

Be Careful and Honest in What You Say: Fraud in Arbitration

by Vincent Moran QC

Vincent Moran QC acted for the successful Claimant in *Celtic v Knowles*, the first reported decision under the 1996 Arbitration Act (“the Act”) in the construction field setting aside or remitting an award in arbitration because it was obtained by fraud. In this article he lays out the background to the case and the implications of the TCC’s decision.

Introduction

The Claimant (“Celtic”) and the Defendant (“Knowles”) had been involved in a long running arbitration arising out of a fee claim by Knowles (“the Arbitration”) for services provided to Celtic in relation to various adjudication claims made against a third party, Devon County Council (“DCC”). The Arbitration was conducted pursuant to an “ad hoc Arbitration Agreement” between the parties and, in light of a Partial Award in the Arbitration, the fee claim (put at £1.2m) was capped in a maximum potential sum of £178k and was in any event, Celtic contended, subject to a complete defence of set off that will negate any potential recovery.

Celtic’s application was to set aside a part of a further Interim Award, dated 6 September 2016, arising out of an interim application by Knowles pursuant to s39/47 of the Act for certain declarations relating to Knowles’ conduct with DCC. Celtic’s application was made pursuant to s68(2)(g) of the Act, on the basis that

Knowles deliberately (or recklessly) misled the Arbitrator when making the s39/47 application by adducing false evidence as to its behaviour in connection with claiming its outstanding fees from DCC, instead of from Celtic.

Celtic’s Case

Celtic’s case was as follows:

- a. Knowles made its s39/47 application to the Arbitrator for a number of declarations, including ones to the effect that, in accordance with the terms of the ad hoc Arbitration Agreement, (i) it had withdrawn/ extinguished certain historic invoices previously served by Knowles on DCC in respect of part of its alleged fee/payment entitlement against Celtic, (ii) it had provided a Deed of Indemnity and Waiver, and (iii) it was no longer pursuing DCC for the previously invoiced sums.
- b. In support of its application, Mr Rainsberry and Knowles made representations and adduced evidence to the effect that Knowles (i) had withdrawn/extinguished its historic invoices served on DCC, (ii) had not issued further invoices for the relevant sums, (iii) considered itself bound by the Deed of Indemnity and Waiver, and (iv) was no longer pursuing DCC for these sums.
- c. These representations were misleading in light of the content of recent prior correspondence (“the March 2016 Correspondence”) – which, to the contrary, showed that Mr Rainsberry/Knowles (i) had not withdrawn/extinguished the invoices, (ii) had re-claimed (and effectively re-invoiced) the sums previously the subject matter of the ‘withdrawn’ invoices, (iii) did not consider itself bound by the Deed of Indemnity and Waiver, and (iv) were still claiming these sums direct against DCC.

d. The Court could conclude that it was likely that Knowles deliberately misled the Arbitrator in the above respects having regard to (i) the immediate background leading up to the s39/47 application, (ii) the content of the March 2016 Correspondence, (iii) the failure of Mr Rainsberry/Knowles to bring this correspondence to the Arbitrator's attention, (iv) the incredible explanation provided by Mr Rainsberry for his conduct and (v) the absence of any other evidence to support Mr Rainsberry's 'explanation'.

e. Even if Mr Rainsberry's explanation for the March 2016 Correspondence was accepted, it is clear that he deliberately misled the Arbitrator in respect of the matters referred to above (or was at least reckless).

The Law

Section 68 of the Arbitration Act 1996 provides that:

"(1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court challenging an award in the proceedings on the ground of serious irregularity affecting the tribunal, the proceedings or the award. A party may lose the right to object (see section 73) and the right to apply is subject to the restrictions in section 70(2) and (3).

(2) Serious irregularity means an irregularity of one or more of the following kinds which the court considers has caused or will cause substantial injustice to the applicant:

...

(g) the award being obtained by fraud or the award or the way in which it was procured being contrary to public policy;"

An award may therefore be set aside if either (i) it was obtained by fraud or (ii) the award, or the way it was procured, is contrary to public policy – although the Courts have interpreted these limbs consistently.¹ Where the allegation is fraud in the production of evidence, an applicant must make good the allegation by the production of cogent evidence of fraud by a party to the arbitration that was not available at the time of the award and would have had an important influence on the result.²

Section 68(2)(g) of the Act is not concerned with an innocent failure to

provide accurate evidence or proper disclosure, but with extreme cases in which there is "dishonest, reprehensible or unconscionable conduct"³. Fraud must be established to the heightened burden of proof as discussed in *Hornal v Neuberger Products Ltd* [1954] 1 QB 247, *Re H Minors* [1996] AC 563 and *The Kriti Palm* per Rix LJ at paragraphs 256-259.

