REVISITING THE ILLEGALITY DEFENCE

When will the ex turpi causa *doctrine shield conveyancing solicitors from liability for professional negligence?*

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The Illegality Defence: an Outline

The common law defence of illegality has a venerable history. Lord Mansfield CJ referred to it long ago in *Holman v Johnson* (1775) 1 Cowp 341, 343, by its Latin phrase *ex turpi causa non oritur actio* (no action arises from a disgraceful cause). But like many ancient legal doctrines, it has benefitted from a modern makeover.

Until the Supreme Court's decision in *Patel v Mirza* [2017] AC 467, the doctrine of illegality was understood normally to operate as a defence to a civil claim only where the claimant was forced to plead or rely on his participation in illegal activity in order to articulate his claim. This 'reliance principle' is well illustrated by *Tinsley v Milligan* [1994] 1 AC 340, where two co-habitees had purchased a house in the claimant's sole name, but on the understanding that they were joint beneficial owners; the rationale being to assist their perpetration of a fraud on the Department of Social Security. The House of Lords upheld the defendant's counterclaim for a declaration that she was a joint owner under a resulting trust: although it transpired that her equitable title had been acquired in the course of carrying out a fraud, she had not needed to plead or rely on that illegal scheme to bring her counterclaim.

While this 'reliance principle' had the advantage of creating a hard-edged test for the operation of the defence, it faced considerable criticism for arbitrary (and potentially unfair) results which hinged on issues of procedure rather than questions of substance. Doubts were expressed in a number of Supreme Court cases leading up to *Patel v Mirza*, which (by a 5-4 majority decision) set out a new basis for applying the illegality defence. As expressed by Lord Toulson JSC in that case, the "*essential rationale of the illegality doctrine is that it would be contrary to the*

public interest to enforce a claim if to do so would be harmful to the integrity of the legal system". And in assessing whether the public interest would be harmed in that way, a 'trio of considerations' had to be taken into account:

(a) the underlying purpose of the prohibition which has been transgressed and whether that purpose would be enhanced by denial of the claim;
(b) any other relevant public policy on which the denial of the claim might have an impact; and
(c) whether denial of the claim would be a proportionate response to the illegality.

There is much to commend in the reasoning and result of the *Patel v Mirza* case. That said, the new three-step approach is more open-textured and requires judicial value judgments to be made on a range of policy factors and factual matters; as a result the new approach makes the law more uncertain and is likely to drive an increase in litigation. That point is demonstrated by the Supreme Court's revisiting of the illegality defence in *Grondona v Stoffel & Co* [2021] AC 540.

Grondona v Stoffel & Co: the facts and procedural history

In October 2002, Ms Grondona contracted to purchase a long leasehold interest in 73b Beulah Road, Thornton Heath from a Mr Mitchell, with the assistance of a mortgage loan from Birmingham Midshires. Stoffel & Co were retained as her conveyancing solicitors, and also acted for the mortgage lender.

However, and unbeknownst to Stoffel & Co, the mortgage advance was procured by fraud. Ms Grondona had dishonestly misrepresented on her mortgage application form that the sale from Mr Mitchell was not a private sale; that the deposit moneys were from her own resources; and that she would manage the property. The purpose of the fraud, as found by the trial judge, was to raise capital finance for Mr Mitchell from a high street lender, which he would not otherwise have been able to obtain, using Ms Grondona's unblemished credit record.

There were several indicators of this mortgage fraud which Stoffel & Co apparently overlooked. The firm was, remarkably, also instructed by Mr Mitchell, and discovered that Mr Mitchell had purchased the property only three months earlier for a third of the price. Nevertheless the sale, and Ms Grondona's mortgage loan from Birmingham Midshires, proceeded to exchange of contracts and completion.

Following completion, Stoffel & Co negligently failed to deal with registration of the TR1 and DS1 forms, as a result of which Ms Grondona was never registered as legal proprietor, and the lender's charge was never registered. Instead, Mr Mitchell remained the registered proprietor and took out further loans from his lender, on the security of the redeemed charge which should have been removed from the register.

In 2006, Ms Grondona defaulted on payments under the mortgage. Birmingham Midshires brought a claim in debt for the balance of the mortgage loan. She, in turn, issued a Part 20 claim against Stoffel & Co for breach of duty and/or contract.

By the date of trial in January 2016, Birmingham Midshires had obtained summary judgment against Ms Grondona for the sum of £70,000, and an additional balance (in respect of costs) to be subject to an account. Separately, Stoffel & Co had admitted that their failure to register the TR1, DS1 and the Birmingham Midshires charge constituted negligence and/or breach of duty. But the firm nevertheless continued to defend the claim relying on an illegality defence. Their argument was that the property had been put into Ms Grondona's name for an illegal purpose, namely in order to obtain a mortgage loan by a fraudulent conspiracy; and that consequently Ms Grondona should be debarred from claiming damages against them.

The first instance judgment was handed down in April 2016, a few months *prior* to the Supreme Court's decision in *Patel v Mirza*. Consequently the trial judge applied the old 'reliance principle' in holding that, despite Ms Grondona's knowing participation in a mortgage fraud, she was entitled to claim damages against the firm. The claim against Stoffel & Co was conceptually separate from the mortgage fraud, and Ms Grondona had no need to rely on allegations disclosing illegality. The firm appealed.

