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RESTITUTION, REFORM AND ILLEGALITY: AN END TO TRANSACTIONAL UNCERTAINTY?

This article examines the common law defence of illegality in contract, restitution and trust law. It operates as a bar to claims brought in relation to transactions which contravene the law or are deemed contrary to public policy. The defence frequently produces unjust results, and this has led the courts to intervene to assist claimants. Such assistance takes a number of forms, varying from a generous interpretation of illegality to the development of specific exceptions. However, in consequence, this area of law is characterised by a complex matrix of judicial interpretation and discretion with a number of ill-defined exceptions, which lead to transactional uncertainty. Litigants find it difficult to ascertain, without judicial intervention, whether they may bring an action in contract, restitution or trust law. Whilst the legislators and reformers have maintained the need for an illegality defence, this article examines recent recommendations for reform and questions whether the developing doctrine of restitution (or unjust enrichment) in English law is capable of providing an adequate basis for change. In particular, this article examines the concept of a "structured discretion" forwarded recently by the English Law Commission, and considers whether such a proposal can succeed in providing the reform this area of law badly needs.

PARTIES, wishing to make a claim in contract, restitution or trust law, still face the significant obstacle of the illegality defence when bringing an action in English law.[1] For a number of policy reasons the courts have been reluctant to support the claims of parties involved in illegal transactions.[2] The maxim of *ex turpi causa non oritur actio* (the court will not assist a party who founds his or her claim on an illegal or immoral act) expresses the reluctance of the courts to intervene. This, it is believed, will deter parties from entering into illegal transactions and maintain the dignity of the court in refusing to entertain such claims. There also seems to be an element of punishment in that the claimant must suffer the consequences of his or her involvement in the illegal transaction, and a determination

1 See, generally, N Enonchong *Illegal Transactions* (LLP Limited, 1998).

2 The policy grounds for the illegality defence are examined and approved by the Law Commission in its Consultation Paper No 154 "*Illegal transactions: the effect of illegality on contracts and trusts*" (1999), Part VI.

that a claimant should not profit from his or her wrongdoing.[3] On this basis, *in pari delicto potior est conditio defendentis* (where the parties are equally guilty, the defendant is in the stronger position). The courts will not permit a party to an illegal transaction to recover any monies paid or benefits transferred under the illegal transaction and the transaction itself is generally treated as void and unenforceable.

However, the law in this area is far from straightforward. There is no clear definition of what is meant by "illegality" in contract, restitution or trust law. Equally, the effect of such a finding is difficult to state clearly. At times, it will leave the parties to the transaction without any claim at law, but a number of complex exceptions have been developed by the courts to deal with the perceived injustice of refusing assistance to all claimants who may be innocently or collaterally involved in an illegal transaction. To extrapolate the current legal position in relation to illegality is therefore a difficult, if not impossible, task. As Lord Goff remarked in the leading House of Lords case of *Tinsley* v *Milligan*[4] "the principle is not a principle of justice: it is a principle of policy, whose application is indiscriminate and so can lead to unfair consequences as between the parties to litigation."

Few may therefore doubt the need for reform to provide clear guidance to those unfortunate enough to become involved with the after-effects of an illegal transaction. At present, the law is complex and leads inevitably to transactional uncertainty, that is, a situation in which the parties to the transaction cannot be sure that the courts will support the contract should it be subject to challenge. This article will, first, highlight some of the difficulties experienced by litigants in relation to illegal transactions, both in terms of defining "illegality" and ascertaining its effect. It will then examine the scope of the English law of restitution in providing a remedy for parties who seek to recover monies or benefits transferred under an illegal transaction. Restitution represents, perhaps, the most proactive area of common law development in English law, and provides a means of responding to the policy concerns underlying the concept of illegality. Yet, as will be seen, despite the efforts of its strongest advocates,[5] the Law

[3] See JW Wade "Benefits obtained under illegal transactions – Reasons for and against allowing restitution" (1946) 25 Texas Law Review 31 and RA Buckley "Law's boundaries and the challenge of illegality" in RA Buckley (ed) *Legal Structures* (Wiley & Sons, 1996) Ch 9.

[4] [1994] 1 AC 340, 355.

[5] For example, P Birks "Recovering value transferred under an illegal contract" (2000) 1 Theoretical Inquiries in Law 155 and *An Introduction to the Law of Restitution* (Oxford: Clarendon Press, revised ed 1989); AS Burrows and E McKendrick *Cases and Materials on the Law of Restitution* (Oxford University Press, 1997) pp 520-522 and AS Burrows, *The Law of Restitution* (Butterworths, 1993).

Commission in its recent consultation paper has preferred to see reform in terms of a structured judicial discretion supplemented by limited recognition of the restitutionary claim.[6] By examining the nature of illegality, its effect, and prospects for reform, this article will seek to determine whether such reform is capable of addressing the problem of transactional uncertainty, which, as will be seen, is currently inherent to the illegality defence.

I. Current Law: What is "Illegality"?

It remains unfortunate that, despite the drastic consequences of a finding of illegality, there is no clear definition of "illegality" in English law.[7] The Law Commission in its consultation paper favoured a very wide definition for the sake of analysis,[8] but it may be doubted whether this is applied in practice. This leaves litigants in a precarious position. They cannot be sure whether they will be permitted to rely on the terms of the contract involved. At best, "illegality" can be described as signifying that the transaction is contrary to public policy in that it breaches a statutory provision or common morality, although this is vague and arguably of limited utility to litigants. This situation is exacerbated by a number of factors. First of all, the twentieth century saw an increase in statutory regulation, whereby businessmen might easily find themselves inadvertently to have contravened a particular regulation or failed to obtain the appropriate permission or licence. Such a minor contravention may render the parties' transaction unenforceable. Secondly, one party may be unaware of the illegal nature of the transaction or find that the other party has performed a perfectly legal transaction in an illegal manner. In this situation, it seems harsh to penalise an innocent party for the misconduct of another, particularly if the innocent party could not have prevented or even have known of the misconduct of the other party. Thirdly, a transaction may be found to be illegal for conflicting with common morality; a nebulous concept which will vary according to the changing mores of society. The problems associated with these factors will be examined below.

6 Law Commission Consultation Paper No 154 *op cit*.

7 See, generally, MP Furmston, "The Analysis of Illegal Contracts" (1966) 16 University of Toronto Law Journal 267.

8 Law Commission Consultation Paper No 154 *op cit* at 1.4: "any transaction which involves (in its formation, purpose or performance) the commission of a legal wrong (other than the mere breach of the transaction in question) or conduct which is otherwise contrary to public policy." This definition has been criticised as unduly wide: see N Enonchong "Illegal transactions: the future?" [2000] Restitution Law Review 82.

A. *Increased Statutory Regulation*

Businessmen now face a plethora of statutory provisions which regulate commercial transactions. These may vary from absolute prohibition to the mere requirement of certain paperwork in completing a transaction. However, a failure to comply with the relevant provision risks a finding that the whole transaction is illegal. The question facing the courts is whether Parliament, in enacting the provision, intended transactions in breach of the provision to be unenforceable. Although Parliament may occasionally make this clear,[9] in the majority of cases it remains for the court to interpret the statute in question and ascertain whether the Act is intended not only to provide a criminal penalty,[10] but to prohibit all subsequent transactions.

The cases of *Re Mahmoud and Ispahani*[11] and *Archbolds (Freightage) Ltd* v *S Spanglett Ltd*[12] illustrate the difficulties experienced by litigants attempting to predict the response of the court. In both cases, the plaintiff had been deliberately misled by the defendant into believing that the defendant had the correct licence to undertake the delivery in question. When the plaintiff sought to bring an action for breach of contract, the court in *Archbolds* was prepared to award contractual damages, but the Court of Appeal in *Re Mahmoud* refused relief. The distinction rested on the wording of the statute in question. In *Re Mahmoud* the defendant had contravened a statutory order, which provided that "a person shall not ... buy or sell ... certain articles ... except under and in accordance with the terms of a licence".[13] This was held clearly to prohibit all such transactions. In contrast, Pearce LJ, giving the leading judgment in *Archbolds*, held that the defendant's contravention of the Road and Rail Traffic Act 1933 ("no person shall use a goods vehicle on a road for the carriage of goods ... except under a licence") did not render the subsequent transaction illegal. In his Lordship's view, the statute did not intend to forbid by implication all contracts whose performance must, on all the facts, result in a contravention of the Act:

9 Certain statutes deal with this expressly: see s 65(4) of the Road Traffic Act 1988 which provides that "nothing in [s 65(1): offence to supply certain vehicles which do not comply with specified safety requirements] shall affect the validity of any contract or any rights arising under or in relation to a contract." See also section 26, Fair Trading Act 1973 and section 5 of the Financial Services Act 1986.

10 Generally the Act will state that the breach amounts to a criminal offence, although it would seem that this is not essential: *Fuji Finance Inc* v *Aetna Life Insurance Co Ltd* [1997] Ch 173.

