Illegality and public policy

SUMMARY

This chapter considers the complex effect of illegality on contracts, including criminal and civil wrongdoing and other activities regarded as contrary to public policy such as contracting in restraint of trade. For example, some statutes prohibit particular contracts per se, while elsewhere a contract may be entered into for the purpose of committing an illegal act, or an otherwise lawful contract may be performed in an illegal manner. It is generally said that the common law will not enforce an illegal contract, but that other remedies may in certain circumstances still be available, such as the restitutionary remedy of recovery of money paid in advance. There has always been a tension between the rigid application of the illegality rules, even where that might produce a seemingly unfair result, and a more flexible, case-by-case discretionary approach. Whilst the courts have traditionally tended to favour the former, the Law Commission has in the past few years advocated the latter. The Supreme Court has recently (and by majority reasoning) resolved this tension by adopting the Law Commission’s flexible discretionary approach, balancing various policy factors. But this Supreme Court decision concerned a restitutionary action to recover money paid in advance, in other words undoing an illegal contract. It is still not entirely clear whether the same approach will be adopted from now on, where a claimant asks the court to enforce an illegal contract.

W2.1 Illegality impacts on the law of contract in many different ways and, as Sir Robin Jacob has said in ParkingEye Ltd v Somerfield Stores Ltd (2012), ‘Illegality and the law of contract is notoriously knotty territory’. At one end of the spectrum, imagine a ‘contract killing’ where one party promises to pay money to an assassin in return for a promise to murder a chosen victim. Everyone would agree that such a contract should be wholly unenforceable and that the normal remedies for breach of contract should be unavailable to the parties: of course the assassin could not sue his client for the price if he killed the chosen victim but was not paid, and equally the client could not seek specific performance or expectation damages if the assassin failed to perform or botched the assassination attempt. But at the other end of the spectrum, it is less straightforward. One of the parties might infringe a technical regulation in the course of performing an unobjectionable contract, perhaps knowingly, perhaps unwittingly. What if a driver hires a car to drive to Calais, with a view to buying and bringing home more than the permissible number of duty-free cigarettes: should that illegality affect the car hire contract?
W2.2 A related issue is whether other remedies should be barred by illegality as well, even if they would not involve enforcing an illegal contract. Returning to our examples from the previous paragraph, if the driver of the hire car paid in advance but no hire car was ever provided, there seems no objection to her obtaining a restitutionary remedy to recover the money paid in advance (on the normal principle that the payment was made on a basis, or for a consideration, that totally failed). But what of very serious illegality—if the assassin required to be paid up front, but then made no attempt to perform the contract, should the client be able to seek his money back? Many lawyers would feel just as uncomfortable with this sort of remedy as with straightforward enforcement of the contract, though Lord Neuberger in the seminal Supreme Court decision of *Patel v Mirza* (2016), seemed astonishingly comfortable with the prospect (obiter, of course). A restitutionary remedy returns the parties to the pre-contractual position, so seems easier to justify in the context of illegality than full-blown enforcement. But a broader question, to which we will return, is whether the court should use the same approach to deciding how illegality affects enforcement compared with other remedies. *Patel v Mirza* involved a restitutionary claim—the defendant claimed to have a source of information within crisis meetings between RBS and government officials, and said it would be possible to make money spread-betting on the movement of RBS shares. So the claimant paid £620,000 to the defendant for this purpose, a clear example of an illegal agreement for insider dealing in shares (a criminal offence). In the event, the agreement could not be, and was not, carried out, because the expected inside information was not forthcoming. The claimant issued proceedings against the defendant, seeking repayment of his money, and succeeded unanimously in the Supreme Court. But the court’s reasoning was not unanimous—the majority favoured a discretionary approach (explicitly weighing up relevant policy factors), whereas the minority favoured a rule-based approach. We will return to this decision in detail, and consider what its implications are for contractual enforcement cases in future.

W2.3 The policy of the law was summed up over two centuries ago by Lord Mansfield in *Holman v
Johnson (1775):

_No Court will lend its aid to a man who founds his cause of action upon an immoral or 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 this ground that the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff._

As will be seen, the application of this maxim of public policy in the contractual context gives rise to difficulty (similar difficulties arise when tort claimants involved in illegality seek damages, which are outside the scope of this chapter). The maxim reveals the tension between the courts’ policy not to become involved with illegality and a desire for a fair result on the merits between the parties. By declining to hear the claimant’s claim, the court may leave the defendant with a windfall—paying nothing for the claimant’s performance or retaining the price without being compelled to return it or to compensate for his own defective performance. Far from deterring illegality, this can have the effect of making the contract even more valuable to the defendant. The courts have strained to avoid such undesirable outcomes, with the result that the law is complex and, on occasion, contradictory.

W2.4 Finally, it should be borne in mind that illegality, unlike, for example, duress or misrepresentation, does not affect just the formation of contracts. Occasionally, it is straightforwardly illegal to make a particular contract; more commonly a contract may be of a perfectly lawful kind but one or both parties may have an illegal purpose in mind when making it, or may later perform it in an illegal manner. Illegality is a potential problem at each of these stages in the life of a contract.

W2.5 We first need to consider what is meant by ‘illegality’ because, in the contractual context, it is a wider notion than just breach of the criminal law. It extends to some civil wrongdoing involving dishonesty and many examples of conduct which, though not criminal, is regarded as ‘contrary to public policy’, which rather loose notion can be grouped into areas of similar policy concerns. In addition, breach of
statute may give rise to problems of contractual illegality.

Illegality and public policy at common law

Criminal/civil wrongdoing

W2.6 Commission of a crime is a paradigm example of illegality, so an agreement under which, for a price, the defendant agrees with the claimant to kill or assault a third party is obviously unenforceable. The same applies to agreements to commit fraud on a third party, such as HM Revenue & Customs or an insurance company. In Taylor v Bhail (1995) a school suffered storm damage. The headmaster agreed with a builder that, if the builder inflated the price of the work in his estimate by £1,000 so as to defraud the insurance company, he would be awarded the contract. The builder agreed, did the work and sued for the remaining instalment of the price, but the Court of Appeal refused his claim, regarding the contract as a ‘plain conspiracy to defraud the insurance company’. (Although the result might appear to give a windfall to the fraudulent headmaster, Millett LJ explained that both parties were in fact left out of pocket because the fraud entitled the insurance company to avoid paying out on the claim.) However, commission of a tort or other civil wrong is not so straightforward, because most lack the culpability usually required before the courts will apply the illegality defence. The current approach was summed up by Lord Sumption in Les Laboratoires Servier v Apotex Inc (2015), a case about whether infringement of a (foreign) patent engaged the illegality principle and thus prevented the infringer from enforcing a cross-undertaking in damages:

In my opinion the question what constitutes "turpitude" for the purpose of the defence depends on the legal character of the acts relied on. It means criminal acts, and what I have called quasi-criminal acts. This is because only acts in these categories engage the public interest which is the foundation of the illegality defence. Torts (other than those of which dishonesty is
an essential element), breaches of contract, statutory and other civil wrongs, offend against interests which are essentially private, not public. There is no reason in such a case for the law to withhold its ordinary remedies. The public interest is sufficiently served by the availability of a system of corrective justice to regulate their consequences as between the parties affected.

Public policy: general issues

W2.7 Contracts to commit crimes actually make up a very small proportion of the common law cases on illegality. Most involve the nebulous notions of ‘public interest’ and ‘public policy’ going beyond conduct that falls foul of the criminal law. For example, in Parkinson v College of Ambulance Ltd (1925) the court decided that an agreement whereby one party made a donation to a charity in return for a promise of a knighthood was unenforceable, so the disappointed donor could not sue for the return of his donation when the honour was not forthcoming. Two things should be noted about this example. The first is that in Patel v Mirza Lord Toulson disapproved of the denial of the restitutionary remedy in Parkinson and suggested that the decision should be overruled accordingly, though we do not know what his attitude would have been if the donor in Parkinson had tried to enforce the agreement instead. Secondly, at the time Parkinson was argued as a case of conduct contrary to public policy, but criminal legislation enacted in the same year as Parkinson (the Honours (Prevention of Abuses) Act 1925) means that if those facts arose today, they would constitute a criminal offence.