The Court of Appeal, applying the new test which had in the meantime been expounded in *Patel v Mirza*, dismissed the appeal. Gloster LJ considered that although mortgage fraud was a '*canker on society*', barring the claim against the negligent firm would not enhance the fight against mortgage fraud. On the contrary, there was a public interest in ensuring that solicitors' clients had a civil remedy for professional negligence, where they were not seeking to profit from a wrong but ensure that the mortgage lender's security was adequately protected by registration. The Supreme Court granted Stoffel & co permission to appeal.

Decision on appeal to the Supreme Court

The Supreme Court's decision was unanimous (in contrast with the *Patel* case); Lord Lloyd-Jones JSC delivered the only judgment. Having summarised the history of the illegality doctrine and the effect of the *Patel v Mirza* case, his Lordship stated that the "*essential question*" was whether allowing the claim would "*damage the integrity of the legal system. The answer will depend on whether it would be inconsistent with the policies to which the legal system gives effect.*" By reference to the 'trio of considerations' set out above, it was necessary for the court to identify, at a high level of generality, the policies to which the law gave effect which were engaged by the question whether to allow the claim; and to ascertain whether allowing the claim would be inconsistent with those policies or, where different policies competed with one another, where the overall balance lay. It might not be necessary in every case to go on to consider questions of proportionality: but where it was, the court would have to give close scrutiny to the detail of the case in hand.

Having re-stated the approach to illegality set out in *Patel v Mirza*, Lord Lloyd-Jones proceeded to work through the 'trio of considerations':

(1) Would the underlying purpose of the prohibition which had been transgressed be enhanced by denial of the claim? No: while the courts should not encourage mortgage fraud, the non-availability of a civil remedy against negligent conveyancing solicitors was unlikely to have any impact at all on potential mortgage fraudsters. This was particular so on the facts of the *Grondona* case.

Stoffel & Co's breach of duty came after completion. By that time, the mortgage fraud was complete. The most likely effect of denying a claim against the negligent solicitors would be to prejudice the position of the mortgage lender.

(2) Was there any other relevant public policy, which denial of claim would adversely impact? Yes: the public policies that solicitors should performing their duties diligently and without negligence, and that clients should have a civil remedy where those duties were breached. It was a striking fact was that following exchange and completion Ms Grondona had acquired an equitable interest in the property; namely, an equitable right to be registered as proprietor. Consequently it would be incoherent for the law, on the one hand, to grant Ms Grondona civil remedies against Mr Mitchel and/or HMLR to enforce her property rights whilst, on the other hand, denying her a remedy against her conveyancing solicitors for failure to protect those very same property rights. In any event there was more likelihood that mortgage fraud would be prevented if solicitors appreciated they should be alive to the possibility of fraud and question any irregularities in the transaction.

(3) It was accordingly not necessary to consider questions of proportionality, since the relevant public policy considerations all weighed in favour of permitting the claim. Nevertheless, Lord Lloyd-Jones concluded that it would not have been a proportionate response to deny the claim: the mortgage fraud committed against Birmingham Midshires was not central to the professional negligence claim, but was conceptually distinct from it; a fact demonstrated by the fact that Ms Grondona had no need to plead or rely on it in order to bring her Part 20 claim.

Lessons for Property Lawyers

Stepping back from the detail, the result in *Grondona* seems correct. Why should conveyancing solicitors escape liability for clear negligence or breach of retainer, simply because they have the good fortune to be instructed by a mortgage fraudster rather than an honest client? The fraud in this case involved concealing from Birmingham Midshires facts relevant to its decision

to lend: namely, the true relationship between seller and purchaser, their agreement about the management of the property and the fact that the loan was to be used by Mr Mitchell, not to acquire the property at arm's length. But the fraud did not extend to the underlying conveyancing transaction, which was genuine: the property needed to be transferred to Ms Grondona's so that she could grant a charge securing the mortgage loan. In other words, the illegality tainted the loan and the bank's decision to lend, but not the underlying transfer, which was genuine. Ms Grondona could have enforced her equitable rights by applying to be registered as proprietor. It would have made no sense for the law to prevent her from suing her solicitors for negligently failing to do precisely that.

There are a number of lessons to be drawn from the case for property lawyers – including both property litigators and transactional lawyers:

1. The new test of illegality is likely to result in better justice for the parties, and a more coherent legal system. But it does so at the expense of certainty: it will be less clear to parties and their legal advisers how the *Patel v Mirza* considerations will be applied until a significant body of precedent has been built up.

2. Property litigators (especially those acting for defendants) should continue to consider whether the doctrine of illegality can provide a valid defence. But the outcome in *Grondona* suggests that it will take a rare case for conveyancing solicitors to be able to take advantage of the defence. The likelihood is that the negligence or breach of duty would need to have an immediate connection to the illegality in question, and that the public interest in preventing that illegal conduct would have clearly outweigh other relevant policy considerations. Where third parties – such as mortgage lenders – are involved, it may take strong facts indeed to establish the defence. Consequently, where fraud is contested and would be a live factual issue at trial, legal advisers will need to consider whether the prospect of success is worth the potentially considerable cost of litigating the issue at trial.

3. Transactional lawyers, and especially conveyancers, will already be well aware of the need to be alive to possible fraud, and in particular mortgage fraud. The judgments in *Grondona* offer little comfort to conveyancing solicitors who find themselves innocently caught up in such fraud. Both Gloster LJ in the Court of Appeal and Lord Lloyd-Jones in the Supreme Court endorsed the argument that the fight against mortgage fraud could be *promoted* by maintaining liability against conveyancers. Transactional lawyers will – as ever – want to ensure that they have implemented robust systems to ensure compliance with all relevant regulatory and professional obligations.

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