11 [1921] 2 KB 716. See also *J Dennis & Co Ltd* v *Munn* [1949] 2 KB 327.

12 [1961] 1 QB 374. Note MP Furmston (1961) 24 Modern Law Review 394.

13 The Seeds, Oils and Fats Order 1919.

> The object of the Road and Rail Traffic Act 1933 was not ... to interfere with the owner of the goods or his facilities for transport, but to control those who provided the transport, with a view to promoting its efficiency. Transport of goods was not made illegal.[14]

This would appear to present the courts with a considerable amount of discretion in determining whether subsequent transactions have been impliedly prohibited by the statute in question. Much depends on the wording of the statute. In the notorious decision of the Court of Appeal in *Phoenix General Insurance Co of Greece SA* v *Halvanon Insurance Co Ltd,*[15] Kerr LJ held that the wording of the Insurance Companies Act 1974, which provided for an offence of "effecting and carrying out contracts of insurance" without authorisation, rendered all such insurance contracts illegal and unenforceable.[16] His Lordship held that, even though the effect of such a finding would be contrary to "good public policy and common sense",[17] the wording of the Act left no room for the introduction of considerations of public policy. "The only other remedy, albeit only for the future, is legislation; unless the House of Lords can find a way of overcoming the problem."[18] This ruling has been partially reversed by section 132 of the Financial Services Act 1986,[19] but it demonstrates the limitations of statutory interpretation. The leading case of *St John Shipping Corporation* v *Joseph Rank Ltd*[20] further highlights the tensions in this area of law. Devlin J held that the starting point for any court must be to address two fundamental questions:[21]

(a) Does the statute intend to prohibit contracts at all?

(b) If so, does this contract belong to the class which the statute intends to prohibit?

[14] *Supra*, note 12, p 386. See also *Bloxsome* v *Williams* (1824) 3 B & C 232.

[15] [1988] QB 216.

[16] *Ibid*, p 273, approving Parker J in *Bedford Insurance Co Ltd* v *Instituto de Resseguros do Brasil* [1985] QB 966.

[17] *Ibid.*

[18] *Ibid*, p 276. Although, on the facts of the case, the court was able to assist the plaintiffs on the basis that the plaintiffs were authorised to continue as an insurer if they had been acting lawfully before the Act came into force.

[19] This provision enables the assured, but not the insurer, to enforce the insurance contract. This came into force on January 12, 1987.

[20] [1957] 1 QB 267. Note C Grunfeld (1957) 20 Modern Law Review 172. See also *Hughes* v *Asset Managers plc* [1995] 3 All ER 669 and *Cope* v *Rowlands* (1836) 2 M & W 149; 150 ER 707.

[21] [1957] 1 QB 267, 287.

If the contract is not expressly prohibited, then a court should consider the object of the statute, the mischief it is designed to prevent, its language and scope, the consequences for the innocent party and any other relevant considerations.[22] On the facts of the case, which involved overloading a ship contrary to the Merchant Shipping (Safety and Load Line Convention) Act 1932, Devlin J held that contracts for the carriage of goods were not prohibited by the statute. The object of the Act was to prevent overloading which would be achieved by the imposition of a fine.[23]

Devlin J in *St John Shipping* was noticeably influenced by the consequences of a finding of illegality on the shipowners. His Lordship observed the difficulties which would follow if a shipowner who accidentally overloaded his ship by a fraction of an inch could not recover any penny of freight.[24] Devlin J recognised the distinct risk that illegality could be used to undermine commercial transactions, particularly in view of the volume of regulations influencing such transactions. In such cases, a trivial breach might result in a party losing a sum vastly in excess of any criminal penalty, which would be retained by the defendant, regardless of his or her conduct:

> Commercial men who have unwittingly offended against one of a multiplicity of regulations may nevertheless feel that they have not forfeited all right to justice, and may go elsewhere for it if courts of law will not give it to them. In the last resort they will, if necessary, set up their own machinery for dealing with their own disputes in the way that those whom the law puts beyond the pale, such as gamblers, have done.[25]

One must be sympathetic to such concerns. A finding of illegality does not necessarily involve reprehensible conduct and to undermine the whole transaction for a mere error of judgment appears drastic in the circumstances. A further example may be seen in *Shaw* v *Groom*.[26] In this case, a tenant challenged the landlord's claim for arrears of rent on the basis that the landlord had failed to provide certain statutory information in the rent book, which was a criminal offence under section 4 of the Landlord and Tenant

[22] *Phoenix General Insurance Co of Greece SA* v *Halvanon Insurance Co Ltd* [1988] QB 216, 273 *per* Kerr LJ.

[23] The shipowners in the case had, in fact, been prosecuted.

[24] *Supra*, note 20, p 281.

[25] *Ibid,* p 289.

[26] [1970] 2 QB 504. See also Pearce LJ in *Archbolds (Freightage) Ltd* v *S Spanglett Ltd* [1961] 1 QB 374, 386.

Act 1962. Notwithstanding its finding that the legislation was intended to protect tenants, the Court of Appeal refused to accept that a minor breach would undermine the whole contractual relationship.[27]

B. *The Innocent Party*

The courts will adopt further circumspection where only one party to the transaction knows, or should be aware of, its illegal nature. This may be due to ignorance of the nature of the transaction, or because the transaction itself is not illegal but one party has chosen to perform it in an illegal manner. In both cases, the courts have shown a reluctance to leave the innocent party without any remedy at law.

1. *Ignorance of the Illegal Nature of the Transaction*

The first situation raises a number of difficulties. The innocent party faces the argument that ignorance of the law is no defence.[28] It can be contended, however, that this is not an absolute barrier to recovery. First, it would seem only to apply where the claimant "participates" in the unlawful purpose in full knowledge of the facts which render the transaction illegal[29] and the contract could not be carried out without a violation of the law.[30] Where, for example, the contract could be carried out without violating the law, a claim in contract would persist. Therefore, in *Waugh* v *Morris*,[31] despite the fact that the parties contemplated that hay would be delivered to a London wharf which, unknown to either party, was unlawful,[32] this was not a term of the contract and the defendant, who unloaded the hay by other legal means, was still acting under a valid contract. More significantly, recent case law has suggested that, although the innocent party cannot claim in contract, he or she may be able to bring a claim in restitution. There are two lines of authority which logically overlap. First, it is established

[27] See Sachs LJ, *supra* at 525.

[28] See *JM Allan (Merchandising) Ltd* v *Cloke* [1963] 2 QB 340, 348 *per* Lord Denning MR "where two people together have the common design to use a subject-matter for an unlawful purpose, so that each participates in the unlawful purpose, then that contract is illegal in its formation and it is no answer for them to say that they did not know the law on the matter."

[29] Lord Denning MR, *ibid*, p 348.

[30] *Ibid*, thereby distinguishing *Waugh* v *Morris* (1873) LR 8 QB 202. See also *Hindley and Company Ltd* v *General Fibre Company Ltd* [1940] 2 KB 517.

[31] (1873) LR 8 QB 202.

[32] As contrary to the Contagious Diseases (Animals) Act 1869.

law that a claimant may recover benefits transferred under an illegal transaction when its illegality was masked by a mistake of fact.[33] Following *Kleinwort Benson Ltd* v *Lincoln City Council*,[34] where the House of Lords finally abolished the distinction between mistakes of fact and law, there is no reason why such authority should not also apply to mistakes of law.

The second line of authority is more difficult. In a series of cases concerning contravention of the Solicitors' Practice Rules 1990, the Court of Appeal has considered whether the parties to such transactions could recover a reasonable sum for services rendered.[35] In the difficult case of *Mohamed* v *Alaga & Co*,[36] the plaintiff was a professional translator, who was a prominent member of the Somali community in the United Kingdom. He agreed with the defendant firm of solicitors to introduce Somali asylum-seekers to the firm and provide translating and other services. In return, the firm would pay him half of any fee received from the Legal Aid Board in respect of these clients. Such a fee-sharing arrangement was contrary to the Solicitors' Practice Rules 1990 and unenforceable.[37] Although the plaintiff was ignorant of the Rules, he had clearly participated in the illegal transaction. The Court of Appeal, overturning Lightman J below, held that this did not prevent him bringing a claim for restitution and recovering a reasonable sum for services rendered. Lord Bingham CJ held that:

> [T]he preferable view in my judgment is that the plaintiff is not seeking to recover any part of the consideration payable under the unlawful contract, but simply a reasonable reward for professional services rendered ... It is furthermore in my judgment relevant that the parties are not in a situation in which their blameworthiness is equal. The defendant is a solicitors' firm and bound by the rules ... By contrast the plaintiff, on the assumption made (which I have no difficulty in accepting) was ignorant that there was any reason why the defendant should not make the agreement which he says was made.[38]

The restitutionary claim is therefore dependent on the greater culpability of the other party and presumably no claim would lie where both parties

[33] See *Oom* v *Bruce* (1810) 12 East 225, 104 ER 87.

