Patel v Mirza: A Tale of Insider Trading and Illegality in the Supreme Court

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I. Introduction

SALMAN MIRZA RECEIVED £620,000 from Chantrakant Patel to bet on the share prices of the Royal Bank of Scotland (RBS), based on insider information, known to the former. The parties anticipated a government announcement that would affect the price of RBS shares, but the announcement was never made and the bet was never placed. Mr Mirza then refused to repay the funds transferred by Patel.

Mr Patel sought to recover the £620,000 in a claim for unjust enrichment for failure of consideration. The High Court dismissed Mr Patel's claim on the ground that the court should not aid a claimant seeking to rely on illegal activity.[1] The agreement between the parties was illegal because it amounted to a conspiracy to commit the offence of insider dealing under section 52 of the *Criminal Justice Act 1993*. On appeal, the Court of Appeal found for Mr Patel, and ordered repayment of the sums.[2]

In the Supreme Court, a nine-Justice panel had to decide whether Mr Mirza was required to repay the sums and, if so, on what grounds. The Justices of the Supreme Court unanimously agreed that Mr Patel was entitled to repayment of the amount he had paid to Mr Mirza, but were sharply divided in their approaches to the issue. The difference in approach is significant not only because of the differing views advanced by their Lordships on the defence of illegality, but, at a lower level of abstraction, about the role of the courts in civil disputes.

The discussion follows in three parts. In the first part, the doctrine of illegality as a defence or a bar to relief is set out and its operation in *Patel v Mirza* is addressed.

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1. *Patel v Mirza* [2013] EWHC 1892 (Ch).
2. *Patel v Mirza* [2014] EWCA Civ 1047.

In the second and third parts, the different approaches of the Supreme Court are considered in detail. In the fourth part, the schisms underlying the different approaches in the judgments in *Patel v Mirza* are explored.

II. The Issue of Illegality

The defence of illegality has been the subject of judicial discussion in a number of recent judgments and in *Patel v Mirza,* the Supreme Court took the opportunity to reform the doctrine.[3]

The traditional illegality defence was governed by two Latin maxims to which there were two principal exceptions. The two maxims were: *ex turpi causa non oritur actio* (no action can arise from a base cause) and *in pari delicto potior est conditio defendentis* (in the case of mutual fault, the position of the defendant is the stronger one).[4] The two exceptions to these maxims were the rule in *Tinsley v Milligan*[5] and *locus poenitentiae*. Under *Tinsley v Milligan,* a claim would succeed if it could be pleaded without reliance on the illegal conduct. Under *locus poenitentiae*, the claimant could succeed if they voluntarily withdrew from the illegal transaction.[6]

Within which of these principles or exceptions was Mr Patel's claim to be analysed? Were these principles and rules satisfactory? All nine Justices of the Supreme Court eschewed a broad conception of *ex turpi causa* and agreed that illegal conduct should not, on its own, preclude a claimant from seeking relief from the courts.

However, the Justices of the Supreme Court adopted sharply different approaches to these questions. Their judgments, discussed below, can be thought of as espousing two different approaches. The first can be thought of as the discretionary 'balancing approach', put forward by the majority (Lord Toulson SCJ, supported by Lords Kerr, Wilson and Hodge SCJJ and Lady Hale DPSC) and the second 'rules-based approach' of the minority (advanced by Lord Neuberger PSC and Lords Clarke, Mance and Sumption SCJJ). The majority sought to achieve a narrower application of the defence of illegality by balancing the policy considerations that arise in a given case. By contrast, the minority preferred a rules-based approach to achieve the same result.

III. The Balancing Approach

The majority judgment, delivered by Lord Toulson, provides a new test for illegality that is predicated on balancing the competing considerations in a given

[3] *Hounga v Allen* [2014] 1 WLR 2889; *Les Laboratoires Servier v Apotex Inc* [2015] AC 430 and *Bilta (UK) Ltd v Nazir (No 2)* [2016] AC 1.

[4] *Holman v Johnson* (1775) 1 Cowp 341.

[5] *Tinsley v Milligan* [1994] 1 AC 340.

[6] *Tribe v Tribe* [1996] Ch 107.

case. The majority rejected the two maxims (*ex turpi causa* and *in pari delicto*) and provided a new test for the application of the defence of illegality.