Background

The Arbitration was concerned with fee claims arising under three separate fee agreements made between the parties regarding the adjudication of certain disputes with DCC (referred to as Adjudications 6, 7 and 8). At the start of their relationship, the parties entered into a Deed of Assignment which, Celtic contended, made Knowles' entitlement to payment of fees contingent upon receipt by Celtic of the proceeds of the Adjudications against DCC.

Knowles interpreted the Deed of Assignment as giving it a right to make claims for its alleged outstanding fees to third parties that owed Celtic money and first made direct claims for payment of such sums from DCC after the decision in Adjudication 6. This led DCC to seek an injunction and declarations in relation to the anticipated claim by Knowles/Celtic for the said Adjudication 6 sum – and, on 14 February 2014, the TCC made an Order declaring, amongst other matters, that the Adjudicator did not have jurisdiction to order the payment of sums to Knowles.

After the further decision in Adjudication 8, to the effect that DCC pay Celtic a sum of money (on 3 and 7 February 2014), Knowles again served invoices on DCC claiming an entitlement to be paid directly by DCC in relation to its outstanding fees – and in spite of the TCC decision dated 17 January 2014. DCC refused to pay these sums and Knowles thereafter commenced the Arbitration on 19 March 2014 seeking payment of some of its alleged Adjudication 8 fee entitlement. The Arbitration was by the ad hoc Arbitration Agreement subsequently expanded to include the disputes connected with Knowles' fee entitlements in respect of Adjudications 6 and 7 as well.

Knowles' interim application, which was the subject matter of the s68 application, included a request for declarations in respect of the fulfilment of certain conditions of the ad hoc Arbitration Agreement.

Declaration 1 was sought in the following terms:

"A declaration that Knowles has complied with paragraph 3 of the Arbitration Agreement as it has withdrawn its invoices served on Devon County Council."

Paragraph 3 of the ad hoc Arbitration Agreement stated:

"That Knowles will withdraw and extinguish its invoices served on Devon County Council" (my emphasis).

The Arbitrator's determination on this matter on 6 September 2016 found that Knowles had withdrawn and extinguished those invoices which it had previously issued against DCC by the issue of the credit notes referred to above.

Declaration 2 was sought in the following terms:

"A declaration that Knowles has complied with paragraph 4 of the Arbitration Agreement in that it has provided an indemnity in favour of DCC indemnifying the latter against Knowles pursuing sums owed by DCC to CBE under an assignment in favour of Knowles dated 19.11.10."

Clause 4 of the Ad Hoc Arbitration Agreement (which Knowles' Declaration 2 is seeking to cover) states:

"THAT Knowles will provide an indemnity in favour of Devon County Council in the matter of the Celtic BioEnergy Ltd assignment in favour of Knowles and that it will not pursue Devon County Council for such sums as are owed by Devon County Council" (my emphasis).

The Arbitrator's determination on this matter on 6 September 2016⁴ found that Knowles had complied with the terms of paragraph 4 of the ad hoc Arbitration Agreement in that (i) it had provided a form of indemnity and waiver in favour of DCC in a form which was agreed with Celtic, and (ii) Knowles did not retract its agreement to the Deed of Indemnity in the letter dated 27 November 2014.

Developments after the Interim Award

Celtic obtained information in the March 2016 Correspondence to the effect that Knowles had misled the Arbitrator in relation to Declarations 1 and 2 set out above. In particular, it was clear from Knowles' letter to DCC of 16 March 2016 that Knowles were continuing to seek payment from DCC at that time, on the premise that they were entitled to do so pursuant to the Deed of Assignment.

