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Supreme Court of Canada: Arbitration agreements may be inoperative where 'chaotic arbitral processes' would compromise resolution of a receivership

December 13, 2022

By Alfred Pepushaj

The Supreme Court of Canada's ("**SCC**") recent decision in *Peace River Hydro Partners v Petrowest Corp.*, 2022 SCC 41 ("***Peace River***"), clarified whether, and in what circumstances, a contractual agreement to arbitrate should give way to a court-ordered receivership under s. 243 of the *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3 ("***BIA***").

Background

In December 2015, Peace River Hydro Partners and related corporations ("**Peace River**") were formed to build a hydroelectric dam in British Columbia. Peace River subcontracted to Petrowest Corporation and its affiliates ("**Petrowest**"). The agreements between Peace River and Petrowest contained various clauses providing that the parties would resolve any disputes through arbitration ("**Arbitration Agreements**").

Petrowest subsequently became insolvent, and the Alberta Court of Queen's Bench (as it then was) appointed Ernst & Young as receiver ("**Receiver**") pursuant to s. 243 of the *BIA*.

The Receiver commenced a civil claim against Peace River to recover amounts it allegedly owed to Petrowest for work that had been completed. In response, Peace River applied for a stay of the Receiver's civil claim under s. 15 of the former B.C. *Arbitration Act*[i] on the basis that the contracts between the parties contained mandatory arbitration clauses ("**Civil Claim Proceedings**").

Section 15 (as it then was) stated, in part:

(1) If a party to an arbitration agreement commences legal proceedings in a court against another party to the agreement in respect of a matter agreed to be submitted to arbitration, a party to the legal proceedings may apply, before filing a response to civil claim or a response to family claim or taking any other step in the proceedings, to that court to stay the legal proceedings.

(2) In an application under subsection (1), the court must make an order staying the legal proceedings unless it determines that the arbitration agreement is void, inoperative or incapable of being performed.

The B.C. Supreme Court Decision

The chambers judge of the B.C. Supreme Court dismissed Peace River's stay application, thereby allowing the Receiver to continue the Civil Claim Proceedings.[ii] Although the chambers judge found that s. 15 of the former *Arbitration Act* was "engaged," which would have required her to stay the Civil Claim Proceedings, Justice Iyer relied on her "inherent jurisdiction" to dismiss the stay

application. She found that s. 183 of the *BIA* empowered her to disrupt "private contractual rights" in order to achieve fairness in the bankruptcy or insolvency process and to promote the underlying objectives of the *BIA*, such as the proper administration and protection of a bankrupt's estate. The chambers judge concluded:

[…] I agree that the inherent jurisdiction of the court should be used sparingly. However, the significant cost and delay inherent in the multiple proceedings that would occur in this case as compared to judicial determination is unfair to the creditors and contrary to the objects of the BIA.

On that basis, I conclude that granting the stay sought by the defendants would significantly compromise achievement of the objectives of the BIA in relation to the bankruptcy proceedings.[iii]

Peace River appealed the chamber judge's decision on the basis that, among other things, courts do not have inherent jurisdiction under s. 183 of the *BIA* to decline the mandatory stay contemplated by s. 15 of the *Arbitration Act*.

The B.C. Court of Appeal Decision

The B.C. Court of Appeal upheld the chamber judge's decision, but with different reasoning.[iv]

The Court of Appeal did not consider whether the chambers judge had discretion under the *BIA* and instead, it relied on the doctrine of separability in arbitration law to dismiss Peace River's appeal. The doctrine of separability permits an arbitration clause to be treated as a "self-contained contract collateral to the containing contract."[v] Accordingly, the Court of Appeal held that a receiver could disclaim an otherwise valid arbitration agreement, notwithstanding that the receiver adopts the containing contract for the purpose of suing on it.

According to the B.C. Court of Appeal, s. 15 of the *Arbitration Act* was not engaged on the basis that the Receiver, by commencing the Civil Claim Proceedings, had disclaimed the Arbitration Agreements. Accordingly, the Receiver was not a party to the Arbitration Agreements and therefore, s. 15 of the *Arbitration Act* did not apply. If the Receiver was a party, its disclaimer rendered the Arbitration Agreements "void, inoperative or incapable of being performed" within the meaning of s. 15(2) of the *Arbitration Act*.

Peace River appealed the B.C. Court of Appeal's decision.

The Supreme Court of Canada's Decision

Majority Decision

In two concurring judgments, the SCC held that Peace River's appeal should be dismissed.

The main question before the SCC was: In what circumstances is an otherwise valid arbitration agreement unenforceable under s. 15(2) of the *Arbitration Act* in the context of a court-ordered receivership under the *BIA*.

Justice Côté, writing for the five-member majority, set out a two-part framework for stays of proceedings in favour of arbitration.

1. **Technical Prerequisites**

Under the first part of the framework, the applicant for a stay in favour of arbitration must establish the technical prerequisites on the applicable standard of proof. Justice Côté set out the following four "technical prerequisites":

- an arbitration agreement exists;
- court proceedings have been commenced by a "party" to the arbitration agreement;
- the court proceedings are in respect of a matter that the parties agreed to submit to arbitration; and
- the party applying for a stay in favour of arbitration does so before taking any "step" in the court proceedings.

The standard of proof under the first part of the framework is lower than the usual civil standard. The applicant must only make out an "arguable case" that the four technical prerequisites are met.

