

Does the Availability of the Illegality Defence Depend on the Scope of the Duty Owed?

This essay is written in honour of Jonathan Brock QC, but it was through the submissions of another leading Silk named Jonathan that I had my first introduction to the Latin maxim *ex turpi causa*; and to the illegality defence. While still a student, I had decided to attend at least one hearing in the House of Lords before its transmogrification into the Supreme Court. I therefore spent an afternoon at the back of a committee room overlooking the Thames listening to the submissions of Jonathan Sumption QC (as he then was) in *Stone & Rolls v Moore Stephens*.¹

When judgment was handed down, I did my best to work out what the case had actually decided. I confess I found it difficult to do so. It seems that I was not alone. In its Final Report on the illegality defence, the Law Commission concluded that it was “*difficult to anticipate what precedent, if any, Stone & Rolls will set*”² and, in *Bilta v Nazir*, Lord Neuberger said that it should be “*put on one side in a pile and marked ‘not to be looked at again’*.”³

In this essay, I intend to disobey Lord Neuberger and return to *Stone & Rolls*, because I believe it illustrates how the courts have been blown off course in their analysis of the illegality defence. In particular, it is submitted that the availability of the illegality defence should not depend upon the scope of the defendant’s duty to the claimant and that, properly analysed, the case law reflects this.

The Problem: Judicial Conflation

It is widely accepted that the law on the illegality defence is confused, confusing and in desperate need of clarification. The defence has been considered by the House of Lords or Supreme Court at least five times in six years.⁴

It is submitted that one of the main problems is that the courts have not always drawn clear distinctions between issues which should properly be considered separately. In particular, several judgments have conflated issues of duty, attribution and the illegality defence *per se*. This approach leads to anomalous and unprincipled decision-making since, as Lord Sumption said in *Bilta*, it “*invites distinctions between different situations which are irrelevant to the principle that [the court is] applying*.” This is likely “*to see the law of illegality revert to the multiplicity of micro-topics and sub-rules which once characterised it*.”⁵

The problematic conflation of different issues was apparent in *Stone & Rolls*. The great challenge of the case, in my view, was that it arose at the intersection of three different and equally difficult issues: (i) the scope of duty owed by auditors; (ii) the principles of attribution to corporate entities; and (iii) the availability of the illegality defence.

¹ [2009] UKHL 39.

² Law Commission, *The Illegality Defence* (Law Com No. 320, 2010), at 3.32.

³ *Bilta v Nazir* (No. 2) [2015] UKSC 23, at [30].

⁴ *Gray v Thames Trains* [2009] UKHL 33; *Stone & Rolls* [2009] UKHL 39; *Hounga v Allen* [2014] UKSC 47; *Les Laboratoires Servier v Apotex* [2014] UKSC 55; and *Bilta* [2015] UKSC 23.

⁵ *Bilta*, at [105].

As is well known, the company of Stone & Rolls had been created for the purpose of defrauding banks. The company's sole director, manager and shareholder was a Mr. Stojevic. An action was brought by the company at the instigation of its liquidators (who were seeking recovery for creditors) against the company's auditors. The auditors raised the illegality defence on the basis that Mr. Stojevic's knowledge should be attributed to the company.

By a majority of 3:2, the House of Lords decided that the auditors were entitled to rely on this defence and so dismissed the claim. However, the judgments of the majority are inconsistent. Lords Walker and Brown held that, since Mr. Stojevic's knowledge was to be attributed to the 'one-man' company, the company was effectively relying on its own fraud to found its cause of action against the auditors; application of the 'reliance' test from *Tinsley v Milligan* therefore defeated the claim.⁶

Lord Phillips was also part of the majority but took a different approach, holding that "*the real issue is not whether the fraud should be attributed to the company but whether ex turpi causa should defeat the company's claim for breach of the auditor's duty. That in turn depends, or may depend, critically on whether the scope of the auditor's duty extends to protecting those for whose benefit the claim is brought.*"⁷

Lords Toulson and Hodge adopted a similar approach in *Bilta*, holding that "*the public interest which underlies the duty that the directors of an insolvent company owe for the protection of the interests of the company's creditors... requires axiomatically that the law should not place obstacles in the way of its enforcement.*"⁸

With respect to their Lordships, the approach taken by Lord Phillips in *Stone & Rolls* and by Lords Toulson and Hodge in *Bilta* conflates questions of duty, attribution and illegality, which should properly be kept separate.

Illegality and the Defendant's Duty

It is submitted that the availability of the illegality defence should not (and does not) turn on whether the defendant owed a duty to the claimant or on the scope of that duty. Indeed, as Lord Sumption said in a lecture to the Chancery Bar Association in 2012: "*In every case, the position is or must be assumed to be that but for the illegality defence, the Claimant's loss will be recoverable as flowing from the Defendant's breach of duty.*"⁹

The ultimate availability of the illegality defence therefore depends on something other than the defendant's duty. This may be illustrated by the different outcomes in two cases involving the same duty of care. In *Delaney v Pickett*, the claimant was injured as a result of the defendant's negligent driving while transporting a substantial amount of cannabis. The judge found that "*they were acting in concert in a joint enterprise for illegal purposes.*"¹⁰ The defendant was nevertheless *unable* to raise the illegality defence to defeat the claim because, as Ward LJ explained, "*the damage suffered by the claimant was not caused by his or their criminal activity. It was caused by the tortious act of the first defendant in the negligent way in which he drove his motor car.*"¹¹

⁶ [1994] 1 AC 340.

