Does Crime Pay? The Illegality Defence Revisited

Stoffel & Co v. Grondona **[2020] UKSC 42**

Even though a transaction formed part of a mortgage fraud, a client was still entitled to sue her solicitors for causing her loss by failing to carry out the transaction properly.

A. Introduction

1. Few would argue with s.1 of the Forfeiture Act 1982, which prevents a murderer from taking the benefit of a gift in their victim's will. But should an employee who willingly accepts their wages in tax-free cash be barred from complaining of unfair dismissal? These sorts of questions are the province of the so-called "illegality defence", which is regularly invoked as an objection to civil claims which are in some way tainted by illegal activity.

2. But it would be absurd to say that *any illegality whatsoever* on the part of a claimant provides a sufficient basis for denying an otherwise legitimate claim: again, few would argue that a plumber who breaks the speed limit while driving to a job forfeits the right to be paid for their work on site. So how do the Courts draw the line in deciding whether the "illegality defence" is engaged? When is it appropriate to deprive a party of their strict legal rights on this basis?

3. Formulating a satisfactory answer to these questions was a task which repeatedly troubled the House of Lords, the Law Commission, and latterly the Supreme Court in the decade prior to the landmark decision in *Patel v. Mirza* [2016] UKSC 42.

4. In that case, the issue was whether Mr Patel should be allowed to use the Courts to sue for the return of £620,000 which he had given to a (former) friend to facilitate insider trading. The Supreme Court unanimously decided that he should – but the nine-judge panel split five-four, over the course of a 91-page judgment, on the correct way to reach that conclusion.

5. The beauty of *Stoffel & Co v. Grondona* [2020] UKSC 42, then, is that it provides a neat judicial illustration (at the highest level) of how the "illegality defence" should be applied post-*Patel*. Involving mortgage fraud and professional negligence in the conveyancing field, it is also perfectly designed to appeal to litigators who work in the Business & Property Courts.

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B. Key Facts

6. **2000**. Maria Grondona and Cephas Mitchell were business partners. In early 2000, they agreed that Ms Grondona would take out mortgage loans in her name in respect of four designated properties but that Mr Mitchell would pay off the mortgages, receive rent from any tenants, carry out any repairs, and have the exclusive right to sell. In return, Ms Grondona would receive 50% of the net profits made on the sale of any of the properties.

7. In short, Ms Grondona's role was to obtain finance at preferential rates from high street lenders because Mr Mitchell's credit history left him unable to do so. Of course, Ms Grondona exposed herself to legal risks in the process, and that explains why she stood to be so well rewarded for her efforts.

8. **2002**. In July 2002, Mr Mitchell bought a 125-year lease of 73B Beulah Road in Thornton Heath ("**the Property**") for £30,000. Mr Mitchell had been able to fund the purchase by taking out a six-month bridging loan from BM Samuels Finance Group plc ("**BM Samuels**"), which was secured and duly registered against the Property.

9. In order to put his purchase of the Property on a more stable footing (by obtaining longer-term financing at much lower rates), Mr Mitchell then sought Ms Grondona's assistance. In October 2002, Ms Grondona "purchased" the Property from Mr Mitchell for £90,000 – of which £76,475 comprised lending from Birmingham Midshires ("**Midshires**").

10. Ms Grondona had obtained this mortgage loan from Midshires by fraud (i.e., knowingly false statements): she had misrepresented on the application form that the transaction was an advertised sale; that the deposit money came from her own resources; and that she would be managing the property herself.

11. Crucially, however, Midshires' mortgage was never registered against the Property by Stoffel & Co ("**S&C**"), the firm of solicitors which Ms Grondona and Midshires had instructed to undertake the legal aspects of the purchase. That was not all: S&C also failed to lodge a valid Form TR1 transferring ownership of the Property from Mr Mitchell to Ms Grondona *and* to register the Form DS1 which would have released BM Samuels' charge against the Property.

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(Here, the evidence was of incompetence, not of complicity in the fraud: amongst other things, there were issues with the Form TR1 which S&C submitted to HM Land Registry.)

12. This was the crux of the dispute: as a result of S&C's failures, Mr Mitchell remained the registered legal owner of the Property (with Ms Grondona having nothing to her name); BM Samuels retained the benefit of a charge against the Property; and Midshires had no security for its lending beyond Ms Grondona's promise to pay the sums due.

13. **2006**. Ms Grondona (or, more likely, Mr Mitchell) did in fact honour that promise until 2006. After Ms Grondona began to default on her repayments, however, Midshires issued a claim against her to recover the money it was owed.

