

Patel v Mirza [2016] UKSC 42 – Illegality and Restitution Explained by the Supreme Court

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It's a pleasure for me to be here this evening to give this lecture not least because Queens' College was the alma mater of my mentor, Bill Wedderburn, who was a student here in the late 1940's. He secured a double starred first as an undergraduate; he took the George Long prize for Jurisprudence and won the prestigious Chancellor's Medal for the then graduate LL.B. degree. Soon afterwards he was appointed a Fellow at Clare: I'm told the appointment was effected on the platform at Cambridge Railway Station by one of my predecessors, Sir Henry Thirkhill. That's how it was done in those days. Bill thereafter became the youngest ever holder of the Cassel Chair of Commercial Law at the LSE and when I arrived there in the heady 60's he was my tutor and I eventually became his research assistant.

In the Court of Appeal in the **Patel** case (para 47) Gloster LJ, in sympathy with the 'hapless law student', said of the illegality concept "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."

The same point (differently expressed) had elegantly been made by Bingham LJ in 1987 in **Saunders v Edwards** [1987] 1 WLR 1116 at 1134 to the effect that the law must:

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

In summary I think the Supreme Court has clarified the law in many respects which I will endeavour to identify. In other respects our highest court may have created some new uncertainties and, I'm pleased to report, no diminution in work for inventive lawyers and some of their more dubious clients. Again I will try to pinpoint those areas of uncertainty.

The facts of the case were simple. Mr Patel paid £620k to Mr Mirza to bet on the price of shares in RBS. The agreement was based on the fact that Mr Mirza had access to inside information from his RBS contacts which would enable him to predict or anticipate movements in the market price of the shares. This agreement was a conspiracy to commit an offence of insider trading contrary to section 52 of the Criminal Justice Act 1993. The inside information, which would have moved the market, never arrived. The bet wasn't placed and although he said he would return the money Mr Mirza decided to keep it. When sued for its return he pleaded illegality and invoked the two classic Latin maxims: *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, i.e. 'the loss should lie where it falls.'

All nine Justices were agreed in the result, namely, that Mr Patel should be entitled to recover his £620k or, which comes to the same thing, Mr Mirza should not be permitted to retain the money because he would thereby have been unjustly enriched. Yet another way of analysing the result is that it was possible for Mr Mirza to make full restitutio of Mr Patel's money and that Mr Patel would neither be profiting from his admitted participation in an illegal agreement, nor would he be invoking the court process for the purpose of enforcing the agreement: the key words there are 'profiting' and 'enforcing'.

A restitution lawyer would regard that outcome as an excellent example of the modern law in action. At first glance this result appears to offend against the spirit and possibly even the letter of Lord Mansfield's nearly 250 year old dictum in **Holman v. Johnson** which I apologize for quoting but everybody else does so I suppose I should as well.

“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 it 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 actio*. No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the court says he has no right to be assisted.”

I would emphasize the phrases in that famous passage: "he has no right to be assisted" and "they [the court] will not lend their aid to such a plaintiff". It does

seem to me obvious that granting Mr Patel, in effect, the remedy of restitution necessarily involved assisting him and/or giving him aid notwithstanding the blatant illegality at the heart of the contract. I will come back to this point.

The Supreme Court judgments draw attention to two even earlier decisions of Lord Mansfield, one in 1760 - **Smith v. Bromley** - and the other in 1773 - **Walker v. Chapman**. In the former case Lord Mansfield allowed the plaintiff to recover money she had paid to secure her brother's discharge from bankruptcy. The payment was an illegal consideration. This decision is cleverly explained by Lord Mance [para 194] on the basis that the legal prohibition was designed for the protection of bankrupts and their families so that the parties were *non in pari delicto* and the rejection of the illegality defence was, for that reason, consistent with principle. In the latter case the defendant, who was a page to the King, agreed to take a bribe in return for getting the plaintiff an appointment in the Customs. The bribe was paid but the appointment never happened. Lord Mansfield allowed the claim for the return of the bribe making a distinction between reversing the illegal contract and claiming a benefit under it. One way of looking at these decisions is that Lord Mansfield had the foresight to anticipate the modern law of restitution 250 years ahead of his time.

