ARBITRATION CLAUSES SHOULD BE RESPECTED, MOST OF THE TIME: SUPREME COURT OF CANADA SHIFTS FOCUS AWAY FROM SINGLE PROCEEDING MODEL FOR INSOLVENCIES IN RENDERING ARBITRATION CLAUSE INOPERATIVE

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The Supreme Court of Canada's decision in *Peace River Hydro Partners v. Petrowest Corp.*[1] establishes a new framework for deciding whether an arbitration clause ought to be rendered inoperative owing to a receivership. The presumption remains that an arbitration clause should be enforced, but in the right set of circumstances it may be disregarded to promote the efficient advancement of an insolvency proceeding.

Petrowest also takes the analysis in a direction that is different from a trend that was developing. In cases like the Ontario Court of Appeal's decision in *Mundo Media Ltd., (Re)*,[2] courts were inclined to attenuate the presumption in favour of arbitration, emphasizing the importance of the single proceeding model of insolvency law. We summarized the Court of Appeal's decision in *Mundo Media* in our previous bulletin.

Following *Petrowest*, those responsible for maximizing value for creditors in an insolvency proceeding and looking to avoid an arbitration clause governing a dispute involving the debtor must show that the arbitration would compromise the efficiency of the insolvency proceeding. Otherwise, the arbitration clause ought to govern. On the other side of the coin, those requesting that a debtor's claim against them proceed in accordance with an arbitration agreement are wise to advance evidence of the purpose for which arbitration was chosen, and of a willingness to have an arbitration proceed expeditiously.

Background

In December 2015, Peace River Hydro Partners ("**Peace River**") agreed to subcontract construction work to Petrowest Corporation ("**Petrowest**"). The parties executed several contracts providing that disputes arising from their relationship were to be resolved through arbitration (the "**Arbitration Agreements**").

In 2017, following financial difficulties, Petrowest was placed into receivership pursuant to s. 243 of the *Bankruptcy and Insolvency Act*[3] (the "***BIA***") and an order of the Alberta Court of King's Bench. The Receiver sued Peace River in the British Columbia Supreme Court claiming over $10 million in accounts receivable owed

to Petrowest and its affiliates. Peace River applied to stay the BC proceedings under s. 15 of the BC *Arbitration Act*[4] (the "***Arbitration Act***") on the ground that the Arbitration Agreements governed the dispute. The Receiver opposed the stay application arguing that the Arbitration Agreements did not bind it.

Notably, the Receiver did not rely on the single proceeding model in its opposition to Peace River's application. Indeed, the Receiver was appointed by the Alberta Court of King's Bench, but was pursuing the claim against Peace River in British Columbia, opting for litigation of the matter in another province instead of applying for directions or a declaration within the receivership proceeding in Alberta.

Decision in the Court Below

At first instance, the Supreme Court of British Columbia agreed with the Receiver and dismissed the stay application, finding that the Receiver was not bound by the Arbitration Agreements. In its reasoning, the chambers judge focused on the inefficiency that would result from participating in multiple arbitral proceedings, which would seemingly conflict with the objective of the *BIA* favouring an efficient resolution to insolvency proceedings. Peace River appealed the lower court's decision right up to the Supreme Court of Canada.

Decision at the Supreme Court of Canada

The Supreme Court of Canada considered the circumstances in which an otherwise valid arbitration agreement may be inoperative where a party was subject to insolvency proceedings under the *BIA*. The Supreme Court ultimately dismissed the appeal, finding that the Arbitration Agreements were inoperative in the circumstances.

Writing for the majority, Justice Côté observed that as a starting point, valid arbitration agreements should generally be respected. This is supported by a decisive line of Supreme Court of Canada jurisprudence, the pro-arbitration stance adopted by provincial and territorial legislation across Canada, and the foundational principle that parties are free to contract as they see fit.

Although recent decisions have highlighted the tension between arbitration law and insolvency law, Justice Côté explained that the two areas of law have much in common; each prioritizes efficiency and expediency, requires procedural flexibility, and relies on specialized decision makers to achieve their respective objectives. Where these interests converge through arbitration, parties should be held to their agreement to arbitrate notwithstanding ongoing insolvency proceedings.

However, the majority considered that in certain insolvency matters, it may be necessary to preclude arbitration in favour of a centralized judicial process where arbitration would compromise the orderly and efficient conduct of the insolvency proceeding. Although the Ontario Court of Appeal in *Mundo Media* agreed

that arbitration should sometimes give way to a centralized judicial process, its conclusion was grounded in a different line of argument.

In *Mundo Media*, the Ontario Court of Appeal ruled that a party should not be allowed to contract out of the single proceeding model where it will have a serious adverse affect on creditors. The Ontario Court of Appeal focused on whether the party arguing to uphold the arbitration clause was a stranger to the bankruptcy, and the materiality of the party's dispute to the debtor's estate. The Court of Appeal did not grapple with the competence-competence principle, that arbitrability is generally decided by an arbitrator and not a court, even though arbitration legislation empowers courts to determine whether an arbitration agreement is inoperative.

In *Petrowest*, the Supreme Court shifted the focus away from the single proceeding model and the materiality of the claim at issue to the insolvency proceeding as a whole. Indeed, since the Receiver, who was appointed in Alberta, had commenced a claim in British Columbia, it couldn't very well argue that the single proceeding model was at all relevant. Instead, Justice Côté focused on the orderly and efficient resolution of the insolvency proceeding. Justice Côté accepted that respect ought to be afforded to the competence-competence principle, but that a court could decide the issue of arbitrability if the party looking to avoid arbitration could establish on a balance of probabilities that the arbitration agreement was inoperative.