In the case at bar, Justice Côté found that Peace River had established an "arguable case," thereby meeting the four technical prerequisites. She noted, among other things, that the Receiver is a "party" to the Arbitration Agreements—rejecting the B.C. Court of Appeal's holding—on the basis that receivers, as officers of the court, are not precluded from being considered a party to an arbitration agreement within the meaning of s. 15(1); s. 15(1) does not preclude non-signatories like receivers from being considered parties; and preventing arbitration in receivership would subvert the core arbitral principles of party autonomy.

2. **Statutory Exceptions**

In the second part of the framework, the party seeking to avoid arbitration must show, on a balance of probabilities, that one or more of the statutory exceptions applies. One such exception is when the arbitration clause is "void, inoperative or incapable of being performed," as set out in s. 15(2) of the *Arbitration Act*. If the party seeking to avoid the stay fails to establish same, the court must grant a stay of the proceedings.

Justice Côté set out the following non-exhaustive list of factors to determine whether an arbitration agreement is inoperative under s. 15(2):

- **The effect of arbitration on the integrity of the insolvency proceedings:** An arbitration agreement may be inoperative if it would lead to an arbitral process that would compromise the objective of the insolvency proceedings (i.e., the orderly and expeditious administration of the debtor's property). In the instant case, the "chaotic nature" of the arbitral proceedings chosen by the parties would undermine the orderly and efficient resolution of the receivership, to the detriment of affected creditors and contrary to the purpose of the *BIA*. For example, in this case the Receiver would have been required to participate in and fund at least four different arbitrations involving numerous counterparties and at least some of Petrowest's claims involved entities not subject to any of the Arbitration Agreements, which meant these claims might have to be determined by a court, in parallel with the arbitral proceedings.
- **The relative prejudice to the parties to the arbitration agreement and the debtor's stakeholders:** The court should override the parties' agreement to arbitrate their dispute only where the benefit of doing so outweighs the prejudice to them. Peace River did not demonstrate that it would suffer any prejudice should the Civil Claim Proceedings be allowed to continue.
- **The urgency of resolving the dispute:** The court should generally prefer the more expeditious procedure. If the effect of a stay in favour of arbitration would be to postpone the resolution of the dispute and hinder the insolvency proceedings, this militates in favour of a finding of inoperability. In this case, it would not have been possible to distribute the proceeds of Petrowest's property to their creditors until the dispute was resolved, thereby militating in favour of finding the Arbitration Agreements inoperative.
- **The effect of a stay of proceedings arising from the bankruptcy or insolvency proceedings:** Bankruptcy or insolvency legislation may impose a stay that precludes any proceedings, including arbitral proceedings, against the debtor. If such a stay applies, the debtor cannot rely on an arbitration agreement to avoid the bankruptcy or insolvency; the agreement becomes inoperative. In the instant case, the stay did not apply since the Receiver commenced the Civil Claim Proceedings on the debtors' behalf.
- **Any other factor the court considers material in the circumstances** : The Court's language with respect to this factor reflects its position that the exercise is a highly factual one and that courts may be asked to consider additional factors when asked to

determine the operability of an arbitration agreement.

In ultimately dismissing Peace River's appeal, Justice Côté found that the "chaotic nature" of the arbitral process set out in the Arbitration Agreements (e.g., multiple overlapping proceedings) was the determinative factor in this case. Therefore, enforcing the Arbitration Agreements would have compromised the orderly and efficient resolution of the receivership proceedings, contrary to the objectives of the *BIA*.

Concurring Decision

Justice Jamal, writing for the four-member minority, agreed with Justice Côté's analysis that pursuant to ss. 183 and 243 of the *BIA*, courts have jurisdiction to hold that an arbitration agreement is "inoperative" and dismiss a stay application accordingly. However, Justice Jamal's point of departure was that the provisions of the receivership order authorized the Receiver to sue in court and to disclaim the Arbitration Agreements, thereby rendering the Arbitration Agreements inoperative.

Takeaway

While the SCC's decision in *Peace River* arose in B.C.'s *Arbitration Act* context, the court noted that the general components to the stay provisions in arbitration legislation are similar across various Canadian jurisdictions. Thus, the Court's analysis is relevant beyond the B.C. context.

Arbitration agreements are to be enforced in the insolvency context unless enforcing them would prevent the orderly and efficient resolution of a dispute. Indeed, there is a legislative and judicial preference for holding parties to their arbitration agreement. However, pursuant to ss. 243(1) and 183(1) of the *BIA*, courts may find an arbitration agreement to be inoperative where arbitration would compromise the orderly and efficient resolution of a receivership.

In determining whether a stay of proceedings should be granted in favour of arbitration, the exercise is highly fact-specific. The analysis necessitates considering, among other things, the relevant statutory context, the arbitration agreements in play, as well as the principles of party autonomy, freedom of contract, and the policy objectives of bankruptcy and insolvency law. In particular, this case reaffirms one of the core features of bankruptcy and insolvency proceedings—the "single proceeding model" where all stakeholder rights are enforced through a single centralized judicial process.

[i] The B.C. *Arbitration Act,* RSBC 1996, c. 55, was repealed and replaced in 2020 by *Arbitration Act*, SBC 2020, c 2.

[ii] *Petrowest Corporation v Peace River Hydro Partners*, 2019 BCSC 2221 ("**B.C. Supreme Court Decision**") at para. 34.

[iii] B.C. Supreme Court Decision, *ibid*, at paras. 60-61.

[iv] *Petrowest Corporation v Peace River Hydro Partners*, 2020 BCCA 339 ("**B.C. Court of Appeal Decision**").

[v] B.C. Court of Appeal Decision, *ibid*, at para. 54.

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