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SCC in recent Petrowest decision says arbitration and insolvency not as different as they may seem

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On November 10, 2022, the Supreme Court of Canada (SCC) released its much awaited decision in *Peace River Hydro Partners v. Petrowest Corp*. (Petrowest). As we have discussed in previous blog posts including a recent piece on the Ontario Court of Appeal's decision in *Mundo Media Ltd. (Re)*, Canadian courts have been faced with the tension between arbitration, a consensual method of dispute resolution where parties can customize their process and select their own decision-maker, and insolvency, where disputes involving the debtor are involuntarily consolidated in a single insolvency proceeding. In Petrowest, the SCC provided further clarity on circumstances in which the single-proceeding insolvency model will render an arbitration agreement "inoperative". More specifically, the SCC refused to stay the civil lawsuit of a receiver in favour of multiple arbitration agreements. Instead the arbitration agreements were deemed to be inoperative to facilitate the insolvency process. It was clear in the decision, however, that this determination will depend on a highly factual analysis.

Factual background

The appellant, Peace River Hydro Partners (Peace River) is a construction partnership formed to build a hydroelectric dam in British Columbia. Peace River subcontracted work to the respondent, Petrowest Corporation (Petrowest Corp), a construction company in Alberta and its affiliates. The contracts between Peace River and Petrowest Corp contained agreements that the parties would arbitrate any disputes (the Arbitration Agreements). When Petrowest Corp experienced financial difficulties, the Alberta Court of Queen's Bench granted an order, pursuant to s. 243(1) of the *Bankruptcy and Insolvency Act* (BIA), appointing a receiver (Receiver) to manage the assets and property of Petrowest Corp and its affiliates. The Receiver then brought a civil claim against Peace River seeking to collect funds allegedly owed to Petrowest Corp and its affiliates for subcontracted work. Peace River applied under s. 15[1] of British Columbia's *Arbitration Act* (the Act)[2] for a stay of proceedings on the ground that the Arbitration Agreements governed the dispute. Both the British Columbia Superior Court and Court of Appeal found that the stay application should be dismissed.

Holding

The Supreme Court of Canada held that the stay application should be dismissed.

Reasoning

The SCC was faced with the question of in what circumstances is an otherwise valid

arbitration agreement unenforceable under s. 15(2)[3] of the Act in the context of a court-ordered receivership under the BIA. Justice Côté, writing for the majority on behalf of Chief Justice Wagner and Justices Moldaver, Rowe and Kasirer, followed a two-part framework for analyzing whether to allow a stay of proceedings in favour of arbitration:

1. Technical prerequisites

The first part of the framework was with respect to technical prerequisites. More specifically that the party applying for a stay of proceedings must establish that the relevant mandatory stay provision in the applicable arbitration statute applies to the arbitration agreement at hand which typically involves meeting the following four "technical prerequisites":

1. There must be an arbitration agreement.
2. Court proceedings must have been started by a "party" to the arbitration agreement.
3. The court proceedings must involve a matter that the parties agreed to resolve via arbitration, and
4. The applicant must apply for a stay before taking any "step" in the court proceedings.

Notably, the applicant must make out an "arguable case" that each prerequisite has been met and all four prerequisites must be established to move to the second stage of the analysis. The majority held that Peace River successfully established an arguable case that all the technical prerequisites were met.

1. Statutory exceptions

In the second part of the analysis, the party seeking to avoid the stay must establish that the arbitration agreement is "void, inoperative or incapable of being performed" on a balance of probabilities. If they fail to do so, the court must grant a stay of the proceedings. Significantly, this analysis necessarily turns on the particular factual scenario before the court. The SCC laid out a list of non-exhaustive factors to consider when making this determination:

1. The effect of arbitration on the integrity of the insolvency proceedings.
2. The relative prejudice to the parties caused by resolving the dispute via arbitration.
3. The urgency of resolving the dispute.
4. The applicability of a stay of proceedings under bankruptcy or insolvency law, and
5. Any other factor the court considers material in the circumstances.

The majority held that the Receiver succeeded in proving that the arbitration agreements were inoperative, because arbitration in this case would compromise the orderly and efficient resolution of the insolvency proceedings.

Arbitration and insolvency have important commonalities

The majority specifically emphasized that arbitration and insolvency law need not always exist at "polar extremes". In fact, they have much in common including an emphasis on efficiency and expediency, procedural flexibility, and expert decision-making. The majority also held that generally courts should hold parties to their agreements to arbitrate even when one of them has become insolvent since to do otherwise would "not only threaten the important public policy served by enforcing arbitration agreements and thus Canada's position as a leader in commercial arbitration, but also jeopardize the public interest in the

expeditious, efficient, and economical clean-up of the aftermath of a financial collapse." (para 10)

Separability and the Receiver's ability to disclaim the arbitration agreements

The majority also held that contrary to the Court of Appeal's conclusion, disclaimer and separability do not affect the Receiver's status as a party to the Arbitration Agreements (para 166). The majority was of the view that the Court of Appeal misapplied the doctrine of separability (the concept that an arbitration agreement is a distinct agreement) as it does not apply absent a challenge to the validity of the main contract or of the arbitration agreement itself and that a consideration of separability was not required to resolve this appeal (para 167). Additionally, the majority reasoned that it is for a court, not a receiver to determine whether an arbitration agreement is valid and enforceable according to the narrow statutory exceptions set out in s. 15(2).

Concurring decision: Focus on the powers of the Receiver under the receivership order

Justice Jamal wrote a brief concurring decision on behalf of Justices Karakatsanis, Brown and Martin. The concurring reasons agreed with the majority that the Arbitration Agreements are inoperative, but reasoned that the Receiver was at liberty to disclaim and render an arbitration agreement inoperative in view of the language of the receivership order. However, the concurring decision agreed with the majority that a receiver cannot unilaterally revoke a valid arbitration agreement by starting a court action pursuant to a receivership.

Takeaways

This decision marks the next chapter in the case law saga of arbitration vs. insolvency law. Arbitration law is typically marked by party autonomy whereas insolvency law has close judicial oversight. However, this decision really emphasizes the shared interests between the two regimes rather than their differences. More specifically – the advantages of efficiency, expediency, procedural flexibility and decision-makers with specialized expertise all highlight that perhaps the regimes are not so different after all. In fact, it is this same goal of efficiency that may result in a stay being refused in the face of an arbitration clause because insolvency proceedings are the most efficient and effective means of resolution in the circumstances. In that regard, it is clear from the SCC's decision that this determination is to be made on a case-by-case basis based on the specific facts at hand. A stay may be refused if enforcing an arbitration agreement prevents the orderly and efficient resolution of a dispute; however arbitration agreements are otherwise enforceable even in the insolvency context.

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[1] Section 15(1) under Stay of proceedings reads as follows: "(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] *Arbitration Act*, RSBC 1996, c 55.

[3] Section 15(2) under Stay of proceedings reads as follows: "(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."