Parallel Litigation and Arbitration: Abuse of Process?

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Introduction

An arbitration takes place between A and B in London. There are parallel court proceedings in Australia between A and C in which B's liability to A is relevant. To what extent can A and C rely on, or be bound by, the arbitrator's findings?

The High Court of Australia has recently articulated the principles concerning abuse of process in relation to concurrent arbitration and litigation proceedings. *Michael Wilson & Partners v Nicholls & Ors*[1] concerned the uncommon circumstance in which a party pursued arbitration and litigation against separate parties whose liability arose out of the same conduct. The question before the High Court was whether it was an abuse of process for a plaintiff to commence litigation in Australia after commencing an arbitration in a foreign jurisdiction against a different party whose liability arose from the same transactions. It unanimously held that this did not necessarily amount to an abuse of process.

Facts

Background

Michael Wilson & Partners Ltd (MWP), a company founded by Michael Wilson in 1998 and incorporated in the British Virgin Islands, is a law firm and business consultancy operating from the Republic of Kazakhstan in Central Asia and from Europe. In 2001, MWP entered into an agreement with Mr Emmott, an Australian solicitor, pursuant to which Mr Emmott became a shareholder and director of the company. The contract was described as a 'co-operation agreement' and stated that MWP would operate as a 'quasi-[p]artnership' between MWP and Mr Emmott. Over the next few years, two other Australian lawyers, Mr Nicholls and Mr Slater, were employed by the firm.[2]

By mid-2006, Messrs Emmott, Nicholls and Slater had all left MWP, taking several clients with them. MWP alleged that they had conspired to divert clients and business opportunities away from MWP for their own benefit.

The London arbitration between MWP and Mr Emmott

In August 2006, MWP initiated arbitration proceedings against Mr Emmott. His contract provided that any disputes would be referred to arbitration in London and that the governing law of the contract was that of England & Wales. MWP alleged breach of contractual and fiduciary obligations. It sought an account of profits, damages for breach of contract and compensation for breach of fiduciary duties. In February 2010, the arbitral tribunal issued an interim award as to liability, holding Mr Emmott liable in respect of some, but not all, of these allegations. The tribunal found that certain clients would have left MWP in any case once Mr Emmott had gone, because they did not want to deal with Mr Wilson. Accordingly, MWP was denied relief in respect of those clients. In relation to the remaining clients, Mr Emmott was ordered to pay equitable compensation to MWP, which was to be set-off against various payments that MWP owed to him. The precise sum was to be quantified at a later hearing. MWP unsuccessfully challenged the interim award in the English High Court on the grounds of serious irregularity and error of law.[3]

The New South Wales litigation

Trial judgment

In October 2006, following the commencement of the arbitration, separate proceedings were initiated by MWP in the Supreme Court of New South Wales against Messrs Nicholls and Slater and their related companies. The defendants could not be joined as parties to the London arbitration as their employment contracts with MWP did not contain arbitration clauses. Mr Emmott was invited to join the NSW proceedings, but declined. He could not be compelled to join the litigation because of the arbitration clause in his contract. However, as MWP alleged that Mr Emmott was the 'principal offender', his conduct was nonetheless relevant to MWP's claims in the litigation.

At trial, MWP's allegations against Messrs Nicholls and Slater were similar to those against Mr Emmott in the arbitration, though the overlap was not exact. In the litigation, MWP alleged breach of contractual and fiduciary obligations, as well as 'accessorial liability' for knowingly assisting Mr Emmott in his breaches of fiduciary duty. In addition, MWP alleged that the defendants were liable on the basis of the torts of conspiracy and wrongfully inducing a breach of contract. MWP sought damages, compensation and an account of profits. At first instance before Einstein J, MWP succeeded and was awarded more than A$8 million.[4]

Crucially, the defendants were held liable to compensate MWP even in respect of the clients that the arbitrators subsequently held would have in any case left MWP. Thus, there was an inconsistency between the findings of the arbitrators and those of Einstein J which impacted on the quantification of damages and compensation.

The NSW appeal

By the time the matter came before the NSW Court of Appeal, the arbitrators had rendered their interim award on liability. Messrs Nicholls and Slater argued that they could not have any greater liability than that of Mr Emmott as determined in the interim award and that therefore instituting and maintaining the NSW proceedings was an abuse of process. The NSW Court of Appeal agreed and allowed the appeal.

The Court's reasoning deserves closer attention. As a general principle, while the categories of abuse of process are not closed, one recognised category is when proceedings are initiated against a party in a second forum while proceedings are pending between the same parties in another forum.[5] That was not strictly the case here, as different parties were involved. However, the NSW Court of Appeal drew on this category to find, by analogy, that there had been an abuse of process due to the existence of related proceedings, namely the London arbitration.

Basten JA emphasised that MWP had been partly unsuccessful in the London arbitration and that its pursuit of those failed claims in NSW amounted to a 'collateral challenge' on the findings made in the arbitration.[6] His Honour appeared concerned that MWP was seeking to obtain a better result against the defendants than it had obtained against Mr Emmott.