14. As part of her defence, Ms Grondona brought an additional claim against S&C in which she sought an indemnity in respect of Midshires' claim and/or damages. Specifically, Ms Grondona alleged that, if S&C had acted with due care and skill, she would have been registered as the owner of the Property – meaning that she could simply have sold the Property to redeem Midshires' loan, rather than going further into debt.

15. In response, S&C predictably raised the "illegality defence": although the firm admitted it had been negligent, Ms Grondona was nonetheless prevented from obtaining an indemnity or damages because the purpose behind her purchase of the Property and the associated mortgage was illegal (in that it was a conspiracy to obtain finance for Mr Mitchell by misrepresentation).

C. Route to the Supreme Court

16. **County Court**. Midshires obtained summary judgment against Ms Grondona for £78,000 in May 2014, leaving only the dispute between Ms Grondona and S&C to be resolved. (There had also been various settlement agreements between the other parties caught up in the fraud, but none of these was relevant to Ms Grondona's claim.)

17. That dispute was eventually tried by HHJ Walden-Smith over four days in January 2016. Her Honour found that Ms Grondona had dishonestly participated in a mortgage fraud together with Mr Mitchell and that the mortgage application was a "sham arrangement whereby Ms

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Grondona lent her good credit history to Mr Mitchell to enable him, behind the scenes and out of sight of the potential lender, to obtain finance".

18. Nonetheless, the Judge concluded (applying the pre-*Patel* law on illegality) that Ms Grondona did not have to rely on any illegality in advancing her claim against S&C: that claim, for breach of contract and/or negligence, was "conceptually entirely separate" from the fraud.

19. S&C's attempt to deploy the "illegality defence" therefore failed and Ms Grondona's claim was allowed, with HHJ Walden-Smith awarding her £78,000 in damages (i.e., the value of the asset which, but for S&C's negligence, would have been registered in her name).

20. **Court of Appeal**. The proceedings in the County Court concluded, following a second hearing regarding the precise value of Ms Grondona's claim, on 11 May 2016. Two months later, on 20 July 2016, the Supreme Court's decision in *Patel* established an entirely new approach to the "illegality defence". This was fertile ground for an appeal, and S&C asked the Court of Appeal to apply the "correct" legal principles (as articulated in *Patel*) to the facts found at first instance by HHJ Walden-Smith.

21. The appeal was heard in March 2018 by a two-person panel (which suggests that the senior judiciary considered it to be a simple case). Giving judgment in September 2018, Gloster LJ (with whom Flaux LJ agreed) reached the following conclusions:

    21.1. HHJ Walden-Smith had made an error of law in concluding that the mortgage application was a "sham", because it was intended to, and did, have effect as between Ms Grondona and Midshires ([26] to [35]);

    21.2. It was also an error of law to conclude that Ms Grondona had never intended to become the legal owner of the Property (even if it was Mr Mitchell who would have the beneficial interest in the Property - i.e., the right to its use and enjoyment) ([26] to [35]); and

    21.3. The fraudulent purpose underlying Ms Grondona's purchase of the Property did not provide a basis for preventing her from recovering damages in respect of S&C's admittedly negligent failure to register her title to the Property ([36] – [39]).

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22. In dismissing the "illegality defence", Gloster LJ carefully adopted the new approach endorsed by the majority of the Supreme Court in *Patel*. That approach boiled down to the "trio of necessary considerations" articulated by Lord Toulson at [107] in *Patel* and then repeated (almost) verbatim at [120]. These were as follows:

> "One cannot judge whether allowing a claim which is in some way tainted by illegality would be contrary to the public interest, because it would be harmful to the integrity of the legal system, without:
>
> a) considering the underlying purpose of the prohibition which has been transgressed … and whether that purpose will be enhanced by denial of the claim,
>
> b) considering conversely any other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and
>
> c) … [considering] whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal Courts".

23. As Lord Toulson emphasised, "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" ([120]). Put differently, "the law should be coherent and not self-defeating, condoning illegality by giving with the left hand what it takes with the right hand" ([99]).

24. Dealing with the first consideration, Gloster LJ was unconvinced that denying Ms Grondona's claim against S&C would realistically support the criminal laws against mortgage fraud:

> "Mortgage fraud is, of course, a canker on society and it is extremely important that dishonest applicants for mortgages should not be empowered by the law to abuse the system. However, I see no public interest in allowing negligent conveyancing solicitors (or, in financial terms, their insurers), who are not party to, and know nothing about, the illegality, to avoid their professional obligations simply because of the happenstance that two of the clients for whom they act are involved in making misrepresentations to the mortgagee financier. On the contrary, it seems to me that there is more likelihood that mortgage fraud would be avoided if solicitors appreciate that they should be alive to, and question, potential irregularities in any particular transaction. Moreover, the

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> premise that it would assist the fight against mortgage fraud if mortgagors involved in making false representations to mortgagees were unable to recover if their solicitors were negligent in failing to register the mortgagee's security seems, to say the least, questionable" ([37]).