Lord Toulson's judgment is a detailed treatment of the authorities on illegality. The judgment places much emphasis on the policy rationales for the maxims: (i) that no person should be allowed to benefit from his own wrongdoing, and (ii) that the law should be coherent and must not condone illegality by 'giving with the left hand what it takes with the right hand.'[7]

The new test advanced by Lord Toulson adopts a holistic approach to the issue of illegality and is aimed at directing the court to reach the best result in terms of policy, in any given case. Approving Professor Burrows's 'range-of-factors' approach, Lord Toulson set out a 'trio of considerations' that a court must consider in order to judge whether recognising a claim tainted by illegality might be contrary to the public interest.[8]

The court must take into account:

(i) the underlying purpose of the rule which has been broken by the claimant's illegal conduct;
(ii) other relevant public policies that might be rendered ineffective or less effective by the court's denial of the claim; and
(iii) the possibility of 'overkill' unless the law is applied with a proper sense of proportionality.

Lord Toulson concluded that a claimant who is able to satisfy the requirements of a claim in unjust enrichment for failure of consideration should not, in general, be barred from recovery merely because the consideration was unlawful.[9] Applying the trio of considerations to Mr Patel's claim, Lord Toulson allowed the claim, reasoning that it would not undermine the integrity of the legal system.

A. To balance or not to balance?

The flexibility that this approach affords is attractive and Lord Toulson considered that safeguarding the integrity and harmony of the law required this level of flexibility, despite it often being criticised for bringing with it the risk of unpredictability and uncertainty.[10] His Lordship advanced three responses to such criticism.[11]

Firstly, he noted that the present state of the law, which was rule-based, was just as prone to criticisms of uncertainty. In particular, his Lordship drew attention

[7] *Patel v Mirza* [2016] UKSC 42 [99]. See also: *Hall v Hebert* [1993] 2 SCR 159, 169 (McLachlin J).
[8] *Patel v Mirza* [2016] UKSC 42 [101].
[9] *Patel v Mirza* [2016] UKSC 42 [116].
[10] *Patel v Mirza* [2016] UKSC 42 [108].
[11] *Patel v Mirza* [2016] UKSC 42 [113].

to the criticism that *Tinsley v Milligan* had received and noted the Law Commission's four-fold criticism of this area of law: that it was complex, uncertain, arbitrary and lacked transparency.[12]

Secondly, Lord Toulson noted that it was not evident that a problem of uncertainty or unpredictability existed in jurisdictions where a more flexible approach had been adopted. Yet, this was not persuasive for Lord Mance, who considered the reliance placed on other jurisdictions to be unsatisfactory and highlighted that the court had no information on the effectiveness of approaches adopted in jurisdictions like New Zealand and Australia.[13]

Thirdly, Lord Toulson argued, while ordinary citizens who engage in lawful activity have an entitlement to legal certainty, that consideration applied with less vigour to persons engaged in illegal activity.[14] Lord Neuberger, however, questioned the premise of this argument and concluded instead that the entitlement to certainty was universal and not lost by one's engagement in illegal activity. At any rate, his Lordship noted that the rights of third parties may be at stake and their entitlement to legal certainty should not be undermined because of the claimant's engagement in illegal conduct.[15]

Lord Toulson's approach, premised on the view that the illegality defence is based on public policy concerns, seeks to address those public policy concerns by requiring the court to explicitly engage with those considerations in each case. It is an approach that inherently requires balancing.

Engaging in such an exercise will often require the court to make a policy judgment, if not a moral one. What of the argument that such an exercise would be more appropriate to be left for Parliament to undertake and that legislative reform ought to be vehicle for the sort of change proposed by Lord Toulson?[16] Lord Toulson rightly rejected that argument noting that the Law Commission had already produced detailed proposals for reform in this area and suggested that the government may have more pressing priorities for reform. He reiterated Kirby J's view in *Clayton*: 'waiting for a modern Parliament to grapple with issues of law reform is like waiting for the Greek Kalends. It will not happen.'[17]

IV. Rule-Based Approaches

Lord Neuberger and Lords Mance, Clarke, and Sumption adopted rules-

[12] *Patel v Mirza* [2016] UKSC 42 [20] and [23].
[13] *Patel v Mirza* [2016] UKSC 42 [207].
[14] *Patel v Mirza* [2016] UKSC 42 [137].
[15] *Patel v Mirza* [2016] UKSC 42 [158] (Lord Neuberger).
[16] *Tinsley v Milligan* [1994] 1 AC 340, 364D (Lord Goff).
[17] *Clayton v The Queen* (2006) 231 ALR 500 [119] (Kirby J); *Patel v Mirza* [2016] UKSC 42 [114].

based approaches to the defence of illegality. However, their approaches are not homogeneous and each followed a distinct route in their reasoning and formulated their rules in very different ways.

Given the relative similarities in the approaches of Lords Neuberger and Mance, their judgments are explored together in the following. Lord Sumption's judgment, which adopts somewhat different reasoning, is then explored.

