Article

Illegality as a defence under Cayman Islands, British Virgin Islands, and Bermuda law: a comparison with English law and Hong Kong law

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The general doctrine of 'illegality', in commercial litigation, is based on two related principles:

- **Firstly, that no person should benefit from his or her own illegal act or wrong; and**
- **Secondly, that the law (and the Court) should not condone, reward, or enforce, illegal behaviour.**

In jurisdictions such as Bermuda, the British Virgin Islands, and the Cayman Islands, the alleged 'illegality' of one party or another is often relied upon, in practice, as a defence to a claim, whether the claim is asserted in contract, tort, equity, or restitution.

It is quite often asserted, for example, that a claim should be dismissed because the claimants (or, in the case of a company in insolvent liquidation, the company's former directors and officers) have allegedly been guilty of some fraud, dishonesty, breach of statute (such as an immigration or tax law), or regulatory non-compliance (such as a breach of Anti-Money Laundering, Beneficial Ownership, or Sanctions regulations).

The application of the 'illegality' doctrine is not straightforward, however, and it requires careful consideration in every case, not least in cross-jurisdictional cases where different governing laws might potentially apply to the issue.

In *Patel v Mirza* [2016] UKSC 42, Lord Toulson and a majority of the United Kingdom Supreme Court noted that the application of the doctrine of 'illegality' had caused a good deal of uncertainty, complexity, and inconsistency, in earlier English case law.

In attempting to offer clarity and some degree of consistency to the doctrine of 'illegality' under English law, Lord Toulson concluded in *Patel v Mirza* [2016] UKSC 42, that "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".

In doing so, the majority of the United Kingdom Supreme Court rejected the 'reliance' approach reflected in the earlier House of Lords' decision in *Tinsley v Milligan* [1994] 1 AC 340, whereby the courts would, somewhat inflexibly, refuse relief to a party that was obliged to rely on its own illegality to plead or to establish its case: but not in other cases.

In assessing whether the public interest would be harmed in such a way as to affect the integrity of the legal system, Lord Toulson held that the English courts were obliged to adopt a more flexible approach, on the facts of any given case, by considering:

- the underlying purpose of the legal prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim;
- any other relevant public policy on which the denial of the claim may have an impact; and
- 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.

The United Kingdom Supreme Court has re-affirmed the *Patel v Mizra* approach in three more recent English cases, including Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd [2019] UKSC 50, *Stoffel and Co v Grondona* [2020] UKSC 42 and *Henderson v Dorset Healthcare University NHS Foundation Trust* [2020] UKSC 43.

The modern, flexible English approach has also been followed and applied at first instance in the Grand Court of the Cayman Islands, in the lengthy judgment of Chief Justice Smellie in the case of *Ahmad Hamad Algosaibi and Brothers Company v SAAD Investments Company Limited (In Official Liquidation) (SICL) and Others*, Grand Court of the Cayman Islands, 31 May 2018.

In his judgment in that case (at page 1201), Chief Justice Smellie also noted that the following considerations provided 'useful benchmark' guidance for the resolution of any dispute in which the defence of 'illegality' is raised, as a matter of Cayman Islands law:

- how seriously illegal or contrary to public policy the conduct was;
- whether the party seeking enforcement knew of, or intended, the conduct;
- how central to the contract or its performance the conduct was;
- how serious a sanction the denial of enforcement is for the party seeking enforcement;
- whether denying enforcement will further the purpose of the rule which the conduct has infringed;
- whether denying enforcement will act as a deterrent to conduct that is illegal or contrary to public policy;
- whether denying enforcement will ensure that the party seeking enforcement does not profit from the conduct; and
- whether denying enforcement will avoid inconsistency in the law thereby maintaining the integrity of the legal system.

The modern, flexible English approach has also been followed in the Bermuda Courts in three recent cases decided under Bermuda law: *Lydia Caletti v Ralph DeSilva* [2017] Bda LR 102, *X Limited v Y* [2019] SC Bda Civ 58, and *Samann Ltd v Just Add Bermuda Ltd* [2019] SC Bda 83 Civ.