[34] [1999] 2 AC 349.

[35] See also *Hughes* v *Kingston upon Hull City Council* [1999] QB 1193; *Thai Trading Co* v *Taylor* [1998] QB 781. See, generally, *Swain* v *The Law Society* [1983] 1 AC 598.

[36] [1999] 3 All ER 699.

[37] An agreement for the sharing of fees was contrary to rule 7 of the Solicitors' Practice Rules. Equally, payment in consideration of the introduction of clients fell foul of rule 3 of the Rules.

[38] *Supra,* note 36, pp 706-707.

were equally guilty. This can therefore be interpreted as resting on the "*non in pari delicto*" line of authority (which will be examined below) in which the courts have permitted recovery where one party is less guilty than the other because he or she has been influenced by mistake, fraud or duress which masks the illegality of the transaction.[39] The Court of Appeal unfortunately did not specify its reason for granting a restitutionary remedy. The Court rejected the view of Lightman J that permitting a restitutionary claim on such facts would contradict and circumvent the statutory provisions[40] but, without a clear explanation of the award, this would appear to be a valid concern.[41]

Alaga was, however, re-examined by a differently constituted Court of Appeal in *Awwad* v *Geraghty & Co*[42] four months later. *Awwad* was a straightforward case of a differential fee agreement on which there was clear authority that, unless it was sanctioned by statute,[43] such arrangements were contrary to the Solicitors' Practice Rules. The party claiming restitution was the solicitor herself, who was a partner in her own firm. She was therefore not in a position to claim lesser culpability and the Court of Appeal rejected her claim to recover a reasonable sum for services rendered. Miss Geraghty had relied on *Alaga* and therefore the Court examined this decision in the course of its reasoning. Schiemann LJ explained *Alaga* as a case where the illegality had related to sharing the legal aid fee in return for the introduction of clients. This was clearly prohibited and the plaintiff would not be able to claim such a fee. This did not prevent him, however, claiming his fee in restitution for translating and other services rendered. There was nothing illegal in providing such services and he would therefore be entitled to claim a reasonable fee. In contradistinction, Miss Geraghty's claim rested on an illegal arrangement which was wholly contrary to the rules in question.

It is submitted that *Alaga* is best viewed as an exceptional case where legal performance could be severed from illegal performance under the contract. On this basis, the public policy aims of the law are not undermined, but the law recognises that a restitutionary basis for relief may exist.

[39] Professor Birks has suggested that *Alaga* may be interpreted as a mistake of law case: see "Recovering value transferred under an illegal contract" (2000) 1 Theoretical Inquiries in Law 155, 174.

[40] See Lightman J [1998] 2 All ER 720 at 725-726. The Court relied on the House of Lords' opinions in *Westdeutsche Bank* v *Islington* LBC [1996] AC 669 which overturned previous House of Lords' authority in *Sinclair* v *Brougham* [1914] AC 398 that a claim for restitution would undermine the invalidity of an *ultra vires* borrowing contract. One might question, however, the application of *Westdeutsche* outside *ultra vires* claims.

[41] Such limited analysis may be due to the fact that *Alaga* was a striking out decision.

[42] [2000] 3 WLR 1041. Comment N Andrews [2000] Cambridge Law Journal 265.

[43] See Access to Justice Act 1999.

2. *Illegality in Performance*

A further means of assisting the innocent party is to draw a distinction between transactions which are illegal by their very nature (initial illegality) and transactions which are legal but performed in an illegal manner (illegality in performance). With respect to the latter, the courts have shown themselves willing to adopt a more flexible approach and permit the innocent party (but not the guilty party)[44] to enforce the contract.[45] On this basis, the Court of Appeal in *Archbolds (Freightage) Ltd* v *S Spanglett Ltd*[46] held that where the defendant had chosen to carry out contracts for the carriage of goods in an illegal manner, the plaintiff could still bring a claim for contractual damages. Pearce LJ noted that the claim would not be permitted where both parties knew that it would be performed illegally or could only be performed in an illegal manner.[47]

C. *Common Law illegality*

The scope of contracts illegal as contrary to public policy is a continuing area of debate.[48] Whilst the common law has developed certain categories, it is unclear how broadly they should now be interpreted and to what extent cases from the nineteenth and early twentieth century should be regarded as valid authority today.[49] For example, the well known case of *Pearce* v

[44] Note, however, that Devlin J in *St John Shipping Corporation* v *Joseph Rank Ltd* [1957] 1 QB 267 permits the 'guilty' party to sue under the contract on the basis that the contract is not within the ambit of the statute. His Lordship was undoubtedly influenced by the first principle stated above.

[45] See, for example, *Re Mahmoud and Ispahani* [1921] 2 KB 716; *Anderson Ltd* v *Daniel* [1924] 1 KB 138; *Edler* v *Auerbach* [1950] 1 KB 359.

[46] [1961] 1 QB 374. Arguably, there is authority in *Bloxsome* v *Williams* (1824) 3 B & C 232; 107 ER 720 to permit an innocent party to withdraw even where the contract is *ex facie* illegal, although this was doubted by Parker J in *Bedford Insurance Co Ltd* v *Instituto de Resseguros do Brasil* [1985] QB 966, 985.

[47] *Ibid*, p 384.

[48] See GH Treitel *Law of Contract* (Sweet and Maxwell, 1999) 10th ed, pp 393-415, who, in his textbook, defines 22 heads of public policy in addition to contracts in restraint of trade. *Anson's Law of Contract* (Oxford University Press, 1998) 27th ed, by J Beatson pp 349-359 in turn proposes 9 different types of illegality. In addition, it is unclear under several heads whether all such contracts are illegal or merely void. For example, JC Smith, *Smith and Thomas: A Casebook on Contract* (Sweet and Maxwell, 2000) 11th ed, pp 682-684 treats contracts in restraint of trade, which oust the jurisdiction of the court, and which are prejudicial to the married state as void and not within their category of illegal contracts.

[49] See JL Dwyer "Immoral contracts" (1977) 93 Law Quarterly Review 386.

Brooks[50] questions our modern attitudes to sexual morality.[51] In that case, a coachbuilder was unable to bring a claim in contract on the basis that he had known the customer to be a prostitute and that she would use the carriage for the purposes of her trade.[52] One might question to what extent such contracts, which indirectly support sexual immorality, would be regarded as illegal under current law.[53] Equally questionable are cases such as *Hermann* v *Charlesworth*[54] where the court sought to protect young women from being forced or tricked into marriage by rendering contracts for marriage brokage illegal. On this basis, the status of marriage bureaux or dating agencies should now strictly be under question.[55]

Other areas are admittedly clearer. A contract to commit a crime[56] or a tort[57] will be illegal on a simple application of the *ex turpi causa* rule. However, public policy may characterise conduct as illegal even if a statute has removed the criminal element. For example, maintenance and champerty are no longer treated as crimes or torts in England,[58] but this has not prevented courts regarding such agreements as illegal as contrary to public policy. Equally, transactions which threaten the interests of the state[59] or the administration of justice[60] are illegal, but again it is for the courts to specify

50 (1866) LR 1 Exch 213.

51 See, also, *Feret* v *Hill* (1854) 15 CB 207 (using leased premises for brothel); *Taylor* v *Chester* (1869) LR 4 QB 309 (security for money spent in brothel).

52 "If a woman, who is known to be a prostitute, wants an ornamental brougham, there can be very little doubt for what purpose she requires it" *per* Pigott J, *supra*, p 219.

53 The case itself prompts Lord Denning MR in *JM Allan (Merchandising) Ltd* v *Cloke* [1963] 2 QB 340 at 348 to draw difficult distinctions between merely selling food or taking in laundry from prostitutes and supporting their trade in a more positive way, for example by renting a flat to a prostitute.

54 [1905] 2 KB 123. See also *Cole* v *Gibson* (1750) 1 Ves Sen 503; 27 ER 1169.

55 See R Powell "Marriage brocage agreements" (1953) 6 Current Legal Problems 254. See also authority concerning contracts prejudicial to marriage: *Wilson* v *Carnley* [1908] 1 KB 729; *St John* v *St John* (1803-5) 11 Ves Jun 526; 32 ER 1192; *Brodie* v *Brodie* [1917] P 271; *Westmeath* v *Westmeath* (1831) 1 Dow & Cl 519, 6 ER 619.

56 See *Cowan* v *Milbourn* (1867) LR 2 Ex 230.

57 *Clay* v *Yates* (1856) 1 H & N 73; 156 ER 1123; *Allen* v *Rescous* (1677) 2 Lev 174, 83 ER 505; *Brown Jenkinson & Co Ltd* v *Percy Dalton (London) Ltd* [1957] 2 QB 621; *Taylor* v *Bhail* [1995] CLC 337 and *Birkett* v *Acorn Business Machines Ltd* [1999] 2 All ER (Comm) 429.

