THE HON FRANK
J C NEWBOULD KC

Arbitrating insolvency issues – *a Canadian Perspective*

In Canada, a number of lower court decisions had dealt with the issue of permitting arbitration clauses made in pre-filing agreements to be used to determine issues arising in insolvency cases.

On November 10, 2020, the Supreme Court of Canada delivered its much-anticipated decision in *Peace River Hydro Partners v. Petrowest Corp.,* 2022 SCC 41 dealing with the issue in a receivership. In a five to four decision, it laid down guidelines to be used in deciding whether to permit arbitration in an insolvency. Whether these guidelines lead to an increased permission to use arbitration in an insolvency context remains to be seen.

Peace River was a partnership formed to build a hydroelectric dam in British Columbia. It subcontracted work to Petrowest, an Alberta-based construction company, and its affiliates. The parties made several agreements governing their relationship which contained arbitration provisions. Each applied to a different set of potential disputes and provided for different arbitration procedures. Some of the purchase orders did not contain arbitration clauses.

Petrowest and its affiliates encountered financial difficulties and were placed into receivership in Alberta under section 243(1) of the Bankruptcy and Insolvency Act (BIA), a federal statute applicable throughout Canada. Ernst & Young was appointed Receiver of Petrowest under a typical order that gave it the powers to take action on behalf of Petrowest.

The Receiver brought a civil claim in the Supreme Court of British Columbia against Peace River seeking to collect accounts receivable allegedly owed to Petrowest and the Petrowest affiliates by Peace River.

In Canada, arbitration statutes provide for litigation in the courts to be stayed if the dispute is the subject of an arbitration agreement. This is the same with the UNCITRAL Model Law governing international arbitration.

Peace River applied to stay the civil proceedings under s. 15 of the British Columbia Arbitration Act on the grounds that the arbitration agreements governed the dispute. The Receiver opposed the stay application, arguing that the BIA authorized the court to assert centralized judicial control over the matter rather than send the Receiver to multiple arbitral forums.

The judge at first instance stayed the arbitrations and the BC Court of Appeal dismissed the appeal. The Supreme Court also dismissed the appeal. Justice Côté for the majority held that arbitration was permissible in a receivership but in this case it should not be allowed. Justice Jamal for the minority held that the Receiver had disclaimed the arbitration agreements by suing Peace River in the court to recover the amounts owed so that the Arbitration Act was not engaged.

The B.C. *Arbitration Act* provided:

> 15 (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.

Justice Côté held that the way to resolve differences in the bankruptcy and arbitration regimes was to consider if the arbitration provision would be "inoperative" in the circumstances of any particular case.

> *"[126] The final interpretive issue lies at the heart of this appeal. It boils down to the following question: Where the technical prerequisites in s. 15(1) of the Arbitration Act are met, does s. 15(2) give a court the power to refuse a stay under s. 15(2) by finding that an arbitration agreement has become "inoperative" or "incapable of being performed" because of court-ordered receivership proceedings?"*

Justice Côté stated that the BIA was remedial legislation and to be given a liberal interpretation in order to achieve its objectives. She stated that under s. 243(1)(c) of the BIA, a court may appoint a receiver to, among other things, "*take any... action that the court considers advisable*" if the court considers it "*just or convenient to do so*". She held that this very expansive wording gives judges the "*broadest possible mandate in insolvency proceedings to enable them to react to any circumstances that may arise*" in relation to court-ordered receiverships. Her conclusion on the power of a court was succinct:

> *"In my view, practicality demands that a court have the ability, in limited circumstances, to decline to enforce an arbitration agreement following a commercial insolvency. Said differently, ss. 243(1)(c) and 183(1) provide a statutory basis on which a court may, in certain circumstances, find an arbitration agreement inoperative within the meaning of s. 15(2) of the Arbitration Act."*

Justice Côté provided a non-exhaustive list of factors that may be relevant in determining whether a particular arbitration agreement was inoperative.

(a) The effect of arbitration on the integrity of the insolvency proceedings. Party autonomy and freedom of contract must be balanced with the need for an orderly and equitable distribution of the debtor's assets to creditors. An arbitration agreement may therefore be inoperative if it would lead to an arbitral process that would compromise the objective of the insolvency proceedings, namely the orderly and expeditious administration of the debtor's property. The court should have regard to the role and expertise of the court-appointed creditor representative, if any, in managing the insolvency proceedings.