W2.8 Judicial notions of public policy and its substance change over time, but the principles, seen in certain categories of related cases, remain relatively consistent. Such categories include immorality, the administration of justice and, very importantly, restraint of trade.
Public policy and immorality

**W2.9** Contracts involving immorality are contrary to public policy, but the perception and meaning of immorality has changed and narrowed considerably over the past century. For example, agreements to introduce members of the opposite sex with a view to marriage were unenforceable at the start of the twentieth century, as were agreements between unmarried cohabiting couples; indeed, the courts’ moral zeal went further so that, for example, in *Upfill v Wright* (1911) the court refused to allow a landlord, who let premises to a woman he knew to be the mistress of a married man, to enforce the lease and sue for the rent.

**W2.10** Nonetheless, some areas of sexual morality remain beyond the pale even today, in the eyes of the courts at least. In the extraordinary case of *Sutton v Mischon de Reya* (2003) Hart J concluded that a solicitor instructed to draft a ‘slavery agreement’ between a male prostitute and his willing ‘slave’ had not been negligent in advising that such an agreement would be unenforceable, nor for failing to come up with a way of devising enforceable slavery arrangements! A similar rule would probably also apply today to contracts for prostitution services, although maybe not to contracts tangentially connected with prostitution: loans made to a lap-dancing prostitute were held not to be tainted with illegality in *Sutton v Hutchinson* (2005) because they were distinct from the customer’s other payments for sexual services. It is interesting to compare *Pearce v Brooks* (1866), where a prostitute hired a carriage from a coachbuilder, but returned it in a damaged condition and failed to pay all the hire instalments. The coachbuilder sued, but the court held that, because the jury found that he knew of her immoral purpose (and in today’s parlance, could be said to have ‘participated’ in it), he was not entitled to recover.

**W2.11** *Pearce v Brooks* is a striking example of ‘non-enforcement’ conflicting with the ‘merits’ of the case. Many would think that immorality had been encouraged, not discouraged, by allowing the prostitute to avoid paying all the hire instalments and for the damage caused to the carriage. Presumably the
courts took a broader view, that carriage owners would be less likely to contract with prostitutes in
general in future as a result of the decision, although this presupposed a rather unlikely level of
knowledge of the law on the public’s part. Today the courts invariably refuse to endorse self-serving
pleas of illegality by unmeritorious parties (see, for example, Armhouse Lee Ltd v Chappell (1996),
where the operator of telephone sex lines tried unsuccessfully to resist paying for advertising
contracts by pleading, with ‘brazen cynicism’, that its own services were contrary to public policy).

Public policy and the administration of justice

W2.12 A second group of related cases involves contracts which impact on the administration of justice.
Agreements to suppress evidence are contrary to public policy, as are agreements to oust the
jurisdiction of the court. In theory, so are agreements which encourage speculative litigation, as where
a party with no interest in the outcome of litigation funds or otherwise supports it (‘maintenance’),
especially if that party takes a financial stake in the outcome (‘champerty’).

W2.13 However, public policy in this area has changed as dramatically as it has in the field of morality, as
the rules on the funding of litigation illustrate. There are now significant exceptions to the rules of
maintenance and champerty, of huge practical significance: indeed, such contracts are now actively
encouraged as a replacement for civil legal aid. For some years, conditional fee arrangements
between solicitors and clients, whereby a solicitor charges more if the client’s litigation is successful,
have been permitted by statute. Moreover, it is now also possible for a client to make an enforceable
damages-based agreement (often referred to as a contingency fee arrangement), whereby the solicitor
stands to recover a percentage of the damages awarded to the client (there is no equivalent possibility
for a defendant in litigation). There are various statutory requirements for an enforceable damages-
based agreement, such as a cap on the percentage figure, and a rule that the agreement cannot
combine damages-based payments if the client wins with a reduced level of conditional fee if the
client loses. So an agreement that falls foul of these requirements will remain unenforceable.
We will now turn to another major area of public policy of concern in the law of contract, the treatment of contracts and covenants in restraint of trade.

**Public policy against contracts in restraint of trade**

### Meaning of restraint of trade

**W2.14** One of the oldest and most significant heads of public policy (dating to at least the time of Magna Carta) is that contracts and contractual terms in ‘restraint of trade’ are void and unenforceable. Today, restrictions on competition are principally regulated by statute and European Union law, but the traditional common law rule of public policy is alive and well, operating in many cases alongside the more recent jurisdictions. The courts are wary of giving too rigid a definition of ‘restraint of trade’, though Diplock LJ suggested in *Petrofina (Great Britain) Ltd v Martin* (1966) that a covenant in restraint of trade is ‘one in which a party (the covenantor) agrees with any other party (the covenantee) to restrict his liberty in the future to carry on trade with other persons not parties to the contract in such manner as he chooses.’

**W2.15** This definition was modified somewhat in *Esso Petroleum Co Ltd v Harper’s Garages (Stourport) Ltd* (1968) so as to explain why the doctrine of restraint of trade has no application to, for example, familiar covenants in leases restricting tenants’ use, and change of use, of leasehold premises. Lord Reid explained:

> Restraint of trade seems to me to imply that a man contracts to give up some freedom which he otherwise would have had. A person buying or leasing land had no previous right to be there at all, let alone to trade there, and when he takes possession of that land subject to a negative restrictive covenant he gives up no right or freedom which he previously had.
This also explains why, for example, sole agency agreements between a member of the public and a particular estate agent are unobjectionable, and indeed why it is generally not in restraint of trade to contract to work exclusively for one person. However, the doctrine of restraint of trade is not confined to conventional forms of ‘trade’. In Proactive Sports Management Ltd v Rooney (2011) the Court of Appeal held that an eight-year ‘Image Rights Representation Agreement’ entered into between the claimant management company and premiership footballer Wayne Rooney (or strictly speaking, the company to which he had assigned his image rights) was caught by the restraint of trade doctrine (and, indeed, amounted to an unreasonable restraint, see para W2.26). As Arden LJ said:

*a person’s ancillary activity of exploiting his image rights is just as capable of protection under the doctrine of restraint of trade as any other occupation. Public policy is concerned with the manner in which a person may properly realise his potential, not only for the good of that individual but for the economic benefit of society generally. It cannot logically matter whether the realisation is a person’s primary activity or not.*

**W2.16** The law’s approach to covenants in restraint of trade reflects a stark clash between freedom of contract and freedom to trade and earn a living. English law resolves this tension by taking as its starting point that, in a market economy, competition between traders is a matter of public good, so any contractual provision which has the effect of stifling competition and is oppressive in that respect is prima facie unenforceable. However, an exception exists for reasonable restraints, which are valid and enforceable. But be warned—as Arden LJ said in Proactive Sports Management Ltd v Rooney (2011), ‘The boundary between contracts that are contrary to public policy as being in restraint of trade and that will not be enforced, and contracts that contain acceptable restrictions is an uncertain and porous one.’
Reasonable restraints of trade enforceable

W2.17 The exception for reasonable restraints of trade was spelt out in *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd* (1894), where a gun manufacturer sold his business and covenanted with the purchaser that he would not work for a rival business thereafter. The covenant was held to be reasonable and thus enforceable by injunction, despite lasting for 25 years and covering an unlimited geographical area. Lord Macnaghten said:

> It is sufficient justification, and indeed it is the only justification, if the restriction is reasonable—reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.

W2.18 So the reasonableness test, in theory, has two elements: (1) the provision must offer reasonable protection to the parties (in practice, the covenantee); and also (2) be reasonable in the public interest. In practice, the courts tend to equate the two and regard the public interest as synonymous with enforcing covenants that are reasonable between the parties (though see the *Esso Garage* case, para W2.25).

The reasonableness of a provision in restraint of trade is judged in the light of the transaction as a whole. The two most common, though not the only, situations in which a covenant in restraint of trade might be imposed are on the sale of a business and in employment contracts.

W2.19 On the sale of a business, a percentage of the price (often a significant percentage) will represent the ‘goodwill’ of the business, so it is important for the purchaser to be able to protect that goodwill by preventing the previous owner of the business setting himself up in competition. Moreover, it is reasonable in the public interest that such provisions are effective on the sale of a business, because
otherwise businesses could not be sold freely and for their full value.

W2.20 In other words, the purchaser of a business pays a price based on the seller’s assets, including the seller’s goodwill, set against the seller’s liabilities (which the purchaser also takes over). It is very different where an investor merely takes shares in a company in return for an investment of capital—such an investor does not have the same legitimate interest in preventing competition (see Dranez Anstalt v Hayek (2002)).

