

Client Update

English Court of Appeal Clarifies Test for Abuse of Process in Subsequent Litigation Collaterally Challenging an Arbitral Award

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The English Court of Appeal in *Michael Wilson & Partners v. Sinclair* [2017] EWCA Civ 3 has clarified that a subsequent litigation is not an abuse of process for being a collateral attack against a previous arbitral award, where the respondent to the litigation was not a party to the earlier arbitration. The case reiterates that non-parties to an arbitral award are not bound by it, but in so doing are exposed to the risk of being separately sued in court.

BACKGROUND

In 2006, the appellant (“MWP”) brought arbitral proceedings against one of its former directors, Mr. Emmott, claiming that he had breached contractual and fiduciary duties by personally accepting an issue of shares and funds on the successful completion of certain transactions, rather than by accepting them on behalf of MWP (the “Arbitration”). The arbitral tribunal (the “Tribunal”) dismissed the claim, essentially accepting Mr. Emmott’s defence that he held the shares and funds on trust for the benefit of a third party, Mr. Sinclair.

Importantly, Mr. Sinclair was not a party to the arbitral proceedings—he had refused MWP’s invitation to join the Arbitration, although he gave evidence and had funded Mr. Emmott’s defence.

MWP then commenced an action in the High Court of England and Wales in 2010, not against Mr. Emmott, but against Mr. Sinclair and companies related to him (together, the “Sinclair Defendants”). The Sinclair Defendants applied to strike out the action as an abuse of process, on the basis that it was a collateral challenge to the Tribunal’s earlier award. Mr. Emmott was joined as a Part 20

defendant by the Sinclair Defendants, but the claim against Mr. Emmott was eventually discontinued.

THE HIGH COURT DECISION

The High Court had ruled that it was an abuse of process to permit MWP to make the same factual allegations which it had made, and which had been rejected, in the Arbitration. The High Court made a number of preliminary observations, including that there is no “hard edged” rule that a prior arbitration award cannot found an allegation for abuse of process, and that the burden of demonstrating an abuse of process was on the parties alleging the abuse. The judge held that the abuse threshold prescribed an exacting standard that would not have been met in the case solely on the basis that the factual allegations against Mr. Sinclair mirrored the allegations against Mr. Emmott in the Arbitration. However, the judge identified “special circumstances” that led to his finding of an abuse, including the fact that Mr. Sinclair had already undergone cross-examination in the Arbitration, and the Tribunal had intended the award to lead to the transfer of the shares to Mr. Sinclair (thereby indirectly determining their rights to the shares).

THE COURT OF APPEAL DECISION

Although endorsing many of the principles enumerated by the High Court, the Court of Appeal overturned its decision. In so doing, it made important observations on the interplay between litigation and arbitral proceedings, and on the circumstances in which subsequent litigation which collaterally challenged a prior arbitral award would be an abuse of process. The Court emphasised that the fact that parties may not have been in the same proceedings will not per se preclude an abuse of process. Rather, the courts must focus on identifying whether there was a vexatious use of litigation for improper purposes.

The Court agreed with the High Court that the starting point was that it will be “a rare case, perhaps a very rare case, where court proceedings against a non-party to an arbitration can be said to be an abuse of process”: para [68]. There are important differences between arbitration and litigation, since the former is based on consent between particular parties under an arbitral agreement, while the latter is subject to the court’s coercive powers to compel joinder of parties. There are therefore “good reasons why a court should be cautious” before accepting that a collateral attack in an earlier arbitration is an abuse of process in later court proceedings: para [54].

The Court concluded that the “high threshold” was not met in this case: para [87]. It emphasised the following factors:

- The only means for MWP to pursue its claims against the Sinclair Defendants would be through a court action: para [93];
- There is no general rule that an invitation to the court to come to a different view from that of an arbitral tribunal would constitute an illegitimate collateral attack on the award: para [94];
- The fact that Mr. Sinclair was a witness in the Arbitration and had funded the defence did not bear any weight on the question of abuse of process, especially in light of his equivocal treatment of the Arbitration. Further, the Tribunal had no jurisdiction to grant any relief as between MWP and Mr. Sinclair: para [97];
- The Sinclair Defendants were not a party to the earlier arbitral proceedings, and were therefore not bound by the Tribunal's determination on the ownership of the shares: para [89]. In fact, Mr. Sinclair had refused to be a party, and had maintained in other proceedings that the outcome of the Arbitration was "totally irrelevant" to the dispute between him and MWP. The court noted that there was a lack of mutuality which it suspected Mr. Sinclair would have sought to exploit—the Sinclair Defendants, although they now relied on the award to found the abuse of process claim, would have claimed to not be bound by the award if the Arbitration had been decided differently: para [98];
- Since Mr. Sinclair was not bound by the Tribunal's findings, the case did not fall "within the spirit" of the issue estoppel principle: para [98]; and
- Mr. Emmott was not vexed twice by MWP—he was joined as a Part 20 defendant by the Sinclair Defendants and the claim against him was eventually discontinued. Notwithstanding the Court of Appeal's determination that Mr. Emmott was a potential witness, it emphasised that the abuse jurisdiction is only concerned with *parties*, and not *witnesses*: para [99].

TAKEAWAYS

This case reiterates that a person must be a party to an arbitral award in order to be bound by it. Conversely, if the person is not a party, then that person is likely capable of being sued in later litigation, even if an earlier arbitral award had decided the same issues.

Arbitration clauses should therefore be carefully drafted at the outset in order to bind all parties across the full suite of transaction documents.

Additionally, in commencing an arbitral claim, parties should carefully consider the extent to which the interests of non-parties to the arbitral agreement are at stake. If they are, then parties should seek advice on:

- whether those non-parties can be joined to the arbitration, and if so, how; and
- whether it might be better to commence court proceedings in the interests of certainty and finality, and to minimise the risk of inconsistent judgments and awards.

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Please do not hesitate to contact us with any questions.