A. 'The Rule'

(i) Illegal Conduct – A Preliminary Point

Before turning to Lord Neuberger's substantive approach, it is worth noting that his Lordship construed the meaning of 'illegal conduct' narrowly and explained that an illegal contract would normally be an agreement the whole purpose or essential ingredient of which was the commission of a crime, or one that could not be performed without the commission of a crime.[18]

This is a narrower definition of illegality compared to the suggestions made in earlier case law. In *Nayyar v Denton Wilde,* Hamblen J considered illegality to include immoral acts and 'improper conduct evincing serious moral turpitude'.[19] Similarly in *Safeway Stores,* Flaux J suggested illegal conduct could include 'morally reprehensible' conduct.[20] The approaches taken by Flaux and Hamblen JJ are arguably over-inclusive in their focus on the moral value of the conduct in question rather than its criminal character. There must be some legal sanction upon the conduct for the law to appear inconsistent and incoherent if it were to allow a claim in the civil courts based on such conduct.

Furthermore, whilst a broader approach may have been appropriate under the old regime, which was premised on 'base' causes and 'penitence', Lord Neuberger's approach is consistent with the objective of narrowing the application of the defence of illegality supported by all nine Justices of the Supreme Court. A narrower approach to illegal conduct, furthermore, avoids the court having to undertake an exercise in moral evaluation. Reasonable minds can invariably disagree on what constitutes 'morally reprehensible' conduct.

On the other hand, there is the concern that a claimant whose conduct is strictly not within the remit of the criminal law, due to a technicality rather than the particular nature of his/her conduct, may be able to escape the application of

[18] *Patel v Mirza* [2016] UKSC 42 [159].

[19] *Nayyar v Denton Wilde Sapte* [2009] EWHC 3218 (QB) [92] (Hamblen J).

[20] *Safeway Stores v Twigger* [2010] EWHC 11 (Comm) [26].

the *ex turpi causa* rule. Further, under Lord Neuberger's approach conduct that is unlawful as a matter of civil law – breach of trust, for example – may not come within the definition of illegality. This may be an area where courts could widen the definition of 'illegal conduct' to include unlawful conduct, more generally, rather than being limited to criminal conduct.

(ii) The Substance of 'the Rule'

In any event, once the presence of illegal conduct has been established, Lord Neuberger considered that the courts should ask whether it should operate as a bar to relief. The starting point in his Lordship's analysis is 'the Rule' that, in general, the claimant should be entitled to the return of the monies paid. His Lordship supported this rule by reference to a long line of case law, from *Smith v Bromley* to *Tribe v Tribe*.[21]

Lord Neuberger further noted the desirability of 'the Rule' in public policy terms because it ensures that the law does not inadvertently legitimise the illegal transaction in putting the parties back in their original positions.[22] For example, in a case like *Parkinson* – where the claimant donated a large sum of money to the defendant charity under an unlawful agreement to receive a knighthood in return – not letting the claimant recover the sums he had paid meant that the defendant was legitimately entitled to keep the sums paid.[23] That cloaked the illegal transaction with legitimacy it did not deserve.

Nonetheless, Lord Neuberger was reluctant to endorse a 'clear and inflexible' rule as he considered that would inevitably lead to difficulties in application. Lord Neuberger recognised that there will be exceptions to the Rule. If the defendant is intended to be protected by the criminal legislation that was breached, it would not be appropriate to apply the Rule inflexibly to that instance. Similarly, if the defendant was unaware of the illegality of the conduct as a matter of fact, then it would not be fair to require him to return the sums especially if he or she had altered his position. In these cases, his Lordship considered that the Rule should not be automatically invoked.

(iii) 'The Rule' and locus poenitentiae

The exception of *locus poenitentiae* provides that a claimant who repents his illegal conduct and voluntarily withdraws from the transaction should be able to

21 *Patel v Mirza* [2016] UKSC 42 [145]–[152], *Smith v Bromley* (1702) 2 Doug KB 696n; *Tribe v Tribe* [1996] Ch 107.

22 *Patel v Mirza* [2016] UKSC 42 [153]–[154].

23 *Parkinson v College of Ambulance Ltd* [1925] 2 KB 1

succeed in his/her action.[24] Lord Neuberger argued, however, that 'repentance' should not be a requirement for recovery.[25] Instead, his Lordship contended that the court ought to engage in an objective analysis of the illegal purpose and whether it had been carried out, rather than in moralistic enquiries as to whether the claimant repents his unlawful conduct.