W2.21 Very different considerations apply to covenants in contracts of employment, purporting to restrict an employee’s freedom to trade once his employment has come to an end. If the covenantor in the Nordenfelt case had merely been an employee of the company, who was subject in his contract of employment to an identical unlimited prohibition on competing for 25 years once his employment ended, such a provision would certainly have been wholly unreasonable and unenforceable.

W2.22 In Herbert Morris Ltd v Saxelby (1916) the employee covenanted that, for seven years after the termination of his employment he would not, directly or indirectly, carry on any similar business. The House of Lords held that this clause was wider than reasonably necessary for the protection of the employer, and therefore unenforceable. As Lord Shaw put it, ‘it is, justly interpreted, a claim to put him in such a bondage as regard to his own labour that, if he seeks to find employment or advancement elsewhere, he must, for seven years of his life, become an exile.’ The House explained that, in the employer/employee context, the public interest favours an employee’s liberty to work and earn a living, and the employer’s legitimate interest is confined to protecting its trade secrets and its customers. Here, on the other hand, the employer was trying to stifle the employee from using his own skill and experience, admittedly built up as a result of his employment, but nonetheless not something the employer legitimately had any right to suppress.

W2.23 So only clauses which genuinely protect the employer’s interest in its trade secrets and customer connections will be regarded as reasonable. In Mason v Provident Clothing and Supply Co Ltd (1913)
a very wide clause was held unenforceable. It was not confined to protecting the claimant’s existing
customers, nor did the employee possess any meaningful trade secrets deserving of protection: his job
merely involved using his natural aptitude and skills. Overall, the clause was, ‘a thing under the guise
of a contract which is not protection for the employer, but a means of coercing and punishing the
workman and putting him under a tyrannous and, therefore, a legally indefensible restraint.’

W2.24 In contrast, where the relevant covenant is only as wide as is necessary to protect the employer’s
legitimate interests in its customer base and trade secrets, it is regarded as reasonable and will be
enforced by injunction (on the availability of an injunction, see Dyson Technology Ltd v Strutt
(2005)). In *Fitch v Dewes* (1921) a solicitor covenanted that on the termination of his employment, he
would not practise within a seven-mile radius of Tamworth. The House of Lords held this restriction
to be reasonable and enforceable, for the protection of the employer, who ‘desires to protect his
professional secrets and desires to protect his clients from being enticed away by a former clerk who
has access to all his papers and has been in direct personal relation with a number of his clients.’ It
was equally reasonable in the public interest, ‘because otherwise solicitors carrying on their business
without a partner would be extremely chary of admitting competent young men to their office and to
the confidential knowledge to be derived by frequenting those offices.’ This case shows the
importance of taking account of all the circumstances of the contract, the parties’ relationship and all
the surrounding facts. If, for example, a commercial firm of solicitors in the City of London today
required its trainee solicitors to covenant that, on leaving the firm, they would not seek employment
with other law firms within a seven-mile radius, such a clause would probably be regarded as in
restraint of trade!

W2.25 Although sales of businesses and employment contracts are the most common examples, restraint of
trade can be raised about covenants in all sorts of contracts. For example, in *Esso Petroleum Co Ltd v
Harper’s Garages (Stourport) Ltd* (1968) H owned two garages and entered into two ‘solus
agreements’ with E, under which H agreed to buy all its fuel from E. E in turn covenanted to supply
H’s fuel requirements and to provide various other advantages. One agreement was expressed to last for four years; the other (contained in a mortgage deed) for 21 years. When cheaper petrol became available elsewhere, H began to sell it in breach of its solus covenants, so E sought injunctions.

The House of Lords held that the covenants were in restraint of trade, but that in respect of the first garage the four-year tie was reasonable and enforceable. However, on the facts the 21-year tie was unreasonable, as going far beyond what could be justified for preserving the value of E’s security (indeed, it may have reduced its value compared with an equivalent, ‘untied’ garage). Their Lordships took notice of reasonableness both as between the parties and also for the general public. Indeed, the latter concern was particularly important, given that the agreements had been freely entered into between two commercial parties.

W2.26 Similarly, the Court of Appeal in Proactive Sports Management Ltd v Rooney (2011) agreed with the trial judge that Wayne Rooney’s ‘Image Rights Representation Agreement’ made with the claimant management company was in unreasonable restraint of trade and was thus unenforceable (although the claimant was entitled to be paid a ‘reasonable sum’ for services performed). This was because the agreement was for a far longer period than is usual, gave Rooney no opportunity to terminate early, imposed ‘very significant restrictions’ on Rooney’s freedom of action and gave the claimant 20 per cent commission on any sponsorship deals it negotiated. Moreover it was signed when Rooney was just 17 years old, commercially inexperienced and without the benefit of independent advice. Overall, the Court of Appeal agreed with the trial judge’s clear conclusion, ‘that Proactive has been unable to discharge the burden of showing that the restraints embodied in the Image Rights Representation Agreement, and in particular its duration, were reasonable having regard to the legitimate interests of the parties.’
Interpretation of covenants in restraint of trade

W2.27 Two issues of interpretation of provisions in restraint of trade are worth bearing in mind. The first is that the courts are concerned with substance rather than form: it does not matter how a covenant is phrased, if in substance it is in restraint of trade. This is clear from *Wyatt v Kreglinger & Fernau* (1933), where employers promised to pay a gratuitous pension to an employee ‘as long as you do nothing at any time to our detriment (fair business competition excepted)’. The judge held that this, in substance, was in restraint of trade and unenforceable: therefore the employer’s promise, unsupported by any consideration, could be freely withdrawn. It did not matter that the employee was not promising not to act to the employer’s detriment. Nor did it matter that, rather unattractively, the employers were invoking the doctrine of restraint of trade and relying on it to resist honouring one of their own promises.

W2.28 Secondly, the courts often have to construe the meaning of an ambiguous provision and must (as with any exercise in contractual interpretation) seek to ascertain the meaning that the parties intended, judged objectively. Simon Brown LJ in *JA Mont (UK) Ltd v Mills* (1993) said, ‘the court should not too urgently strive to find within restrictive covenants *ex facie* [on their face] too wide, implicit limitations such as alone could justify their imposition.’ As Chadwick LJ explained in *Arbuthnot Fund Managers v Rawlings* (2003), ‘the court must steer a course between giving to the clause a meaning which is extravagantly wide; and giving to the clause a meaning which is artificially limited.’ Recently, the Court of Appeal in *Harcus Sinclair LLP v Your Lawyers Ltd* (2019) had to consider a contract between two firms of solicitors working together on the group action about the Volkswagen emissions scandal. The contract included a restriction saying the claimant firm could not work on any action for ‘other groups of claimants in the contemplated group action’. The principal issue was one of interpretation: did this restriction just cover the particular action they were currently working on or any action arising from the scandal? The Court of Appeal held that the trial just had
been broadly correct to construe the clause as catching any action arising from the scandal, but went on to hold that the restriction was an unreasonable restraint of trade. This was because the defendant’s only legitimate interest under the agreement when it was entered into had been to protect the confidential information that it was disclosing for the purpose of obtaining legal advice from the claimant, and the broad restriction in the undertaking went far beyond what was required to do that.

W2.29 Sometimes the proper construction of a contractual provision might be narrow enough to involve a reasonable restriction on the employee, thereby rendering the covenant enforceable. For example, in *Home Counties Dairies Ltd v Skilton* (1969) a former employee argued, unsuccessfully, for a wide construction of a noncompetition clause, but the Court of Appeal accepted a narrower interpretation, thereby rendering the clause reasonable and enforceable. The opposite conclusion was reached recently by the Court of Appeal in *Tillman v Egon Zehnder Ltd* (2017). Here the claimant was employed by the defendant (an international head-hunting firm) as a consultant, under a contract of employment that contained a post-termination restrictive covenant. The covenant prohibited her from ‘directly or indirectly engag[ing] or be[ing] concerned or interested in any business carried on in competition with any of the businesses of the Company’ for six months after termination of her employment. The claimant resigned and wished to work for a US competitor, so argued that this clause was in unreasonable restraint of trade, because the word ‘interested’ potentially covers the acquisition of shares in a competitor, however minor that shareholding. The Court of Appeal agreed that this was the only available meaning of the clause. As Longmore LJ put it:

> It is true that courts will sometimes construe a restraint in a limited way according to the context of the case ... What is not permissible is to construe well-understood words or phrases in a manner contrary to their natural meaning.

The court therefore struck out the clause, even though that led to a result that might be regarded as unmeritorious, since the claimant was actually going to take up employment, not a shareholding,
with a competitor.