58 Criminal Law Act 1967, sections 13,14.

59 *Porter* v *Freudenberg* [1915] 1 KB 857; *Sovfracht (V/O)* v *Van Udens Scheepvaart en Agentuur Maatschappij (NV Gebr)* [1943] AC 203; *Ertel Bieber & Co* v *Rio Tinto Co* [1918] AC 260; *Regazzoni* v *KC Sethia (1944) Ltd* [1958] AC 301; *Soleimany* v *Soleimany* [1999] QB 785.

60 See *R* v *Andrews* [1973] QB 422; *Keir* v *Leeman* (1844) 6 QB 308, (1846) 9 QB 371; *Windhill Local Board of Health* v *Vint* (1890) 45 ChD 351; *R* v *Panayiotou* [1973] 3 All ER 112, but note s 5(1), Criminal Law Act 1967.

the extent of these categories. Whilst it may be clear that a donation to a charity to obtain a knighthood is contrary to the interests of the state,[61] would this extend to a contract to lobby for recognition of the deserving character of the applicant?[62] Equally, whilst it is recognised to be illegal to trade with the enemy at time of war, should the courts enforce a contract which would involve the commission of a criminal act in a foreign and friendly state, but which would be legal in the United Kingdom?[63] Public policy or common law illegality is therefore a primary source of uncertainty in this area of law and risks imposing on modern businessmen the social and commercial mores of a previous age.

D. *The Illegality Dilemma*

The concept of "illegality" itself is therefore productive of considerable uncertainty. Judicial attempts to lessen the impact of the illegality defence have led to the present complex and unpredictable state of the law. Such intervention rests on the desire to avoid the drastic effects of illegality, which render the transaction unenforceable and leave the defendant in possession of benefits received, however unjustly acquired. Even where the statute in question identifies the transaction as illegal and unenforceable, the courts may still be reluctant to leave the parties to the consequences of illegality. A good example may be seen in relation to the Moneylenders Act (Cap 188) of Singapore. Section 15 provides that "No contract for the repayment of money lent by an unlicensed moneylender shall be enforceable." This avoids the uncertainties of the Moneylenders Act 1900 (UK), which had no equivalent provision.[64] Nevertheless this has not prevented the development of a body of case law which seeks to avoid the effects of section 15 by interpreting the transaction to be outside the ambit of the

[61] *Parkinson* v *College of Ambulance Ltd and Harrison* [1925] 2 KB 1. See also *Montefiore* v *Menday Motor Components Co* [1918] 2 KB 241.

[62] See now Honours (Prevention of Abuses) Act 1925.

[63] See *Foster* v *Driscoll* [1929] 1 KB 470.

[64] This Act has been repealed and replaced by the Consumer Credit Act 1974, see s 192(3)(b), Sch 5. English common law, in any event, had found loan transactions which were not registered under the Act to be void for illegality: see *Lodge* v *National Union Investment Company Limited* [1907] Ch 300; *Victorian Daylesford Syndicate* v *Dott* [1905] 2 Ch 624; *Bonnard* v *Dott* [1906] 1 Ch 724.

statute,[65] either under one of the exceptions[66] or because the contract was not a loan agreement within the meaning of the Act.[67] Section 15 also does not resolve whether the borrower can recover any securities given to the lender for the loan[68] and, if so, whether recovery is conditional on repayment of the monies given.[69]

It is submitted that such transactional uncertainty may only be addressed by lessening the unjust consequences of a finding of illegality. If the courts can be confident that such a finding will not lead to injustice, then a more coherent and structured concept of "illegality" will develop. The current uncertainty rests primarily on judicial attempts to circumvent the consequences of illegality. We will therefore examine the effects of illegality in the next part of this article, first setting out the current legal position, before examining the prospects for reform. Reform, it is suggested, is vital if there is to be any hope of reducing transactional uncertainty in this area of law.

II. Current Law: The Effect of Illegality

This must be the key issue in any discussion of illegality: to what extent may a claimant seek a remedy in civil law? Assuming that the court has reached a decision that the transaction is illegal and unenforceable, the inevitable question is whether the court may offer any assistance to the claimant. The starting point is a negative one: the court will not assist a claimant involved in an illegal contract. The classic policy statement is that of Lord Mansfield in *Holman* v *Johnson*:

65 See, for example, *Vernes Asia Ltd* v *Trendale Investment Pte Ltd* [1988] SLR 202 where the plaintiff succeeded in avoiding s 15 by establishing that, although the agreement had been negotiated in Singapore, the plaintiff had not carried out business in Singapore as required by s 5(1) of the Act. Grimberg JC states clearly that the object of the Act is to control moneylenders in Singapore and the court will not assist those who do business with moneylenders who reside and carry on business elsewhere.

66 For example, s 2(a)-(e): *Lorrain Esme Osman* v *Elders Finance Asia Ltd* [1992] SLR 369.

67 In *Subramaniam Dhanapakiam* v *Ghaanthimathi* [1991] SLR 432, a friendly loan between two long-time friends did not render the plaintiff a moneylender within the Act. See also *Litchfield* v *Dreyfus* [1906] 1 KB 584; *Newton* v *Pyke* [1908] 25 TLR 127. Note also *Nissho Iwai International (Singapore) Pte Ltd* v *Kohinoor Impex Pte Ltd* [1995] 3 SLR 268.

68 See *Lodge* v *National Union Investment Co Ltd* [1907] 1 Ch 300.

69 Authority suggesting that the plaintiff must give counter-restitution of any benefits received in English law (*Lodge* v *National Union Investment Co Ltd* [1907] 1 Ch 300) has now been discredited: see *Chapman* v *Michaelson* [1908] 2 Ch 612; [1909] 1 Ch 238; *Cohen* v J *Lester Ltd* [1939] 1 KB 504; *Kasumu* v *Baba-Egbe* [1956] AC 539. A different view was taken by the High Court of Australia in *Nelson* v *Nelson* (1995) 132 ALR 133, (1995) 184 CLR 538.

> 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. 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 in fault, *potior est conditio defendentis.*[70]

Lord Mansfield's statement makes no attempt to hide the possible unjust consequences of the courts' refusal to intervene.[71] On this basis, the courts have found it legitimate to intervene to assist "meritorious" claimants who are less culpable by reason of mistake or fraud (the "*non in pari delicto*" exception) or because they have withdrawn from the transaction before its illegal purpose has been achieved. A further exception permits recovery where the claimant does not rely on the illegal transaction but on independent property rights. All three lines of authority represent an attempt to mitigate the harshness of the illegality rule and permit the court to intervene to achieve a just result.

Yet, this goal is far from being achieved. The exceptions to the illegality defence do not apply in any structured way and their scope is unclear. The concept of "*non in pari delicto*" is obviously a relative one and leaves much to the discretion of the court. It is difficult to justify, for example, why only the victim of a fraudulent misrepresentation of the legality of the transaction should recover monies paid,[72] and not the victim of a negligent misrepresentation.[73] Equally, it is unclear on current authority whether a claimant can recover for mistake of law or fact when both, and not just

[70] (1775) 1 Cowp 341, 343; 98 ER 1120, 1121.

[71] *Ibid*, p 343: "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".

[72] *Hughes* v *Liverpool Victoria Friendly Society* [1916] 2 KB 482.

[73] *Harse* v *Pearl Life Assurance Co* [1904] 1 KB 558, although such a claimant would now be advised to bring an action for mistake of law.

one party, is mistaken.[74] The case law does suggest the existence of further categories of the "*non in pari delicto*" exception, such as duress, undue influence and possibly exploitation and vulnerability, but authority is limited.[75] The development of a further category of claimants who are specifically protected by statute,[76] such as the lessees in *Kiriri Cotton Co Ltd* v *Dewani*[77] and *Gray* v *Southouse,*[78] appears to be limited by the Court of Appeal decision in *Green* v *Portsmouth Stadium.*[79] In *Green*, Denning LJ held that it was a matter of the true interpretation of the statute: did Parliament intend the possibility of a civil action by this limited class of plaintiffs?[80] Such reasoning is very close to that adopted for the tort of breach of statutory duty,[81] for which the courts will only in limited circumstances permit a civil remedy in tort.[82] Goff and Jones have commented that *Green* makes it "difficult to establish this right of recovery today."[83]

The withdrawal exception[84] is no clearer. The leading case law provides no real guidance as to *when* withdrawal must take place to ensure the recovery of monies paid or benefits transferred. The most recent authority is the Court of Appeal decision in *Tribe* v *Tribe*[85] in which the Court merely stated that a party may recover benefits transferred "provided that he has withdrawn

74 In the leading case of *Oom* v *Bruce* (1810) 12 East 225, 104 ER 87, the report does not clarify whether one or both parties were unaware of the outbreak of war which rendered the transaction illegal. Nevertheless, it is generally cited as an example of the "*non in pari delicto*" exception.

