

Restitution Under an Illegal Contract: A Scots Law Perspective on *Patel v. Mirza*

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Abstract: The illegality doctrine is an area where Scottish materials are sparse and conflicting. There have therefore been calls for law reform in Scotland, even along the lines of the United Kingdom Supreme Court (UKSC) decision in *Patel v. Mirza*. Moreover, *Patel* is already being mentioned with approval in Scottish courts and texts, and this suggests that any case which comes after it is likely to follow it closely.

1. Introduction

1. In July 2016, the United Kingdom Supreme Court (UKSC) delivered its decision in *Patel v. Mirza*.¹ In summary, the court held that a contracting party who satisfied the requirement for unjust enrichment should not be debarred from enforcing a claim to recover money paid under an illegal contract. In laying down this rule, the UKSC overruled a previous decision in *Tinsley v. Milligan*² which laid down the ‘reliance principle’ under English law, under which the court would not give aid to a claimant (formerly called a plaintiff). The UKSC, in overruling this principle, pointed out that the current state of the illegality doctrine in English law had led to serious problems and uncertainties with the potential for injustice against a claimant who had paid money under an illegal contract.³

2. The case has received significant attention in England,⁴ as it marked the latest in a line of recent cases where the UKSC has wrestled with a doctrine long considered to be unsatisfactory and a serious attempt by the court to draw a line under the matter.⁵

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1 Supreme Court of the United Kingdom (UKSC) 20 July 2016, *Patel v. Mirza*, <https://www.supremecourt.uk/cases/docs/uksc-2014-0218-judgment.pdf> = [2017] AC, p 467.

2 House of Lords (HL) 24 June 1993, [1994] 1 AC, p 340.

3 UKSC 20 July 2016, *Patel* (*supra* n. 1), paras 112–114.

4 E.g. J. GOUDKAMP, ‘The End of an Era? Illegality in Private Law in the Supreme Court’, 133. *LQR* (*Law Quarterly Review*) 2017, p 14; A. GRABINER, ‘Illegality and Restitution Explained by the Supreme Court’, 76. *CLJ* (*Cambridge Law Journal*) 2017(1), p 18; E. LIM, ‘*Ex Turpi Causa*: Reformation Not Revolution’, 80. *MLR* (*Modern Law Review*) 2017(5), p 927.

5 UKSC 30 July 2014, *Hounga v. Allen*, https://www.supremecourt.uk/decided-cases/docs/UKSC_2012_0188_Judgment.pdf = [2014] 1 WLR, p 2889; UKSC 29 October 2014, *Les Laboratoires*

3. This is an area where Scots law has kept a close eye on developments south of the border.⁶ Therefore, it is worth considering the implications of the decision in Scotland and how well it fit with broader Scots law in this area. As in England,⁷ the illegality doctrine represents an area where calls have been made for law reform in Scotland,⁸ even along the lines of the UKSC decision in *Patel v. Mirza*.⁹

2. Facts and Decision

4. The respondent, Mr Patel, transferred the sum of £62,000 to the appellant, Mr Mirza for betting on the price of RBS shares. The payment was made with the intention that Mirza would obtain inside information regarding an imminent government announcement which were to affect the price of the shares. Mirza's expectation regarding the government announcement turned out to be mistaken and as such the bet never took place. However, Mirza refused to repay the money. Patel subsequently sued Mirza to recover the sum. The claim was premised on unjust enrichment. To establish his claim, Patel had to show that there was a failure of consideration. Failure of consideration rested on the fact that the purpose for which the payment had been made was in violation of section 52 the English Criminal Justice Act 1993, which made it a criminal offence for a person to deal in, or conspire to deal in, securities with the aid of inside information.