25. Turning to the second consideration, Gloster LJ concluded that to deny Ms Grondona's claim would *weaken* other relevant public policies:

> "There is a genuine public interest in ensuring that clients who use the services of solicitors are entitled to seek civil remedies for negligence/breach of contract against a defendant arising from a legitimate and lawful retainer which was entered into between them, in circumstances where the client was not seeking to profit or gain from her mortgage fraud, but merely to ensure that that the chargee's security was adequately protected by registration" ([38]).

26. Finally, Gloster LJ accepted that it would be "entirely disproportionate" to deny Ms Grondona's claim in light of the potentially relevant factors which Lord Toulson had identified at [107] in *Patel*. Amongst other things, Ms Grondona was not seeking to "profit" from the mortgage fraud but merely to unwind it so as to cover the liabilities she had incurred.

27. On that basis, Gloster LJ dismissed the appeal and permitted Ms Grondona to recover damages in respect of S&C's negligence.

D. The Supreme Court's Decision

28. **Summary**. By this stage, therefore, S&C's "illegality defence" had been rejected by three judges. Nonetheless, S&C sought permission to appeal *again* on the basis that Gloster LJ had fundamentally erred in her analysis and application of *Patel*.

29. The announcement in March 2019 that S&C would be granted a third bite of the cherry was therefore something of a surprise. Most likely, this second appeal was seen by the Supreme Court as an opportunity to "bed in" the *Patel* approach after what had been a fairly heated difference of opinion between the two opposing camps of Law Lords. In line with those expectations, S&C's appeal was unanimously dismissed in a judgment handed down on 30 October 2020.

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30. **The *Patel* Guidelines Applied**. How did the Supreme Court arrive at this decision? Lord Lloyd-Jones, giving the only judgment, began with a brief survey of Lord Toulson's conclusions in *Patel* before reviewing each of the "trio of necessary considerations".

31. *(1) Impact of Denying Claim on Underlying Purpose of Transgressed Prohibition*. One purpose of the criminalisation of mortgage fraud is undeniably deterrence. Echoing Gloster LJ, however, Lord Lloyd-Jones felt that fraudsters were unlikely to be deterred from committing fraud by the risk that they would be left without a civil remedy if their solicitors proved to be negligent. Allowing Ms Grondona to continue with her civil claim would not therefore undermine the criminal law against fraud ([29]).

32. Moreover, it was also true that another purpose of the criminalisation of mortgage fraud is to protect mortgage lenders from suffering loss. But barring Ms Grondona's claim against S&C – in respect of conveyancing failures which all post-dated the fraudulent mortgage application – would not improve Midshires' position. In fact, it is actually *in lenders' interests* that solicitors act carefully to secure mortgages against properties.

33. Gloster LJ had therefore been correct in her approach to Lord Toulson's first consideration.

34. *(2) Impact of Denying Claim on Any Other Relevant Public Policies*. Here, once more echoing Gloster LJ, Lord Lloyd-Jones identified the "important countervailing public policies in play" as including (i) the general interest in conveyancing solicitors performing their duties to their clients diligently and (ii) the general interest in those clients being able to seek a civil remedy for any loss suffered due to negligence. Accordingly, "to permit solicitors to escape liability for negligence in the conduct of their clients' affairs when they discover after the event that a misrepresentation was made to a mortgagee would run entirely counter to these policies" ([32]).

35. It was also relevant that, as a matter of established property law, Ms Grondona had acquired an equitable right to registered as the legal owner of the Property under the executed (and "specifically performable") contract of sale with Mr Mitchell *even though that contract of sale was tainted with illegality*. Lord Lloyd-Jones felt it would be "incoherent for the law to accept on the one hand that an equitable interest in the property passed to the respondent, notwithstanding that the agreement for sale was tainted with illegality, while on the other refusing, on the basis

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of the same illegality, to permit proceedings against a third party in respect of their failure to protect that equitable interest by registering the Form TR1 at the Land Registry" ([34]).

36. Again, then, Gloster LJ had been correct in her approach to Lord Toulson's second consideration.

37. *(3) Proportionality of Denying Claim.* Although his conclusions in respect of the first two considerations meant that it was not strictly necessary to consider proportionality – because, weighing the relevant public policy factors, "the clear conclusion emerges that the [illegality] defence should not be allowed" ([26]) – Lord Lloyd-Jones nonetheless did so for the sake of completeness.