I think the time has come when our judges should stop quoting the Lord Mansfield dictum in isolation as if were a necessary mantra to be uttered in all illegality cases. It is certainly easier to understand and has a good deal more force when read in conjunction with the other two cases and taking account of the **actual result** in each case. It is worth noting that in all three cases, namely, **Smith v Bromley**, **Walker v Chapman**, and **Holman v Johnson**, the claims were allowed despite the illegal aspects of each case.

In **Holman v Johnson**, the plaintiff sold goods to the defendant in Dunkirk knowing that the defendant's purpose was illegally to smuggle the goods into England. The defendant pleaded the illegality defence to the plaintiff's claim. Lord Mansfield decided the plaintiff could recover even though he knew the defendant's intention. For Lord Mansfield, the key point was that the plaintiff was not personally involved in the smuggling.

These cases suggest it might be more appropriate to evaluate Lord Mansfield's judgments in terms of the American realist philosophy of jurisprudence, by which I mean Lord Mansfield's approach should be tested by reference to what he does rather than by what he says.

Prior to the Court of Appeal ruling in **Patel** there was uncertainty as to the relevance of the state of mind and motivation of the claimant/plaintiff seeking relief in an illegality case, particularly where the planned illegal purpose, for

whatever reason, had not been proceeded with. In a line of case law culminating in the decision of **Bigos v. Boustead** in 1951 the courts examined the moral quality of the claimant's decision to withdraw so that if the withdrawal was involuntary, eg by reason of some intervening frustrating event outside the control of the claimant, relief would be refused: there had to be genuine regret. In the glossed words of Lush J "absent penitence there can be no *locus poenitentiae*". In 1996 in **Tribe v. Tribe**, Millett LJ rejected the moralising. One of the consequences of this Supreme Court ruling is that the **Bigos** cases have been overruled. If the entitlement to recovery is dependent upon the non-performance of the illegality the reason for that failure is now irrelevant.

That analysis leads naturally to the heart of the matter. The facts of **Tinsley v. Milligan** are well known. These two people agreed to purchase a house, both contributing to the price. They agreed to put the property in Ms Tinsley's name so as to enable Ms Milligan dishonestly to represent to the DSS that she was not a house owner. She would then make and did make fraudulent social security claims. The two women fell out and Ms Tinsley pleaded illegality as her defence to Ms Milligan's claim to her share of the property. By a narrow 3:2 majority the House of Lords acceded to the claim by reference to the equitable presumption of a resulting trust which Ms Milligan was entitled to assert as a matter of procedure and she did not need to rely on the illegal agreement to sustain her cause of action. The pure technicality of the reasoning troubled all of their Lordships and was made manifest in the later case of **Collier** where the father, seeking recovery of assets he'd transferred to his daughter in an illegal endeavour to put his assets beyond the reach of his creditors, was defeated by the equitable presumption of advancement to his daughter: another procedural technicality. If Ms Tinsley had been a man and the son of Ms Milligan, her claim, i.e. Ms Milligan's claim, would have been rejected.

The reasoning in both these cases and the result in **Collier** have (rightly) been rejected by the Supreme Court in **Patel**. In light of the new judgments both Ms Milligan and Mr Collier would have succeeded in their claims notwithstanding the obvious fact that in both cases there was a blatantly illegal feature of the transaction.

Lord Toulson, with whom Lady Hale, Lord Kerr, Lord Wilson and Lord Hodge agreed, decided that the reliance rule laid down in **Bowmakers** and **Tinsley v. Milligan** should no longer be followed [para 110]. The key passages of Lord Toulson's judgment are paras 101, 109, 115, 120 and 121.

The Lord Toulson analysis is described in a number of the judgments as the 'range of factors' approach. It permits the court, inter alia, to examine the "underlying purpose" of the prohibition transgressed by the transaction and to

inquire whether that purpose will be enhanced by the denial of the claim: in **Tinsley** enabling Ms Milligan more effectively to deceive the DSS with her social security applications; in **Collier** giving the father a dishonest basis for denying his creditors access to his property assets which he had 'transferred' to his daughter; in **Patel** to consider whether the policy underlying the rule which made the contract illegal - the insider trading legislation - would be 'stultified' if Mr Patel's claim were allowed to succeed, cf para 15 summarising and later - para 115 - approving the approach of Gloster LJ in the Court of Appeal.