5. At the court of first instance, the judge held that Patel's claim was unenforceable because he had to rely on the illegality to establish the claim for unjust enrichment and that the general rule would not intervene to assist in recovery paid for an illegal purpose.¹⁰ This position is sometimes expressed in the maxims *ex turpi causa non oritur actio* (no action arises from a disgraceful or turpitudinous cause) and *in pari delicto potior est conditio defendentis* (where both parties are equally in the wrong the defender's position is stronger) and its authoritative modern statement came in *Tinsley v. Milligan*.¹¹

Servier v. Apotex Inc., <https://www.supremecourt.uk/cases/docs/uksc-2012-0158-judgment.pdf> = [2015] AC, p 430; UKSC 22 April 2015, *Bilta (UK) Ltd. v. Nazir (No. 2)* = [2016] AC, p 1.

6 W.W. MCBRYDE, *The Law of Contract in Scotland* (Edinburgh: Thomson/W. Green, 3rd edn 2007), paras 13–39.

7 Law Commission Report on *The Illegality Defence* (LAW COM No 320, 16 March 2010).

8 See L. MACGREGOR, 'Pacta Illicita', in K. Reid & R. Zimmermann (eds), *A History of Private Law in Scotland* (Oxford and New York: Oxford University Press 2000), p 156; L. MACGREGOR, 'Illegal Contracts and Unjustified Enrichment', 4. *EdinLR (Edinburgh Law Review)* 2000, p (19) at 33.

9 See H.L. MACQUEEN & J. THOMSON, *Contract Law in Scotland* (West Sussex: Bloomsbury Professional, 4th edn 2016), preface to the fourth edition, where the author refers to, and supports, the decision of the UKSC in *Patel*.

10 Chancery Division 5 July 2013, *Patel v. Mirza* [2013] EWHC, p 1892 (Ch) = [2013] Lloyd's Rep FC, p (525) at paras 37–44.

11 House of Lords 24 June 1993 (*supra* n. 2), p 340.

6. The judge also held that Mr Patel could not bring himself with the *locus poenitentiae* exception to this rule, which allowed recovery in cases where the claimant had voluntarily withdrawn from the contract before it was performed. In this case, the plan had not been carried through because the anticipated information did not materialize rather than because of Patel's repentance.

7. On appeal to the Court of Appeal, the decision was reversed. The court relied on its earlier decision in *Tribe v. Tribe*¹² to establish that what mattered was not whether the claimant had withdrawn voluntarily or shown 'genuine repentance' but rather that the scheme had not in fact been prosecuted.¹³ Thus the judges of the Court of Appeal were unanimous as to the result.

8. However, Gloster LJ dissented most forcefully on the best approach to the basic question of the law's proper response to a claim which inevitably involved reliance on some prior illegality. She relied on two decisions of the House of Lords to support a move from a 'formalistic' to a 'discretionary' approach.¹⁴ The latter approach suggested, that the court required not merely to consider whether the claimant relied on an illegality and whether a technical exception such as *locus poenitentiae* applied but rather to consider the question in broad policy terms, reflecting on the nature and seriousness of the illegality, the effect (if any) of denying recovery on the policy of the rule whose breach had given rise to the illegality and the proportionality of the denying recovery as a response to the illegality.¹⁵

9. Mr Mirza appealed to the UK Supreme Court which dismissed the appeal. As in the Court of Appeal, the Justices were unanimous as to the result but divided as to the proper analysis.

10. Lord Toulson framed the issue as a contest between formally applying the rule that the court will not give its aid to a one who founds on an immoral or illegal act (on the one hand) and tempering the rule by consideration of the underlying policy (on the other).¹⁶ He therefore sought to evaluate the 'doctrine of reliance' as laid down in *Tinsley v. Milligan*.¹⁷ According to Lord Toulson, there are two broad discernible policy reasons for the English law doctrine of illegality: the first is that a person should not be allowed to benefit from his own wrongdoing; the second is that the law should be coherent and not self-defeating condoning illegality by

12 Court of Appeal (CA) 26 July 1995, [1996] Ch, p 107.

13 CA 29 July 2014, *Patel v. Mirza* [2014] EWCA Civ, p 1047 = [2015] Ch, p (271) at paras 43-46, per Rimer LJ, paras 95-98 per Gloster LJ, paras 113-118.