**Severance**

**W2.30** The presence of a covenant in restraint of trade does not automatically taint the rest of the contract. It may be possible for the objectionable, unenforceable covenant to be *severed* from the rest of the contract, as long as it can be separated cleanly without altering the meaning and point of what remains (sometimes called the ‘blue pencil rule’) and as long as it did not form the main consideration for the other party’s obligations. Moreover, the court can sever an objectionable covenant even if it is contained within one clause, if in essence what is involved is a distinct obligation: as *T Lucas & Co v Mitchell* (1974) shows, what counts is substance, not syntax. On the other hand, the court will not rewrite a contract or attempt to disentangle objectionable words—severance requires a clean excision of an offending obligation. For this reason, the Court of Appeal decided that severance was not available in *Tillman v Egon Zehnder Ltd* (see para **W2.29**).

**W2.31** The court will not sever an obligation if to do so would distort the obligations remaining in the contract, but this should not be taken too far since on one level every instance of severance changes slightly the balance of the obligations in the contract. For example, in *Marshall v NM Financial Management Ltd* (1995) the court was willing to sever a proviso which purported to restrict a freelance life assurance salesman’s entitlement to commission earned but not yet received, by making it conditional on his not competing with the company’s business, after the end of his contract period. This was because the proviso added nothing to the balance of rights between the parties, since ‘in substance the consideration for the payment of renewal commission is not the acceptance by the plaintiff of the proviso, but his services in procuring business before his resignation.’ (See also *Beckett Investment Management Group Ltd v Hall* (2007), in which part of a non-competition clause was severed.)
Finally it should be noted that severance is not confined to provisions in restraint of trade, but has more general application to contractual provisions contrary to public policy. However, serious illegality is usually regarded as tainting the whole contract, so that severance is out of the question. Certainly in *Taylor v Bhail* (1995) (see para W2.6) the Court of Appeal wholly rejected the builder’s invitation to ‘sever’ the £1,000 extra sum and enforce the building contract as if it contained just the legitimate price.

**When is illegality a defence to enforcement of a contract?**

As has already been mentioned, there is considerable uncertainty and complexity in the law on when illegality operates as a defence to an action. The courts in illegality cases face a dilemma—is it better to adopt the traditional, strict application of the *ex turpi causa* rules of public policy, with its potential for harsh, unfair results? Or would it be preferable to have a more flexible discretion to resolve the case in a way which reflects both the often conflicting public policy concerns and the relative merits of the parties, perhaps at the expense of certainty and predictability of outcome? The Law Commission in its consultation paper *Illegal Transactions: The Effect of Illegality on Contracts and Trusts* (CP No 154 (1999)) recommended that the current rules of public policy should be replaced by a discretion whereby the court could decide whether or not to enforce or give effect to illegal transactions. This recommendation was revisited in further instalments of the Law Commission’s deliberations, *The Illegality Defence: A Consultative Report* (CP No 189 (2009)) followed by its final report *The Illegality Defence* (LC No 320 (2010)), suggesting that the courts should, in each case, carry out a balancing exercise to weigh up the various policies at stake and decide whether the illegality defence can be justified. The Law Commission identified a number of policies underlying the illegality principle, namely (i) furthering the purpose of the rule of law which the illegal conduct has infringed; (ii) consistency; (iii) that the claimant should not profit from his or her wrong; (iv)
deterrence; and (v) maintaining the integrity of the legal system, which should be assessed with proportionality in mind to see whether or not refusal of relief furthers one or more of these policies. The Law Commission’s view was that this reform can be introduced without legislation (other than in the field of trusts).

W2.34 As will be seen, the Law Commission’s recommended ‘balancing factors’ approach found favour with the majority of the Supreme Court in Patel v Mirza (2016) in the context of a restitutionary claim. It seems likely that the same approach will henceforth be adopted for claims to enforce contracts potentially affected by illegality, but there is as yet no authoritative decision to that effect (although in Okedina v Chikale (2019) the Court of Appeal applied Patel v Mirza to various statutory claims arising out of the dismissal of an employee, stating that they ‘can be characterised as “contractual”, in the extended sense that they either are made under the contract of employment or arise out of it’). Outside the employment context, it seems that Norris J’s dictum from Ronelp Marine Ltd v STX Offshore & Shipbuilding Ltd (2016) remains accurate, namely that the question of the application of Patel v Mirza to contractual enforcement claims remains ‘uncertain to an exceptional degree’.

W2.35 The remainder of this chapter will therefore consider the traditional approach to when illegality will be a defence to contractual enforcement, involving relatively rigid rules. It will then turn to other possible remedies, particularly restitutionary recovery of money paid in advance, now governed by the Patel v Mirza discretionary approach. Finally, it will consider whether Patel v Mirza should apply to contractual enforcement claims and, if so, whether in practice the outcome of such claims would differ from that obtained using the traditional rule-based approach.

Traditional rule-based approach - summary

W2.36 One of the reasons the Law Commission proposed a discretionary ‘balancing factors’ approach was that it is difficult to identify the traditional rules about the effect of illegality (by statute and common
law) on contracts, the relevant case law being both complex and contradictory. A useful distillation is the dictum of Elias J, President of the Employment Appeal Tribunal, in *Enfield Technical Services v Payne* (2007), which is itself adapted from Peter Gibson LJ’s seminal decision in *Hall v Woolston Hall Leisure Ltd* (2000). Elias J identified three broad categories:

*The first is where the contract is entered into with the intention of committing an illegal act.*

*The second is where the contract is expressly or impliedly prohibited by statute. The third ... is where the contract was lawful when made but has been illegally performed, and the party seeking the assistance of the court knowingly participated in the illegal performance.*

Although this dictum places contracts expressly or impliedly prohibited by statute as the second of three categories, it is preferable to deal with that issue first, before moving to the first and the third (both of which can involve conduct that is illegal either at common law or statute). This is because the question of whether a statute expressly or impliedly prohibits the contract itself is a rather different question—essentially one of statutory construction. For this reason, the Law Commission’s recommendation for a discretionary approach to illegality has no role to play in such cases—the courts should not be free to override the meaning of a statute. =As the *Consultative Report* (CP 189) put it:

*In disputes relating to contracts involving the breach of a legislative provision, the courts should continue to look first at the legislation itself in order to determine whether it expressly or impliedly provides how the contractual claim is affected. When Parliament enacted the legislation, it will have been able to consider at length and in context, the policies behind the prohibition imposed. Where the legislation provides what should be the effect on a contract, we think that it would be wrong to give the court a power to ‘second guess’ this, without the benefit of all the time and information that would have been before Parliament.*
Contract itself expressly or impliedly prohibited by statute: illegality per se

W2.37 Sometimes the words of a statute expressly prohibit a particular type of contract. It is then said to be illegal per se. In *Re Mahmoud and Ispahani* (1921) Statutory Regulations provided that ‘a person shall not ... buy or sell or otherwise deal in’ certain specified items, including linseed oil, without a licence. The claimant, who had a linseed oil licence, sold a quantity of linseed oil to the defendant. The defendant told the claimant that it also had a licence, but it did not. The defendant then refused to accept delivery of the linseed oil, the claimant sued for damages, but the claim failed (despite the defendant’s evident lack of merit) because, as a matter of construction, the contract of sale was expressly prohibited under the Regulations unless both parties possessed a licence. As Bankes LJ explained, given that the language of the Regulations clearly prohibited this sort of contract:

... it is open to a party, however shabby it may appear to be, to say that the Legislature has prohibited this contract, and therefore it is a case in which the Court will not lend its aid to the enforcement of the contract.

Interestingly Scrutton LJ in the same case deliberately left open the question of whether the claimant might have a separate remedy against the defendant on the basis of his fraudulent misrepresentation. If that is correct, the regime for contracts illegal per se is not as draconian as it first appears (particularly since, nowadays, damages may be obtained under the Misrepresentation Act 1967 without the need to establish fraud). We will return to this issue at paras W2.56.

