
# SINGLE PROCEEDING MODEL TRUMPS CONTRACTUAL RIGHTS - ARBITRATION CLAUSE HELD "INOPERATIVE" IN INSOLVENCY PROCEEDING

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A recent decision of the Ontario Court of Appeal invalidated an arbitration and forum selection clause in a commercial agreement in favour of having a dispute between the debtor and its former customer adjudicated within a receivership proceeding.

In *Mundo Media Ltd., (Re)*,[1] the Court of Appeal compelled one party to defend its position in an Ontario court despite an existing contractual arrangement providing for arbitration in New York under New York law. The decision in Mundo Media provides that the "single proceeding" model of insolvency law may usurp the normal function of an arbitration and forum selection clause where the fallout of a financial collapse of one of the parties to the clause calls for a more efficient resolution of the dispute from the perspective of the insolvent party's creditors.

**The Facts**

In 2017, Mundo Media Ltd. ("**Mundo**") and SPay Inc. ("**SPay**") entered into two separate contracts. Each contained an arbitration clause requiring all disputes, including the arbitrability of the dispute, to be arbitrated in New York under New York law. In 2019, the Ontario Superior Court of Justice placed Mundo in receivership.

The receiver brought a motion for an order directing SPay to pay unpaid invoices to Mundo totaling US$4,124,000. Shortly afterwards, SPay sought to stay the receiver's motion on the basis of the arbitration clauses.  At first instance, the receiver's motion was granted.

On appeal, the Ontario Court of Appeal addressed whether the claim by the receiver, as part of an insolvency proceeding under the *Bankruptcy and Insolvency Act*, justified voiding the arbitration agreement and forum selection clause between SPay and Mundo as a result of the "single proceeding" model of insolvency.

**"Single Proceeding" Model – What is it?**

The single proceeding model is a legal concept intended to bring efficiency to the insolvency process. It

promotes a collective process that supersedes individual claims by different creditors. Traditionally, it groups possible actions against the debtor into a single proceeding in a single jurisdiction, as opposed to fragmented proceedings in multiple forums. The model puts creditors on equal footing, and avoids the risk that a more aggressive creditor will realize on its claims against the debtor, while other creditors lose out through attempting to compromise with the debtor.[2]

For the single proceeding model to apply to a third party who is not already involved in the insolvency proceeding, such as SPay, the party must not be a stranger to the insolvency proceeding.[3]

In *Mundo*, SPay argued it was a stranger to the insolvency proceeding such that the pre-condition for the application of the single proceeding model was not met. Moreover, SPay argued that the model is only meant to centralize claims *against* a debtor, rather than by a debtor. Thus, SPay reasoned that since it was not making a claim *against* Mundo, the model should not apply.

**The Single Proceeding Model Prevails Over an Arbitration Clause**

The Court of Appeal rejected SPay's arguments. It observed that the claim against SPay represented the largest account receivable of the bankrupt's estate, and, as such, was "inextricably interwoven" in the bankruptcy proceeding.[4] In particular, the receiver's claim against SPay was the largest claim of the estate for the receiver to pursue. Moreover, SPay's proposed set-off to the receiver's claim would significantly impact other creditors. In all of those circumstances, it was held that SPay was not a "stranger" to the proceeding.[5]

The Court of Appeal reasoned that allowing SPay to avoid the single proceeding model would defeat the model's purpose: to avoid inefficiency and chaos caused by the decentralization of a receivership process.[6] Regardless of the form of SPay's set-off claim, whether asserted as a claim or a defense, SPay would "step into the shoes" of a creditor to Mundo and should be placed on the same footing as other creditors. The Court stated that permitting otherwise would effectively allow SPay to use the form of proceeding to obtain priority where it is not otherwise warranted.[7]

Notably, the Court of Appeal agreed with the lower court judge that the arbitration clause between SPay and Mundo was rendered inoperative by the single proceeding model in Ontario. As such, the court avoided the requirement under the *International Commercial Arbitration Act*, *2017* (Ontario) to refer Mundo's claim against SPay to arbitration absent, among other things, inoperability of the arbitration agreement.

The court did so without reconciling the Supreme Court of Canada's guidance in *Dell Computer Corp. v. Union de consommateurs* that "a challenge to the arbitrator's jurisdiction must be resolved first by the arbitrator" except where "the challenge to the arbitrator's jurisdiction is based solely on a question of law."[8] While the Court of Appeal seems to have framed the issue as a question of law – whether the single proceeding model

rendered the arbitration clause invalid – the Court engaged extensively with the factual record to determine whether SPay was a stranger to the bankruptcy and thus whether the single proceeding model had any application. Since a detailed review of the facts was necessary, it's unclear why it was appropriate to treat the inoperability of the arbitration agreement solely as an issue of law, and an explanation as to why the Supreme Court of Canada's strong guidance set out in *Dell* did not apply would have been welcome.

The Court also observed that ordinarily the single proceeding model is used as a "shield" so that debtors can protect themselves from having to defend against claims in multiple proceedings or jurisdictions. However, the Court saw no jurisprudence precluding the model from being used as a "sword", which permits a debtor to proactively assert the model as a means of consolidating claims in one forum, regardless of an arbitration clause.[9] On the facts before it, the Court stated that the use of the model as a sword aligns with the model's purpose, and this may supersede an arbitration clause. As stated by the Justice Thorburn: "parties should not be allowed to contract out of the single proceeding model where one party may make claims that will seriously adversely affect all creditors."[10]

These observations are also interesting. With respect to jurisprudence precluding the model from being used a "sword", Supreme Court of Canada jurisprudence requires that a forum selection clause be respected absent "strong cause" for ignoring it, and the factors going to the assessment of "strong cause" are applied restrictively in a commercial context.[11]

The use of the model as a sword, to recover a disputed receivable, is also not compellingly aligned with the purpose of the single proceeding model. The purpose of the model, as conceived, is to avoid the inefficiency and chaos of having the estate representative attend to claims against the debtor in multiple jurisdictions, and to obtain assistance from the court overseeing the restructuring or liquidation process in recovering specific property of the debtor. Outside of those circumstances, the model would not appear to be relevant. No reported decision had previously held that a party with no interest in commencing any proceeding against the debtor could be drawn into a Canadian insolvency proceeding to defend against a claim by the debtor for damages.

**Takeaway**

The decision of the Ontario Court of Appeal in *Mundo Media* continues a trend toward expanding the reach of Canadian insolvency courts. The effect of the trend is that the interests of creditors are preferred over contractual rights of parties that ask for nothing from the debtor, insofar as those parties bargained for a right to defend any claim by the debtor in a different forum.

While the outcome is difficult to reconcile with long-standing jurisprudence on the enforceability of those types of provisions outside the bankruptcy and insolvency context, the jurisprudence is now clear. In particular,

typical arbitration and forum selection clauses are likely ineffective where a debtor's claim against a contractual counterparty is of any material significance to recovery for creditors.

[1] 2022 ONCA 607 [*Mundo Media*].
[2] *Ted Leroy Trucking [Century Services] Ltd.*, *Re*, 2010 SCC 60 at paras 6, 22.
[3] *Mundo Media* at para 42.
[4] *Mundo Media* at para 46.
[5] *Mundo Media* at paras 48-50.
[6] *Mundo Media* at para 48.
[7] *Mundo Media* at para 51.
[8] *Dell Computer Corp.v. Union des consommateurs*, 2007 SCC 34 at paras. 84-85.
[9] *Mundo Media* at para 52.
[10] *Mundo Media* at para 52.
[11] *Douez v. Facebook, Inc.*, 2017 SCC 33 at para 31.

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**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.