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How will the court approach the illegality defence?

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Dispute Resolution analysis: In the recent case of *Patel v Mirza*, the Court of Appeal comprehensively analysed the complex and hitherto inconsistent approach to the illegality defence. Philip Shepherd QC at XXIV Old Buildings examines the significance of the decision and its implications for lawyers and their clients.

Original news

Patel v Mirza [2014] EWCA Civ 1047, [2014] All ER (D) 279 (Jul)

The claimant sought the repayment of funds paid to the defendant for the purposes of an illegal agreement for insider dealing in shares, which had been frustrated. The judge dismissed his claim on the basis that it was barred by illegality. The Court of Appeal, Civil Division, in allowing the appeal, held that the judge had not been wrong to find that the claimant had needed to rely on any illegality in making his claim. However, it was open to the claimant to rely on the wholly unperformed illegal agreement and be entitled to recover his money, as genuine repentance on the part of the withdrawer was not required.

What were the key features of this case?

- o First, the Court of Appeal sought a principled basis for allowing or refusing relief in any given factual scenario. Here the context was insider trading and spread betting and at issue was whether recovery of £620,000 paid by the claimant to the defendant was barred by the claimant's 'reliance' on an illegal agreement to use inside information. What did 'reliance' really mean?
- o Second, the Court of Appeal had to decide whether the claimant came sufficiently within the locus poenitentiae to allow recovery--on what basis should recovery be allowed or refused where an illegal agreement is not performed.
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The facts

The claimant was a property dealer. The defendant was a senior director of Tullett Prebon and a forex trader who suggested the illegal scheme.

The defendant told the claimant that he had advance access to information that would affect the price of RBS shares and that he could place a spread bet on those shares using his IG Index account. The claimant handed over £620,000 to the defendant to place the bet.

The defendant never placed the bet and subsequently told the claimant that it would not proceed. When the claimant asked for the return of the money the defendant told the claimant (falsely as the judge found) that

his bank had mistakenly repaid the money to a Mr Georgiou, a mutual friend, who had since become bankrupt. In fact he simply kept the money.

The way the illegality issue arose

The claimant sued for the return of the money on the basis of money had and received and unjust enrichment.

The defendant pleaded a 'change of position' defence, but did not plead illegality. This was raised by the judge at trial and embraced by the defendant when his pleaded defence appeared to be failing under cross-examination. Only in closing submissions did the defendant argue that the claimant was not entitled to return of the money due to the illegality and because it was the defendant who had decided not to proceed with the scheme (relying on *Bigos v Bousted* [1951] 1 All ER 92, whose correctness was doubted in *Tribe v Tribe* [1996] Ch 107, [1995] 4 All ER 236).

In response, the claimant argued that although he referred to the illegal agreement he did not rely on it in the sense that he was not seeking to enforce it. In any event he claimed that the illegality lay in intention only and hence he was within the locus poenitentiae, relying on the 1996 Court of Appeal decision in *Tribe v Tribe*.

Judgment of Deputy High Court Judge David Donaldson QC

The judge dismissed the defendant's change of position defence, but held that illegality barred recovery of the money because:

- o the claimant was relying on an illegal agreement, and
- o he could not claim to be within the locus poenitentiae as he had not initiated withdrawal from the scheme

How did the court approach the defence of illegality?

The Court of Appeal allowed the appeal and gave judgment for the claimant for the full amount of his claim, plus interest and costs. Rimer LJ held that although the claimant was relying on an illegal agreement, which would have barred recovery, he was entitled to relief because (agreeing with Millett LJ in *Tribe*) repentance was not required and it made no difference who had initiated withdrawal, so long as the illegal agreement had not been carried into effect.

Gloster LJ held that it did not matter whether an illegal agreement was referred to in the pleadings (disagreeing with Rimer LJ and Vos LJ on this point). What mattered was whether the illegal agreement was an ingredient of the claimant's cause of action and here it was not.

What is the significance of this decision?

Gloster LJ held that the key was to examine the policy considerations at play following the House of Lords' decisions in *Stone & Rolls Ltd (in liq) v Moore Stephens (a firm)* [2009] UKHL 39, [2009] 4 All ER 431 and *Gray v Thames Trains Ltd* [2009] UKHL 33, [2009] 4 All ER 81. In a powerful judgment, she held that the policy underlying the criminal law applicable to insider trading (namely the Criminal Justice Act 1993, s 52 (CJA 1993)) did not require an investor to lose all his rights when, for whatever reason, no insider information was received and no insider dealing took place.

The claimant was not seeking to enforce the illegal agreement, but was simply enforcing his right to recover the money when the illegal transaction did not proceed. Gloster LJ could see no warrant for holding that, even if the original agreement amounted to a criminal conspiracy, the claimant be denied recovery. The defendant was under a common law duty as agent to return money paid to him by his principal and, in any event, the claimant was within the locus poenitentiae and entitled to recovery on that ground.

What should lawyers take from this decision?

First, the illegality doctrine should not be applied in a mechanistic way by looking simply at whether a claimant is relying on an illegal agreement in the broad sense. Instead, the issue is whether a claimant is relying on the illegal agreement as an element of his or her cause of action, or whether it is simply part of the background or narrative.

Second, when considering whether a claimant has gone too far to enable him or her to claim recovery of money or benefits paid under an illegal agreement that has not been performed, whether or not the agreement has been executed is key. In other words, if the illegality was in 'intention only', then it is not too late to invoke the assistance of the court. It does not matter who initiated the non-performance of the illegal agreement.

Does the judgment highlight any grey areas?

Unsurprisingly, the court did not consider how to approach a case where the non-performance of an illegal agreement is brought about by the intervention of a regulator. As matters stand, the authorities suggest that where the non-performance is due to the illegal scheme being frustrated by the forces of law and order, the claimant may still be denied recovery.

What happens next?

The defendant was refused permission to appeal to the Supreme Court by the Court of Appeal. It remains to be seen whether the defendant will apply (or has applied) to the Supreme Court for permission to appeal and, if so, whether the Supreme Court will give permission, and on what terms.

Philip Shepherd QC specialises in commercial litigation and arbitration involving international aspects. His practice focuses on private international law, particularly aviation, conflicts of law, international jurisdiction disputes, product liability and cases involving the application of foreign laws. In Patel v Mirza, Philip acted for the successful appellant/claimant.

Interviewed by Kate Beaumont.

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