

Corporate

Supreme Court Decision on Illegality and the Enforcement of Contracts

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A recent decision of the Supreme Court in the case of *Quinn and others v Irish Bank Resolution Corporation Limited and others* given on 27 March of this year sets out criteria which are likely to be the basis on which Irish courts will, in future years, determine the question of the enforceability of a contract in respect of which there is an allegation of some degree of illegality.

Legal Background

For many hundreds of years, the courts have refused, on grounds of illegality, to enforce certain contracts. This has been so even where the courts recognise that in an action for breach of contract, to plead illegality may “*sound at all times very ill in the mouth of the defendant*”.

It is not for the defendant’s sake however that the objection is ever allowed “*but it is founded in general principles of policy that no court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act*”.

As society and regulation has evolved, the courts in Ireland and elsewhere have however recognised the difficulties that a rigid application of the principle will create. It is recognised that illegality is a spectrum and while at one end of the spectrum the matter can be very clear-cut as one moves from that end, the position becomes less so.

For example, it is clear that the courts will not enforce a contract to carry out a robbery or to be paid for a robbery carried out. On the other hand, X might contract with Y that Y should drive X from Dublin to Cork “as quickly as possible”. With a distance between the cities of 250 kilometres and a maximum permissible speed limit of 120 kilometres an hour, it is not possible to drive between Dublin and Cork in less than two hours while always observing the speed limit. If Y (perhaps out of concern for X) completes the journey in less than two hours (while not causing harm to X) should the courts refuse to give Y an order for payment of the agreed fee on the ground that performance was tainted with illegality?

Factual Background

The case arose out of the litigation in respect of guarantees given by members of the Quinn family and by companies wholly owned by them in respect of monies loaned by IBRC to other companies within the Quinn group.

It had been directed that as a preliminary issue it ought to be determined by the Courts whether, as contended by the Quinns, the loans by IBRC were contrary to Section 60 of the Companies Act, 1963 (**Section 60**) or were in breach of the Market Abuse Regulations (**MAR**) and thus the illegality rendered the guarantees unenforceable. The High Court ruled in favour of the Quinns and the matter was appealed.

In giving its judgement, the Supreme Court noted that the ever-developing complexity of society and regulatory law can result in breaches of regulatory provision, some bordering on the innocent. It noted how in prior cases, courts have sought to deal with the possibility that a ruling that the contract was founded on illegality and thus enforceable might result in an unjustified windfall for a party.

While recognising the harshness of a rigid application of the rule of non-enforcement, the Supreme Court found much to be said for the criticism of an approach that sought to turn the principle of illegality from a rule of law – that such a contract is unenforceable – into a power which could be exercised by the court on a discretionary basis depending on the merits of the case.

The Supreme Court indicated that

“whatever may be the disadvantage to the rule of law approach, the uncertainty which would be created by leaving the question of enforceability up to a very broad consideration by a trial judge on the facts of any individual case would arguably be worse”.

The Supreme Court preferred an alternative approach of having regard to what might be seen to be the policy requirements of the relevant statute which created the legality in the first place.

On that basis, a court ought to assess whether the requirement of public policy in respect of a provision rendering an activity illegal also requires that contracts sufficiently connected with that particular illegality are to be regarded as unenforceable. Such an approach is statute specific but not case specific.

The court laid out the following criteria to be addressed:-

1. Whether the relevant legislation expressly states that contracts of a particular class or type are to be treated as void or enforceable. If the legislation does so provide, then nothing further needs to be done other than to determine whether the contract in question comes within the category of contracts which are expressly void or unenforceable.
2. Where the relevant legislation is silent as to whether a contract is to be regarded as void or unenforceable, the court must consider whether
 - (a) the requirement of public policy (which suggest that a court refrain from enforcing a contract tainted with illegality) and
 - (b) the policy of the legislation concernedare such that in addition to whatever sanction might be provided for in the legislation, an additional sanction or consequence in the form of treating relevant contracts as being void or unenforceable must be imposed.
3. In considering 2 above, the court should assess:-
 - (a) whether the contract in question is designed to carry out the very act which the relevant legislation is designed to prevent; and
 - (b) whether the wording of the statute itself might be taken to strongly imply that the remedies or consequences specified in the statute are sufficient to meet the statutory end;
 - (c) whether the policy of the legislation is designed to apply equally or substantially to both parties to a relevant contract or whether the policy is exclusively or principally directed towards only one party ;
 - (d) whether the imposition of voidness or unenforceability of a contract might be counter-productive to the statutory aim as found in the statute,
4. The Supreme Court indicated that further factors which might properly be taken into account in an appropriate case are:-
 - (a) whether having regard to the purpose of the statute, adverse consequences for breach set out in the statute should be considered to be adequate to secure the statutory purpose without having to treat the relevant contract;

- (b) whether the imposition of voidness or unenforceability of the contract might be disproportionate to the seriousness of the unlawful conduct in question, in the context of the relevant statutory regime in general.

Having laid out an overall principled framework for the analysis of the question, the Supreme Court then turned to the question before it namely whether “*a proper analysis of the respective statutory regimes leads to the conclusion that, as a matter of policy, a court should regard contracts which are tainted by any illegality arising under these two regimes – Section 60 and MAR – as being unenforceable.*”

Section 60

The court noted Section 60(1) provides that:-

“subject to certain exceptions, it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan or otherwise, any financial assistance for the purpose of or in connection with a purchase of any shares in the company”.

and that Section 60(14) provides that

“any transaction in breach of this Section shall be voidable at the instance of the company against any person who had notice of the facts constituting the breach [of Section 60(1)].”

The Supreme Court noted that sub-section 14 would be entirely redundant if every contract to which Section 60 was applicable was regarded as unenforceable. If contracts were to be regarded as void and unenforceable, there would be no need for the company which has entered into a contract in breach of Section 60(1) to be entitled to treat the contract as voidable. The Supreme Court held that the clear statutory policy must be that a company which has, in breach of Section 60(1), entered into a contract may elect to treat the contract as enforceable.

MAR

The Supreme Court noted that the MAR regulations set out a number of consequences for market manipulation including criminal sanctions, potential administrative sanctions and that Section 32 of the Investment Funds Companies and Miscellaneous Provisions Act, 2005 (the **2005 Act**) provides for civil liability where there has been a breach of the MAR.

Applying to the MAR the criteria for statutory analysis set out earlier in the judgment, the Supreme Court noted that transactions in breach of MAR are not always in themselves unlawful but may be rendered unlawful by reason of their purpose.

It was the view of the Supreme Court that the weight to be attached to the potentially counter-productive consequence of treating contracts as unenforceable by reason of a breach of MAR is such as outweighs the other factors identified under the second criterion.

With regard to the question whether the imposition of the additional consequences of unenforceability might be said to enhance or to be counter-productive to the achievement of the objects of the MAR, the Supreme Court held that policy does not require that contracts entered into by a company whose shares are the subject of market abuse should be regarded as unenforceable by the company.

Conclusion

Having regard for all of the foregoing, the Supreme Courts held that the underlying lending contracts were enforceable notwithstanding the matter of illegality whether under Section 60 or MAR.

For further information on this topic please contact: John Olden, Partner, Corporate, E: jolden@efc.ie