Lord Mance, whose approach is similar to Lord Neurberger's in many ways, stressed that Lord Toulson's approach did not allow for sufficient consideration of *locus poenitentiae*. His Lordship considered that the principle had been expressed in older cases such as *Smith v Bromley* to include an incomplete illegal transaction, not only one from which a party withdrew.[26]

Whether this is desirable as a matter of public policy is questionable. The rule on *locus poenitentiae* before *Tinsley v Milligan* was firmly grounded in repentance and not in whether the parties had managed to fulfil their illegal transaction. There is a policy justification for the law coming to the aid of a repentant claimant, but it is by no means obvious that one who was merely unsuccessful in his or her illegal venture should have a legitimate cause of action.

(iv) 'The Rule' and the 'Range-of-Factors'

Despite their relative similarities, Lords Neuberger and Mance had very different views about the value of the 'range-of-factors' approach.

Although analytically very different to Lord Toulson's approach, Lord Neuberger's proposed application of the Rule overlaps in some respects with the former, because it envisages that flexibility will be required in some cases and that each case should be decided on its particular facts. The underlying premise of Lord Neuberger's approach is that rigid rules are not appropriate in this context. Further, his Lordship highlighted that despite initial misgivings, he had concluded that Lord Toulson's approach provided a 'reliable and helpful guidance' of the considerations that a court should grapple with in these types of cases.[27]

In sharp contrast, Lord Mance all but rejected Lord Toulson's approach. His Lordship considered that the latter's approach required judges to make a value judgment in a 'highly unspecific non-legal sense' and by reference to 'a mélange of ingredients'. Lord Mance's analysis, on the other hand, follows from his view that the law on illegality did not require wholesale reform to achieve a just result in this

[24] *Tribe v Tribe* [1996] Ch 107.

[25] *Patel v Mirza* [2016] UKSC 42 [156].

[26] *Patel v Mirza* [2016] UKSC 42 [193]–[194]; *Smith v Bromley* (1760) 2 Doug KB 696n, 697 (Lord Mansfield CJ).

[27] *Patel v Mirza* [2016] UKSC 42 [174]–[175].

case.[28] His Lordship argued for a limited approach which 'focussed on the need to avoid inconsistency in the law, without depriving claimants of the opportunity to obtain damages for wrongs or to put themselves in the position in which they should have been.' That, for Lord Mance, did not require adopting the 'range-of-factors' approach which he considered to be open-ended and uncertain.[29]

Lord Neuberger's approach then can be characterised as occupying a middle ground between the approaches of Lords Toulson and Mance and the other Justices of the Supreme Court.

B. 'Founded on an Illegal Act'

In a similar vein to Lords Neuberger and Mance, Lord Sumption (with whom Lord Clarke agreed) argued for an approach based on rules rather than balancing a range of factors. The crux of the issue, for his Lordship, was whether the claim was '*founded* on an illegal act.'[30] In other words, Lord Sumption argued that the court needed to consider how closely connected to the illegal conduct the claim is in a given case, thus endorsing the reliance principle. He considered that the reliance test provided the narrowest test of connection available.[31] Therefore, Lord Sumption concluded, with the exception of *in pari delicto* and *locus poenitentiae*, a claim founded on an illegal act – in the sense that the claimant will need to rely on his/her illegal conduct to establish the claim – should not be allowed to succeed.

Lord Sumption considered that the defence of illegality defence should remain as narrow as possible because it represents a departure from the principle that the courts should provide remedies in support of legal rights. That view is reminiscent of McLaghlin J's judgment in the Canadian case of *Hall v Hebert*, in its description of *ex turpi causa* as a draconian power.[32]

The 'range-of-factors' approach, in his Lordship's view, broadened the scope of the defence to an unacceptable extent as it does not require any connection between the illegality and the claim. Lord Sumption, like Lord Mance, considered that approach to be unprincipled because it was designed not to vindicate the public interest as against the legal interests or rights of the parties, but to evaluate the moral equities between them. His Lordship objected to the nature of the balancing exercise which would involve the judge attaching as much or as little weight to a particular consideration, or to the illegality of the conduct, as they considered appropriate.

[28] *Patel v Mirza* [2016] UKSC 42 [192], [204].
[29] *Patel v Mirza* [2016] UKSC 42 [192].
[30] *Patel v Mirza* [2016] UKSC 42 [233], [239].
[31] *Patel v Mirza* [2016] UKSC 42 [239].
[32] *Hall v Hebert* [1993] 2 SCR 159, 169 (Canada).

V. The Underlying Schisms

Lord Sumption described the differences in approach between the rule-based and range-of-factors as a 'judicial schism'. That schism appears to be only the tip of the iceberg. Underlying that schism were two others: (i) whether fairness or certainty should be the primary consideration for the court, and (ii) what the role of the courts is in the adjudication of civil disputes.