¹ see Russell on Arbitration (24th edn) at paragraphs 8-112; Merkin Arbitration Act 1996 (5th edn) at pages 315-317

² (see Russell on Arbitration (24th edn) at paragraphs 8-112 to 8-118; Double K Oil Products v Nestle Oil Oyj [2009] EWHC 3380, per Blair J at paragraphs 33-35)

³ see Chantiers De L'Atlantique SA v Gaztransport & Technigaz SAS [2011] EWHC 3383 per Flaux J at paragraphs 55-61; Profilati Italia Srl v Paine Webber [2001] 1 All ER 1065; Gater Assets Ltd v Nak Naftogaz Ukrainy [2008] EWHC 237 at [39]-[40]

⁴ at 1/26/221-224

However, the position and submissions taken by Knowles before the Arbitrator were to exactly the opposite effect i.e. that it had withdrawn and extinguished its invoices to DCC, had not issued a further invoice, was not still pursuing such a claim and had provided (and not retracted) a valid DOIW to and in favour of DCC which it was still content to abide by. No indication was provided on the part of Knowles in the March 2016 Correspondence that it was withdrawing or changing this stance as to its existing entitlement to and demand for payment as previously communicated in the earlier correspondence.

Celtic's case was that Knowles and Mr Rainsberry had therefore misled the Arbitrator by asserting:

- a. In relation to Declaration 1, that they (i) had *withdrawn and extinguished* its invoices, thereby removing its alleged claim/entitlement to be paid direct by DCC and the associated bar to payment of proceeds by DCC into the stakeholder account, and (ii) had not re-issued or reclaimed or pursued the same from DCC – at a time when the Knowles claim had been re-asserted, re-invoiced and not finally withdrawn by virtue the March 2016 Correspondence.
- b. In relation to Declaration 2, that the Defendant had (i) provided the required Deed of Indemnity, (ii) not revoked the same, and (iii) not pursued DCC direct for the relevant sums.

Knowles denied that there had been any possible deceitful misrepresentations on its part.

Importantly, however, Knowles did not suggest that it had simply forgot to mention the March 2016 Correspondence during its s39/57 application – by an oversight or carelessness – and did not deny that the March 2016 Correspondence, on its face, completely contradicted the position it had taken previously on Declarations 1 and 2 before the Arbitrator. Initially, Mr Rainsberry's only explanation offered was that (i) Knowles had been intending to elicit an acknowledgment from DCC that it would rely upon the Deed of Indemnity (because the Celtic had previously argued that an impediment to any settlement between it and DCC was the objections raised by DCC to the Deed of Waiver and Indemnity dated 18 July 2014), and (ii) in any event the correspondence was irrelevant.

Celtic's primary case was that the evidence established, to the required standard, that Mr Rainsberry/Knowles deliberately misled

the Arbitrator by presenting false evidence to the effect that (i) the relevant invoices had been withdrawn and extinguished, (ii) Knowles had not issued further claims/ invoices, (iii) Knowles considered the Deed of Indemnity as still binding on it and the parties generally, and (iv) Knowles was no longer pursuing DCC direct for payment.

Alternatively, even if Mr Rainsberry's explanation of his real motive for writing the March 2016 Correspondence is accepted, nevertheless the evidence shows that he deliberately misled the Arbitrator. In fact, on analysis, the issue of Mr Rainsberry's subjective intention in respect of the March 2016 Correspondence does not exculpate him or Knowles for providing inconsistent evidence to the Arbitrator and/or failing to disclose the March 2016 Correspondence or its content.

Objectively construed, Celtic contended that it was abundantly clear (and would have been clear, or should have been clear, to Mr Rainsberry) from the March 2016 Correspondence that Knowles, as matter of fact, made (and were still making) a further positive claim to be entitled, by alleged reason of the Deed of Assignment, to payment directly from DCC of the Adjudication 8 Sum. Mr Rainsberry/ Knowles therefore must have known that it was untrue to suggest the contrary to the Arbitrator as part of its s39/47 application – whether or not there was some ancillary or hidden purpose in acting in this way toward DCC in March 2016.

Alternatively, whether guilty of deliberate deception or recklessness, this conduct amounted to dishonest, reprehensible and unconscionable conduct within the meaning of s68(2)(g) of the 1996 Arbitration Act.

