ARBITRATION CLAUSES AND SHAREHOLDER DISPUTES: ARE "FUSSY DISTINCTIONS" UNDERMINING EFFICIENT DISPUTE RESOLUTION?

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In 2007, the House of Lords declared that it was time to make a "fresh start" in the English approach to the scope and effect of arbitration clauses. In the *Fiona Trust* decision, Lord Hoffman held that "the construction of an arbitration clause should start from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal". Lord Hope put the matter more bluntly, holding that a reader of a simple arbitration clause should not trouble himself with "fussy distinctions".[1]

The recent Ontario Superior Court decision in *Haas v. Gunasekaram & Feng*,[2] refusing to enforce an arbitration clause in a shareholders' agreement, raises the issue of whether a "fresh start" is needed in Canada as well. If the decision is followed, the resulting uncertainty over the scope and enforceability of arbitration clauses in shareholders' agreements and other contracts is only likely to lead to more costly "litigation over arbitration" until either appellate courts or legislative reform resolve the problem.

The Shareholders' Dispute and the Motion to Stay

The litigants in the *Haas* case were all shareholders of an Italian restaurant in downtown Toronto. The plaintiff claimed that he had been induced to enter into the shareholders' agreement by fraudulent misrepresentations concerning the restaurant's business prospects and the way it would be managed. He sued the defendants for misrepresentation, breach of fiduciary duty and oppressive conduct. The defendants moved to stay the action on the basis of a broadly worded arbitration clause providing that "any dispute ... respecting this Agreement or anything herein contained ... shall be referred to a single arbitrator ...".[3]

Pro-Arbitration in Principle, but Not in Practice

The Ontario Superior Court cited the leading decisions from the Supreme Court of Canada and the Ontario Court of Appeal regarding the approach on a motion to stay an action in favour of arbitration. This jurisprudence requires the validity of arbitration clause to be decided by an arbitrator in first instance unless

the matter involves a pure question of law or one of mixed fact and law requiring only "superficial consideration of the documentary evidence".[4] The stay should only be refused if it is "clear" that the matter falls outside of the arbitration agreement.[5]

Here, the plaintiff alleged that the claims fell outside the scope of the arbitration clause because they dealt with the creation of the agreement, rather than its breach.[6] The Court only partially agreed with this characterization, but it still allowed the entire action to proceed.

"Contractual in Substance": A Fussy Distinction?

The Court began by considering whether each of the plaintiff's claims were "contractual in substance" and whether the arbitration clause was simply "factual background". It found that both the misrepresentation and the breach of fiduciary duty claims were not "contractual in substance", but acknowledged that the oppression claim relied on breaches of the shareholders' agreement.[7]

On this first issue, the Court appears to have suffered from a mistaken belief that only claims containing an element of contractual breach can be arbitrated. This runs counter to repeated court decisions finding that tortious claims or those based on breaches of statutory provisions are arbitrable.[8] Here, the plaintiff himself characterized his misrepresentation claim as dealing with the "creation of the agreement". Therefore, it was at least arguable that the claim dealt with a matter "respecting the Agreement".

Similarly, as the contents of the shareholders' agreement covered the running of the business, it is difficult to see why a claim for breach of fiduciary duty is not connected to that agreement. The shareholders' agreement was not simply an extraneous part of the factual background, such as in a wrongful dismissal action by an employee who also happens to be a shareholder. It was the very result of the alleged misrepresentations and was relevant to the defendants' impugned fiduciary obligations.

Rewarding Strategic Pleading?

Having found that some but not all of the claims were subject to the arbitration clause, the Court exercised its discretion under the Ontario *Arbitration Act*, 1991 to refuse a stay. Here, the Court appeared to make two further errors. First, the Court should not have applied this statute in lieu of the Model Law contained in the *International Commercial Arbitration Act*. The Court applied the *Arbitration Act*, *1991* because the restaurant that was the "subject matter of the dispute" was situated in Ontario. However, the Model Law still applies to disputes with a subject matter situated in Ontario as long as "the parties … have, at the time of the conclusion of that agreement, their places of business in different States". Here, the plaintiff was an overseas resident and so the Model Law applied.[9] Unlike its domestic counterpart, the Model Law on International Commercial Arbitration does not give a court discretion to refuse a stay.

