

# Non-restitution of payments made under an illegal contract: catalogue of cases

Ángel Carrasco Perera

Professor of Civil Law, Universidad de Castilla-La Mancha

Academic Counsel, Gómez- Acebo & Pombo

*The defence of illegality, enunciated in arts. 1305 and 1306 of the Civil Code (abbrev. CC), operates as follows: (1) that which is promised under an illegal contract - contra bonos mores (in breach of good customs) or contra legem (against the law) - is unenforceable (the ex turpi causa non oritur actio rule); (2) that which is delivered under an illegal contract cannot be recovered if the turpitude attaches to both parties or to the party that gave such irrecoverable consideration (the in pari causa turpitudinis melior conditio est possidentis rule).*

## PARADIGM CASES

The judicially determined cases that follow below have been chosen on account of being illustrative of hypothetical events with the greatest 'commercial' impact.

### 1. Violations of competition (antitrust) law. Vertical distributions

Civil courts have consistently refused to apply the non-restitution rule under art. 1306 CC to void contracts characterised by violations of legislative provisions governing competition, and have referred the settlement of voidness to the mutual restitution under art. 1303 CC (judgments of the Supreme Court of 30 June 2009 [RJ 4704], 30 July 2009 [RJ 4580] and 12 January 2015 [RJ 262]).

The judgment of the European Court of Justice in the *Courage* case (20 September 2001) was, however, more nuanced. The Court did not sustain that a party to a contract liable to restrict or distort competition is barred from claiming damages for loss caused by performance of that contract on the sole ground that the claimant is a party to that contract, but

rather that a party to a contract liable to restrict or distort competition is barred from relying on his own unlawful actions to obtain damages where it is established that that party bears "significant responsibility" for the distortion of competition. In this case, the discussion concerning the illegality defence did not revolve around claims of voidness, performance or restitution, but around an action for damages arising from the voidness of the transaction.

- Commentary:

*The qualification to the illegality defence in these contractual scenarios responds to unspoken logic; these contracts have been presented as transactional packages, coalesced from the application of Community Regulation (EEC) No 1984/83 so that the perimeter of the possible voidness is extensive, and in such broad contractual spaces it would be unfair and disproportionate to apply a non-restitution rule throughout the set of independent but coalesced consideration. It would make no sense, for instance, that because of the voidness of an exorbitant exclusive purchasing obligation, the supplier could*

*keep a leasehold for which it does not pay or recover without compensation rent paid during the quiet enjoyment of the same. Beyond this, the 'Courage' judgment is very expressive in that there is no objection in principle to the application of the 'ex turpi causa non oritur actio' rule in this field of EU law, and that the deprivation of cause of action may extend to claims for damages.*

## 2. Competition violations. Cartels

The judgment of the Seville Provincial Court (*Audiencia Provincial*) (Fifth Chamber), of 28 November 2013 [JUR 2014\49457], held not only that a stake in a (cotton) cartel is a void transaction inasmuch as illegal, but also *in pari causa turpitudinis*, although neither the Spanish Competition Tribunal nor the judicial review jurisdiction considered the latter when they held the cartel void. Consequently, what a cartel member delivered, not only in pursuance of the contract, but also in compliance of the arbitral awards determining disputes between the cartel members, cannot be recovered, having been delivered in turpitude, no matter that the resulting situation lead to an enrichment of the counterparty.

## 3. Absolute simulations and 'fiducia cum amico' arrangements

In the instant cases a transfer of ownership of assets to a third party is simulated, for the purpose of defrauding other persons or the Public Administration, arranging a trust-like device (*fiducia cum amico*) with a transferee who undertakes to manage the property subject to the transferor's instructions and to return it upon the latter's request. Ultimately, the transferee may claim that the contract is illegal by reason of its fraudulent purpose and, under the aegis of art. 1306 CC, refuse to make restitution. The case law to date is opposed to this claim: the contract is certainly void, but the ordinary restitution under art. 1303 CC applies (judgments of the Supreme Court of 28 March 2012 [RJ 5588], 31 October 2012 [RJ 2013/1547], 3 May 2016 [JUR 2016/104093], 30 May 2016 [RJ 2307] and 10 June 2016 [JUR 2016\145193]).

- Commentary:

*Notwithstanding the categorical position of the Supreme Court, the legal doctrine is incorrect. Art. 1306 CC should be applied, thereby achieving the desired special and general prevention effects to discourage such sham transaction. Rightly, on the other hand, the judgment of the Madrid Provincial Court (Twentieth Chamber) of 1 February 2011 [AC 2011\350] and of 19 December 2011 [JUR 2012/22953].*

## 4. Contribution claim against co-directors by director who paid damages

The judgment of the Supreme Court of 18 June 2012 [RJ 8990] applies here the *in pari causa turpitudinis melior conditio est possidentis* rule to the director who seeks contribution from the company and the remaining directors once such director, defendant jointly and severally liable for company debts, paid the creditors who filed a liability claim for debts (cf. art. 367 of the Companies Act).