This analysis is neatly summarized by Lord Kerr at para 124:

“Central to Lord Toulson’s analysis is the “trio of considerations” which he identified in para 101 of his judgment. The first of these involves an examination of the underlying purpose of the “prohibition which has been transgressed”. By this, I understand Lord Toulson to mean the reasons that a claimant’s conduct should operate to bar him or her from a remedy which would otherwise be available. That such reasons should be subject to scrutiny is surely unexceptionable. Whether in order to preserve “the integrity of the legal system” (per McLachlin J in **Hall v Hebert** [1993] 2 SCR 159 at 169) or to allow a proper understanding of the true nature of the public policy imperative for recognising a defence of illegality, the purpose of the denial of a remedy to which the claimant would otherwise be entitled should be clearly understood.”

Lord Neuberger agreed with the restitution approach: the ratio of the Supreme Court decision, i.e. of all the judgments, is captured in the first para of his judgment at paras 145-6 of the printed report; what he calls 'the Rule':

“The present appeal concerns the claim for the return of money paid by the claimant to the defendant pursuant to a contract to carry out an illegal activity, and the illegal activity is not in the event proceeded with owing to matters beyond the control of either party.

In such a case, the general rule should in my view be that the claimant is entitled to the return of the money which he has paid.”

After recording his initial reluctance Lord Neuberger agrees with the Lord Toulson analysis - paras 174-5. As we shall see this means that on the obiter aspect of the judgments - the range of factors versus the narrow rule – the Supreme Court divided 6:3 in favour of the former with (interestingly) the commercial lawyers (Lords Mance, Clarke and Sumption) in the minority.

Lord Neuberger also rejected the **Bigos** line of cases and analysed the application of his Rule to cases even where 'the contemplated illegal activity has been performed in part or in whole' [paras 167-8].

This takes me to some really interesting passages in the judgment of Lord Neuberger - paras 176 and 178:

“[Para 176 Lord Neuberger] A simple example is a case where the consideration for which the claimant paid or owed money was inherently illegal, rather than happening to involve an illegal act in order to be achieved. In such cases, it seems to me that considerations of certainty and policy indicate that the claimant should generally be able to refuse to pay any money which is due under the contract and, indeed, to recover the money he had paid. Thus, if the claimant paid a sum to the defendant to commit a crime, such as a murder or a robbery, it seems to me that the claimant should normally be able to recover the sum, irrespective of whether the defendant had committed, or even attempted to commit, the crime. If the defendant had not attempted the crime, the Rule would generally apply. If he had actually succeeded in carrying out the crime, he should not be better off than if he had not done so. I suppose one could justify that conclusion on the ground that the law should not regard an inherently criminal act as effective consideration.”

I recognise the unlikelihood of litigation along these lines but I confess I was rather shocked when I first read para 176 and I tried to see where the typographical error omitting the 'not' was made. I mused that Lord Mansfield might not merely have turned in his grave, he surely would have jumped out of it and sought to remonstrate with Lord Neuberger over this passage. I would not quarrel with the logic of the restitution analysis which is impeccable: the contract killer should not be unjustly enriched at the expense of his contracting employer whether or not the murder has been carried out. It is also understandable that the killing of someone should not be recognized as 'effective consideration' and this opens the way to the restitution remedy. That said why would the grant of that remedy not fall foul of Lord Mansfield's dictum about the court not assisting the transgressor or lending its aid to a plaintiff whose cause of action 'appears to arise *ex turpi causa*'. I'm not convinced that the anticipated response, to the effect that the court would not be enforcing the bargain or allowing the employer to profit from the bargain, would be very convincing. In the realm of public policy it is difficult to think of a more offensive or objectionable outcome in the procedural guise of a claim in restitution.