In the *Samann* case, the Supreme Court of Bermuda expressly acknowledged the importance of the public policy in a creditor-friendly, international financial centre such as Bermuda that "where a lender contracts with a borrower to lend money then, absent illegality, the courts will enforce the terms of the contract".

In practice, international businesses doing business in Bermuda, the British Virgin Islands, and the Cayman Islands should take a measure of comfort from the judicial flexibility associated with the doctrine of 'illegality' in the commercial context, having regard to the range of public policy considerations involved in every case.

Given the obvious importance of the local Court's assessment of the commercial, public policy, and regulatory considerations associated with an 'illegality' defence, it will be apparent that a successful outcome in any given commercial dispute usually depends, to a considerable extent, on the quality of analysis, evidence, and submissions put before the local Court at first instance, having regard to the law governing the cause of action or defence, as well as the law that is said to be applicable to the allegedly illegal act.

There is some scope for technical legal argument as to the precedential status of *Patel v Mirza* [2016] UKSC 42 in the British Overseas Territories of Bermuda, the British Virgin Islands, and the Cayman Islands, having regard to certain earlier decisions of the Privy Council, such as *Chetty v Servai* (1908) LR 35, *Singh v Ali [*1960] AC 167, and *Chettiar v Chettiar* [1962] AC 294. This was a point noted, in passing, by Mr. Justice Adrian Jack of the BVI High Court in two recent interlocutory decisions at first instance in the BVI: *Ganjaei v Sable Trust Ltd* [2021] ECSCJ No 466 and *Briefline Assets Ltd v Falin* [2021], unreported, 17 June 2021.

In practice, however, the Bermuda, BVI, and the Cayman courts would be expected to treat the recent English case law (now set out in four separate decisions of the United Kingdom Supreme Court, and followed by the Supreme Court of Bermuda and the Grand Court of the Cayman Islands) as highly persuasive, whether at first instance or (if that were to become necessary) on appeal.

The legal position in Hong Kong, however, has not yet developed in the same way as in England and Wales, Bermuda, or the Cayman Islands, and it remains somewhat inflexible, on the current authorities.

The Hong Kong judiciary have repeatedly noted, for example, that, pending appellate review by the Hong Kong Court of Final Appeal, both the Hong Kong Court of First Instance and the Hong Kong Court of Appeal remain bound to apply the older, more inflexible approach to the issue of 'illegality' under Hong Kong law, as set out in *Tinsley v Milligan* [1994] 1 AC 340: see, in particular, Kan *Wai Chung v Hau Wun Fai* [2016] 5 HKC 585, *Arrow ECS Norway AS v M Yang Trading Ltd & Ors* [2018] 5 HKC 317, and *Idemitsu Chemicals (Hong Kong) Ltd v Brilliant One Shipping Co Ltd* [2021] HKCFI 1175.

The current divergence between Hong Kong law on the one hand, and English, Bermuda, Cayman Islands, and British Virgin Islands law on the other hand, means that, in cross-border cases where the doctrine of 'illegality' might arise, careful consideration should be given to the most appropriate jurisdiction, and the appropriate governing laws, as well as the manner in which any claim, or defence, is presented to the Court.

*The authors are members of Conyers' **Asia Disputes & Restructuring Group (ADRG)** which is tasked with providing sophisticated Bermuda, British Virgin Islands and Cayman Islands litigation advice to clients connected to our multi-lingual (Cantonese, English and Mandarin) team based in Asia. The ADRG integrates the most experienced and highly rated partner-led litigation teams in Asia, Bermuda, the British Virgin Islands and Cayman Islands and delivers seamless and comprehensive services across jurisdictions round the clock. Our advocates in these jurisdictions are leaders in their fields and recognised by all leading independent directories. Our greater depth and range of expertise in the region distinguishes us from our competition and ensures that our clients receive comprehensive, reliable and thorough advice.*

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