- Commentary:

*The legal doctrine is obviously incorrect because the action for contribution brought by the jointly and severally liableco-debtor who pays is not a restitution the remaining joint and several debtors are beneficiaries of.*

## 5. Criminal sentence imposing on the purchaser the restitution of that received by means of asset stripping for which the transferor is convicted

This is the legal doctrine contained in the judgment of the Supreme Court of 25 January 2013 [RJ 1264], in a case where property was rolled back to the seller by reason of a ruling of invalidity due to a criminal conviction of said seller for asset stripping, without the criminal court ruling for the buyer to recover from the former the amounts paid to take on the mortgage on the property sold and returned. The civil court applies art. 1305 CC and rejects restitution.

- Commentary:

*Unacceptable judgment. Because the 'ex turpi causa non oritur actio' on the basis of this provision presupposes that one of the parties 'in pari causa turpitudinis' aims to trigger the restitutionary mechanism resulting from voidness, which is not the case, or presupposes that the consideration the illegal act consisted of has been confiscated as an effect of the crime, which is not the case either. If, in the presence of reciprocal enforcement, the contractual parties are in a situation of in pari causa turpitudinis' and the criminal sentence orders – against the requirement of art. 1305 CC – unilateral restitution instead of confiscation, then the civil court should not be neutral in the face of the restitution required by the party to which the return was imposed; such party can also recover what he gave, because applying the penalty of non-restitution selectively is unfair.*

## 6. Excessive remuneration of directors

This should be treated as an illegal contract, regardless of whether the remuneration was fixed by the general meeting of shareholders or by the directors themselves. The judgment of the Supreme Court of 24 October 2006 [RJ 6710] considers this an illegal contract subject to art. 1306 CC. Questionable decision, because if the transaction had truly been void, the heirs of the former director should have been ordered to return to the company all that was earned, because illegality, if any, could not have rested on the company that overpaid. Art. 1306 CC is in fact applied as a means of denying restitution at all.

- Commentary:

*Applying in these situations art. 1306 CC is a disservice to the company which, as such, cannot be in turpitude by creating a situation where the in pari causa rule produces the same effect as if voidness had been held to exist with future effects only.*

## 7. Violations of the indivisible minimum units regime

The judgment of the Supreme Court of 18 March 2009 [RJ 1652] argues strongly that in

any breach of a legislative provision that must lead to voidness (in this case, the division and sale of property without respecting legislation concerning minimum units), use can be done not of art. 1306 CC, but of art. 1303 CC.

## 8. Forbidden pharmacy management contract

The judgment of the Supreme Court of 2 April 2002 [RJ 2485] regards as void by reason of illegality a pharmacy management contract, forbidden, under the guise of a sale and purchase contract regarding the same pharmacy. The Supreme Court argues that a broad interpretation must be given to the *causa turpitudinis* under art. 1306 CC to cover any contract with an unlawful purpose or *contra legem* that is not a criminal offence.

- Commentary:

*Though, once again, the effect of this classification is limited. Indeed, the barring of an action is limited only to the restitution of profits obtained by the manager whilst running the pharmacy, but it is certainly not enough to prevent the transferor from recovering ownership of the pharmacy. The solution reached is correct, as the 'ex turpi causa non oritur actio' rule cannot go beyond denying the restitution of what is delivered under the contract. If the contract's purpose is a temporary assignment of use, such is what the defendant retains, in the form of release from the duty to pay for the use obtained and to return any proceeds from such use. The defendant cannot withhold what he could not have obtained under the contract if such had been valid, and so you cannot refuse to return the possession lying with the transferor as owner.*

## 9. Breach of transactional prohibitions bearing on insurers

The judgment of the Supreme Court of 9 November 2008 [RJ 2009/392] unequivocally postulates the solution of voidness in the face of a violation of sectoral legislation on the organisation of private insurance companies. The Court is of the opinion that voidness of contract due to a violation of sector-related legislative provisions does not entail the typical restitution of consideration, and finds turpitude to prevent such restitution; the case involved a bond

granted (and paid) by the insurer to guarantee the payment of another insurer's debt.

- Commentary:

*Thus, in essence, this judgment once again reaches, thanks to art. 1306 CC, an outcome equivalent to that which would have been produced if the bond contract had been held*

*valid, so that having the consideration under the contract been fulfilled and accomplished, no action is granted to the parties to recover what they have given as consideration. I am certain that if the creditor had sued the insurance company in this story, and payment had not yet been made, the judge would have ordered payment as if it were a valid contract.*

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