Second, the refusal to stay the case appeared to reward strategic behaviour by the plaintiff. The plaintiff had initially pleaded several contractual claims, but abandoned most of them in the face of the motion to stay. Although the Court believed that refusing to stay the claims would avoid increased costs and delay of parallel arbitration and litigation, its refusal to sanction strategic behaviour creates an incentive that increases inefficiency. It encourages plaintiffs to attempt an end run around arbitration clauses through artful pleading - conduct that itself is costly and time-consuming.

Drafting Considerations for Efficient Dispute Resolution

Although the issues considered in *Haas* are not limited to shareholders' agreements, these types of agreements are perhaps the most vulnerable ones to strategic litigation to circumvent arbitration clauses. By their very nature, shareholders' disputes may often combine contractual claims with claims for breach of fiduciary duty or oppression. In order to minimize the scope for "litigation over arbitration", parties should consider the following issues in drafting dispute resolution clauses for these contracts:

- *Is arbitration appropriate*? Many shareholder disputes can be decided by a case-managed application to the Commercial List of the Ontario Superior Court rather than an ordinary civil trial process. In such cases, concerns over the speed of the court process and the commercial expertise of the judge provide less justification for arbitration. Nonetheless, arbitration may still be warranted based on other factors such as the need for a neutral forum and for cross-border enforceability of awards where one shareholder is not resident in Canada.
- *Keep it simple*. Unless there is a compelling business reason to send some disputes to arbitration and others to litigation, it is best to have "one-stop" adjudication and to have the arbitration clause clearly express this intention. In addition, the model clauses for widely used arbitration rules are a good starting point for any drafting exercise. These model clauses incorporate by reference the more detailed procedural rules that will govern the arbitration and avoid more complex wording that can create ambiguities regarding the parties' intention to arbitrate.
- *Use a broadly worded clause*. Although the Haas decision involved a fairly broad arbitration clause, the result might have been avoided if the clause had clarified that it also applied to disputes about the validity of the agreement. For example, the model clause of the London Court of International Arbitration provides that "any dispute arising out of or in connection with this contract, *including any question regarding its existence, validity or termination*, shall be referred to and finally resolved by arbitration ...".
- *Capture all parties*. Shareholder agreements may or may not provide that the corporation is a party to the agreement. For arbitration purposes, an agreement where the corporation is a signatory, along with all shareholders, ensures that the corporation is also bound by the arbitration clause. This may be useful for discovery purposes and for the scope of available remedies.

- *International vs. domestic.* Arbitrations situated in Ontario and involving Ontario businesses may be subject to different legal regimes depending on whether the parties are exclusively Canadian or whether one maintains its place of business outside of Canada. The differences between the regimes should be considered and the appropriate rules should be selected with this issue in mind.

by Robert Wisner

1 *Premium Nafta Products Limited v. Fiji Shipping Company Limited* ("*Fiona Trust*"), [2007] UKHL 40, paras.13, 27.

2 2015 ONSC 5083.

3 *Ibid*. paras.2-4.

4 *Dell Computer Corp. v. Union des consommateurs*, [2007] 2 S.C.R. 801, at para. 84.

5 *Dalimpex Ltd. v. Janicki* (2003), 64 O.R. (3d) 737 at para .22.

6 *Haas v. Gunasekaram & Feng*, supra., para.12.

7 *Ibid*., paras.20-22.

8 *Woolcock v. Bushert* (2004), 246 D.L. R. (4th) 139 (Ont. C.A.).

9 *Haas v. Gunasekaram & Feng*, supra., para.3. The decision does not suggest that the plaintiff only became resident overseas after the conclusion of the agreement, so as to exclude the operation of the Model Law.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.