondly, it is based on public policy, and not on the perceived balance of merits between the parties to any particular dispute.”

There are several aspects of the Supreme Court’s judgment in Apotex which suggest that they will eschew any attempt to engage in an assessment of how bad Patel’s conduct was, or how unfair it might be to leave the money with Mirza. Lord Sumption JSC was especially critical of Arnold J at first instance, and Etherton LJ on appeal, for doing just that (e.g. at [21]).

How then will the Supreme Court resolve the question whether repentance is needed in order to rely upon the locus poenitentiae doctrine? On the one hand we might expect it to continue

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21 Indeed in Gray Lord Hoffmann said, at [30]: “The maxim ex turpi causa expresses not so much a principle as a policy. Furthermore, that policy is not based upon a single justification but on a group of reasons, which vary in different situations.” See further Les Laboratoires Servier v Apotex Inc [2013] Bus LR 80, per Etherton LJ at [73], although see contra [2014] 3 WLR 1257, per Lord Sumption JSC at [19].
to promote a more principled and predictable application of the doctrine, which would militate against inquiries into the subjective mindset of the claimant in search of genuine repentance. On the other hand, it might promote the practice of judicial abstention and leave the loss to lie where it fell on the basis that, absent repentance, there is nothing to move the Court to aid Patel. In any event, we can likely expect the approach of Gloster LJ in considering the circumstances of the illegality, degree of moral turpitude and consequences of applying or disapplying the doctrine to be rejected.

For certain, the appeal in Patel provides an important opportunity for the Supreme Court to indicate clearly the direction in which the law of illegality is to develop absent Parliamentary intervention.

NICHOLAS POINTON

St John's Chambers, Bristol

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