14 CA 29 July 2014, *Patel* (*supra* n. 13), paras 53-60, citing H.L. 17 June 2009, *Gray v. Thames Trains Ltd.* [2009] UKHL, p 33 = [2009] AC, p 1339 and HL 30 July 2009, *Stone & Rolls Ltd. v. Moore Stephens* [2009] UKHL, p 39 = [2009] AC, p 1391.

15 CA 29 July 2014, *Patel* (*supra* n. 13), para. 53.

16 UKSC 20 July 2016, *Patel* (*supra* n. 1), paras 1 and 9.

17 *Ibid.*, paras 17-20.

‘giving with the left hand what it takes with the right hand’.¹⁸ In his view, the reliance approach as stated in *Tinsley* has the undesirable consequence of tempting judges to focus on whether a claimant is to obtain a benefit from his own wrongdoing rather than on the question whether debarring the claimant would produce inconsistency and disharmony in the law and so cause damage to the integrity of the English legal system.

11. Thus, Lord Toulson held that in determining whether allowing a claim founded on an illegal contract will be harmful to the integrity of the English legal system, several factors must be considered¹⁹: the first is a consideration of the purpose of the prohibition which has been transgressed²⁰; secondly, whether a rejection of the claim will have an impact on another relevant public policy which might be rendered ineffective by refusing a claim founded on unjust enrichment;²¹ and thirdly, whether it will be a proportionate response to the illegality to deny the claimant’s claim. In relation to this last factor, Lord Toulson held that in determining whether a denial of the claim will be proportionate, a range of factors need be considered. This includes seriousness of the illegal conduct, its centrality to the contract, whether it was intentional, the party’s respective culpability, and the fact that punishment for criminal offences was within the purview of the criminal courts and hence there should not be an additional imposition of penalty on a claimant which may be disproportionate to the nature of the wrongdoing.²²

12. The reliance principle as laid down in *Tinsley* was overruled, and Lord Toulson held that there was no logical basis why consideration of public policy should require Patel to forfeit the money which he had paid to Mirza and which were never used for the purpose for which they were paid. According to Lord Toulson, ‘such a response would not be a just and proportionate response to the illegality’.²³ Patel was seeking to unwind the transaction and not to get any benefit from it. Therefore, since he satisfied the ordinary requirement of a claim for unjustified enrichment, he was not debarred from claiming a repayment of the money paid to Mirza.

13. The minority²⁴ of the UKSC agreed with Lord Toulson’s conclusions but disagreed the shift to the discretionary approach. They suggested that the range of factors proposed by Lord Toulson risked arbitrariness and was too discretionary

18 *Ibid.*, para. 99.

19 *Ibid.*, para. 120.

20 E.g. for whose benefit was the prohibition made. Lord Toulson held that where the purpose of the prohibition is for the benefit of a certain class of persons, this will be defeated if a person within that class is debarred from bringing a claim simply because he or she relies on an act violating the prohibition. UKSC 20 July 2016, *Patel* (*supra* n. 1), para. 102.

21 UKSC 20 July 2016, *Patel* (*supra* n. 1), para. 103.

22 *Ibid.*, paras 107–109.

23 *Ibid.*, para. 115.

24 Lords Sumption, Mance and Clarke.

and could prove problematic.²⁵ Lord Mance considered that the reliance principle remains significant, but would only prevent recovery where the claimant seeks to profit from the contract and to enforce, rather than to reverse, the agreement.²⁶

3. Illegality and Unjustified Enrichment Under Scots Law

14. The UKSC did not refer to Scots law but the historic position in Scotland closely mirrors that in England. The Scots law approach to illegality contract is founded on two cases: *Cuthbertson v. Lowes*²⁷ and *Jamieson v. Watt's Trustees*²⁸ which have been argued to be problematic.²⁹

15. In Scots law, illegal contracts are generally unenforceable.³⁰ However, the consequences of the illegality may vary depending on the culpability of the parties. Where the parties are equally culpable (i.e. *in pari delicto*), the court will not implement the contract or award damages for breach. Therefore, the losses or benefits arising from such a contract lie where they fall. Essentially a defender under this rule who has received payment, as in *Patel*, gains a windfall where the contract has been partly performed (again, with reference to the maxim *ex turpi causa melior est conditio possidentis*).³¹ However, the harshness of this rule is alleviated if it is only one of the parties who had the intention to perform the contract in an unlawful way or carry out the illegality. In this case, the innocent party can recover his losses.