75 See *Smith* v *Cuff* (1870) 6 M & S 160, 105 ER 1203; *Smith* v *Bromley* (1760) 2 Doug 696n, 99 ER 441 and *Atkinson* v *Denby* (1862) 7 H & N 934; 158 ER 749. See also *Williams* v *Bayley* (1866) LR 1 HL 200 and *Davies* v *London and Provincial Marine Insurance Co* (1878) 8 Ch D 469 (money paid to stifle prosecution). The status of cases such as *Re Thomas* [1894] 1 QB 742 where the court decided it was inequitable to refuse to return monies paid under an illegal transaction must also be questioned.

76 *Browning* v *Morris* (1778) 2 Cowp 790, 792; 98 ER 1364 *per* Lord Mansfield.

77 [1960] AC 192.

78 [1949] 2 All ER 1019.

79 [1953] 2 QB 190.

80 *Ibid*, p 196 *per* Denning LJ. On the facts of the case, his Lordship found nothing in the Betting and Lotteries Act 1934 to authorise a civil action by a bookmaker, who had been overcharged for entrance to a dog-racing track in contravention of the Act.

81 His Lordship cites the leading breach of statutory duty case of *Cutler* v *Wandsworth Stadium Ltd* [1949] AC 398 in support of his reasoning.

82 See *Lonrho Ltd* v *Shell Petroleum Co Ltd (No 2)* [1982] AC 173; P Giliker and S Beckwith *Tort* (Sweet and Maxwell, 2000) Chapter 7.

83 G Jones (ed), *Goff and Jones: the Law of Restitution* (Sweet and Maxwell, 1998) 5th ed, p 615.

84 Also known as the "locus poenitentiae" exception.

85 [1996] Ch 107. See G Virgo "Withdrawal from illegal transactions – a matter for consideration" [1996] Cambridge Law Journal 23.

from the transaction before the illegal purpose has been wholly or partly carried into effect."[86] The meaning of "wholly or partly carried into effect" remains in question. For example, one must assume that this had not occurred in the leading case of *Taylor* v *Bowers*[87] where the plaintiff was permitted to withdraw from an illegal agreement to defraud his creditors, although two meetings with his creditors had taken place and he had already transferred his business assets to his nephew. Even if the decision can be explained on the basis that no compromise had been reached with his creditors, this was entirely fortuitous and unsurprisingly the decision has received criticism.[88]

Professor Birks has argued that the exception reflects a reward for penitence,[89] but the case law does not wholly support such analysis. Whilst in terms of public policy it seems entirely consistent with Lord Mansfield's dictum that the illegality defence should be trumped by the desire to promote repentance by the parties to the transaction, the courts do not appear to have consistently adhered to such a strict moral line.[90] The approach of Prichard J in *Bigos* v *Bousted*[91] may therefore be contrasted with the more liberal statements of Millett LJ in *Tribe* v *Tribe*.[92] In *Bigos*, Prichard J refused to allow a defendant to recover share certificates deposited with the plaintiff in relation to an illegal loan. The defendant had withdrawn only because the plaintiff had refused to produce the money promised. Mere frustration

86 Millett LJ, *ibid*, p 34. The courts also appear to retain an equitable discretion to permit withdrawal from a transaction, see *Hermann* v *Charlesworth* [1905] 2 KB 123, although the case may be explained on the basis that the illegal purpose was the arrangement of the marriage and this had not taken place, even though introductions to potential partners had taken place.

87 (1876) 1 QBD 291. The doctrine is said to be founded on the dictum of Buller J in *Lowry* v *Bourdieu* (1780) 2 Doug KB 468, 471; 99 ER 299, 300.

88 See Fry LJ in *Kearley* v *Thomson* (1890) 24 QBD 742, 746; *Anson's Law of Contract op cit* pp 389-390; G Jones (ed), *Goff and Jones: the Law of Restitution* (Sweet and Maxwell, 1998) 5th ed, p 617 but note the comments of Millett LJ in *Tribe* v *Tribe, supra*, note 85, p 125.

89 P Birks, *An Introduction to the Law of Restitution* (Oxford: Clarendon Press, revised ed 1989) pp 301-303.

90 Although it may be argued that the courts' refusal to permit the exception to be relied upon where the contract involves a serious crime, for example, where one person has paid another to murder a third party, reflects a moral approach to the exception: see *Tappenden* v *Randall* (1801) 2 B & P 467, 471; 126 ER 1388, 1390 *per* Heath J; *Kearley* v *Thomson* (1890) 24 QBD 742, 747, *per* Fry LJ.

91 [1951] 1 All ER 92. See also *Parkinson* v *College of Ambulance Ltd and Harrison* [1925] 2 KB 1, 16, *per* Lush J and *Harry Parker Ltd* v *Mason* [1940] 2 KB 590.

92 *Supra*, note 85.

of purpose without repentance would not suffice.[93] In contrast, in *Tribe* v *Tribe,* a father had transferred his share certificates to his son, for a consideration which was never paid, to avoid potential claims from his creditors. This proved unnecessary, but his son refused to return the shares. The father successfully brought a claim on the basis that he had withdrawn before the illegal purpose had been carried into effect. The parallels with *Taylor* v *Bowers* are obvious. In both cases, the fact that the purpose was not carried out was entirely fortuitous. Both plaintiffs had intended to carry out the purpose and withdrawal had been due to external circumstances: in *Taylor,* the nephew selling the goods, in *Tribe*, the settlement with the creditors in question. Such decisions hardly support a moral basis to the doctrine. Millett LJ in fact recognises this explicitly:

> 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. It is true that this is not necessary to encourage withdrawal, but a rule to the opposite effect could lead to bizarre results.[94]

His Lordship did, however, exclude situations where the claimant simply withdraws because his or her plan has been discovered.[95]

Despite valiant attempts to explain the doctrine more coherently,[96] the law at present is confusing and contradictory. Until the courts identify the rationale underlying this exception, its utility will be limited. One particular attempt will be noted here.

Professor Beatson has suggested that recovery should only be allowed where denial would increase the probability of the illegal purpose being achieved.[97] On this basis, he argues that *Taylor* v *Bowers* was correct in

[93] Relying on *Alexander* v *Rayson* [1936] 1 KB 169 and *Berg* v *Sadler and Moore* [1937] 2 KB 158. The Court refused to be influenced by the fact that the defendant had undertaken the illegal loan to support the convalescence of his sick daughter in Italy.

[94] *Supra*, note 85, p 135. Nourse LJ, however, preferred not to become embroiled in the debate in relation to withdrawal generally: *Supra*, note 85, p 121.

[95] *Supra*, note 85, p 135.

[96] See, for example, R Merkin, "Restitution by Withdrawal From Executory Illegal Contracts" (1981) 97 Law Quarterly Review 420, the classic article of JK Grodecki, "*In pari delicto potior est conditio defendentis*" (1955) 71 Law Quarterly Review 254, who argues for a more flexible approach, and N Enonchong, "Title Claims and Illegal Transactions" (1995) 111 Law Quarterly Review 135.

[97] J Beatson "Repudiation of Illegal Purpose as a Ground for Restitution" (1975) 91 Law Quarterly Review 313.

permitting the plaintiff to withdraw in that it prevented a fraud of his creditors. Again, this may be criticised as an attempt to rationalise cases decided on their own facts and it cannot explain *Tribe* v *Tribe* where the father, in recovering his shares after the danger of seizure of his assets had passed, succeeded in achieving his illegal purpose of protecting his assets.[98] Nevertheless, the Law Commission accepted recently that if the claimant is able to show that his or her withdrawal from an illegal contract would reduce the likelihood of the illegality being achieved, then this is a policy which the law should pursue. It recommended that, in such cases, the court should have a discretion to allow the claimant to withdraw and recover any benefits which he or she had conferred on the defendant.[99]

The uncertainty invoked by the withdrawal and *"non in pari delicto"* exceptions is clear: litigants do not know whether they will recover benefits transferred and this uncertainty conflicts with any intended deterrent effect underlying the exceptions, leading to accusations of arbitrary justice. Such difficulties apply equally to the third exception mentioned above: independent property rights.[100] Here, the claimant may recover on the basis that his or her claim is not based (or "does not rely") on the illegal transaction, but on the assertion of independent proprietary rights. Therefore, if A grants B a two year lease, which is in fact illegal, it should follow that A will be able to regain possession at the end of the two year period, regardless of the illegal transaction, on the basis of A's reversionary interest in the premises.[101] English law also accepts that property rights can pass under an illegal transaction. One party may assert such rights against the other[102]

[98] See FD Rose "Gratuitous transfers and illegal purposes" (1996) 112 Law Quarterly Review 386, 390.

[99] Law Commission Consultation Paper No 154 *op cit* at 7.64.

[100] This may be viewed as an exception to the illegality defence or as a separate doctrine based on property rights.