Lord Sumption, at para 254, gives a similar example of the contract killing and essentially makes the same point as Lord Neuberger, namely that the hitman, whether successful or otherwise, should be obliged to disgorge the payment to his employer. In this passage, Lord Sumption implicitly recognises the extraordinary nature of such a claim: his solution is that in such a case both parties would be exposed to confiscation orders under the Proceeds of Crime Act 2002. In support of his analysis, and as you would expect, he cites Aquinas to the effect that the solution to the conundrum is that “*neither party should have the money, which should be paid to charity*” (*Summa Theologica II.2, Q 62, para 5*). As a matter of morality, this is the right result.

As I've said Lord Mance is in the minority on the obiter aspects of the judgments. He adopts what he calls "a limited approach" which is three pronged: the avoidance of inconsistency in the law; allowing the claimant to seek compensation for injury or damage suffered, i.e. permitting the tort remedy; and enabling parties to be restored to the status quo ante [para 192].

A key part of Lord Mance's analysis (in agreement with Lord Sumption at paras 245-252) is his rejection of 20th century case law which had the effect of unduly restricting the rescission principle [para 197].

“The logic of the principle is that the illegal transaction should be disregarded, and the parties restored to the position in which they would have been, had they never entered into it. If and to the extent that the rescission on that basis remains possible, then prima facie it should be available.”

Like Lord Neuberger, Lord Mance would give the rescission remedy more flexibility with the use of suitable adjustments, subject to the particular facts of the case, eg the availability of the defence of change of position.

On this basis Lord Mance would retain the reliance test as a bar to relief "but only in so far as it is reliance in order to profit from or otherwise enforce an illegal contract. Reliance in order to restore the status quo is unobjectionable." [para 199].

Approached in this way Lord Mance concludes that today the court would reach the right answer in **Tinsley**, in **Collier** and, indeed, in **Patel** for the right reasons. In **Tinsley** the court would focus on the objective fact of the respective financial contributions made by the two women towards the property purchase and "the parties' actual and, by itself, legal purpose of joint ownership." [para 201]. The fact that in **Collier** the illegal scheme had been carried out, because the property had been conveyed to the daughter, would not be conclusive since

rescission would still be possible. As Lord Sumption put it [para 238] Mr Collier "had an equitable interest in the property because the lease was gratuitous and there was no intention to make a gift."

As to the decision in **Patel**, Lord Mance's conclusion is shortly stated at para 203:

"It also follows that in the present case I consider that no problem exists about recognising that Mr Patel is entitled to require Mr Mirza to return the stake which Mr Patel put up for the illegal purpose of use by Mr Mirza to make profits for their joint benefit by misuse of inside information. The claim does not seek to enforce or profit by the illegality. It seeks merely to put the position back to where it should have been, and would have been had no such illegal transaction ever been undertaken."

In the closing paragraphs of his judgment Lord Mance [204-209] expresses his strong disagreement with the majority obiter view on the proposed 'range of factors' analysis.

"I must however return to the suggestion, unnecessary in my view for the resolution of this appeal, that the law of illegality should be generally rewritten."

Lord Mance in para 206:

"What is apparent is that this approach, would introduce not only a new era but entirely novel dimensions into any issue of illegality. Courts would be required to make a value judgment, by reference to a widely spread melange of ingredients, about the overall "merits", or strengths, in a highly unspecific non-legal sense, of the respective claims of the public interest and of each of the parties. But courts could only do so, by either allowing or disallowing enforcement of the contract as between the two parties to it, unless they were able (if and when this was possible) to adopt the yet further novelty, pioneered by the majority of the Australian court in **Nelson v Nelson** [1995] HCA 25, (1995) 184 CLR 538, of requiring the account to the public for any profit unjustifiably made at the public expense, as a condition of obtaining relief."

Lord Mance's criticisms of the majority approach are supported by Lord Clarke who views the 'range of factors' approach as amounting to the court merely giving itself a discretion whether to grant or refuse relief. In para 215 Lord Clarke refers to the same concern having been expressed by Lord Goff in **Tinsley** [1994] 1 AC 340 at 358E-F, on which point all members of the 1994 Appellate Committee were agreed.

For his part Lord Sumption, with his characteristic rigorous analysis, agrees with Lord Mance and Lord Clarke and strongly disagrees with the other six on the obiter point. He views the debate as the latest example of "a long standing schism between those judges and writers who regard the law of illegality as calling for the application of clear rules, and those who would wish to address the equities of each case as it arises."