"The defendants [to the NSW litigation] could not be joined as parties to the London arbitration as their employment contracts … did not contain arbitration clauses. Mr Emmott … could not be compelled to join the litigation because of the [London] arbitration clause in his contract."

Agreeing, Lindgren AJA acknowledged that the trial judge had handed down his decision before the arbitral tribunal's interim award but did not seem to consider this an important fact.[7] He held that it would be vexatious and oppressive, and would bring the administration of justice into disrepute, if MWP could argue that Messrs Nicholls and Slater bore accessorial liability to a greater extent than the liability of the principal, Mr Emmott.[8] Their liability should therefore be limited by the London arbitrators' findings against Mr Emmott and MWP should not be permitted to argue otherwise. In this regard, His Honour noted that there may be a risk of double recovery.[9]

The NSW Court of Appeal ordered a new trial in which MWP would be prohibited from obtaining a better result against Messrs Nicholls and Slater than it had obtained against Mr Emmott in the London arbitration. MWP obtained special leave to appeal to the High Court of Australia.

The High Court decision

The High Court unanimously reversed the NSW Court of Appeal's decision, holding that the NSW Supreme Court proceedings were not an abuse of process. It rejected the reasoning of the NSW Court of Appeal as well as several reformulations of the argument made by the respondents in the High Court.

First, the Court rejected Basten JA's formulation of an abuse of process by 'collateral challenge' to the arbitration. It noted that the Supreme Court proceedings had been initiated and that judgment had been handed down by Einstein J *before* the interim award was rendered. The High Court held that the proceedings therefore could not amount to a collateral attack on the arbitrators' findings on liability as there was not yet a relevant award to attack.[10]

Secondly, the Court rejected Lindgren AJA's characterisation of the abuse of process. The majority held that there would be no risk of double recovery as Messrs Nicholls and Slater would have an equity to prevent this.[11]

Thirdly, the Court pointed out that not all of MWP's claims against Messrs Nicholls and Slater related to Mr Emmott's breach of fiduciary duty: MWP had also made claims in contract and tort. Thus, it could not be said that the respondents' liability was limited by nature and extent to the relief that MWP obtained against Mr Emmott in the arbitration.[12]

Fourthly, the Court noted that liability for breach of fiduciary duty by a principal and that of a knowing assistant can, and often does, differ in nature and extent. For example, the

principal may have made no profit from the default, while the knowing assistant may have profited greatly. Consequently, the liability of Messrs Nicholls and Slater in the litigation did not depend on the relief MWP obtained against Mr Emmott in the arbitration.[13]

Obiter, the High Court commented that MWP would not have been prevented from pursuing its case against Messrs Nicholls and Slater even if the arbitrators had found that Mr Emmott had *no* liability for breach of fiduciary duty.[14] Similarly, the Court accepted that the NSW Supreme Court could have made findings that Mr Emmott was liable for breach of fiduciary duty, even though he was not a party to the litigation.[15]

The High Court concluded with a general statement that pursuing claims in multiple fora against parties whose liability arises out of similar conduct does not inexorably lead to the conclusion that there is an abuse of process.[16] It therefore allowed the appeal and remitted the matter back to the NSW Court of Appeal for further hearing of the issues that had not been decided.

Comment

This case represents a welcome clarification of the law of abuse of process in the context of arbitration. In essence, it is clearly not necessarily an abuse of process to initiate litigation proceedings while arbitration proceedings concerning the same transactions, but between different parties, are pending. Nor is it necessarily an abuse of process to raise arguments that are inconsistent with the findings made in such an arbitration.

This will not, however, always be the case. On different facts, such proceedings could amount to an abuse of process if the plaintiff tried to set up the *same* case as was to be heard and determined in the related arbitration. The High Court's reasoning indicates that this may require a detailed technical analysis of the parties' respective liabilities. The decision indicates that this kind of abuse of process is difficult to establish unless the allegations and relevant liability in the arbitration and litigation are identical (or at least substantially identical). The High Court did not expressly rule out the possibility that an abuse of process may arise even when the two relevant proceedings involve different parties whose liability arises out of the same transactions. The manner in which the High Court rejected each of the respondents' arguments seems to indicate, however, that such situations will be rare.[17] That said, by leaving open the possibility, the law on this matter is not entirely settled.

> **"The High Court concluded ... that pursuing claims in multiple fora against parties whose liability arises out of similar conduct does not inexorably lead to the conclusion that there is an abuse of process."**

The problem of reliance on an award by a non-party

A point that is not clearly addressed in the judgments is that neither of the defendants had any right to make submissions in the London arbitration. This raises an interesting question: to what extent should a party be bound by, or (as in Messrs Nicholls and Slater's case) be able to benefit from, an arbitration to which it is a stranger?[18] The NSW Court of Appeal did not appear to think there was a problem with extending arbitrators' findings to affect a non-party, but there are some clear issues with this.