W2.38 Atkin LJ in *Re Mahmoud and Ispahani* explained that a statutory prohibition might also be inferred from the terms of the statute where the statute imposes a penalty upon the person entering into a particular contract, though ‘one has to examine very carefully the precise terms of the statute imposing the penalty upon the individual’. So where the other provisions of a statute make it abundantly clear that Parliament intended to prohibit a particular type of contract, the courts will give effect to that intention. The process resembles the rather fictitious search for parliamentary intention.
in the tort of breach of statutory duty when the statute is silent as to whether a civil remedy should be available, with consideration given to other penalties in the statute and whether it is intended to protect the public. So in *Hill v Secretary of State for the Environment, Food and Rural Affairs* (2005) Hart J held that the statutory prohibition on undischarged bankrupts acting as company directors or taking part in the management of a company did not taint contracts so made with illegality, so the company was allowed to sue on the contract. After all, the statute was intended to protect the creditors of the company, so this policy would be thwarted if the company’s debtors could resist paying what they owed on the company’s contracts.

**W2.39** Another striking example of statute impliedly prohibiting the contract per se is seen in *Mohamed v Alaga & Co* (1998). Here the defendant solicitor entered into an agreement with the claimant, who was a Somali translator, whereby the claimant would introduce clients to the defendant and provide translation services and, in return, the defendant would share with the claimant 50% of the legal aid fees obtained in respect of those clients. He alleged that the defendant owed fees pursuant to this agreement. The problem was that regulations made under the Solicitors Practice Rules 1990 prohibited solicitors from paying for the introduction of clients and from making such fee-sharing arrangements; these regulations had statutory force and were part of the disciplinary regime for the conduct of solicitors. The Court of Appeal held that the claimant could not enforce the agreement, it was illegal per se. The court emphasised the public interest in outlawing such fee-sharing agreements and that it would ‘defeat the public interest … if a non-solicitor party to a fee-sharing agreement could enlist the aid of the court to enforce against a solicitor an agreement which the solicitor is prohibited from making’. *Mohamed* also shows the draconian effect of concluding that a contract is illegal per se—neither party can enforce it, even if one (the claimant here) is wholly innocent of any wrongdoing. Happily for the claimant, the court found a way to reduce the harshness to the claimant—by allowing him to recover on a *quantum meruit*, though this entitled him not to the share of the fees he had been promised, merely a reasonable sum for professional
services rendered. This outcome (which, a cynic might say, partly undermines the statutory prohibition!) was approved by the Supreme Court in *Patel v Mirza*.

**W2.40** It is not always easy to determine whether a statute impliedly prohibits a *contract* per se, or merely prohibits *conduct* that might be the subject of a contract. The distinction is subtle but important. In *St John Shipping Corp v Joseph Rank Ltd* (1957) Devlin J held that a shipowner was entitled to recover freight due on a contract of carriage, despite having breached a statute which made it a criminal offence to overload a ship. He rejected the cargo owners’ argument that the statute also, by implication, prohibited per se any contract for the carriage of goods which involved overloading a ship. Devlin J stressed the regulatory nature of the statutory provision and concluded that Parliament intended only a criminal penalty:

> ... I think that a court ought to be very slow to hold that a statute intends to interfere with the rights and remedies given by the ordinary law of contract. Caution in this respect is, I think, especially necessary in these times when so much of commercial life is governed by regulations of one sort or another which may easily be broken without wicked intent ... To nullify a bargain in such circumstances frequently means that—in a case of such triviality that no authority would have felt it worthwhile to prosecute—a seller, because he cannot enforce his civil rights, may forfeit a sum vastly in excess of any penalty a criminal court would impose.

Recently the Court of Appeal in *Okedina v Chikale* (2019) adopted an equivalent approach. An employer illegally employed, and then dismissed, a vulnerable foreign national; this was a criminal offence on the part of the employer under statute, but the employer attempted to argue that the statute prohibited the contract altogether, which would have prevented the vulnerable claimant bringing any claims based on it. The Court of Appeal disagreed, applying *St John Shipping*. As Underhill LJ said, ‘in the absence of an express prohibition a court should only find that Parliament has intended to prohibit a contract of a particular kind, or in particular circumstances, where the implication is clear’.
Moreover, when determining whether such a prohibition should be implied, a test of necessity applied, having regard to ‘considerations of public policy in the light of the mischief which the statute is designed to prevent, its language, scope and purpose, the consequences for the innocent party, and any other relevant considerations’. Since such an implication would deprive potentially innocent, vulnerable foreign nationals of a remedy, Underhill LJ concluded: ‘I do not believe that it can be said that the undoubted public interest in preventing foreign nationals from working illegally requires … section 21 to be construed as evincing a clear statutory intention that contracts of the kind to which they refer should be unenforceable.’

**Illegality of purpose or performance of an otherwise lawful contract: common law illegality**

**W2.41** Outside cases of statutory illegality per se, the first and third categories of Elias J’s dictum (quoted in W2.36) might be thought of as the common law’s application of the *ex turpi causa* public policy. Lord Toulson in *Patel v Mirza* quoted a slightly different formulation of the traditional rule-based approach, taken from Burrows (2016) *Restatement of the English Law of Contract*:

Rule 1. A contract which has as its purpose, or is intended to be performed in a manner that involves, conduct that is illegal (such as a crime) or contrary to public policy (such as a restraint of trade) is unenforceable (a) by either party if both parties knew of that purpose or intention; or (b) by one party if only that party knew of that purpose or intention.

Rule 2. If rule 1 is inapplicable because it is only the performance of a contract that involves conduct that is illegal or contrary to public policy, the contract is unenforceable by the party who performed in that objectionable way but is enforceable by the other party unless that party knew of, and participated in, that objectionable performance.

**W2.42** So the effect of illegality in such cases has traditionally depended on whether the party seeking to
enforce the contract knew about and actually participated in the illegal performance. This can be illustrated by considering two contrasting cases about the carriage of goods by road. In *Ashmore, Benson, Pease & Co Ltd v AV Dawson Ltd* (1973), hauliers made a contract to transport a large piece of equipment for its owner, even though both parties knew that this would put the lorry five tons over its permitted statutory maximum weight. The lorry toppled in transit and the equipment was damaged, but the owners’ claim for damages was rejected. The majority of the Court of Appeal accepted that the contract was not illegal per se, but went on to hold, unanimously, that the contract was performed in a manner which rendered it illegal and that the equipment owner knew of and participated in the illegality.

**W2.43** In contrast, in *Archbolds (Freightage) Ltd v S Spanglett Ltd* (1961) the defendant vehicle owners, unbeknown to the claimants, were not licensed to carry goods other than their own, but nonetheless agreed to carry the claimants’ whisky. The whisky was stolen and the claimants sued for damages. The Court of Appeal rejected the defendants’ self-serving argument that the contract of carriage was illegal per se and thus unenforceable because their vehicle did not have the appropriate licence, because it was not a contract to use an inappropriately licensed vehicle. It was instead merely performed unlawfully by the defendants, who could not have sued for the price under the contract, but that did not prevent the innocent claimants, who had no intent to breach the statute, from suing on it. If both parties had intended to perform in a manner that breached the statute, the result would have been different. Likewise, the Court of Appeal held in *Payne v Enfield Technical Services Ltd* (2008) that where an employee, who had in good faith opted to be categorised as self-employed for tax purposes, later sought to rely on unfair dismissal legislation (which covers contracts of employment but not self-employed freelance contracts), he should not be treated as having unlawfully performed his contract of employment. The result might have been different if the claimant had made misrepresentations, express or implied, as to the facts, but he had merely made a genuine mis-categorisation unaccompanied by false representations.
The two preceding paragraphs might suggest that the law is both straightforward and fair to claimants. The Law Commission, however, examined the numerous cases on illegality at common law (in its project discussed at W2.33) and identified problems and complexity across the board, including uncertainty about whether a contract is for the purpose of committing an illegal act invariably unenforceable, the degree of knowledge or participation required to prevent enforcement by the otherwise innocent party, and, where illegality in performance is concerned, whether the guilty party formed the intention to do the illegal act before or after the contract was made and why that should matter. As has been said, its recommendation was the abandonment of the traditional rule-based approach and its replacement with a judicial discretion, sometimes known as the ‘balancing factors’ approach. Before we consider the merits of that suggestion in the context of contractual enforcement, we should reflect on whether other remedies might be available in the context of illegality in contract. For example, one area where the rule-based approach seems to be applied with vigour is in statutory claims relating to employment contracts—it has been held that an employee who knows that his or her employer was defrauding the Inland Revenue by not paying income tax or National Insurance contributions cannot bring a statutory claim for compensation for unfair dismissal or redundancy. But the most significant issue, which we will look at in a little detail, is whether a claimant can reclaim (by virtue of a restitutionary remedy) money paid or property transferred to the defendant pursuant to an illegal contract. This is especially important, because it is the arena in which the Law Commission’s approach has been authoritatively accepted.