[101] See B Coote, "Another Look at *Bowmakers* v *Barnet Instruments*" (1972) 35 Modern Law Review 38, 48, RN Gooderson, "Turpitude and Title in England and India" [1958] Cambridge Law Journal 199, 209 and A Stewart, "Contractual Illegality and the Recognition of Proprietary Interests" (1988) 1 Journal of Contract Law 134, 142-144. Case law examples include *Alexander* v *Rayson* [1936] 1 KB 169 and *Feret* v *Hill* (1854) 15 CB 207, 139 ER 400, but note the contrary view of CJ Hamson, "Illegal Contracts and Limited Interests" (1949) 10 Cambridge Law Journal 249, 256-257. The same rule applies to bailment (*Belvoir Finance Co Ltd* v *Stapleton* [1971] 1 QB 210) and pledges (*Taylor* v *Chester* (1869) LR 4 QB 309, 314 *per* Mellor J).

[102] *Singh* v *Ali* [1960] AC 167. The court relied on *Scarfe* v *Morgan* (1838) 4 M & W 270, 281, 150 ER 1430, 1435 and some support may be found in *Feret* v *Hill* (1854) 15 CB 207, 139 ER 400; *Simpson* v *Nichols* (1838) 3 M & W 240, 244, 150 ER 1132, 1134 and *Elder* v *Kelly* [1919] 2 KB 179.

or even a third party[103] provided that he or she is not required to rely on the transaction itself.[104] Therefore, if C sells D a boat and the transaction contravenes certain statutory provisions, D still obtains title to the boat and C cannot recover it. However, D could not sue C for a failure to deliver the boat as this would amount to an action for breach of the illegal contract, which would not be permitted at law.[105] Yet, even if such rules are correct, which has been challenged,[106] they cannot explain why in the leading case of *Bowmakers Ltd* v *Barnet Instruments Ltd*,[107] the plaintiff finance company was able to assert its remaining property rights in goods transferred under an illegal hire purchase agreement by relying on the defendants' failure to pay all the instalments due. This would appear to amount to breach of contract, which would not entitle a court to intervene.[108] This decision can only be explained if one accepts the argument that there was a clause in the agreement terminating the defendants' interest in the goods for non-payment of instalments.[109]

The law becomes even more complicated when one adds equitable property rights to the equation. The majority of the House of Lords in *Tinsley* v

[103] *Belvoir Finance Co Ltd* v *Stapleton* [1971] 1 QB 210.

[104] Lord Denning justified the principle in *Singh* v *Ali* [1960] AC 167, 176 as follows: "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'".

[105] See GH Treitel *Law of Contract* (Sweet and Maxwell, 1999) 10th ed, p 463.

[106] The concept of property passing under an illegal contract has received valid criticism from a number of authors – see MJ Higgins "The transfer of property under illegal transactions" (1962) 25 Modern Law Review 149, SH Goo "Let the estate lie where it falls" (1994) 45 Northern Ireland Legal Quarterly 378 – although it now seems firmly entrenched in English law following the majority view of the House of Lords in *Tinsley* v *Milligan* [1994] 1 AC 340.

[107] [1945] KB 65. See CJ Hamson, "Illegal Contracts and Limited Interests" (1949) 10 Cambridge Law Journal 249 and A Stewart, "Contractual Illegality and the Recognition of Proprietary Interests" (1988) 1 Journal of Contract Law 134.

[108] In contrast, the defendants' decision to sell the goods received under the first and third illegal hire purchase agreements without authorisation would be sufficient to terminate their interest in the goods and permit the plaintiff finance company to assert its reversionary interest in the goods.

[109] See GH Treitel *Law of Contract op cit* p 458. B Coote *loc cit* at 38 also suggests that it is reasonable to suppose that this would include such a clause. The case report is unfortunately equivocal, stating that the "familiar form" of hire purchase agreement was used: *Supra*, note 107, p 66.

Milligan[110] was of the opinion that a party to an illegal transaction could nevertheless obtain rights under a resulting trust provided he or she did not rely on the transaction. They rejected the minority view[111] that equity required the plaintiff to possess clean hands. If a resulting trust could be established without having to raise the illegal character of the arrangement, then such rights would be recognised by the courts. In *Tinsley* v *Milligan* itself, the majority held that Ms Milligan, who had contributed to the purchase price of a property which had been placed in the sole name of Tinsley to allow Ms Milligan to claim social security benefits fraudulently, did not have to rely on the illegal purpose to assert her rights under a resulting trust.

Such reasoning raises problems of its own, particularly in relation to the presumption of advancement.[112] As recognised by the Court of Appeal in *Tribe* v *Tribe*,[113] where the doctrine applies, the court will assume that the claimant intended a gift and this can only be rebutted by revealing the true state of affairs, *ie*, the illegal purpose, in which case the court will refuse to intervene. Current law therefore leaves equitable claims entirely dependent on the nature of the relationship between the parties – boyfriend to girlfriend creates a resulting trust; husband to wife is treated as a gift.[114] It is hardly surprising that the High Court of Australia in *Nelson* v *Nelson*[115] refused to follow *Tinsley* and preferred a discretionary approach which examined the underlying policy of the Act in question. McHugh J reflected the view of the Court in commenting that:

[110] [1994] 1 AC 340. Comment H Stowe, "The 'Unruly Horse' has Bolted: *Tinsley* v *Milligan*" (1994) 57 Modern Law Review 441; RA Buckley "Social security fraud as illegality" (1994) 110 Law Quarterly Review 3; AGJ Berg "Illegality and equitable interests" (1993) Journal of Business Law 513.

[111] Lords Goff and Keith dissenting: see Lord Goff at 357-8.

[112] See, generally, *Snell's Equity* (Sweet & Maxwell, 2000) 30th ed by J McGhee.

[113] *Supra*, note 85. See N Enonchong "Illegality and the presumption of advancement" [1996] Restitution Law Review 78. The relationship between father and son in *Tribe* is the classic application of the presumption of advancement. See also *Palaniappa Chettiar* v *Arunasalam Chettiar* [1962] AC 294.

[114] As illustrated by more recent case-law, such as *Lowson* v *Coombes* [1999] 2 WLR 720 (CA) (see MP Thompson [1999] The Conveyancer 242; I Cotterill "Property and impropriety – The *Tinsley* v *Milligan* problem again" [1999] Lloyd's Maritime and Commercial Law Quarterly 465) and *Silverwood* v *Silverwood* (1997) 74 P & CR 453. G Virgo and J O'Sullivan are highly critical of the elevation of the presumption of advancement to conclusive status: "Resulting trusts and illegality" in *Restitution and Equity* (Mansfield Press, 2000) ed P Birks and FD Rose pp 103-107.

[115] (1995) 132 ALR 133; (1995) 184 CLR 538. See FD Rose "Reconsidering illegality" (1996) 10 Journal of Contract Law 271.

> A doctrine of illegality that depends upon the state of the pleadings or the need to rely on a transaction that has an unlawful purpose is neither satisfactory nor soundly based in legal policy. The results produced by such a doctrine are essentially random and produce windfall gains as well as losses, even when the parties are in *pari delicto.*[116]

Tinsley may therefore be criticised for paying insufficient attention to the underlying policy of the relevant legislation and the interests of justice in favour of rules of procedure.[117] McHugh J in *Nelson* recommended that a new approach was needed, which would grant the courts a discretion to intervene subject to guiding principles.[118] The majority also held that recovery would be subject to repayment by Mrs Nelson of any sums forwarded under the transaction. Such a requirement is not, it would seem, part of English law.[119]

Tinsley has also been subject to academic criticism. Professor Enonchong has persuasively asserted that the law in fact permits the parties to rely on the illegal transaction to prove title.[120] Indeed, it is extremely difficult to draw the distinction required by Lord Browne-Wilkinson in *Tinsley*[121] between the claimant relying on the illegal transaction, and the claimant simply referring to the underlying agreement to evidence his or her property rights. There is also the problem recognised by Professor Buckley that there is nothing to prevent non-meritorious litigants using the exception, for example the suggestion of Lord Goff in *Tinsley*[122] that a member of a terrorist gang may seek to rely on the exception to assert property rights to their

[116] *Ibid*, p 189. Dawson J at 167 did succeed in basing his judgment on the fact that the mother did not rely on her fraudulent conduct in any direct or necessary way, although it is submitted that 'reliance' was used in a different sense in *Tinsley* v *Milligan, supra.*

[117] Note the criticism of Nourse LJ and the trial judge in *Tribe, supra*, note 85, p 118, Millett LJ, *supra*, at 134 and Nourse LJ in *Silverwood* v *Silverwood* (1997) 74 P & CR 453, 458, CA. See also Law Commission Consultation Paper No 154 *op cit* at 3.22.

[118] *Supra*, note 115, pp 192-193.

