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July 2019

PROFESSIONAL NEGLIGENCE BRIEFING

THE ILLEGALITY DEFENCE: BACK TO THE SUPREME COURT AGAIN

Illegality and the doctrine of "ex turpi causa non oritur acta" rival the issue of vicarious liability for the number of appellate level decisions they have generated in recent years. In *Patel v Mirza* [2016] UKSC 42 the Supreme Court sat as a court of 9 in order to definitively deal with the issue of when illegal or immoral conduct might bar an otherwise good claim in tort or contract. The issue has not, however, gone away, with the Supreme Court scheduled to hear another 4 cases which raise the issue. In this Briefing, Andrew Warnock QC summarises the *Patel* decision and the forthcoming appeals.

Patel v Mirza [2016] UKSC 42

The claimant paid a large sum of money to the defendant pursuant to an illegal agreement that the defendant would use the money to bet on share prices movements using insider information. In fact, the insider information never materialised so the bets were not placed and the claimant sued for his money back. The defendant argued that the claim was barred by illegality, because the claimant had to rely on his own illegal conduct to prove his claim. The Supreme Court rejected this defence and held that a claimant who satisfied the ordinary rules of a cause of action for just enrichment should not automatically be barred from enforcing it by reason only of the fact that he had paid the money over in the first place for an unlawful purpose; there was no logical basis why considerations of public policy should require the claimant to forfeit the moneys which were never used for the illegal purpose, enriching the defendant in the process.

The Supreme Court considered the issue of illegality more widely, across both contract and tort. The majority agreed with Lord Toulson's judgment. He identified two broad policy reasons for the common law doctrine of illegality: (i) a person should not be allowed to profit from his own wrong-doing and (ii) the law should be coherent and not self-defeating, condoning illegality by giving with the left hand what it takes with the right. In assessing whether the public interest would be harmed in allowing a claim it was necessary (a) to consider the underlying purpose of the prohibition which had been transgressed and whether that purpose would be enhanced by a denial of the claim, (b) to consider any other relevant public policy on which 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.

The Supreme Court departed from the reasoning of the House of Lords in *Tinsley v Milligan* [1994] 1 AC 340. In that case the claimant and defendant had bought a house together but put it into the name of the defendant only so as to assist the claimant in making false social security benefit claims. When the parties fell out and the claimant sought to establish her beneficial interest the defendant pleaded illegality. The House of Lords held that a party to an illegal agreement could not enforce a claim against the other party if he had to rely on his own illegal conduct to establish the claim. The claimant in that case did not have to rely on her

illegal conduct and so succeeded. In *Patel*, Lord Toulson rejected the reasoning in the case, but approved the actual outcome of the decision on its facts, because to have deprived the claimant of her cause of action would have been disproportionate to her wrong-doing and would have left the defendant unjustly enriched.

The Forthcoming Appeals

(1) Singularis Holding Ltd v Daiwa Capital Markets Europe Ltd [2018] UK84.

The defendant equity and brokerage business held money in a client account for the claimant company. The claimant was solely owned by S, who was also a director and had "dominant influence" over the claimant's affairs. At S's direction, the defendant paid the claimant's money into bank accounts in the names of other companies with which S was involved. S's actions were fraudulent. The claimant, now in liquidation and seeking compensation on behalf of its creditors, sued the defendant for negligence and breach of contract.

The first question which arises is whether S's actions were attributable to the claimant. The Court of Appeal held that they were not, because the company had innocent directors and so was not a "one man company". Moreover, the claimant had been a legitimate company carrying out legitimate business and attributing Mr S's knowledge of his fraud to the company would devalue the duty owed by the defendant to not make payments without proper inquiry in the face of obvious signs of fraud.

The question of illegality arises only if the Supreme Court takes a different view from the Court of Appeal on the issue of attribution. The Court of Appeal, however, rejected that defence as well. The trial judge had applied the *Patel v Mirza test* and concluded that the rules against directors' frauds and breaches of fiduciary duty would not be enhanced by allowing or denying the claim, whereas denying the claim could have a negative impact on the duty owed by banks to help reduce financial crime and would also be disproportionate, particularly where any wrongdoing on the part of the claimant could be dealt with by reducing damages for contributory negligence. Giving the judgment of the Court of Appeal Sir Geoffrey Vos C held that an appellate court should not interfere with an application of the *Patel v Mirza* test merely because it might have taken a different view, but only if the judge had proceeded on an erroneous legal basis. He held that the Judge had proceeded on the correct legal basis and that her decision on the issue was right.

The case is due to be heard by the Supreme Court on 23 July 2019.

(2) Henderson v Dorset Healthcare University NHS Foundation Trust [2018] EWCA Civ 1841

The claimant suffered from paranoid schizophrenia. The defendant hospital trust admitted that it had negligently treated her condition. The claimant alleged that but for the defendant's breach of duty she would not have killed her mother by stabbing her during a psychotic episode. The claimant was convicted (by guilty plea) of manslaughter on the grounds of diminished responsibility for the stabbing and was ordered to be detained in a secure hospital. The Claimant's personal responsibility for the attack was considered to be low by the sentencing judge. She sought damages for personal injury, loss of liberty, the loss of her share of her mother's estate (denied to her because of her conviction) and the future costs of psychotherapy and a support worker.