16. Since illegal contracts are generally unenforceable where the parties are *in pari delicto*, there is a reluctance to allow a claimant to pursue a claim for unjustified enrichment. However, this is not always the case as the court's attitude has been drawn between two policy considerations, i.e. either to impose the punitive measures stipulated by the law, or to allow the losses fall where they lie hence essentially allowing the defender to gain a windfall. This division is reflected by *Cuthbertson* and *Jamieson*.

17. In *Cuthbertson v. Lowes*, the Weights and Measures Act stipulated that the sales which made reference to the traditional Scotch as opposed to the imperial acre were to be treated as void. In contravention of the statute, *Cuthbertson* sold potatoes to *Lowes* by the Scotch acre. *Lowes* paid part of the purchase price and

25 UKSC 20 July 2016, *Patel* (*supra* n. 1), para. 192 per Lord Mance.

26 *Ibid.*, paras 201-202.

27 Court of Session 20 July 1870, (1870) 8 M, p 1073.

28 Court of Session 29 March 1950, 1950 SC, p 265.

29 L. MACGREGOR, 4. *EdinLR* 2000, p 26.

30 Illegal contracts are distinct from void contracts which are defective on grounds of lack of consent or capacity. Void contracts are a legal nullity without effect.

31 Court of Session 14 December 1982, *Barr v. Crawford* (1983) SLT, p 481; L. MACGREGOR, 4. *EdinLR* 2000, p 27.

withheld the remainder. He argued that the contract was in contravention of the Act and was therefore null and void. However, the court took the view that if Lowes' contention was accepted, he would continue to retain possession of the potatoes and therefore receive a large gain at the expense of the seller who was to bear the whole loss.³² According to the court, this outcome will be 'inequitable' and will produce an unpleasant result.³³ The court admitted that there is no doubt that the court cannot enforce performance of an illegal contract; however, there 'was no turpitude in a man selling his potatoes by the Scotch and not by the imperial acre; and although he cannot sue for implement of such a contract, [there was] no authority, in the absence of *turpi causa*, which prevents the claimant from recovering the market value of the potatoes'.³⁴ In the court's opinion, this avoided enforcing the contract, but was an equitable way to prevent the defender from receiving a large gain at the expense of the claimant.³⁵

18. *Cuthbertson* shows that even where a contract is illegal and the parties are *in pari delicto*, a party may bring a claim for recompense or restitution if there was no moral turpitude. In other words, recompense or restitution will be unavailable to a claimant only where there is some form of immorality in the performance of the contract, or rather where a party by his action contributes to such illegality in the performance of the contract. It is only in the case of moral turpitude that the court will refuse to grant relief under the laws of unjust enrichment. A mere violation of a statutory provision does not debar a party from claiming recompense or restitution, and such a claim does not amount to enforcing the contract. Crucially, it was not the case that all illegality excluded the pursuer from the assistance of the court.

19. On the other hand, in *Jamieson v. Watt's Trustees*, the court arrived at a somewhat different conclusion which appears to be difficult to reconcile with *Cuthbertson*.³⁶ In *Jamieson*, the proprietor of a cottage engaged a joiner to do some building works. Wartime legislation provided that a licence had to be obtained in carrying out such works. The joiner properly obtained a licence in accordance with the legislation to carry out work to the extent of £40, but carried out a £114 work in breach of the licence and legislation. The defender refused to pay the balance, and the claimant relied on *Cuthbertson* to claim a recompense for the work done. Lord Justice Clerk Thomson described *Cuthbertson* as a 'special case turning on its own circumstances'.³⁷ The effect of the statute in *Cuthbertson* was to make the contract void and because of that nothing prevented the court from

32 Court of Session 20 July 1870, *Cuthbertson* (*supra* n. 27), p 1075.

33 *Ibid.*

34 *Ibid.*

35 *Ibid.*, p 1076.

