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UK Supreme Court adopts new "range of factors" approach to defence of illegality

Recent decision adopts less formal, more expansive test for the defence of illegality in English law.

Overview

The UK Supreme Court has rejected a formal "reliance" test to determine whether a defendant to a civil claim can rely on the claimant's wrongdoing to defeat the claim, replacing it with a more fact-sensitive "range of factors" approach, which may expand cases in which the defence operates.

"*No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act*", Lord Mansfield's *dicta* in *Holman v Johnson* (1775)[1], encapsulate the English common law defence of illegality to civil claims. The defence is based on the public policy that a person should not be able to benefit from their own wrongdoing, and that the courts should not enforce claims that harm the integrity of the legal system. This defence is potentially far-reaching and can apply in any civil claim, and the recent case of *Patel v Mirza*[2] indicates that all litigants should now consider it whenever allegations or evidence indicate wrongdoing.

However, whilst the rationale is clear, authorities have been less so. As Gloster LJ put it in the Court of Appeal, "*it is almost impossible to ascertain or articulate principled rules from the authorities*"[3], either for the recovery of money or other assets paid or transferred under illegal contracts, or for the range of cases to which the defence might apply (*e.g.* to claims for contractual damages or performance, to claims in tort, or to restitutionary claims for unjust enrichment).

In the previous leading case of *Tinsley v Milligan*[4], the majority of the House of Lords (now the UK Supreme Court) articulated what became known as the "*reliance test*". Broadly, this meant that if a defendant raised a defence of illegality, the court would consider whether the claim "*relied*" on the claimant's own illegal act. If it did, then — subject to certain exceptions — the defence of illegality would succeed.

The reliance test has long been subject to criticism (most notably by the UK Law Commission in its 2009 Consultation Paper[5]) that it created arbitrariness, uncertainty and the potential for injustice. This was largely because the test focused on procedural issues rather than the policy reasons underlying the doctrine of illegality, and created uncertainty as to what exactly amounts to "*reliance*".

In *Patel v Mirza,* the Supreme Court rejected the reliance test and held that a "*range of factors*" test should apply instead. This may expand the range of cases in which illegality can be argued. It might also lead to uncertainty in the test's application. However, case law has historically produced few cases regarded as unjust (and indeed even the Law Commission did not suggest that the law had resulted in unsatisfactory outcomes), and so uncertainty may prove to be an overstated concern.

Facts

Mr Patel transferred funds to Mr Mirza in anticipation of Mr Mirza acquiring insider information in order to commit market abuse by using the funds to bet on the price of RBS shares. The bet ultimately did not take place as the insider information never materialised. Mr Mirza refused to repay the funds to Mr Patel, and Mr Patel sued Mr Mirza to recover the funds, a restitutionary claim based on the failure of their agreement. Mr Mirza argued the defence of illegality on the basis that the agreement amounted to a conspiracy to commit an offence of insider dealing under section 52 of the Criminal Justice Act 1993 (the CJA), and Mr Patel had therefore relied on his own illegal act in order to found his claim.

The illegality defence was successful at first instance but overturned on appeal. Mr Mirza subsequently appealed to the Supreme Court.

Majority decision: "range of factors" approach

The majority of the Supreme Court, having considered the Law Commission report and jurisprudence in Australia, Canada and the US, endorsed Gloster LJ in the Court of Appeal and agreed with the criticisms of the "*reliance test*", in particular:

- The test resolved cases according to a procedural technicality, which has nothing to do with the underlying policies
- The test did not permit differentiation between "*peripheral and central*" or "*minor and serious*" illegality
- Courts had sought ways to avoid the rule if they did not like the consequences
- A rule based on public policy "should strive for the most desirable policy outcome"
- A refinement of a "rule-based" approach would not be satisfactorily accomplished

Accordingly, Lord Toulson (for the majority) set out the new "*range of factors*" test as follows:

> "*The essential rationale of the illegality doctrine is that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system… In assessing whether the public interest would be harmed in that way, it is necessary*
>
> *a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim,*
>
> *b) to consider any other relevant public policy on which the denial of the claim may have an impact, and*
>
> c) *to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts*."[6]

In adopting this test, the Supreme Court recognised the potential for uncertainty, but noted that this was not an area where certainty was "*particularly important*". Citing Lord Mansfield[7]: "'*In all mercantile transactions the great object should be certainty' […] The same considerations do not apply in the same way to people contemplating unlawful activity*".

Applying the test, the Supreme Court decided that the purpose of the legislation was to prevent market abuse, while Mr Patel's claim was to reverse the payment made for that purpose. Accordingly, the claim was not contrary to the policy behind the rule prohibiting the illegal conduct, and so the Supreme Court granted Mr Patel's appeal.

Dissenting views: a modified reliance principle?

Whilst agreeing with the outcome of the appeal, the minority of the Supreme Court (Lord Sumption, Lord Mance and Lord Clarke) disagreed with the rationale of the majority. In Lord Sumption's view, all the considerations the Law Commission identified were already reflected in the development of the reliance test, properly applied[8]. In contrast, Lord Sumption considered the "*range of factors*" test to be:

> "*far too vague and potentially far too wide to serve as the basis on which a person may be denied his legal rights. It converts a legal principle into an exercise of judicial discretion, in the process exhibiting all the vices of 'complexity, uncertainty, arbitrariness and lack of transparency' which Lord Toulson JSC attributes to the present law*."[9]

Lord Sumption favoured a principled approach founded on the "*reliance test*", which did not "*depend on adventitious procedural matters*"[10] (which he considered wrongly determined *Tinsley v. Milligan*) but would instead focus on the substance of what must be proved: "*a direct causal link between the illegality and the claim, distinguishing between those illegal acts which are collateral or matters of background only, and those from which the legal right asserted can be said to result*"[11].

Lord Sumption also identified exceptions to the reliance test, in cases where the parties were not *in pare delicto*, *i.e.,* not legally on the same footing rather than on the basis of comparative blameworthiness — for example, if the claimant's illegality was involuntary, or if the rule of law generating the illegality was intended to protect the claimant[12].

What next for the defence of illegality?

It is clear that the Supreme Court was united in its rejection of the formal "reliance test" set out in *Tinsley v. Milligan*, and that the majority favoured the "*range of factors*" approach. It remains to be seen whether the concerns Lord Sumption raised will prove justified, especially given that he accepted that those factors are borne out by existing decisions.

It is possible that the case law on the doctrine of illegality will now develop a clear set of principles to illustrate the "*range of factors*" approach adopted by the majority. In the meantime, it is clear that the defence of illegality may now be a potentially relevant factor in a wider range of disputes, and will not depend on how the case is formally pleaded. Claimants and defendants would be well advised to consider this in every dispute involving a potential illegal factor.

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[1] 1 Cowp 341, 343

[2] [2016] UKSC 42 http://www.bailii.org/uk/cases/UKSC/2016/42.html

[3] Paragraph 47, endorsed by the Supreme Court at paragraph 15

[4] [1994] 1 AC 340

[5] *The Illegality Defence* (Consultation Paper 189).

[6] Paragraph 120 of the judgment.

[7] *Vallejo v. Wheeler* (1774) 1 Cowp 143, 153

[8] Paragraph 260-1.

[9] Paragraph 265.

[10] Paragraph 237.

[11] Paragraph 239

[12] Such as in *Hounga v. Allen* [2014] 1 WLR 2889, where a victim of human trafficking was nevertheless entitled to compensation from her employers despite her illegal status.