[119] See *Kasumu* v *Baba-Egbe* [1956] AC 539; *contra Lodge* v *National Union Investment Co Ltd* [1907] 1 Ch 300. In *Tinsley* v *Milligan, supra*, no such requirement was suggested, although Ms Milligan had reached a settlement with the Department for Social Security in relation to benefits fraudulently claimed.

[120] See N Enonchong, "Title Claims and Illegal Transactions" (1995) 111 Law Quarterly Review 135. Also N Enonchong *Illegal Transactions* (LLP Ltd, 1998); "Illegality: the fading flame of public policy" (1994) 14 Oxford Journal of Legal Studies 295. See also AS Burrows *The Law of Restitution* (Butterworths, 1993) at 469 and Law Commission Consultation Paper No 154 *Illegal transactions: the effect of illegality on contracts and trusts* (1999) paragraph 2.66.

[121] *Supra*, note 4, p 370.

[122] *Ibid*, p 362.

hide-out.[123] This may be countered by authority which excludes claims for recovery when this would be grossly immoral,[124] but highlights a distinct danger that, by establishing this further exception, the courts may find it difficult to prevent non-meritorious litigants asserting independent property rights. *Tinsley* may therefore threaten the very rationale of the illegality doctrine.

The current law relating to the effect of illegality is therefore uncertain, unpredictable and represents a clear example of unstructured common law judicial intervention. At present, it appears to provide a forum for the opportunistic to try their hand at the law as stated above. It has received well-deserved and extensive academic criticism, but this appears to have had little impact despite its recognition by the courts, which seem resigned to the fact that any resolution must come from the Law Commission or the legislature itself.[125] There appears to be no judicial imperative to rationalise this area of law beyond the continued acceptance of the "exceptions approach" which, put bluntly, rests on a finding of a suitable loophole to rescue a meritorious litigant from the drastic consequences of illegality. *Tribe* v *Tribe* represents an excellent example of the "exceptions approach". The gratuitous transfer of shares from father to son raised the presumption of advancement. The father could not rebut this without relying on his illegal purpose for the transfer and so could not recover his shares on the basis of his independent property rights. Nevertheless, the court found for him on the basis of the withdrawal exception, despite the fact that the shares had already been transferred and withdrawal was motivated by the fact that he no longer needed to protect his assets from his creditors. The sympathies of the Court of Appeal in *Tribe* are obvious[126] and a 'just result' was achieved, but the cost to transactional certainty and the doctrine as a whole cannot be underestimated.

Reform is therefore vital in this area of law. The next section will examine proposals for such reform and whether they are capable of dealing with the problems of transactional uncertainty raised above.

[123] RA Buckley "Law's boundaries and the challenge of illegality" in RA Buckley (ed) *Legal Structures* (Wiley & Sons, 1996) at 232. In the recent case of *MacDonald* v *Myerson* [2001] EGCS 15, for example, MacDonald was able to recover the proceeds of sale of two properties from his solicitors despite being convicted of mortgage fraud in relation to the two houses.

[124] See Du Parcq LJ in *Bowmakers Ltd* v *Barnet Instruments Ltd* [1945] KB 65, 72. See also GL Williams "The legal effect of illegal contracts" 8 Cambridge Law Journal 51, 62. A second possible exception may be in case of statutory illegality rendering the transaction unenforceable and ineffective: see *Amar Singh* v *Kulubya* [1964] AC 142, PC.

[125] See Lord Goff in *Tinsley* v *Milligan*, *supra*, note 4, p 363.

[126] See Nourse LJ, *supra*, note 85, p 122.

III. Reform

A number of proposals for reform have been formulated. It is submitted that the current state of the law requires positive intervention to provide litigants with a more coherent picture of the operation of the illegality defence. On this basis, maintaining the *status quo* simply will not suffice. We will study two options here. First, we will examine the potential of restitution to assist claimants and whether clearer recognition of its operation in relation to illegality will resolve some of the problems outlined above. Secondly, we will analyse the recent provisional recommendations of the Law Commission and discuss whether they provide the reform clearly necessary in this area of law.

A. *Restitution*

Leading restitution authors have asserted that restitution can form the basis for a claim despite illegality.[127] In a recent article, Professor Birks has suggested that illegality could be better explained in terms of "stultification", that is, that claims for restitution should be permitted where the claim does not undermine the refusal to enforce the contract.[128] Although it is still disputed whether any aspects of illegality can found a claim for restitution,[129] the Law Commission in its Consultation Paper accepted that the withdrawal exception could be regarded as restitutionary in nature,[130] although it suggested that its application might be limited if the courts finally accept claims for restitution based on partial failure of consideration.[131] It has also been

[127] See, for example, JD McCamus "Restitutionary Recovery of Benefits Conferred under Contracts in Conflict with Statutory Policy – the New Golden Rule" (1987) 25 Osgoode Hall Law Journal 787; AS Burrows *The Law of Restitution* (Butterworths, 1993), Chapter 11; G Jones (ed), *Goff and Jones: the Law of Restitution* (Sweet and Maxwell, 1998) 5th ed, Ch 24 and FD Rose "Illegality limited" (1997/8) 8 King's College Law Journal 69.

[128] See "Recovering value transferred under an illegal contract" (2000) 1 Theoretical Inquiries in Law 155.

[129] See, for example, the doubts expressed by W Swadling "The role of illegality in the English law of unjust enrichment" (2000) Oxford University Comparative Law Forum 5 (ouclf.iuscomp.org).

[130] *Supra*, note 2, paras 2.49-2.56.

[131] See para 7.59 relying on *Goss* v *Chilcott* [1996] AC 788. Note the differing positions of Professor AS Burrows and G Virgo as to whether withdrawal may be explained in terms of total failure of consideration. See AS Burrows *The Law of Restitution op cit* pp 333-335; AS Burrows and E McKendrick *Cases and Materials on the Law of Restitution* (Oxford University Press, 1997) at 511-523) and G Virgo *The principles of the law of restitution* (Oxford, 1999) 747 and 372; "Withdrawal from illegal transactions – a matter for consideration" [1996] Cambridge Law Journal 23 and "The effect of illegality on claims for restitution

suggested that the "*non in pari delicto*" exception represents recognition of the grounds for restitution,[132] for example, mistake, fraud, or even more contentious heads such as exploitation[133] or vulnerability.[134] However, there is authority that total failure of consideration (a recognised head of restitution) is not sufficient to persuade the courts to permit recovery from the defendant.[135]

Whilst such claims should be carefully considered, a number of concerns arise. First, restitution itself is at a stage of transition and is subject to extensive academic and judicial debate. It seems unlikely that it is at present capable of providing the restructuring and certainty required in this area of law. The continuing debate concerning total and partial failure of consideration illustrates the inherent uncertainty apparent within the law of restitution. Reform by restitution would take time and arguably concepts such as "stultification" cannot be defined except on a case-by-case basis. Secondly, it is unclear to what extent the current exceptions reflect inherent restitutionary analysis. Whilst the strongest case may be made for the withdrawal exception, Millett LJ in *Tribe* v *Tribe* was eager to attribute the third exception to restitutionary analysis.[136] Unfortunately, this category does not lend itself to such analysis, but appears to be, in reality, an aspect of property law.[137] In these circumstances, it must be questioned whether restitution alone is at present capable of providing a sufficient degree of certainty in this area of law.

in English law" in W Swadling (ed), *The Limits of Restitutionary Claims: a comparative analysis* Ch 7 (UKNCCL, 1997)). Professor Burrows disagrees with Virgo that withdrawal can be based on total failure of consideration in view of *Thomas* v *Brown* (1876) 1 QBD 714, which denies total failure of consideration where the defendant is able or willing to perform as promised.

[132] See P Birks, *An Introduction to the Law of Restitution op cit* and AS Burrows, *The Law of Restitution op cit*.

[133] See G Virgo *The principles of the law of restitution* (Oxford, 1999) pp 746-7.

[134] See AS Burrows and E McKendrick *Cases and Materials on the Law of Restitution* (Oxford University Press, 1997) at 520; AS Burrows *The Law of Restitution* (Butterworths, 1993) Ch 11.

[135] See *Parkinson* v *College of Ambulance Ltd and Harrison* [1925] 2 KB 1. See also *Berg* v *Sadler and Moore* [1937] 2 KB 158.

[136] His Lordship uses the term "restitution" throughout. In contrast, Nourse LJ (at 121) confines his comments to property transfer cases (see below). Otton LJ agreed with both judges.

[137] See FD Rose "Restitutionary and proprietary consequences of illegality" in *Consensus ad Idem* (editor FD Rose) (Sweet and Maxwell, 1996). See also W Swadling [1995] All England Law Reports Annual Review 456. A distinction should therefore be drawn between "pure proprietary claims" which are not based on restitution and "restitutionary proprietary claims".