**Effect of illegality on restitutionary claims**

Traditionally, a claimant who was prevented by illegality from enforcing a contract is equally prevented from seeking the recovery of money or restitution of other benefits conferred under an illegal contract. Another Latin maxim sets the flavour: *in pari delicto potior est conditio defendantis*, meaning ‘when the parties are equally at fault, the law favours the defendant’. So, where the parties
were *in pari delicto*, the claimant was not permitted to recover money paid to the defendant, even though ordinarily such a claim could be made on the basis of a ground of restitution, for example mistake or total failure of consideration. However, over the years, significant exceptions were recognised which allowed claimants to recover on a restitutionary basis, but which were increasingly nebulous and hard to justify on principle.

**W2.46** The first traditional exception was that restitution would be available where the parties were not *in pari delicto*. It is implicit in the *in pari delicto* maxim that the defendant is only favoured and relief denied where the parties are equally culpable. Where the claimant is less culpable, the parties’ relationship is described as *non in pari delicto* and the claimant can recover, assuming of course that the claimant can establish one of the usual grounds of restitution. This resembles the main principle that innocent plaintiffs not tainted by illegality in performance are permitted to *enforce* the contract, though here total innocence is not required, just that the defendant’s culpability exceeds the claimant’s, as where the statute imposes a duty on one party for the protection of the other. For example, in *Kiriri Cotton Co Ltd v Dewani* (1960) a landlord leased a flat to a tenant in return for a premium as well as an annual rent. Neither party realised this was wrongful, but in fact the premium was contrary to statute. The Privy Council held that the tenant’s claim to recover the premium (on the ground of mistake) should succeed, because the parties were not *in pari delicto*, even though neither knew they were breaking the law nor intended to do so. This was because the relevant statute ‘was intended to protect tenants from being exploited by landlords in days of housing shortage’. Put another way, where one party is responsible for the other party’s mistake in entering into the illegal contract, the other party should not be barred from recovering in the usual way on the basis of that mistake (see also the justification for the award of a reasonable sum in *Mohamed v Alaga & Co* (1999) discussed at para **W2.39**).

**W2.47** The second traditional exception involved a claimant who withdraws from—ie, changes his mind and pulls out of—an illegal transaction. If he withdraws when the contract is purely executory, the
law has no further role to play (there being no question, of course, of the other party enforcing the contract against the withdrawing party). But the law went further and encouraged withdrawal from an illegal transaction by allowing the party withdrawing to bring a restitutionary action, before the illegal purpose has been carried out. (Restitution is the only relevant response here, because it is, of course, impossible for such a party to enforce a contract and withdraw from and repudiate it at the same time.)

In the nineteenth century, the notion of withdrawal was interpreted liberally, and the only requirement was that the illegal purpose had not been performed (see, for example, in Taylor v Bowers (1876)). Over time, the courts’ attitude to withdrawal became more restrictive and they began to insist, not just that the claimant had withdrawn from the transaction before any part of the illegal purpose had been effected or it had been partly performed, but also that the claimant had repented of the illegality: if the claimant was only withdrawing because the illegal venture had failed or been thwarted, that would not do. This sometimes led to very harsh decisions, as in Bigos v Boustead (1951).

W2.43 However, the Court of Appeal decided in Tribe v Tribe (1996) that ‘repentance’ was no longer a requirement for the withdrawal from an illegal transaction. The claimant need show no more than that he withdrew from the transaction, even if he only did so because the illegal purpose did not succeed or because the illegal transaction was no longer needed. In Tribe a father was facing large repair bills from the landlords of two commercial properties leased to him. So he transferred his shares in the family company to one of his sons, to make it appear that he had no assets to enable him to meet the landlords’ claims. The transfer was expressed to be for a consideration that was never paid nor intended to be paid. The father later did deals with the landlords (in one case by surrendering the lease, in the other by purchasing the freehold), so no deception was ever practised on them. He then reclaimed the shares on the basis that the son held them on bare trust for him, but the son defended, saying that the father would need, but was not permitted, to plead their illegal purpose—the reason why the shares had been transferred—in order to establish such a trust.
The Court of Appeal agreed that, generally, a party who needs to plead an illegal purpose in order to establish a claim for the return of property will not be entitled to succeed. But this has no application where the claimant had withdrawn from the illegal transaction. Here, the father could reclaim his shares by relying on the withdrawal principle, because no part of the illegal purpose had been carried into effect (in that no creditors were actually deceived). As Millett LJ explained:

*I would hold that genuine repentance is not required. 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.*

So according to Tribe, withdrawal was a most flexible principle, arguably stripped of all meaning. As long as no part of the illegal purpose had been carried out, all that was needed to withdraw was to seek the aid of the court in reclaiming property or money transferred. The breath of this exception really made a nonsense of the so-called rule.

**W2.45** The third exception was that a claimant would also succeed if he or she could assert title to property without needing to rely on the underlying illegal transaction. Title can pass under an illegal contract, even if the contract could not have been enforced. For example, imagine a contract for the sale of goods tainted in some way by illegality. If the seller does not deliver the goods, the buyer could not enforce the contract or claim damages for the seller’s breach. But if the seller does deliver the goods to the buyer, the buyer gets good title: the seller could not argue that they remained his goods because the underlying contract was illegal.

**W2.46** This principle was applied equally to claims based on equitable interests in property. In *Tinsley v Milligan* (1994) T and M, a lesbian couple, set up home together and contributed equally to the purchase price of a house. However, they agreed that the house should be registered in the sole name of T, so that M could falsely claim housing benefit from the Department of Social Security by making it appear that she did not own any property. Some years later, M admitted this fraud and ‘made her
peace’ with the Department of Social Security. When the couple eventually split up, T sought possession of the house and claimed she was the sole owner of it. M responded by claiming that the house was held on resulting trust for the parties in equal shares. By a majority, the House of Lords found in M’s favour. M was not forced to plead or rely on the underlying illegality to establish title, merely her equal contribution to the purchase price, which gave rise to a presumption of resulting trust. As Lord Browne-Wilkinson explained:

The respondent [M] established a resulting trust by showing that she had contributed to the purchase price of the house and there was a common understanding between her and the appellant that they owned the house equally. She had no need to allege or prove why the house was conveyed into the name of the appellant alone, since that fact was irrelevant to her claim: it was enough to show that the house was in fact vested in the appellant alone. The illegality only emerged at all because the appellant sought to raise it.

W2.47 To understand criticism of this exception, we first need to consider why the father in Tribe v Tribe could not rely on the same principle. The answer is a historical oddity. Generally when legal title to property is transferred into someone else’s name, equity presumes that the transferor did not intend to make a gift unless the contrary is proved, so presumes instead that the parties intended that the new ‘owner’ would hold the property on resulting trust for the transferor. The same presumption of resulting trust applies (as in Tinsley v Milligan) where property is paid for by two or more purchasers, but conveyed into the sole name of one. However, where the apparent generosity is from parent to child or from husband to wife (not vice versa) the opposite is presumed, known as the ‘presumption of advancement’. So the starting point in such cases is that equity presumes that the husband or parent was intending to make a gift, unless they prove the contrary. The presumption of advancement is regarded as very outdated, but is pretty irrelevant in most property cases, because the courts simply listen to the evidence to find out whether generosity was indeed intended. But where the transaction was entered into for an illegal purpose, the Tinsley exception meant that it was vital to know whether
the starting point is a presumption of resulting trust or a presumption of advancement, because this
determined which of the parties faces the task of displacing the presumption, which, of course, they
cannot do without giving evidence of the underlying illegality. In Tribe, it meant that the father was
presumed to have made a gift of the shares to his son, unless he proved that he was not actually
intending to be generous. In Tinsley v Milligan, the presumption of resulting trust applied, so M could
rely on it and T would have needed to rely on the underlying illegality of the transaction in order to
rebut the presumption. As Nourse LJ explained in Tribe, ‘in times when the presumption of
advancement has for other purposes fallen into disfavour ... there seems to be some perversity in its
elevation to a decisive status in the context of illegality.’ This was unacceptable and was at the heart
of the Supreme Court’s dislike in Patel v Mirza of the rule itself and the three exceptions.