⁷ *Stone & Rolls*, at [67].

⁸ *Bilta*, at [129].

⁹ Lord Sumption, "*Reflexions on the Law of Illegality*", 23 April 2012.

¹⁰ [2011] EWCA Civ 1532, at [61].

¹¹ *Ibid.*, at [37].

In *Joyce v O'Brien*, by contrast, the defendant was able to rely on the illegality defence. There, the claimant was injured when he fell from a van being driven dangerously by the defendant. The two were engaged in a joint criminal enterprise at the time of the accident, namely theft of a ladder. The Court of Appeal held that “*although the damage may not have occurred but for the negligent driving of the first defendant, it was caused by the criminal activity in which the claimant was engaged.*”¹² As Elias LJ said, “*the rationale for denying liability must... be cast in terms of causation rather than duty.*”¹³

Somewhat confusingly, Elias LJ added that, in his view, “*the injury will be caused by... the criminal activity of the claimant where the joint criminal illegality affects the standard of care which the claimant is reasonably entitled to expect from his partner in crime.*”¹⁴ With respect, it is difficult to accept that the defendant’s duty to drive carefully was somehow reduced with respect to the claimant by virtue of their joint criminal enterprise; the better view is that the defendant’s duty of care remained the same, but the claimant was simply unable to enforce that duty in the courts because his injuries were caused by his own unlawful conduct.

Illegality and Attribution

Similarly, the availability of the illegality defence is not determined by the principles of attribution. It is true that there will be many cases in which the illegality defence fails as a result of those principles being applied; but they will turn on ordinary principles of attribution rather than the illegality defence *per se*.

Bilta is an example of this sort of case. There, a company’s directors argued that knowledge of a fraud should be attributed to the company, just as Mr. Stojevic’s knowledge was attributed in *Stone & Rolls*. The crucial difference in *Bilta* was that the directors were attempting to attribute *their own* knowledge of wrongdoing to the company to defeat a claim by the company against them. The company was therefore able to rely on the so-called *Hampshire Land* exception to the normal principles of attribution and its claim was allowed to continue.¹⁵

Correctly analysed, therefore, *Bilta* was, as Lord Sumption said, “*a case about attribution.*”¹⁶ The court was not required to consider the operation of the illegality defence *per se* because the company was not burdened with knowledge that would have made its actions unlawful in the first place.

The Illegality Defence Itself

I have argued that the availability of the illegality defence *per se* is not determined either by the scope of the defendant’s duty or by the principles of attribution. It is therefore necessary to identify (insofar as it is possible to do so within the limited confines of this essay) the principles which do determine its availability.

In *Gray v Thames Trains*, Lord Hoffmann said that there were two forms of the illegality defence; a ‘narrow form’ and a ‘wider form’. The ‘narrow form’ of the defence is uncontroversial. It applies where the claimant seeks compensation from the defendant in respect of some fine, penalty or other sanction which was imposed by law.

¹² [2013] EWCA Civ 546, at [47].

¹³ *Ibid.*, at [28].

¹⁴ *Ibid.*

¹⁵ *In re Hampshire Land* [1896] 2 Ch 743.

¹⁶ *Bilta*, at [105].

As Lord Hoffmann said: “*it is the law which, as a matter of penal policy, causes the damage and it would be inconsistent with the law to require you to be compensated for that damage.*”¹⁷

The ‘wider form’ of the defence, which applies where the claim relates to the consequences of criminality, is more difficult. According to Lord Hoffmann:

*“It differs from the narrower version in at least two respects: first, it cannot, as it seems to me, be justified on the grounds of inconsistency in the same way as the narrower rule... Secondly, the wider rule may raise problems of causation which cannot arise in connection with the narrower rule.”*¹⁸

In *Gray*, the claimant experienced a personality change after witnessing a train accident caused by the defendant’s negligence. When he later committed manslaughter, he attempted to sue the defendant for his loss of liberty and earnings whilst in prison as well as for his feelings of guilt and remorse. The claim for loss of liberty and earnings was defeated by the ‘narrow form’ of the illegality defence, while the ‘wider form’ precluded the claim for guilt and remorse.

In considering whether the ‘wider form’ of the defence should apply in any given case, the courts usually adopt the sort of test set out by Lord Sumption (with whom Lords Neuberger and Clarke agreed) in *Apotex*, which was as follows:¹⁹

- (i) What acts constitute turpitude for the purpose of the defence?
- (ii) What relationship must the turpitude have to the claim?
- (iii) On what principles should the turpitude of an agent be attributed to his principal, especially when the principal is a corporation?

