Illegality and contracts
State of the law in Singapore

“As any hapless law student attempting to grapple with the concept of illegality knows, it is almost impossible to ascertain or articulate principled rules from the authorities relating to the recovery of money or other assets paid or transferred under illegal contracts.” Lady Justice Gloster in Patel v Mirza [2014] EWCA Civ 1047.

After the recent Singapore Court of Appeal decision in Ochroid Trading Ltd v Chua Siok Lui (trading as VIE Import & Export) [2018] SGCA 5 hapless law students (and practising lawyers) can now sleep easy. The decision has helpfully clarified and restated the doctrine of illegality under Singapore law. It also took the opportunity to consider the UK Supreme Court decision in Patel v Mirza [2016] UKSC 42 which established a new (and controversial) approach to the question of whether a defendant will be able to rely on the defence of illegality.

UK position before Patel

The leading House of Lords decision before Patel was Tinsley v Milligan [1994] 1 AC 340. Tinsley and Milligan were living together. They both contributed to the purchase price of a house which was held in the sole name of Tinsley. The purpose of this was to allow Milligan to continue making fraudulent social security claims. The relationship between the two soured and Milligan sued for a beneficial interest in the property. As Milligan had contributed to the purchase price, there was an equitable presumption that Tinsley held the house on resulting trust for both parties. With the benefit of the presumption, Milligan did not need to rely on evidence of her illegal motive and her claim succeeded. This became known as the “reliance principle”.

The reliance principle was criticised by academics, judges and in various Law Commission Reports. The main criticism was the arbitrariness of the rule. If Tinsley and Milligan had been husband and wife, there would have been no presumption of trust (an equitable presumption of advancement would have arisen in its place); the burden of proof would have been reversed; and Milligan’s claim would have failed because she would have needed to rely on the evidence of her illegal motive in contributing to the purchase price of the house.

Contents

UK position before Patel… 1
Patel v Mirza............... 2
The Singapore roadmap... 2
What happened in Ochroid Trading?............... 4
Summary and key takeaways............... 6
Appendix...................... 7
**Patel v Mirza**

Mirza told Patel that Mirza would be obtaining inside information about an impending government announcement which would affect RBS’ share price. Patel transferred £620,000 to Mirza to bet on the price of RBS shares, contrary to section 52, Criminal Justice Act (dealing in securities on the basis of inside information). Mirza did not obtain the inside information and the illegal purpose was not carried out. Patel requested his money back. Mirza, with much obfuscation, failed to pay the sum. Patel sued for recovery. Mirza relied on the defence of illegality.

The nine-member UK Supreme Court held that Patel could recover his £620,000. However, the court took different approaches in arriving at its decision.

The majority rejected the reliance principle and took the position that the defence will apply if enforcing the claim would be harmful to the integrity of the legal system. In assessing whether that is the case, the court will undertake a balancing exercise and must consider:

- whether the underlying purpose of the law which has been broken will be enhanced by denying the claim;
- any other relevant public policy which may be affected by denying the claim; and
- whether denying the claim would be a proportionate response to the illegality. When considering the proportionality point, various factors would be relevant although the court would not lay down a prescriptive list. By way of example only, factors might 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.

The majority concluded that there was no reason why enforcement of Patel's claim might be regarded as undermining the integrity of the justice system. Therefore, his claim succeeded.

At the risk of oversimplification, the minority took the view that the law should permit a party to an illegal arrangement to recover any sum paid under it so long as restitution is possible. This is because an order for restitution simply returns the parties to the position in which they would and should have been, had no such illegal arrangement been made.

**The Singapore roadmap**

Just as the UK Supreme Court increased its usual panel size to consider Patel, the Court of Appeal convened a five-member panel instead of the usual three to decide Ochroid Trading. However, only one Judge of Appeal delivered the judgment of the court as the others were in agreement.

There is now a clear roadmap as to how we should approach the doctrine of illegality under Singapore law:
• The first question is whether the contract is prohibited either pursuant to a statute (expressly or impliedly (although the latter should not arise often)) or under an established head of common law public policy (for example, a contract to commit a crime, tort or fraud). If a contract is prohibited by statute or under common law, then there can be no recovery pursuant to the contract (subject to the limited exceptions below).