38. Here, the Supreme Court was more circumspect than the Court of Appeal regarding the force of many of the submissions made on behalf of Ms Grondona. Two particular points, however, did make an impact:

    38.1. First, Ms Grondona's illegal conduct was not "central" to the negligence which formed the basis of her claim: "[S&C's] breach of duty related to the registration of title and the way in which [Ms Grondona] had procured the finance to obtain that title was irrelevant to [S&C's] obligation to register the title" ([40]).

    38.2. Secondly, Ms Grondona was not seeking to *profit* from her wrongdoing: she was, at best, engaged on a damage-limitation exercise ([44]). It did not matter that Ms Grondona's intention in undertaking the mortgage fraud had been to make a profit: in view of the specific relief now sought, she was not enlisting the Court's assistance to realise that profit ([45]). In any event, the question of whether or not a claimant was "getting something" out of their wrongdoing was no longer the sole focus of the Court's multi-factorial inquiry ([46]).

39. Both of those factors led Lord Lloyd-Jones to conclude that Ms Grondona would suffer disproportionate harm if she were prevented from pursuing a claim which she was otherwise entitled to bring.

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40. Over four years later, therefore, HHJ Walden-Smith's decision to award Ms Grondona damages of £78,000 was upheld by the Supreme Court.

E. Lessons Learned?

41. Beyond the unanimous affirmation (and clear application) of the *Patel* approach to the "illegality defence", there are three further points which practitioners can take away from *Stoffel*.

42. First, on prospects of success. Perhaps the most surprising fact about the case is that not one of the eight Judges who considered the claim thought that Ms Grondona should be barred from recovering compensation despite her direct involvement in a mortgage fraud. At first blush, this may seem counter-intuitive – but the reasoning deployed to reach that conclusion is undeniably persuasive.

43. Indeed, Ms Grondona's three-nil victory over S&C chimes with Lord Toulson's observation in *Patel* that it would only be in "rare cases" that the enforcement of a claim for recovery of money paid for an unlawful purpose "might be regarded as undermining the integrity of the justice system" ([121]). This comment suggests that defendants will have an uphill struggle in seeking to rely on the "illegality defence".

44. Second, on approach. The decision in *Stoffel* emphasises that the Courts' guiding light in applying the "illegality defence" will be the public interest in preserving the integrity of the legal system: "the true rationale of the illegality defence… is that recovery should not be permitted where to do so would result in an incoherent contradiction damaging to the integrity of the legal system" ([46]).

45. But, if "the integrity of the legal system" sounds like an extremely open-ended reference point, the Supreme Court in *Stoffel* was careful to circumscribe the scope of the analytical exercise called for. As Lord Lloyd-Jones held at [26] (italics added):

> "An evaluation of policy considerations, while necessarily structured, must not be permitted to become another mechanistic process. In the application of stages (a) and (b) of this trio a Court will be concerned to identify the relevant policy considerations at a relatively high level of generality before considering their application to the situation before the

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> Court. *In particular, I would not normally expect a Court to admit or to address evidence on matters such as the effectiveness of the criminal law in particular situations or the likely social consequences of permitting a claim in specified circumstances.* The essential question is whether to allow 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. *The Court is not concerned here to evaluate the policies in play or to carry out a policy-based evaluation of the relevant laws.* It is simply seeking to identify the policies to which the law gives effect which are engaged by the question whether to allow the claim, to ascertain whether to allow it would be inconsistent with those policies or, where the policies compete, where the overall balance lies".

46. In short, pleading the "illegality defence" is not an opportunity for lawyers to vent their wide-ranging socio-legal frustrations. The Court is "not concerned … to evaluate the policies in play" as being good or bad; the task is, instead, simply to identify and then weigh those policies. The way to carry out that focused inquiry is perfectly illustrated by the judgments of Lord Lloyd-Jones and Gloster LJ in *Stoffel*.

47. Finally, on the "new era" post-*Patel*. In expressing their concerns about the majority's approach in *Patel*, the dissenting Law Lords pulled no punches: as Lord Sumption said at [265], "we would be doing no service to the coherent development of the law if we simply substituted a new mess for the old one". But, in practical terms, how far has the position really changed?

48. Lord Lloyd-Jones' focus on the question of centrality, albeit only at the final stage of the inquiry, undeniably harks back to the pre-*Patel* test of whether the claimant is "relying" on their wrongdoing. Moreover, it is telling that Lord Lloyd-Jones (applying the *Patel* test) and HHJ Walden-Smith (applying the previous test) both saw it as important that Ms Grondona's claim was "conceptually entirely separate" from the fraud. It seems likely, then, that outcomes pre- and post-*Patel* will remain similar – albeit that Judges are now required to expressly articulate and engage with the policy considerations which often lie submerged in their decisions.

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