The Court's Decision

The Court found that:

- a. The threshold for any challenge under s.68 was high.
- b. It was not sufficient to show that one party had inadvertently misled the other, however carelessly. There had to be some form of dishonest, reprehensible or unconscionable conduct that had contributed in a substantial way to obtaining the award.
- c. There might be cases in which recklessness as to whether a statement was true or false might amount to fraud within the meaning of s.68(2)(g).

d. To establish that there had been a substantial injustice, the applicant had to show that the true position, or the absence of the fraud, would probably have affected the outcome of the arbitration in a significant way⁵.

e. Mr Rainsberry had deliberately misled the Arbitrator as alleged by Celtic and that the Interim Award should therefore be remitted back to the Arbitrator for further consideration.

f. This conclusion would have been reached whether or not Mr Rainsberry's explanation had been accepted.

g. The parts of the award challenged were to be remitted to the Arbitrator for reconsideration⁶.

Specifically in relation to Declaration 1, Jefford J held:

"50. It seems to me clear that extinguishing an invoice must mean that the claim on which the invoice was based is extinguished..."

52. Although that correspondence initially made no references to the invoices themselves, the sums claimed were those invoiced. At the conclusion of Knowles's exchanges with DCC, the claims had not been withdrawn and were still extant..."

53. The omission of any reference to the March correspondence by Knowles was, therefore, utterly misleading. It created the impression that by issuing the credit notes in 2014, the claims had been extinguished when Knowles had, just months earlier in 2016, been making the same claims."

Her Ladyship remarked after quoting from the cross-examination of Mr Rainsberry:

"95. This evidence or argument had not been mentioned in Mr Rainsberry's witness statement. It evaded the issue and had all the hallmarks of having been concocted to advance a case that a letter that claimed money and threatened legal proceedings if that money was not paid was not, in fact, a claim, because Mr Rainsberry knew full well, and knew at the time of the application to the arbitrator, that a letter that made a claim against DCC was inconsistent with Knowles having extinguished its claims against DCC and inconsistent with its not pursuing DCC for payment, and ought to have featured in the arbitration....."

⁵ see paras 65-70, 104 of Judgment.

⁶ paras 90-91, 98, 105-1.

“Celtic’s primary case was that the evidence established, to the required standard, that Mr Rainsberry/ Knowles deliberately misled the Arbitrator by presenting false evidence...”

98. Against this background I have no hesitation in concluding that the failure to draw this correspondence to the attention of the arbitrator was deliberate. I cannot accept that Mr Rainsberry did not recognise that it was relevant to the issues of whether the claims had been extinguished or whether Knowles had not pursued DCC for payment. Nor can I accept that Mr Rainsberry did not know that these were relevant issues. The failure to disclose the March correspondence created a wholly misleading impression...

99. I have already said that I do not find his explanation for the March correspondence credible but, even if I had accepted it, I would still have been unable to accept that Mr Rainsberry thought the correspondence irrelevant.”

And, in relation to Declaration 2, Jefford J held:

“57. In coming to his conclusion as to whether Knowles had given a waiver as required under paragraph 4, the arbitrator considered that he had to take into account whether Knowles had retracted its agreement to the waiver. He did so and concluded that they had not and that, therefore, the condition in paragraph 4 had been complied with.

58. In fact, Knowles’ demand for payment from DCC was completely inconsistent with acceptance that the first Deed of Waiver was valid and, on its face, only consistent with Knowles adopting a position that it was for some reason not valid (as DCC had feared)...

60. It is therefore hardly surprising that CBL’s case on this application is that the failure to tell the arbitrator about this correspondence was completely misleading and amounted to fraud. CBL’s primary case was that Knowles’ misled the arbitrator deliberately; its alternative position was that Knowles did so recklessly...

74. The letter dated 16 March 2016 claimed payment of the same sums as had been invoiced, together with a further sum, with the threat of legal proceedings if the sums were not paid. Thus Knowles had pursued DCC for payment after the date of the first Deed of Waiver and, even if the claim and the threat were not pursued, they were never withdrawn. It is no answer to say that the letter did not say what it said because Mr Rainsberry did not really mean what he said...

79. The March correspondence on its face started with an aggressive demand for payment that flew in the face of the first Deed of Waiver...

94. Mr Moran QC posed the same question in relation to paragraph 4 of the arbitration agreement (which provided that Knowles would not pursue DCC):

“Q: If it were a letter of claim, it would be a breach, wouldn’t it?”