As for how a party ought to go about demonstrating that the arbitration agreement was inoperative, the Supreme Court acknowledged that the issue was not settled. Justice Côté wrote that cases interpreting the word "inoperative" in the context of arbitration legislation were clear that matters such as inconvenience, multiple parties, intertwining of issues with non-arbitrable disputes, possible increased costs, and potential delay generally will not by themselves be grounds to find an arbitration agreement inoperative. However, since the *BIA* is remedial legislation, and is to be given a liberal interpretation that promotes the efficient distribution of a bankrupt's funds to various creditors, sections 243 and 183 of the *BIA* ought to be interpreted as providing jurisdiction to find an arbitration agreement "inoperative" where enforcing it would compromise the orderly and efficient resolution of insolvency proceedings.

The Supreme Court outlined a list factors that may be considered in determining whether a court should exercise its jurisdiction to find an arbitration agreement "inoperative."

First, the Court may consider the effect of an arbitration on the integrity of the insolvency proceedings. In *Petrowest*, the Court found that the effect of arbitration would have been "chaotic", requiring the Receiver to participate in, and fund, at least four different arbitrations involving seven sets of counterparties. The Court agreed that this approach would lead to "facts and arguments repeated in multiple forums, before different decision makers, creating piecemeal decisions and a serious risk of conflicting outcomes."[5]

Second, a Court might consider the relative prejudice to the parties to the arbitration agreement, on the one

hand, and the debtor's stakeholders on the other hand. The court should override an agreement to arbitrate "only where the benefit of doing so outweighs the prejudice to the parties."[6] In applying this factor, the Supreme Court of Canada agreed that Peace River failed to demonstrate any prejudice it would suffer if the Arbitration Agreements were not enforced. The Court observed that a single court proceeding, albeit in British Columbia and not the existing receivership proceeding in Alberta, as opposed to four separate arbitrations, would be more efficient and cost-effective for both parties.

Notably, the appellant does not seem to have advanced evidence on the normal reasons that parties push for arbitration agreements, including the ability to choose a decision maker with appropriate expertise and the ability to keep the dispute and the filed evidence confidential. Parties selecting arbitration as a means of resolving disputes should thus take note. If the expertise of the potential decision maker and the ability to retain confidentiality is important, evidence of a mutual understanding of that importance at the time the agreement was entered may impact a court's decision to enforce an arbitration clause where one party to the dispute is subject to insolvency proceedings.

Last, a court may consider the urgency of resolving the dispute. A court should generally prefer the more expeditious procedure; if the effect of a stay pending arbitration would postpone the insolvency proceeding, this militates towards a finding of inoperability. In *Petrowest*, the Supreme Court of Canada considered that proceeding through the courts was the more expeditious option, and that the difficulty of distributing Petrowest's proceeds to creditors until an arbitration was resolved further militated in favour of the court system.

The analysis here was interesting for at least two reasons. First, it does not appear that either of the Supreme Courts of British Columbia or Canada considered, in *Petrowest*, the period of time it would take for the Receiver's civil claim in British Columbia to wind its way through the system and to trial. Notwithstanding the evidence of the complexity of the arbitration that would flow from enforcing the Arbitration Agreements, it isn't clear that getting to trial outside of arbitration would ever be any quicker.

Second, the delay that the resolution of the claim against Petrowest caused to a distribution of funds to Petrowest's creditors in the Alberta receivership wasn't exceptional. Final distributions in a receivership are often delayed by a single, complicated matter, that the receiver must pursue to a conclusion before making any material payments out to creditors. The receiver, and creditors, often have to consider whether the potential benefit of seeing a claim of the estate through outweighs the costs of doing so, including the time-value of money. It isn't clear why a receiver and creditors ought to be assisted in this calculus opposite contractual counterparties to the debtor who bargained for disputes with the debtor to be decided through arbitration.

In any event, it is now clear that a party looking to enforce an arbitration clause opposite litigants that must answer to an insolvency court ought to advance evidence of a willingness to streamline their arbitration as much as practical to optimize the chances of retaining the bargained-for right to arbitrate.

Conclusion

Petrowest provides clarification on when an insolvency proceeding will displace arbitration. It shifts the focus away from the importance of the single proceeding model and the materiality of the amount at issue to the estate as a whole as previously set out in the Ontario Court of Appeal's decision in *Mundo Media*.

Where parties have agreed to arbitration, valid arbitration clauses will generally be respected. The party seeking to avoid arbitration bears the "heavy onus" of showing that a statutory exception applies, such as the agreement being inoperative. The Supreme Court of Canada's analytical framework inherently makes the application of an arbitration clause in an insolvency proceeding a case-by-case, fact-specific determination, such that the enforceability of a clause is only known after a robust application of the new framework. *Petrowest* gives parties who wish to arbitrate a guide to drafting an arbitration clause such that it will be enforceable even in the face of an insolvency by including reference to a mutual understanding of the importance of having an arbitrator with specialized expertise and retaining confidentiality. The decision also calls on a party to introduce evidence of a willingness to streamline a contemplated arbitration when the other party, answering to an insolvency court, looks to avoid arbitration.

[1] 2022 SCC 41 [*Petrowest*].
[2] 2022 ONCA 607 [*Mundo Media*].
[3] RSC, 1985, c. B-3.
[4] RSBC 1996, c. 55, s. 15.
[5] *Petrowest* at para 175.
[6] *Petrowest* at para 155.

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A Cautionary Note