Patel v Mirza—illegality now rarely a defence to a restitutionary claim

W2.48 As we saw in W2.2, Patel v Mirza involved a restitutionary claim—the defendant claimed to have a
source of information within crisis meetings between RBS and government officials, and said it
would be possible to make money spread-betting on the movement of RBS shares. So the claimant
paid £620,000 to the defendant for this purpose, a clear example of an illegal agreement for insider
dealing in shares (a criminal offence). In the event, the agreement could not be, and was not, carried
out, because the expected inside information was not forthcoming. The claimant issued proceedings
against the defendant, seeking repayment of his money. The trial judge dismissed his claim on the
basis that it was barred by illegality, so the claimant appealed to the Court of Appeal, which allowed
the claimant’s appeal (it applied a very broad version of the second traditional exception—provided
the illegal agreement had not been carried into effect to any extent, the claimant could ‘withdraw’ and
recover his money). The Supreme Court unanimously agreed with this result, but very definitely not
with the reasoning.

W2.49 All members of the Supreme Court agreed that restitutionary claims should not generally be subject
to the illegality rule in the first place. After all, restitution did not give effect to an illegal transaction; quite the contrary, it would unwind it. So generally speaking, a claimant who satisfied the ordinary requirements of such a claim (in the case of Mr Patel, total failure of basis, or consideration) should be entitled to the return of his money or property. Such a claimant should not prima facie be barred from such remedy by reason of the fact that the ‘consideration’ which had failed was illegal. As Lord Sumption put it:

*the reason why the law should nevertheless allow restitution in such a case is that it does not offend the principle applicable to illegal contracts. That principle, as I have suggested above, is that the courts will not give effect to an illegal transaction or to a right derived from it. But restitution does not do that. It merely recognises the ineffectiveness of the transaction and gives effect to the ordinary legal consequences of that state of affairs. The effect is to put the parties in the position in which they would have been if they had never entered into the illegal transaction, which in the eyes of the law is the position which they should always have been in.*

**W2.50** In the same spirit, the *Tinsley v Milligan* ‘reliance’ approach was disapproved for property cases—it put far too much emphasis on the irrelevant ‘procedural question’ of whether the claimant could rely on the presumption of resulting trust or needed to plead the illegal transaction to rebut a presumption of advancement.

**W2.51** For the majority of the Supreme Court, the correct approach was instead to adopt the Law Commission’s recommendation, a discretionary approach balancing the relevant public policy concerns, to determine whether (exceptionally) a restitutionary claim might be barred for illegality. Lord Toulson gave the majority speech. In his view:

*there are two broad discernible policy reasons for the common law doctrine of illegality as a defence to a civil claim. One is that a person should not be allowed to profit from his own wrongdoing. The other, linked, consideration is that the law should be coherent and not self-
defeating, condoning illegality by giving with the left hand what it takes with the right hand.

Restitutionary claims have an unwinding effect and thus do not involve the claimant profiting from his own wrongdoing, but the other policy concern, preserving the integrity of the legal system, is crucial:

I would say that one cannot judge whether allowing a claim which is in some way tainted by illegality would be contrary to the public interest, because it would be harmful to the integrity of the legal system, without a) considering the underlying purpose of the prohibition which has been transgressed, b) considering conversely any other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and c) keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality. We are, after all, in the area of public policy. That trio of necessary considerations can be found in the case law.

W2.52 Lord Toulson then expanded on the test for ‘proportionality’ as follows:

In considering whether it would be disproportionate to refuse relief to which the claimant would otherwise be entitled, as a matter of public policy, various factors may be relevant ... I would not attempt to lay down a prescriptive or definitive list because of the infinite possible variety of cases. Potentially relevant factors include the seriousness of the conduct, its centrality to the contract, whether it was intentional and whether there was marked disparity in the parties’ respective culpability.

He concluded that a claimant, such as Mr Patel, who satisfies the ordinary requirements of a claim for unjust enrichment, should not be debarred from enforcing his claim by reason only of the fact that the money which he seeks to recover was paid for an unlawful purpose: ‘There may be rare cases where for some particular reason the enforcement of such a claim might be regarded as undermining the integrity of the justice system, but there are no such circumstances in this case.’
W2.53 Not all the Supreme Court Justices approved of Lord Toulson’s ‘balancing factors’ approach. For example, for Lord Mance it would:

introduce not only a new era but entirely novel dimensions into any issue of illegality. Courts would be required to make a value judgment, by reference to a widely spread mélange of ingredients, about the overall ‘merits’ or strengths, in a highly unspecific non-legal sense, of the respective claims of the public interest and of each of the parties.

Lords Mance, Sumption, and Clarke thought an orthodox approach to illegality, applying traditional restitutionary rules and exceptions, would yield the same result in virtually every case and would be much more certain (though as the other Justices pointed out, certainty is an important safeguard for parties in commercial cases, but participants in illegal transactions do not perhaps deserve such a safeguard in quite the same way). Whatever the pros and cons, it is Lord Toulson’s reasoning that commanded majority support, and thus forms the ratio of the case on restitutionary recovery.

Contractual enforcement cases—does Patel v Mirza apply?

W2.54 The knotty question remains, does the Supreme Court’s approach in Patel v Mirza apply equally to cases in which a claimant tries to enforce a contract affected by illegality—sue for expectation damages or claim an agreed sum? Although contractual enforcement was not in issue in the case and thus is not within its ratio, it is nonetheless tentatively suggested that it is so caught. First, this is the natural interpretation of Lord Toulson’s approach—many of the examples and illustrations given throughout his judgment included contractual enforcement cases, and he explicitly endorsed the Law Commission’s recommendations, which covered contractual enforcement claims as well as others such as restitutionary claims (it is also worth noting that Lord Toulson was Chairman of the Law Commission during the latter stages of the Illegality project). Secondly, Patel v Mirza has
subsequently been applied, or at least regarded as relevant, in tort claims such as *Henderson v Dorset Healthcare University NHS Foundation Trust* (2018) and, more significantly, in the Supreme Court decision of *Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd* (2019), despite tort forming no part of the ratio of *Patel v Mirza*. Similarly, as has been seen at para W2.34, in *Okedina v Chikale* (2019) the Court of Appeal applied *Patel v Mirza* to various statutory claims arising out of the dismissal of an employee, stating that they ‘can be characterised as “contractual”, in the extended sense that they either are made under the contract of employment or arise out of it’.

W2.55 Thirdly, Lord Toulson referred with approval to an earlier Court of Appeal contractual enforcement case *ParkingEye Ltd v Somerfield Stores Ltd* (2012), decided when he was Toulson LJ, the ratio of which was the application of the Law Commission’s same ‘balancing factors’ approach as *Patel v Mirza*. In *ParkingEye* the claimant had performed its contractual obligations (to provide an automated parking system in the defendant’s supermarket car parks) perfectly lawfully, except that some of the letters it sent to defaulting customers demanding money contained false assertions and amounted to the tort of deceit (though not a criminal offence of dishonesty). The Court of Appeal allowed the claimant to enforce the contract (by means of an action for damages for lost revenue during the unexpired term of the contract) following the defendant’s repudiatory breach of contract. It reached its conclusion by balancing the ‘proportionality factors’ subsequently adopted in *Patel v Mirza*: it was a case where illegality in performance was contemplated by both parties at the time the contract was made, but where the parties had not appreciated that the relevant conduct was unlawful and where the illegality concerned a minor, peripheral aspect of the contract and so was ‘neither essential nor central to the performance’. As Toulson LJ put it, ‘the disallowance of ParkingEye’s claim on the ground of illegality is not compelled by the authorities, and it would not be a just and proportionate response to the illegality’.

W2.56 The application of *Patel v Mirza* to contractual enforcement cases would represent a radical departure from the traditional approach to the defence of illegality. But would it actually make very
much difference to the outcome of cases in practice? The answer is probably not. For a start, long
before the Law Commission’s reports and Patel v Mirza, the reality was that, whilst paying lip service
to the inflexible principle of public policy, the courts had developed so many exceptions and
modifications to it that in practice the operation of the principle already closely resembles a
(structured) discretionary approach. For example, the meaning of illegality itself is flexible, with
public policy moulded to meet contemporary concerns and statutes interpreted purposively. Even
where illegality is found, where a contract is not illegal per se, a claimant can succeed if not
implicated in the illegality. Where the illegal part of a contract can be severed from the rest, the
unobjectionable remainder will be enforced.