• Although the categories of illegality at common law are not closed, the court will not readily add new categories. The Singapore Court of Appeal in an earlier decision (*Ting Siew May v Boon Lay Choo* [2014] SGCA 28) recognised that contracts which are not unlawful per se but which nevertheless involved the commission of a legal wrong either in their formation, purpose or manner of performance was prohibited under common law. However, there is no general rule that these contracts, typically referred to as contracts tainted by illegality, would be automatically unenforceable. There might be legal wrongs which are relatively trivial and it would be disproportionate to render the contract unenforceable. Therefore, contracts tainted by illegality are subject to the principle of proportionality.

• In *Ting Siew May*, the parties backdated an option to purchase a property in order not to be subject to a new Monetary Authority of Singapore (“MAS”) notice on housing loans. The court held that to refuse the enforcement of the option was a proportionate response to the illegality, taking into account the following relevant factors in assessing proportionality:
  
  o The plaintiffs’ intent from the outset was to use the (false) date stated in the option for a purpose which they knew was prohibited.
  o The illegal act which the plaintiffs set out to commit was not trivial.
  o Allowing the plaintiffs’ claim would undermine the purpose of the MAS notice.
  o The plaintiffs’ illegal purpose was not too remote from the option, given that the stating of a false date in the option constituted an overt step taken in the contract itself in furtherance of this illegal purpose.
  o The consequences of denying the plaintiffs’ enforcement of the option would not be so great as to render it a disproportionate response to the illegality.

• If a contract is prohibited by statute or common law or in the case of a contract tainted by illegality, the consequences of denying enforcement would not be so great as to render it a disproportionate response to the illegality, the party who has transferred benefits pursuant to an illegal contract might still be able to recover those
benefits on a restitutionary basis (as opposed to recovery on a contractual damages basis). There are three possible avenues for such recovery:

- First, where the parties are not *in pari delicto*\(^1\) – which include the more specific categories of class protection statutes, situations where there has been fraud, duress or oppression, and cases where the plaintiff entered into the illegal transaction because of a mistake.

- Second, where the doctrine of *locus poenitentiae*\(^2\) applies because there has been timely repudiation or "repentance" by the plaintiff of the illegal contract. There must be genuine and voluntary withdrawal by the plaintiff from the illegal enterprise for the doctrine to apply, and that it would not apply in cases where the illegal purpose was frustrated by circumstances beyond the plaintiff's control or is simply no longer needed.

- Third, where the plaintiff brings an independent cause of action for the recovery of the benefits conferred under the illegal contract, namely:
  - A claim in unjust enrichment.
  - A claim in tort or the law of trusts based on the plaintiff's property or title.
  
  The availability of claims in unjust enrichment, tort or trusts is subject to the principle of "stultification". This means that the court has to determine whether to allow the claim would undermine or make nonsense of the fundamental policy that rendered the contract void and unenforceable in the first place.

**What happened in Ochroid Trading?**

The plaintiff advanced several sums to the defendant pursuant to several agreements (over 700). The plaintiff sued to recover the sums in contract (the principal amounts plus profit amounting to approximately S$10 million) and in unjust enrichment (the principal amounts (without profit) amounting to approximately S$9 million) in respect of approximately 70 agreements. The defendant relied on the defence of illegality in that the sums were loans and the plaintiff was not a licensed moneylender under the Moneylenders Act (Cap 188) ("MLA"). Please note that the court was concerned with the version of the MLA in force on 1 March 2007 and some of the relevant statutory provisions have been amended since then (although their substance remains unchanged).

The court applied the above roadmap and decided as follows.