One problem is that such a principle could unfairly affect the non-party. Suppose, for example, that the London arbitration had made adverse findings against Messrs Nicholls and Slater. It would seem unfair to bind them to these findings as they were unable to make any submissions in the arbitration. One way around this problem, which the NSW Court of Appeal may have implicitly accepted, would be to hold that the non-party can *benefit* from findings in an arbitration, but not be adversely affected by them. Thus, the NSW Court of Appeal allowed Messrs Nicholls and Slater to rely on the arbitrators' findings that limited their liability.

This leads to other problems, however. Most importantly, it creates a 'one-way entitlement':[19] only the non-party to the arbitration can use the arbitrators' findings in subsequent proceedings. It seems unfair and wrong in principle for a stranger to an arbitration (here Messrs Nicholls and Slater) to be able to pick and choose the findings that are favourable to it, while prohibiting a party to the arbitration (here MWP) from relying on findings that are adverse to the stranger.[20] It may also be noted that arbitration, as a private form of dispute resolution, is not normally intended to have consequences for third parties.[21]

No matter how it is dealt with, there are clearly problems in extending arbitrators' findings to affect non-parties in subsequent proceedings. The better option in such circumstances is therefore to permit issues to be re-argued in subsequent court proceedings, as the High Court of Australia held. This does mean that there is a risk of inconsistent decisions arising out of a multiplicity of proceedings, but this is the preferable option in light of the problems outlined above.[22]

Cross-border complex litigation and arbitration

The case also demonstrates the difficulty inherent in an international multi-party, multi-contract dispute, whether in arbitration or otherwise. Because the relevant contracts did not contain a common dispute

resolution clause, MWP was left with little choice but to pursue multiple proceedings in multiple fora. The consensual nature of arbitration meant that Messrs Nicholls and Slater could not be compelled to join the London arbitration as respondents and that Mr Emmott could not be compelled to join the NSW litigation as a defendant.

> **"Practitioners would do well to remember that, at the drafting stage, parties should consider the possibility of a related dispute arising and … includ[ing] a common dispute resolution clause in all of the relevant contracts in order to avoid disputes in multiple fora and possibly permit consolidation."**

Practitioners would do well to remember that, at the drafting stage, parties should consider the possibility of a related dispute arising and adapt their dispute resolution clauses accordingly. Parties can, for example, make it clear that the relevant contracts are related and that any dispute should be resolved in a single proceeding. Another option is to select a seat and procedural rules that permit consolidation of arbitral proceedings where, *inter alia*, a common question of law or fact arises in multiple arbitral proceedings or where the claims arise out of the same transactions.[23]

Without doubt, it would have been preferable for MWP to have included a common dispute resolution clause in all of the relevant contracts in order to avoid disputes in multiple fora and possibly permit consolidation.

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1 (2011) 244 CLR 427.
2 Unlike Mr Emmott, however, it does not appear that Messrs Nicholls and Slater became shareholders or directors of MWP.
3 Per the Arbitration Act 1996 (England & Wales), ss 68 and 69: see *Michael Wilson & Partners Ltd v Emmott* [2011] EWHC 1441 (Comm).
4 *Michael Wilson and Partners Ltd v Nicholls & Ors* [2009] NSWSC 1377.
5 *Michael Wilson & Partners Ltd v Nicholls & Ors* (2011) 244 CLR 427 at [90].
6 *Nicholls & Ors v Michael Wilson & Partners Ltd* [2010] NSWCA 222 at [104].
7 *Ibid* at [225] and [295].
8 *Ibid* at [401].
9 *Ibid* at [393].
10 *Michael Wilson & Partners Ltd v Nicholls & Ors* (2011) 244 CLR 427 at [99].
11 *Ibid* at [101].
12 *Ibid* at [105].
13 *Ibid* at [106].
14 *Ibid* at [107].
15 *Ibid* at [107].
16 *Ibid* at [110].
17 *Ibid* at [100]-[109]
18 These questions have been discussed by the English courts in similar cases using the language of issue estoppel: see *Sun Life Assurance Co of Canada & Ors v The Lincoln National Life Insurance Co* [2004] EWCA Civ 1660; *George Moundreas & Co SA v Navimpex Centrala Navala* [1985] 2 Lloyd's Rep 515. It appears that Messrs Nicholls and Slater assumed that issue estoppel was unavailable to them on the basis that they were not parties to the arbitration: see *Nicholls & Ors v Michael Wilson & Partners Ltd* [2010] NSWCA 222 at [393].
19 This phrase was used by Mance LJ (as he then was) in the *Sun Life* case (*supra*, note 18) at [50].
20 *Ibid* at [65]-[66].
21 *Ibid* at [86-88].
22 *Ibid* at [68].
23 See s 24 of the International Arbitration Act 1974 (Cth) which, like Schedule 2, section 2 of the Hong Kong Arbitration Ordinance (Cap 609), applies on an opt-in basis. See also art 10 of the ICC Rules of Arbitration 2012, which provides some scope for consolidation.

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