As explained above, the third of these questions concerns principles of attribution as they would apply in any other context. It is with the first two questions, therefore, that the availability of the illegality defence in its ‘wider form’ is properly determined.

The first question is usually straightforward. As Lord Sumption said in *Apotex*, turpitude “*means criminal acts, and... quasi-criminal acts. This is because only acts in these categories engage the public interest which is the foundation of the illegality defence.*”²⁰

Not all criminal or quasi-criminal acts will constitute ‘turpitude’ for the purposes of the illegality defence. In *Joyce*, for example, Elias LJ thought that the doctrine would not apply to “*minor traffic offences*”.²¹ Similarly, the Supreme Court held in *Apotex* that the manufacture and supply of a product in breach of a Canadian patent did not constitute turpitude such as to engage the illegality defence.²²

¹⁷ *Gray*, at [29].

¹⁸ *Ibid.*, at [51].

¹⁹ *Apotex*, at [22].

²⁰ *Ibid.*, at [28].

²¹ *Joyce*, above, at [51].

²² *Apotex*, at [34].

The second of the ‘wider form’ questions is more difficult. In practice, the courts usually apply some form of causation test to determine whether the relationship between the turpitude and the claim is such that the illegality defence should be available to the defendant. This causal test has taken different forms, from the procedural ‘reliance’ test applied by Lord Goff in *Tinsley* to the more substantive approach taken by Elias LJ in *Joyce*.

In my view, the ‘reliance’ test as formulated in *Tinsley* (i.e. the illegality defence will not apply if the claimant can plead their claim without relying on the turpitude) is too narrow because it ignores the reality of the claimant’s wrongful acts and their connection with the claim at hand. As Lord Sumption has said: “*The mere fact that the claimant can formulate his claim without relying on his own illegal act, does not mean that his claim is not founded on it... On any view, Miss Milligan’s claim to an interest in the property depended on the dishonest deal that she had made with Miss Tinsley. Its dishonesty consisted in the purpose for which it was made, notwithstanding that that purpose was not apparent from the actual terms of the deal.*”²³

In this respect, a more substantive approach is preferable to the ‘reliance’ test applied in *Tinsley*. This may sometimes lead to harsh decisions, particularly where the defendant effectively receives a windfall when an otherwise valid claim is defeated. It has long been recognised that the illegality defence may produce such results. In *Holman v Johnson*, Lord Mansfield CJ provided the following justification for the defence:

*“The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant...; but it is founded in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may so say. The principle of public policy is this... No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act.”*²⁴

In most cases, however, it is not the illegality defence itself which brings about apparent injustice, but rather the consequences of its application. According to Lord Sumption, “*English law does not regulate those consequences, but simply throws up its hands and leave the loss to lie where it falls.*”²⁵

A (Judicial) Way through the Woods?

In the same lecture, Lord Sumption said that he regretted the Law Commission’s ultimate retreat from its original proposal to introduce a judicial discretion as to the consequences of the illegality defence. Since the Law Commission’s project is now finished, and the Government has rejected even its more limited proposals, it is probably safe to assume that, for the time being at least, legislative reform is not on the cards.

For my part, although introduction of a full judicial discretion may be beyond the proper constitutional boundaries of the courts, they should not be afraid to limit the effect of the illegality defence where the defendant has been unjustly enriched at the claimant’s expense and where both were involved in the relevant wrongdoing. Such an approach would be consistent with Lord Mansfield’s justification for the defence. It may surely be argued that, by refusing to reverse the defendant’s enrichment in circumstances where it permits that party to raise and rely on the illegality defence, the court is in reality allowing (even assisting) the defendant to profit from their own wrongdoing.

²³ Chancery Bar Association lecture.

²⁴ (1775) 1 Cowp 341, at 343.

²⁵ Chancery Bar Association lecture.

Conclusion

Cases in which the illegality defence is raised almost always involve difficult questions of duty, attribution and causation. I have sought to argue that some clarity will be brought to this area if the courts recognise and then endeavour to apply a consistent, principled approach to these distinct issues.

Stone & Rolls is a case in point. There, the company was the claimant because *the law on duty of care* does not currently allow creditors their own right of action against auditors. The company was then endowed with Mr. Stojevic's knowledge because, as a result of *the law on attribution*, the *Hampshire Land* rule did not apply. The company was therefore seeking compensation for the consequences of its own fraud; which constitutes a straightforward application of the illegality defence in its 'wider form'.

It is of course a matter for the law on duty of care as to whether auditors should owe a duty to a company's creditors. Similarly, it is a matter for the law on attribution as to whether the knowledge of directors should be imputed to a company. Merging these issues with the availability of the illegality defence *per se* yields only complexity and anomaly.

In determining whether the illegality defence should be available in any given case, the court should focus on, first, the nature and seriousness of wrongdoing involved and, second, the required link between that wrongdoing and the claim. If the court finds that the illegality defence may be raised, the court may nonetheless mitigate the consequences of its application so that, as far as it is possible to do so, neither of the parties will profit from their own wrongdoing. This would go some way to ameliorating the harshest effects of the illegality defence without undermining either its consistency or the public policy on which it is based.

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