36 See L. MACGREGOR, 4. *EdinLR* 2000, p 26.

37 Court of Session 29 March 1950, *Jamieson* (*supra* n. 28), p 272.

regulating the rights of the parties under the contract. The judges considered that this was to be contrasted with the present case where the pursuer sought relief in respect of his own breach of regulation, and this deprived him of any right to claim under the laws of unjust enrichment. The court thought that the attempt to claim recompense was therefore a means to enforce the agreement.

20. It must be said that the two decisions are based on similar facts: they relate to contracts which violate a statutory regulation. In both cases, an enrichment remedy was sought but that benefit was payment for, rather than return of, the benefit conferred under the illegal contract. The court in *Cuthbertson* made a distinction between contracts which are simply illegal on one hand for violation of a statute and contracts which are illegal as well as having have an element of moral turpitude as to their performance on the other hand. It took the view that while the illegal contracts cannot be implemented in either case, a claimant may claim recompense under the former but not the latter. The court in *Jamieson* framed the matter differently. In the court's view, illegal contracts are simply unenforceable and *Cuthbertson* was a special case not because of the absence of moral turpitude but because the statutory breach resulted (unusually) in voidness, leaving the way open for an enrichment remedy, despite the residuary nature of enrichment in Scots law.

21. Several attempts have been made to reconcile the two decisions. In *Dowling & Rutter v. Abacus Frozen Foods Ltd.*³⁸ Lord Johnston opined that 'the issue of illegality was one of equitable remedy'.³⁹ The phrase is not perhaps the happiest, but the import of the analysis is clear: a flexible approach must be taken to respond fairly to the consequences of an illegal transaction. He also took the view that illegality was generally a question of degrees and the degree of illegality in a contract affects the rights of the parties under the contract. *Jamieson* was considered to be limited to the proposition that a person cannot base a claim for unjustified enrichment on a contract when the 'whole or substantive basis of that claim depends upon the claimant's own admitted illegal activities, whether that be in the formation or in the performance of the contract'.⁴⁰ However, if, as seen in *Cuthbertson*, the contract is carried out in a way which merely involves an 'ancillary infraction of a statute', then a party may be entitled to remedies on the ground of unjustified enrichment as the minor degree of criminality is irrelevant to the purposes of the contract.⁴¹ It is worth noting, however, that the distinction drawn in *Dowling* could be regarded as very similar to the narrow reading of the doctrine of reliance favoured by the minority in *Patel*.

38 Court of Session 12 December 2000, 2002 SLT, p 491.

39 Court of Session 12 December 2000, *Dowling* (*supra* n. 38), para. 21.

40 *Ibid.*, paras 18-19.

41 *Ibid.*, p 494 per Lord Wheatley, whose judgment Lord Johnston endorsed.

22. Hector MacQueen and Joe Thomson also compare the two decisions. According to them, both decisions can be reconciled if the starting point is to treat remedies for unjustified enrichment as an equitable remedy. They argue that where there has been performance under an illegal contract, the person who has benefited is under an obligation to make restitution, though the contract is unenforceable. However, because the remedy is equitable, the defender may contend that it will be inequitable to require him to recompense. The defender may establish this fact by proving that the parties are equally culpable or that there was moral turpitude involved.⁴² According to MacQueen and Thomson, in *Jamieson*, there was an element of moral turpitude, and it would have been inequitable to compel the defender to recompense. On the other hand, in *Cuthbertson*, there was no moral turpitude and there was therefore no inequitable ground not to allow the claimant's claim for recompense.

23. This approach seems closer to that of the majority in *Patel*, leaving, as it does, room for broad consideration of the context in assessing the appropriateness of an enrichment remedy rather than focussing of the role of the illegality as the basis of the claim.⁴³ The decisions in *Cuthbertson* and *Jamieson* make it difficult to project a singular Scots law approach to the illegality doctrine and claims for unjustified enrichment. Authorities and literature on the subject in Scotland is sparse, which has two implications. First, that it is difficult to form a clear view on which proposed reconciliation is preferable and second, that decisions of the UKSC such as that in *Patel* are likely to be influential.