W2.57 Other ‘ways round’ the harshness of the rule-based approach developed over the years deserve a
brief mention. For example, one party might be able to sue the other for damages for inducing him or
her to become embroiled in the illegal transaction. The claimant must be wholly innocent, not just
less blameworthy than the defendant. As the court explained in Askey v Golden Wine (1948), a case
about contaminated wine, if claimants ‘were allowed to be negligent and yet recover damages it
would offer an inducement to them to turn a blind eye to contamination’. In Shelley v Paddock (1980)
the wholly innocent S was induced by the fraud of the defendants to enter into a transaction and pay
money over to them, without realising that the transaction contravened statutory exchange control
legislation. The Court of Appeal awarded S damages for fraud, emphasising that S was innocent and
that public policy did not prevent the court awarding damages. No doubt, if she had chosen to plead
her case differently, S could have recovered the price paid on the basis of total failure of
consideration. However, she was well advised to bring an action for damages for fraud instead, since
this allowed her to recover consequential losses as well as the amount of the price. Pleading and
proving fraud is often difficult, although since the Misrepresentation Act 1967 it is no longer the only
source of misrepresentation damages. Another possibility was to find a defendant who induced the
claimant to enter an illegal transaction liable on a separate collateral warranty of some kind, untainted
by illegality. Damages were awarded on this basis in *Strongman (1945) Ltd v Sincock* (1955) where D did not, as he had undertaken to do, obtain the necessary licence for building work, and then pleaded that statute rendered the building contract unenforceable when sued for the price. The court expressed considerable satisfaction at being able to avoid the effects of illegality in this way by ‘finding’ that D had given a collateral promise to obtain the licence.

W2.58 Perhaps the effect of all the ‘exceptions’ to the strict application of the public policy of unenforceability is that there was already a good deal of discretion operating in the law, to enable the courts to resolve tension between fairness and public policy—maybe *Patel v Mirza* just makes explicit what was happening all along. Of course its critics (such as Lords Sumption and Mance) would retort: if so, why add a novel dimension of complexity and discretion to a regime that is basically successful? After all, the criminal law should be used to express disapproval of illegality (for example under the Proceeds of Crime Act 2002 the state has wide powers to confiscate proceeds of crime, whether on a conviction or without a conviction) and ensure the wrongdoers are punished. This should not be the role of the civil courts (it seems neither Mr Patel nor Mr Mirza was prosecuted). On the other hand, not everyone shares Lord Neuberger’s view (see para W2.2) that the client could seek restitution of a sum paid in advance to a contract killer who did not perform, despite all the elements of the restitutionary claim for total failure of consideration being present.

W2.59 Moreover, we can expect that the courts will still be much more reluctant to entertain pleas to *enforce* an illegal transaction than other sorts of claims that do not do so. As Lord Toulson said in *Patel v Mirza*, ‘the policies which underlie the illegality defence are less likely to come into play where parties are attempting to undo, rather than carry out, an illegal contract.’ One final example is worth reflecting on. *Hounaga v Allen* (2014), involved a teenage girl trafficked illegally into the UK to work for the defendant, but then dismissed by the employer. Miss Hounaga brought an action for damages for breach of her contract of employment as well as in tort for unfair dismissal: the action for breach of contract was unsuccessful and not pursued on appeal to the Supreme Court, for the
reason that it was a direct attempt to enforce an illegal contract; in contrast, the tort action ultimately succeeded in the Supreme Court, by an explicit application of the Law Commission’s balancing factors approach. But maybe the contractual enforcement action should also have been subject to the ‘balancing factors’ approach (the contract in *Hounga* was not illegal per se by statute, though the law has since been changed) and maybe the result might have been different if it had been. As O’Sullivan (2018) has written:

*It is suggested that the relevant factors that led to the award of damages in tort should also permit, rather than preclude, contractual enforcement. There are of course differences: an award of wages owed might be said to allow her to profit from her illegality in a way that does not apply to tortious compensation, and the causal connection between the contract of employment and the illegality is close. But most of the policy factors apply just as much in contract as in tort: the lack of deterrence and potential to encourage employers if contractual rights are denied to employees, just as if tortious compensation is denied, the purpose and protective reach of the international rules on trafficking, and in particular the great disparity in the blameworthiness of the parties. Overall Miss Hounga’s young age and level of learning disabilities left her vulnerable to exploitation, that exploitation being the very entry into the contract which she performed but for which she received no remuneration.*

It is telling, however, that the Supreme Court in *Patel v Mirza* simply accepted that the contractual enforcement claim in *Hounga* had indeed been properly ruled out for illegality. Of course the issue was not before them and they had heard no argument on it. But it seems likely that, even if they do begin (as seems likely) to apply *Patel v Mirza* reasoning in cases about enforcement of contractual claims affected by illegality, the courts are likely to remain cautious about departing too far from existing precedents. Perhaps what is most likely in future is that the existing authorities enunciating the rules and exceptions will remain binding, but when a court has to decide whether to apply or distinguish those rules and exceptions on the novel facts before it, it will do so with more open
consideration of the applicable policy factors.

OVERVIEW

1 It is said to be a basic rule of public policy that a court will not enforce an illegal contract, though the judges are often torn between this rule of public policy and a desire for a fair result on the merits. While some contracts are illegal per se, others are affected by illegality in the manner of performance or are made for an illegal purpose.

2 Illegality at common law is a wider concept than merely the commission of crimes and torts. Other conduct is deemed contrary to public policy, catching transactions such as contracts to purchase honours, contracts that promote sexual immorality, or contracts that interfere with the proper administration of justice.

3 A particularly significant ground of public policy is the unenforceability of contracts and contractual obligations that operate in restraint of trade. Only a reasonable restraint of trade is effective, with the notion of reasonableness involving both the position as between the parties and broader considerations of the interests of the general public. The restraint must be considered in the context of the transaction as a whole and the type of contract. Generally, wider restraints are acceptable in contracts for the sale of a business than in employment contracts. The courts have guidelines to assist in the proper interpretation of provisions in restraint of trade. An offending provision might be severed, leaving the rest of the contract in place, if it can be excised without unduly disrupting the parties’ bargain.

4 Statute might make a particular contract illegal per se. More commonly, the purpose of entering into a contract, or performance of an otherwise lawful contract, might involve breach of a statutory provision or other illegality. In such cases, the claimant can generally still enforce the contract in certain circumstances: traditionally, if he did not know about and did not participate in the breach of statute.

5 In addition to the principle that an illegal contract will not be enforced, there was traditionally also a presumption against allowing a restitutionary remedy in the context of an illegal contract. However there
were traditionally a number of increasingly wide exceptions, which arguably undermined the general rule. In a seminal recent decision, the Supreme Court abandoned this general approach to restitutionary claims, in favour of the Law Commission’s proposed reform, based on considering whether denying the claim would serve the policy rationales underlying the illegality principle (in particular the integrity of the legal system) and whether it would be a disproportionate response.

6 It is not entirely clear whether the same approach will now be applied in claims to enforce contracts affected by illegality. It is suggested that it probably will, and there is already at least one authority in which the court focused on whether refusal to allow enforcement would be a disproportionate response, such as where the illegality was peripheral or minor, and would not serve the policies underlying the illegality principle. In any event, there are already so many exceptions to, and ways of mitigating, the rigid policy against enforcement that the official adoption of the new approach would make little difference in practice to the outcome of cases.

FURTHER READING

Goudkamp ‘The end of an era? Illegality in private law in the Supreme Court’ (2017) 133 LQR 14

O’Sullivan ‘Illegality and Contractual Enforcement’ Chapter 8 in Illegality after Patel v Mirza ed. S. Green and A. Bogg (Hart, 2018)


SELF-TEST QUESTIONS

1 To what extent should the treatment of illegality in cases of contractual enforcement be a matter for the discretion of the court?

2 Why is the reasonableness of a covenant in restraint of trade judged, not just as between the parties, but also taking into account the interests of the general public?
3 Are there some instances of illegality so serious that the courts should refuse to countenance giving any relief to the parties involved?

4 In Montgomery’s garden there is a tree on which a protection order has been issued, the effect of which is to make it an offence, unless there has been official dispensation, to cause the tree to be destroyed or damaged. Montgomery wishes to have the tree removed, and consults his solicitor Nefaria. Nefaria explains the steps required to obtain dispensation and then adds, ‘But if I were you I should just have it taken out and say it was struck by lightning.’ Montgomery then contracts with Onion, who does not know of the order, to have the tree removed, and Onion removes it. Can either Nefaria or Onion sue Montgomery for the price of their services?

For hints on how to answer question 4, please see the guidance on answering the questions on the relevant section of the website.