Lord Sumption analyses and supports the reliance test - the 'narrowest test' - especially in paras 238-239 where he explains that properly applied the reliance test would have produced the right results and for the right reasons in both **Tinsley** and **Collier**. Lord Sumption would also preserve the well-established exceptions - which would entitle the party not *in pari delicto* successfully to avoid the rule: [paras 241-244].

Lord Sumption (like Lord Mance) also subjects the range of factors approach of the majority to some stringent criticism, especially in paras 262-263, broadly speaking because of the resulting uncertainty which (in Lord Sumption's view) would involve the substitution 'of a new mess for the old one.'

"But we are concerned in this case with the law of contract, an area in which the value of certainty is very great. It is one thing to say that a legal right may be overridden by a rule of law. It is another thing altogether to make a legal right, and particularly a contractual right, dependent on a judge's view about whether in all the circumstances it ought to be enforced."

I conclude with some personal observations. **First**, we should all welcome the modern approach of judges genuinely seeking to give transparency to their thinking. These judgments are an excellent example of that approach: we know where the judges are coming from and how they respectively view the judicial role. In particular, a key feature of all the judgments in **Patel** is the judicial desire to mark an indelible dividing line between the criminal and the civil law. Thus the fact that the agreement between Messrs Patel and Mirza amounted to a conspiracy to commit an insider trading offence, contrary to the Criminal Justice Act 1993 s.12, should not of itself determine the outcome of Mr Patel's **civil claim** for the return of the money. The distinct decision whether or not to prosecute Patel and Mirza and the outcome of their criminal trial would be wholly and exclusively a matter for the criminal law. The demarcation line is thereby drawn between the civil and the criminal law and the observations of Lords Neuberger and Sumption about the contract killing example are more easily understood.

Secondly, it is worth noting the way the judges divided: those who had spent time with the Law Commission, Baroness Hale and Lord Toulson (in agreement with Etherton LJ in **Apotex** [2012] EWCA Civ 593) in the majority on the one side and the commercial lawyers who were unified but in the minority on the other. The history, which is described by Lord Toulson in paras 21ff, is instructive and (I suspect) essential to any meaningful understanding of the politics.

Thirdly, the majority approach is likely in future cases to lead to roving inquiries at trial as to the public policy behind particular common law and legislative rules against particular forms of wrongdoing. It is not difficult to contemplate an expansion of the pleadings and an investigation of judicial or legislative policy (including the possible need for expert evidence), which is notoriously hard to discern. In such cases, the uncertainty is increased as is the cost.

Fourthly, and on the other hand, lawyers often laud the notion of **certainty** but I often feel that it has a certain holy grail quality and is not what it's cracked up to be. The outcome of contract law disputes can rarely be predicted with certainty.

Fifthly, it is difficult to think of realistic examples of cases where the application of the two approaches - the range of factors versus the reliance test as reinterpreted in light of **Patel** - would produce different results. I suspect there will be examples where the element of illegality is on the margin of the transaction. No doubt I could invite suggestions from the audience on that point at this stage.

Also, in order to test the listeners, I've got a couple of questions of my own: **first**, assume the transaction contemplated by the facts in **Patel** had proceeded as planned and Mr Mirza had succeeded in converting the £620k into £2m. On the respective approaches adopted by the Justices, I suspect that Mr Patel would have failed in a claim for the £1.38m profit either because the public policy behind the insider dealing legislation would be "stultified" if such a claim were allowed (per Lord Toulson et al) or because Mr Patel would not be allowed to profit from his wrongdoing or enforce the bargain (per Lord Mance et al). The question is: could he get restitution in respect of his gambling money, i.e. the £620k? If you think the answer is yes give reasons and also explain what you think Lord Mansfield would have had to say about that.

The other question assumes (again) that the transaction proceeded as planned but instead of it being profitable Mr Mirza managed to lose the whole £620k. By way of defence to Mr Patel's claim for the return of the £620k could Mr

Mirza successfully plead his own change of position, i.e. that he had spent the money strictly in accordance with the bargain and could no longer give restitutio? Give reasons for your answer.