4. Conclusion: *Patel v. Mirza* in Scotland

24. As earlier noted, the UKSC held in *Patel*, that a claimant who satisfies the ordinary requirements for unjustified enrichment ought to succeed even though the contract is illegal. Lord Toulson adds a range of factors which he said helps in ascertaining whether a relief in enrichment should be granted in respect of an illegal contract which has been performed. These factors are, one, a consideration of the primary purpose of the prohibition which has been transgressed; secondly, whether a rejection of the claim will have an impact on another relevant public policy which might be rendered ineffective by refusing a claim founded on unjustified enrichment; and thirdly, whether it will be a proportionate response to the illegality to deny the claim. According to Lord Toulson, in considering the third factor, a court should also consider the seriousness of the illegal conduct, whether it was intentional and its centrality to the contract.

25. On one hand, it may be said that, generally, this approach is not so different from the approach in Scots law depending on the preferred perspective. First, both

42 H.L. MACQUEEN & J. THOMSON, *Contract Law in Scotland*, p 306.

43 This view appears to be shared by the authors: see *supra* n. 9.

Cuthbertson and *Jamieson*, as pointed out in *Dowling & Rutter v. Abacus Frozen Foods Ltd* and by MacQueen and Thomson, may reflect a general ‘equitable approach’ under Scots law. This leaves room for consideration of the degree of illegality or the moral turpitude involved rather than the illegality *simpliciter* as a test for a claim for unjustified enrichment. In other words, a contract may be illegal but still leave room for a claim for unjustified enrichment. What the court considers is the equitable grounds as reflected in the seriousness of the illegal conduct or moral turpitude.

26. This approach generally seems similar to the approach in *Patel*: the UKSC decision does not adopt illegality *simpliciter* as a yardstick for claims in unjust enrichment. This will depend on a range of factors including, as noted, the seriousness of the conduct and its centrality to the contract. These conditions are generally equitable in nature. However, one difference between *Patel*’ and the Scots law position is that while Scots law has hitherto focussed on the presence, or the lack of, moral turpitude and the degree of illegality, *Patel* has a ‘much wider’⁴⁴ range of factors. Nonetheless, both approaches seem to not treat illegality *simpliciter* as debarring a claimant from claiming a relief on grounds of unjustified enrichment.

27. On the other hand, if as MacGregor argues,⁴⁵ the decisions in *Jamieson* and *Cuthbertson* represent different alternative approaches under Scots law to the issue of illegal contracts and unjust enrichment, then it may be said that Scots law may provide a different approach when compared to the decision in *Patel*. On one hand, in *Jamieson*, the test for a claim for unjustified enrichment is illegality; therefore, once a contract is found to be illegal, a party cannot rely on his own illegality for a relief in unjust enrichment. Essentially losses lie where they fall and a party such as *Patel* may not be successful since, based on *Jamieson*, a claim based on unjustified enrichment effectively enforces the contract. However, *Patel* might have succeeded under the rule in *Cuthbertson* which considers whether moral turpitude is involved. Although the agreement between the parties may be in contravention of statutory provision and hence illegal, the question will be whether there were elements of moral turpitude (or the degree of illegality) involved on the part of Mr *Patel*.

28. In terms of the Scottish materials as they stand, there is little to suggest that one approach will prevail over the other but it must be remembered that in an area where Scottish materials are sparse and conflicting, a solution from over the border is an alluring prospect. *Patel* is already being mentioned in Scottish courts⁴⁶ and, however, a case on similar facts would have been decided before *Patel* any case which comes after it, is likely to follow it closely.

44 H.L. MACQUEEN & J. THOMSON, *Contract Law in Scotland*, Preface.

45 L. MACGREGOR, 4. *EdinLR* 2000, p 28.

46 Court of Session 14 March 2017, *D Geddes (Contractors) Ltd v. Neil Johnson Health & Safety Services Ltd*, <https://www.scotcourts.gov.uk/search-judgments/judgment?id=820f2da7-8980-69d2-b500-ff0000d74aa7> = [2017] CSOH, p 42.