

## THE EFFECT OF ILLEGALITY ON CONTRACTS: SINGAPORE MOVES APART FROM ENGLAND

When is a contract rendered unenforceable as a result of illegality? It is a question that goes to the heart of every commercial transaction and is a notoriously knotty problem. On one hand, the law has to deter contractual parties from engaging in illegal conduct; but on the other there is a need to avoid injustice where a party obtains an undeserved windfall from an unenforceable contract. The Supreme Court decision in *Patel v Mirza* [2016] UKSC 42 favoured the exercise of a discretionary decision by the court based on analysis of a range of factors to determine whether or not to allow the illegality defence. A recent case in Singapore confirmed that the English law approach is not to be followed and provided some clarity on the issue - as a matter of Singapore law, there is now a clear test for the application of the illegality defence.

### BACKGROUND

In the recent decision *Ochroid Trading Ltd v Chua Siok Lui* [2018] SGCA 5, the Singapore Court of Appeal dismissed a claim by an unlicensed moneylender for the return of SGD 10.25 million.

The appellant's claim arises out of a series of 76 agreements. Under these agreements, the appellant was to provide loans to the respondent for the purchase and resale of food products. The funds were to be repaid with a profit on a stipulated date. Each agreement was also supported by a tax invoice from the respondent stating the specifics of the goods which it related to. Both parties accepted that the agreements were not entirely proper - the supporting tax invoices were not genuine documents and did not reflect actual transactions.

The appellant's claim was founded on contract (for SGD 10.25 million including alleged profit) or, alternatively, in unjust enrichment (for the principal sum of SGD 8.9 million without the alleged profit).

The primary issue was whether the claim failed because the agreements were illegal moneylending contracts which are unenforceable under the Moneylenders Act (Cap 188, 1985 Rev Ed) (MLA). The alternative claim in unjust enrichment concerns the impact the illegality of a contract has on an independent claim of unjust enrichment.

### Key issues

- The Singapore Court of Appeal laid down a clear test for the application of the illegality defence.
- The "range of factors" approach in the landmark English court decision is not followed in Singapore.
- Contracts which are not unlawful per se but entered into with the object of committing an illegal act are not automatically unenforceable. The proportionality principle is applicable to assess their enforceability.
- The restitutionary recovery of benefits conferred under an illegal contract would, in principle, be available. The claim is, however, subject to the defence of illegality and public policy.

In determining the appeal, the Court of Appeal considered the applicability of the English authority *Patel v Mirza* [2016] UKSC 42 in Singapore, and decided to depart from the English law position.

## THE ENGLISH LAW POSITION

In the case of *Patel*, the parties entered into a contract under which the claimant paid the defendant money to speculate on shares, with the intention that the defendant should do so on the basis of insider information that the defendant expected to receive. However, no insider information was received and no shares were bought. The defendant failed to repay the money given to him by the claimant and advanced the defence of illegality, referring to the reliance principle (*Tinsley v Milligan* [1994] 1 AC 340) which provides that a claim could not be brought because it involved reliance on the claimant's own illegality.

The majority of the Supreme Court declined to follow the traditional reliance test. Instead, it was held that the deployment of illegality as a defence should be dependent upon a range of factors (the "range of factors" test), including the underlying purpose of the prohibition, public policies and proportionality.

As a result, it was concluded that a claimant who would otherwise satisfy the requirements for a claim for unjust enrichment will not prima facie be debarred from recovering money paid or property transferred by reason of the fact that the consideration which has failed was unlawful. Accordingly, the claimant was entitled to restitution.

While the Supreme Court's decision was welcomed as one achieving a just outcome, there has also been criticism of the uncertainty introduced by the new "range of factors" test.

## THE SINGAPORE DECISION

In *Ochroid Trading*, the Court of Appeal summarised the existing law of illegality (i.e. the two-stage approach) as applicable in Singapore:

- (1) The first stage of the inquiry is for the court to ascertain whether the contract is prohibited either under a statute or common law. If the contract is so prohibited, there can be no recovery pursuant to the illegal contract. However, for the general category of contracts which are not unlawful per se but entered into with the object of committing an illegal act, the proportionality principle laid down in *Ting Siew May v Boon Lay Choo and another* [2014] 3 SLR 609 ought to be applied to determine if the contract is enforceable.
- (2) At the second stage of the inquiry, the court is to ascertain whether, notwithstanding that there can be no recovery pursuant to the illegal contract, there might nevertheless be restitutionary recovery of benefits conferred thereunder. Under the existing law, there are at least three possible avenues for such restitutionary recovery:
  - (i) where the parties are not in *pari delicto* (i.e. where the plaintiff is less blameworthy than the defendant);
  - (ii) where a party to an illegal contract repents in time before the illegal purpose is effected; or
  - (iii) where the restitutionary recovery is premised on recovery through an independent cause of action.

In respect of the first stage of the inquiry, the Court of Appeal decided not to adopt the "range of factors" test in *Patel* to displace the traditional rule that no recovery is permitted under a prohibited contract. The Court of Appeal was of the view that *"to confer on the court a further discretion to permit recovery pursuant to the prohibited contract would render the doctrine of common law contractual illegality nugatory"*.

In the context of considering point (iii) under stage two of the inquiry, the Court of Appeal considered whether there can be an independent claim of unjust enrichment for recovery of benefits conferred under an illegal contract and the limit of such claim. The Court of Appeal concluded that the restitutionary recovery under an illegal contract would, in principle, be available where the ordinary requirements of a claim of unjust enrichment are made out. This is, however, subject to the defence of illegality and public policy.

Applying the above principles, the Court of Appeal found that the transactions in the present case, which were extortionate loans and never part of any bona fide commercial venture, fell within the mischief sought to be addressed by the MLA, and are thus unenforceable under s.15 of the MLA.

Turning to the second stage of the inquiry, the Court of Appeal considered that the ordinary requirements of the claim of unjust enrichment were satisfied; however, the defence of illegality operates to defeat the claim. It was held that to permit recovery of the principal would *"undermine the fundamental policy underlying the MLA and make a nonsense of the legislative prohibition which renders [the subject agreements] void and unenforceable in the first place"*.

## ANALYSIS

The principle of illegality is a controversial area of private law. There has been a long-standing schism between those who regard the law of illegality as calling for the application of clear rules, and those who would wish to address the equities of each case as it arises. As noted by Andrew Phang Boon Leong JA (who delivered the judgment of the Court of Appeal in *Ochroid Trading*), any attempt to settle this particular area of the law of contract is always going to be an uphill task. The issue is, however, crucial to the enforceability of contracts in a wide range of commercial transactions, for example, investors may claim that their investments were void because the relevant representatives did not hold the necessary licence, a buyer may seek the return of the money paid for goods which it turns out to be sold illegally, or a person's interest in a property may be disputed where it was transferred under a contract which breaches statutory requirements. The current position taken by the Singapore court has the benefit of achieving legal certainty. Parties to a transaction should be prepared to face the harsh consequence that their contract tainted by illegality is unlikely to be upheld.

While it would be prudent to consider whether a commercial transaction may fall foul of the MLA, one need not be overly concerned with the effect of such statute. As acknowledged by the first instance judge and confirmed by the Court of Appeal, it would be inappropriate to apply the MLA to commercial transactions between experienced business persons which did not *prima facie* have the characteristics of moneylending. The *Ochroid Trading* case is decided on its specific facts, where the parties had wilfully attempted to structure a transaction so as to evade the application of the MLA.

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