ARBITRATION CLAUSES AND SHAREHOLDER DISPUTES: CLARITY FROM THE ONTARIO COURT OF APPEAL

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In our August 2015 Litigation Bulletin, we warned that the Ontario Superior Court decision in *Haas v. Gunasekaram & Feng*[1] would create uncertainty over the scope and enforceability of arbitration clauses in shareholders' agreements and other contracts. We also warned that more "litigation over arbitration" would follow until either appellate courts or legislative reform resolved the confusion created by the decision.

Fortunately, the Ontario Court of Appeal recognized these risks and recently reversed the Superior Court's decision.[2] In doing so, the Court of Appeal brought needed certainty to the enforceability of arbitration clauses in shareholder disputes. It confirmed that broadly worded arbitration clauses should be construed so as to allow parties to resolve all of their disputes in their chosen forum, regardless of whether these disputes are based in contract, tort or some other cause of action.

The Superior Court's Refusal to Stay Litigation

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]

The Ontario Superior Court refused the stay of proceedings because it found that both the misrepresentation and the breach of fiduciary duty claims were not "contractual in substance". While the Court acknowledged that the oppression claim relied on breaches of the shareholders' agreement, it exercised its discretion to refuse to stay that claim in light of its finding that the other claims fell outside of the scope of the arbitration agreement.[4]

Clarity from the Court of Appeal

The Court of Appeal held that the motion judge made three errors in refusing to stay the litigation in favour of

arbitration. Each error involved the misapplication of well established legal principles and therefore the motion judge's exercise of discretion was not entitled to deference from the Court of Appeal.[5]

First, the motion judge incorrectly assumed that tort claims fall outside of the scope of an arbitration agreement. This is ultimately a matter of the interpretation of the arbitration clause. Words requiring arbitration of disputes "relating to" or "in connection with" an agreement do not require that the claims be based on breach of contract. Instead, as long as the subject matter of the dispute arguably refers to either the interpretation or the implementation of some provision of the agreement, the arbitrator should determine the scope of the arbitration clause.[6] Here, the arbitration clause was broadly drafted and the tort claims all depended in some way on matters encompassed by the shareholders' agreement, even if they did not presuppose a breach of that agreement.

Second, the motion judge incorrectly assumed that a fraud claim vitiates an arbitration agreement. However, an allegation that a contract is void *ab initio* does not make it so until a final judgment is rendered. Broadly worded arbitration clauses do not exclude claims for fraud or illegality.[7] The existence of such a fraud is a matter for the arbitrator to decide.

Third, the motion judge incorrectly exercised his discretion to refuse a stay by failing to advert to the law's policy of enforcing arbitration agreements and letting arbitrators decide the scope of their authority. In light of its findings on the first two issues, the Court of Appeal noted that the motion judge's assumption of a multiplicity of proceedings was incorrect. Furthermore, a multiplicity of proceedings itself is not dispositive and must be weighed against the policy in favour of arbitration.[8]

The Court of Appeal illustrated how such considerations should be balanced in light of the fact that one of the defendants in the litigation below had not appealed the refusal to stay the litigation. While the Court of Appeal noted that this created a risk of multiple proceedings, it observed that this risk could be overcome by the plaintiff taking action to include this remaining defendant in any new arbitration. There was no dispute that all parties were bound by the arbitration agreement and the Court of Appeal therefore left it to the parties to agree to a stay of the remaining litigation in favour of arbitration.[9]

Drafting for Efficient Dispute Resolution

The Court of Appeal's decision reinforces the importance of a well drafted arbitration clause in cases where the parties prefer to have their disputes resolved outside of litigation. This is particularly important in shareholder disputes where claims for breach of fiduciary duty or oppression may arise independently of any breach of contract. In such cases, the parties should consider the following points in drafting their clauses:

- *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*. The Haas decision involved a fairly broad arbitration clause and this was instrumental to the Court of Appeal's decision to reverse the motion judge. However, the result below might have been avoided if the clause had expressly stated 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] 2015 ONSC 5083.
[2] Haas v. Gunasekaram, 2016 ONCA 744
[3] *Ibid*. paras.1, 22 and 28.
[4] *Ibid*., para.22.
[5] *Ibid*., para.31
[6] *Ibid*., paras.32-34
[7] *Ibid*., paras.36-39
[8] *Ibid*., paras.50-58
[9] *Ibid*., paras.57-58

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.