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1. Literally meaning "in equal fault" so that the court will allow recovery for the party who is less at fault.
2. Literally meaning "place of repentance".
Claim in contract

After reviewing the facts and agreements, the court concluded that:

- the transactions were loans. The argument that the payments were investments in the defendant's business on a profit-sharing joint venture basis was rejected;

- the plaintiff was carrying on the business of moneylending. The court found that there was a system and continuity in the transactions because there was an organised system under which the amount required by the defendant for each month would be determined and repaid and there was continuity given that there were over 700 agreements in total pursuant to which more than S$58 million was disbursed over a course of over three years;

- the plaintiff was unlicensed under the MLA;

- the contract was prohibited and unenforceable under section 15 of the MLA (section 14(2)(a) in the latest iteration of the MLA).

As the contract was expressly prohibited by statute, the court did not have to apply the principle of proportionality and the plaintiff's claim in contract failed.

Claim on a restitutionary basis

On the facts, the first (in pari delicto) and second (locus poenitentiae) avenues of recovery on a restitutionary basis were not relevant. The court found that the requirements for the third avenue, unjust enrichment, were satisfied:

- The defendant had been enriched.

- The enrichment was at the plaintiff's expense.

- The enrichment was unjust as there was a total failure of consideration (i.e. the failure of the defendant to repay the loan amounts which was the promised counter-performance based on which the loans were disbursed).

The key question then was whether the defence of illegality applied to defeat the independent claim in unjust enrichment; i.e. whether to permit recovery of the principal sums lent would stultify or undermine the fundamental policy underlying the MLA and make a nonsense of the statutory prohibition which rendered the loan agreements unenforceable.

Identification of the fundamental policy

An examination of the legislative policy underpinning the MLA indicated that unlicensed moneylenders should be precluded from recovering any compensation whatsoever for their illegal loans. Permitting restitution of the principal sums lent would make a nonsense of this policy and render ineffectual the prohibition in section 15 of the MLA (now section 14(2)(a)), which reflects the strong need to deter illegal moneylending due to its status as a serious social menace in Singapore.
Therefore, the defence of illegality defeated the plaintiff’s claim in unjust enrichment.

Summary and key takeaways

- **Clear roadmap**: The Singapore Court of Appeal has come up with a clear and structured roadmap to deal with illegality and contracts. The roadmap, which we have set out in the Appendix, should make analysing the legal issues relating to illegality and contracts more straightforward.

- **Patel balancing exercise not applicable**: The balancing exercise involving a range of factors advocated in Patel does not represent the law in Singapore.

- **Limited role of proportionality**: One of the factors suggested in Patel is the principle of proportionality. This principle is relevant under Singapore law but only in the situation where we are dealing with a contract tainted by illegality. It does not apply if the contract is prohibited by statute or one of the established heads under common law. In a situation involving a contract tainted by illegality, if the illegality is trivial and it would be disproportionate to hold the contract to be unenforceable, there may still be recovery. As demonstrated in Ting Siew May, the application of the proportionality principle will be largely fact-centric.

- **Characterising and identifying substance of the contract**: If the facts of Patel occurred in Singapore, the outcome may well be different. Arguably the parties entered into a contract to commit a crime (insider dealing) which would have been prohibited under one of the established common law public policy heads. Therefore, a claim in contract would automatically fail. There would have been no scope to apply the proportionality principle. It is interesting that the Singapore Court of Appeal thought that while there was illegal conduct in Patel, the contract between Patel and Mirza was not a contract to commit a crime per se and therefore it was not automatically prohibited under an established head of common law public policy.

- **Identifying the fundamental public policy**: The court emphasised that the principle of stultification depended on identifying the fundamental policy that rendered the contract unenforceable in the first place. There could conceivably be situations where allowing a claim might undermine a policy which is not central to the prohibition of the contract in question. Applying the Singapore court’s approach to the claim in unjust enrichment in Patel, we submit that the claim would also arguably fail. To allow enforcement would stultify the fundamental public policy behind our insider dealing laws which we submit is to maintain the integrity of Singapore as an international financial centre.
Appendix

Contract prohibited by statute or common law public policy

Contract tainted by illegality

No recovery in contract

Is denying enforcement a disproportionate response to illegality

Recovery possible in contract

Claims on restitutionary basis

Unjust enrichment

Tort or trusts

Locus poenitentiae

Parties not in pari delicto

Subject to principle of stultification and identification of fundamental public policy
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This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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