A: No


Q: Well, can you just explain that? If [it] were claiming the adjudication 8 sums and pursuing DCC direct, how would that not be a breach of paragraph 4 of the ad hoc arbitration agreement?

A: This letter is not a letter of claim. If a different letter existed which was a letter of claim, that could be a breach of 4. But a different letter doesn’t exist.”

As to the requirement under s68(2)(g) to show substantial injustice before an award will be remitted:

“109. It seems to me that where the key issue is one that would potentially be affected by the material not put before the arbitrator it must follow that CBL have suffered a substantial injustice – namely the wrong result. In any event, the arbitrator made a costs order against CBL which must have been affected by the outcome of the application...

115. I will, therefore, remit the parts of the award that are challenged to the arbitrator so that he can consider his award in possession of the full facts.”



Although it was not necessary to consider Celtic's alternative case in recklessness, Jefford J concluded:

"101. ...Neither party was able to identify any case in which a court had decided one way or the other whether recklessness as to the truth of a statement could amount to fraud within the meaning of s.68(2)(g). High Court Approved Judgment: Celtic -v- Knowles 31.

102. Mr Moran QC's position was simple. In the civil context, fraud can be equated with or could require no more than the tort of deceit. The elements of the tort of deceit are (a) a representation which is (b) false and (c) dishonestly made and (d) intended to be relied upon and in fact relied upon. As Rix LJ put it in *The Kriti Palm* [2006] EWCA Civ 1601 at [256]:

"As for the element of dishonesty, the leading cases are replete with statements of its vital importance and of warnings against watering down this ingredient into something akin to negligence, however gross. The standard direction is still that of Lord Herschell in *Derry v Peek* (1889) 14 App Case 337 at 374: "First, in order to sustain an action in deceit, there must be proof of fraud and nothing short of that will suffice. Secondly, fraud is proven when it is shown that a false representation has been made (1) knowingly, (2) without belief in its truth, or (3) recklessly, careless of whether it be true or false."

103. Accordingly, a false statement recklessly made would be a dishonest statement in the civil context (if not the criminal). As a matter of legal analysis, there is considerable force in that submission. It does not, however, sit entirely easily with the references in the authorities to "reprehensible and unconscionable" conduct. As I said above the authorities are unclear as to whether dishonest conduct and reprehensible or unconscionable conduct are to be regarded as distinct types of conduct or whether they are synonymous. If they are synonymous, that tends to suggest that "dishonesty" in this particular context involves something more than recklessness.

104. These comments – and they are no more than that – are more consistent with what I have called the synonymous reading of the different types of conduct. It seems to me, without deciding the point, because it is unnecessary for me to do so, that there may be cases in which recklessness as to whether a statement was true or false might amount to fraud within the meaning of s.68(2)(g) if there is some other element of unconscionable conduct..."

Implications of the Decision

On one level, given the fact sensitive nature of s68 applications, the wider significance of this decision is difficult to predict.

However, it is suggested that the case emphasises the following:

a. The willingness of the Court in clear cases to interfere with arbitral proceedings;

b. The need to be careful when making representations to and adducing evidence before arbitral tribunals;

c. The possible need to produce, or at least take account of, relevant correspondence or documentation even if no specific order for disclosure has been made in relation to the specific application or hearing.

Perhaps the most startling feature of the case is that it represents an unusual willingness of a Court to make a finding of fraud in a civil context. This may encourage other parties on other cases to more frequently allege that tribunals have been 'deliberately misled'.

Further, there was an interesting question of law raised in the case – namely whether 'recklessness' as to whether representations are true or not was sufficient to establish 'fraud' for the purposes of s68(2)(g) of the AA 1996. Although, given the finding on deliberate dishonesty, it was not necessary for the Court to consider this aspect of Celtic's case the Court did appear to give support to that proposition; albeit with the caveat of "if there is some other element of unconscionable conduct...".

It is respectfully suggested that this may have been too restrictive an analysis. It is not entirely clear why an application under s68(2)(g) of the Act, based merely upon recklessness, should require some other element of unconscionable conduct.

The authorities appear to have interpreted the required element of 'fraud' to include "dishonest, reprehensible or unconscionable conduct". Knowingly making a representation without caring whether it be true or not is a form of dishonesty (in the law of deceit) or, it is suggested, should be considered by itself as amounting, at the very least, to a form of 'unconscionable conduct'.