Both the trial judge and the Court of Appeal held that the claim was barred by the decision of the House of Lords in *Gray v Thames Trains Ltd* [2000] AC 1339. In that case the claimant had suffered psychiatric injury in a negligently caused train trash which led him to kill a man in a road rage incident. The House of Lords ruled against his claim on public policy grounds. Both a narrow and a wide public policy were identified. The narrower policy was that there can be no recovery for damage which flows from a loss of liberty, fine or other punishment lawfully imposed in consequence

of a crime because it is the law, as a matter of penal policy, which causes the damage and it would be inconsistent for the law to require compensation for that damage. The wider policy also involved causation: the tortious conduct of the defendant merely provided the opportunity for the killing, but the immediate cause of the damage was the criminal act of the claimant and it would be offensive to notions of the fair distribution of resources to require compensation for such damage.

The Court of Appeal considered the impact of *Patel v Mirza*. The court noted that in view of the fact that the actual dispute in *Patel v Mirza* was concerned with contractual and unjust enrichment issues, some caution needed to be taken before holding that it implicitly overruled cases in other areas of the law. The Court of Appeal noted that there was no suggestion in *Patel v Mirza* that the *Gray* case was wrongly decided. Moreover, in the *Gray* case the House of Lords had considered the competing public policy considerations which might arise if a claimant bore no or no significant responsibility for the killing but (by a majority) had nonetheless reached the view that a claim arising out of it should be barred.

The Supreme Court gave the claimant permission to appeal in March 2019.

(3) Stoffel & Co v Grondona [2018] EWCA Civ 2031

In this case the claimant had engaged in a mortgage fraud, whereby she took out a mortgage ostensibly to fund a purchase of a property from an arms-length vendor, whereas in fact the real purpose of the mortgage was to raise finance for the vendor, who was a business associate with a poor credit history and who was to continue to have an interest in the property after the sale. The defendant solicitors were instructed by the claimant the business associate and the mortgagee to deal with the relevant conveyances. The mortgage advance having been made, the solicitors negligently failed to register both the transfer of the property to the claimant and mortgagee's charge. As a result, the associate was able to continue to procure further advances for himself from another lender against the security of the property. The claimant ultimately defaulted on the mortgage repayments and the mortgagee sued her for a money judgment. She sued the solicitors for the loss she suffered by reason of the fact that the property was not available to her as security for the loan. By the time the case reached the Court of Appeal it was accepted that she had a complete cause of action for negligence, breach of duty and loss against the solicitors, but they contended that the claim should fail on illegality grounds.

At first instance, the judge had rejected the illegality defence applying *Tinsley v Milligan*: the claimant did not need to rely on her illegal conduct to sue the solicitors on their entirely separate retainer. By the time the case reached the Court of Appeal, *Patel v Mirza* had been decided. The Court of Appeal held that an application of the principles in that case did not bar the claim because denying the claim would do nothing to enhance the fight against mortgage fraud, there was a public policy in requiring professionals to perform their duty and denying recovery would be disproportionate in circumstances where the claim did not involve any profiting from the fraud, the mortgagee itself made no complaint of fraud but on the contrary adopted the transaction and the illegal conduct was merely part of the background story to the claim against the solicitors.

In March 2019 the Supreme Court gave the solicitors permission to appeal limited to the issue of whether the Court of Appeal erred in its application of the *Patel v Mirza* guidelines.

(Mrs Grondona is represented by Andrew Warnock QC and Maurice Rifat of 1 Chancery Lane)

(4) XX v Whittington Hospital NHS Trust [2018] EWCA Civ 2832

The claimant, a victim of clinical negligence which rendered her infertile, sought damages for the cost of commercial surrogacy arrangements which she planned to make in California. Such arrangements are legal in California, but in the UK only non-

commercial surrogacy is allowed under the Surrogacy Arrangements Act 1985. The trial judge ruled against the claim on the basis that commercial arrangements for surrogacy were contrary to public policy in the UK and he was bound by previous authority - *Briody v St Helen's and Knowsley Area Health Authority* [2002] QB 856 - so to hold. The Court of Appeal allowed the claimant's appeal. It held that public policy had changed since the *Briody* decision and that since the claimant was not proposing to do anything unlawful by going *abroad* to make surrogacy arrangements, she could recover the costs. In so ruling, the Court considered the *Patel v Mirza* guidelines. The Court held that the underlying purpose of the statutory prohibition was to render commercial surrogacy unlawful in the UK but not in other countries and that barring recovery would prevent full recovery of the damages necessary to enable the claimant to found a family and would be disproportionate.

The Supreme Court has granted the hospital trust permission to appeal, with the appeal scheduled to be heard in December 2019.

(Whittington Hospital NHS Trust is represented by Lord Edward Faulks QC of 1 Chancery Lane)

Conclusion

In recent decisions, exemplified by Lord Reed's judgment in *Robinson v Chief Constable of West Yorkshire* [2018] UKSC 4, the Supreme Court has tried to move the development of the common law away from broad, contestable notions of public policy to a more rules based and legally certain footing. The *Patel v Mirza* guidelines could be said to represent an exception to this general trend but in his concurring judgment Lord Kerr considered that properly applied Lord Toulson's guidelines would promote rather than detract from consistency in the law. It remains to be seen to what extent scenarios considered in cases decided under the old law would be decided differently now. The pending appeals provide the Supreme Court with an opportunity to consider that question and operation of the test generally across a range of factual situations.

By Andrew Warnock QC