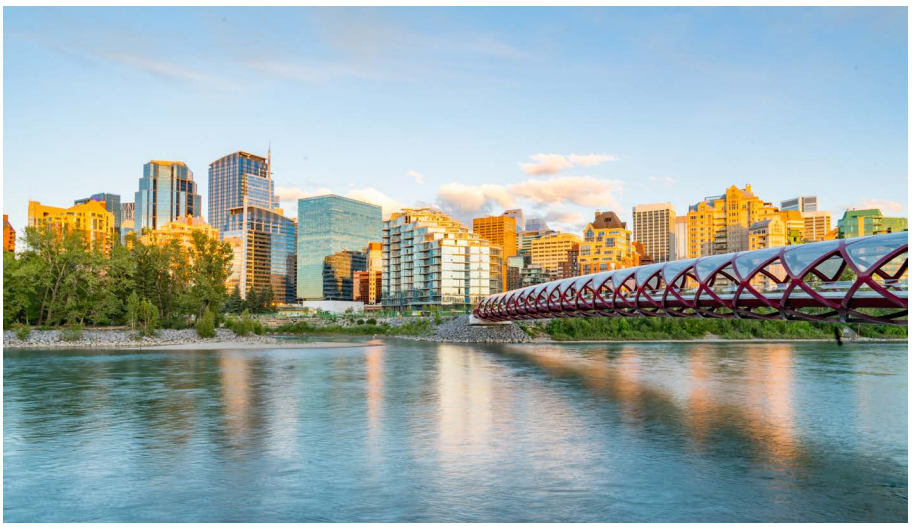
(b) The relative prejudice to the parties from the referral of the dispute to arbitration. The court should override the parties' agreement to arbitrate their dispute only where the benefit of doing so outweighs the prejudice to them.

(c) 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.

(d) The applicability of a stay of proceedings under bankruptcy or insolvency law. 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.

(e) Any other factor the court considers material in the circumstances.

Justice Côté decided that the arbitrations in the case should be stayed, concluding that the inexpediency of the multiple overlapping arbitral proceedings contemplated in the arbitration agreements, as compared to a single judicial process, was the determinative factor in this case.



Some of the claims involved entities not subject to any of the arbitration agreements. Facts and argument would be repeated in different forums, before different decision makers, creating piecemeal decisions and a serious risk of conflicting outcomes.

Justice Jamal for the minority, who held that the Receiver had disclaimed the arbitration agreements by suing in court, agreed with Justice Côté that requiring arbitration of the collection actions would compromise the orderly and efficient resolution of the receivership.

It was understandable in this case on its facts that the Court thought that arbitration should be stayed. Those facts to some extent were extreme and in a simpler case with one arbitration provision agreed by the relevant parties, one may ponder what the result would be, taken the nature of the factors discussed by Justice Côté.

Peace River involved a bankruptcy under the BIA. In Canada, a restructuring of an enterprise is usually undertaken under the Companies Creditors' Arrangement Act, a federal statute applicable throughout Canada with designs similar to a chapter 11 proceeding in the U.S. under the U.S. Bankruptcy Code.

"Facts and argument would be repeated in different forums, before different decision makers, creating piecemeal decisions and a serious risk of conflicting outcomes."

There is little doubt that the principles in *Peace River* would be applicable to arbitration issues under the CCAA. Under the CCAA, section 11 permits a judge to stay *"an action, suit or proceeding"* and courts at the appellate level have held that the word "proceeding" is broad enough to include arbitration proceedings. The jurisdiction of a judge under the CCAA is very broad. Under section 11 a court may make any order it considers appropriate, and this has been interpreted to give courts wide discretion as part of the remedial purpose of the CCAA. See *Ted Leroy Trucking [Century Services] Ltd., Re.* 2010 SCC 60. This discretion is as broad as under the BIA which was held in *Peace River* to be the basis for a court to deal with arbitration issues.

Counsel should bear in mind that in order to succeed in maintaining an arbitration, it will be important to convince a court that it need not control the particular case by having centralized judicial oversight. Factors to consider –

Cost and potential delay will be important factors.

Query whether in overburdened courts, delays of an arbitration will be no greater than in the courts and be less an important factor.

Appeal times from an arbitration decision, which are prescribed by legislation and often in the arbitration agreements, may be no longer than appeal times in the courts.

There are types of disputes that would lend themselves well to arbitration, assuming an arbitration agreement.

Inter-creditor disputes involving priority disputes between secured creditors.

Creditor valuation claims.
In *Peace River*, Justice Côté stated:

> *"This is not to say that a court must decline a stay in favour of arbitration based on inoperability in these circumstances. As Casey notes, it 'may well be that the bankruptcy judge will refer the matter to arbitration as the most expeditious way to prove the creditor's claim'."*

Unfair preference claims, likely under a post-filing *ad hoc* arbitration agreement either agreed or imposed by a court that has such powers.

Time will tell whether arbitrations in insolvency cases will make headway and what the effect of *Peace River* will be. ■