The Law Commission, whilst recognising the merits of restitutionary analysis, preferred to integrate restitutionary analysis into whole scale reform. Referring to proposals for reform in other Commonwealth countries[138] and actual reform undertaken in New Zealand[139] and Israel,[140] the Commission provisionally recommended granting the courts a structured discretion to deal with the effects of illegality.

B. *A Discretionary Approach*

In recommending the adoption of a discretionary approach under which the courts would be able to take into account a number of relevant factors, the Law Commission accepted that reform was necessary in this area of law.[141] The Commission rejected a general discretion to achieve a 'just' result which had been proposed by the Court of Appeal in *Tinsley*,[142] and agreed with the House of Lords in *Tinsley*[143] that such a test was too uncertain. Sufficient certainty would be provided by a structured discretion whereby the court, in considering whether to enforce the contract[144] or permit recovery of monies or benefits transferred under the transaction, would consider five particular issues:

(1) the seriousness of the illegality involved;

(2) the knowledge and intention of the claimant;

(3) whether denying relief will act as a deterrent;

[138] Law Reform Commission of British Columbia, *Report on Illegal Transactions* (1983); Law Reform Committee of South Australia, *37th Report Relating to the Doctrines of Frustration and Illegality in the Law of Contract* (1977); Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (1987).

[139] New Zealand Illegal Contracts Act 1970, ss 6 and 7.

[140] Israeli Contracts (General Part) Law 1973, s 31.

[141] For analysis of the report, see RA Buckley "Illegal transactions: chaos or discretion?" (2000) 20 Legal Studies 155; N Enonchong "Illegal transactions: the future?" [2000] Restitution Law Review 82.

[142] See Nicholls LJ in *Tinsley* v *Milligan* [1992] Ch 310. This argument rests on the "public conscience" test forwarded in tort: see *Thackwell* v *Barclays Bank Plc* [1986] 1 All ER 676, as developed by the Court of Appeal in *Saunders* v *Edwards* [1987] 1 WLR 1116. Its status in tort is currently under question, see *Pitts* v *Hunt* [1991] 1 QB 24.

[143] *Supra*, note 4, pp 363, 369 (Lords Goff and Browne-Wilkinson being in agreement on this point).

[144] This discretion only applies to contracts rendered illegal by statute. It does not apply to contracts which are contrary to public policy on the basis that the courts have already decided that enforcement would be contrary to the public interest: see para 7.13.

(4) whether denying relief will further the purpose of the rule which renders the contract illegal; and

(5) whether denying relief is proportionate to the illegality involved.[145]

The discretion would therefore apply to what have traditionally been regarded as the exceptions to the illegality defence: "*non in pari delicto*", withdrawal and independent property rights. The Commission recommended that the courts should have a discretion to decide whether or not illegality would act as a defence to a restitutionary claim. The withdrawal exception would only be permitted "where allowing the party to withdraw would reduce the likelihood of an illegal act being completed or an illegal purpose being accomplished".[146] Claims based on independent property rights would also be subject to the discretion,[147] although it would not be used to invalidate the disposition of property to a third party purchaser for value without notice of the illegality.[148]

IV. Prospects for the Future

It is important to recognise that the proposals of the Law Commission are provisional and the final report is not expected until the end of 2001 at the earliest, following its decision to add to its consideration the role of illegality in the law of torts. Its proposals do offer, however, the vigorous discussion of illegality requested by academics and the judiciary alike, and a basis on which to alter fundamentally the role of illegality in the twenty-first century. Although the consultation paper is weak in defining "illegality",[149] its strong point is its recognition of the need to offer a structured approach towards determination of the effects of illegality. Its rejection of an unstructured discretion is to be welcomed. As stated above, it is anticipated that, if the effects of illegality are clearer and more equitable, a more coherent and structured definition of illegality will follow. The courts will no longer

[145] See para 7.43 *op cit.* See, generally, N Enonchong "Illegal transactions: the future?" [2000] Restitution Law Review 82.

[146] In deciding this question, courts are directed to consider the genuineness of any repentance (although it is not a necessary condition for the exercise of the discretion) and the seriousness of the illegality. The claimant must also satisfy the court that the contract could not be enforced against him under the enforcement provisions recommended by the Law Commission: para 7.69.

[147] See para 7.26 *op cit.*

[148] See para 7.25. Such a provision is also present in the New Zealand Illegal Contracts Act 1970.

[149] Adopting an unduly wide definition – see note 8 above.

feel obliged to avoid the consequences of illegality and therefore will be less likely to distort the meaning of the concept. The question remains whether the structure suggested by the Law Commission is sufficient to provide transactional certainty. Any discretion inevitably runs counter to predictability and may be criticised as "an inadequate substitute for the certainty in legal rules required by lawyers advising their clients."[150] Virgo and O'Sullivan suggest that even a structured discretion will result in too much uncertainty in an area where clarity is vital.[151] The question remains, however, whether any better solution exists. In view of the nature of illegality, which may vary from minor infraction of the law, such as overloading a lorry by 1 kilogram, to the intentional commission of a criminal act, such as murder, it is submitted that static legal rules cannot be the answer. In fact, the need for reform derives from the existence of such 'predictable' legal rules and the courts' attempts to circumvent them. A structured discretion may create uncertainty, but in view of the current complex legal rules which, it is accepted, often lead to unjust results, and, it is submitted, encourage judicial creativity, a set of guidelines to be applied in each case appears to be the only viable step forward. The only logical alternative is to abandon the concept of 'illegality' altogether, save in the case of serious criminality.[152] This is likely to be unpopular with the judiciary[153] and society as a whole and likely to result in uncertainty, in any event, in defining what is meant by "serious criminality". In the light of such concerns, the Law Commission proposals represent an attempt at limited reform and it is to be hoped that, in applying the guidelines, the courts will create some kind of precedent for future litigants. Indeed, the success of the more flexible provisions of the New Zealand Illegal Contracts Act 1970 must be a ground for optimism.[154]

Two final important points should be made. The proposals, in recognising the impact of restitution on this area of law, seek to integrate it into its reforms. In so doing, the Law Commission ensures that the development of restitutionary analysis does not conflict with the public policy goals of

[150] FD Rose "Restitutionary and proprietary consequences of illegality" in *Consensus ad Idem* (ed FD Rose) (Sweet and Maxwell, 1996) p 204.

[151] G Virgo and J O'Sullivan "Resulting trusts and illegality" in *Restitution and Equity* (Mansfield Press, 2000) ed P Birks and FD Rose p 118.

[152] See G Virgo and J O'Sullivan "Resulting trusts and illegality" in *Restitution and Equity* (Mansfield Press, 2000) ed P Birks and FD Rose. This was rejected by the Law Commission: see Ch 6, Law Commission Consultation Paper No 154 (1999), *supra*, note 2.

[153] The illegality defence was recently approved by the Court of Appeal in *Shanshal* v *Al-Kishtaini* [2001] EWCA Civ 264; *The Times*, March 8, 2001.

[154] See RA Buckley "Illegal transactions: chaos or discretion?" (2000) 20 Legal Studies 155; DW McLauchlan "Contract and commercial law reform in New Zealand" (1984-5) 11 New Zealand Universities Law Review 36.

illegality. It is unfortunate, in this author's view, that in recognising restitution, the Commission did not undertake a more critical appreciation of its role in this area of law. Restitution remains a controversial topic in English law and its existence and principles are still contested by academics and the judiciary alike. It is a pity that the Commission did not take the opportunity to undertake a more rigorous critique of its application in relation to illegality. Equally, the Law Commission in its Consultation Paper notes briefly that, in reaching a decision, the court will need to be satisfied that allowing the restitutionary claim will not undermine its refusal to enforce the contract.[155] The present author would wish to see such a significant principle clearly stated and given greater priority in any legislative reform to avoid a clash of policy objectives between contract and restitution.

In general, however, the Consultation Paper is welcomed as an overdue attempt to address the problems of the illegality defence in English law. It remains to be seen whether the final paper, which current indications suggest will be largely similar to the Consultation Paper,[156] will be adopted by the legislator. Should the Law Commission's proposals not come to fruition, litigants will have little option but to turn once more to the law of restitution to provide some recourse beyond the complexities of the illegality defence and its exceptions. It remains to be seen whether the future of illegality lies with reluctant judicial creativity or whether the legislature will finally undertake the fundamental reform this area of the law needs. Until either eventuality occurs, litigants may look in vain for transactional certainty once the issue of illegality is raised, and will face once more the complexity and incoherence of common law pragmatism at its worst.

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[155] *Op cit* para 7.20, note 43.

[156] In its paper "The illegality defence in tort" prepared for a consultation seminar in London, 22 March 2001, the Law Commission (at para 1.2) notes that following the Consultation Paper, there has been broad support for its provisional proposal to introduce a structured discretion to replace the current rules and, in light of this, the final report is likely to recommend the adoption of a discretionary regime. See now Law Commission Consultation Paper No 160 "The illegality defence in tort" (2001).

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