(i) Fairness and Certainty

For Lord Toulson, it was imperative that the approach adopted not result in unjust or disproportionate outcomes.[33] It would appear then that a paramount concern for Lord Toulson was achieving an equitable result on the facts in each case before the court. Lord Sumption, by contrast, accepted that the equities of a particular case were important but held that they should be subject to pragmatic limits. A more important consideration for Lord Sumption was ensuring the certainty of the law, so that it did not become 'arbitrary, incoherent, and unpredictable even to the best advised citizen.'[34]

To some extent, a tension between fairness and certainty inheres in every civil dispute and, in some respects, it is a zero-sum game. A bright-line rule promotes certainty but (at least) at the potential cost of fairness in individual cases. Rules typically prescribe results in a somewhat rigid manner based on the presence or absence of particular factors. However, they can rarely take into account those considerations that were not in play (for example, on the facts of a particular case) when the rule was formulated. Further, in the context of illegality, these considerations arise in a nuanced manner because they need to be balanced against the general public policy concern of discouraging individuals from entering into illegal transactions. To that end, Lord Toulson is right to hold that, in general, certainty is not an entitlement for those who have engaged in illegal conduct. Equally, that position may be departed from where the rights of third parties are involved, as Lord Neuberger indicated. The flexible approach endorsed by Lord Toulson allows for that outcome.

[33] *Patel v Mirza* [2016] UKSC 42 [101], [120].
[34] *Patel v Mirza* [2016] UKSC 42 [226].

(ii) The Role of Courts

On the role of courts in civil adjudication, Lord Sumption stated that the 'starting point is that the courts exist to provide remedies in support of legal rights.'[35] Under Lord Toulson's approach, on the other hand, the courts ought primarily to be concerned with upholding the integrity and harmony of the law.

At the lowest level of abstraction, this difference in approach reveals a disagreement about the function of civil courts. Are the courts primarily charged with the vindication of the private law rights of individuals or is their function to promote integrity and harmony in the law more generally? In particular, which of these functions should take precedence in the context of illegality?

The vindication of private law rights can be thought of as a narrow conception of the judicial function in civil disputes because the court is concerned only with the entitlement of the parties rather than necessarily reaching a just outcome on the facts. In other words, justice is regarded as simply being able to vindicate one's rights. Lords Sumption and Mance, and to some extent Lord Neuberger, appear to support that view.

A wider conception of the judicial function, by contrast, permits the court to look beyond the strict legal rights and entitlements of the parties. This may well require looking to the factors that Lord Toulson identified in his judgment. With the greatest respect, the narrower conception of the judicial function also assumes to some extent that rights of the parties are settled and the court merely needs to enforce them. In these cases, the court is also necessarily deciding the scope of an individual's rights.

Further, the wider conception can explain why, in some cases, courts do not recognise certain rights and, to that end, is transparent about the considerations that a judge takes into account in deciding a case like *Patel v Mirza*. Furthermore, where public policy concerns are engaged, as in the context of illegality, it is difficult to formulate rules about the rights to which the parties are *prima facie* entitled to without looking to such factors.

Constraints of space preclude a detailed analysis of this topic. It is sufficient to note, for present purposes, that *Patel v Mirza* and the defence of illegality throws into sharp relief a fundamental disagreement about what role the courts play, or should play, in civil adjudication.

[35] *Patel v Mirza* [2016] UKSC 42 [233].

VI. Conclusion

Patel v Mirza is one of those unusual cases where the judges agree on what the just outcome is on the facts but adopt very different routes to reach that result. Of the nine-Justice panel, six delivered their own judgments advancing different solutions. All nine Justices agreed that the defence of illegality should apply more narrowly and that *ex turpi causa* is no longer the starting-point where a claim involves illegal conduct.

Finally, it merits noting that Lord Toulson's 'range-of-factors' approach, which was supported by a majority of the judges, is not necessarily limited to the context of unjust enrichment. As Lord Kerr emphasised:

> '[this] mode of analysis requires examination of the justification for the defence of illegality in whatever context it arises, not a decision to circumvent the defence because of the type of remedy that is claimed.'[36]

Patel v Mirza is likely to have ramifications which go further than the law on unjust enrichment.[37] In any event, the case merits careful attention not only for its rich and nuanced discussion on illegality but also for the valuable insight it provides into the underlying debates about the fairness and certainty and the role of courts in civil disputes.

36 *Patel v Mirza* [2016] UKSC 42 [142] (Lord Kerr).

37 Goudkamp, 'The end of an era? Illegality in private law in the Supreme Court' (2017) 133 LQR 14.