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Peace River Hydro Partners v Petrowest: Are Insolvency and Arbitration at a Crossroads in the Canadian Context?

Vasuda Sinha (Freshfields Bruckhaus Deringer) · Wednesday, February 1st, 2023

On November 10, 2022, the Supreme Court of Canada issued its decision in Peace River v Petrowest. Insolvency and arbitration practitioners alike eagerly anticipated the decision, hoping it would provide clarity on how to resolve challenges that arise when these two specialist areas of practice come together in one case. In this post, we review the decision and consider its implications, as this was not the first and will not be the last jurisprudential showdown between arbitration and insolvency.

Factual and Procedural Background

Peace River Hydro Partners ("Peace River") was a partnership formed to build a hydroelectric dam in the province of British Columbia ("BC"). The relationship between the partners was governed by a General Partnership Agreement and a Guarantee and Cross Indemnity Agreement dated December 17, 2015. In 2015, the construction work was partially subcontracted to a construction company, Petrowest Corp, and its affiliates ("Petrowest"). The work was governed by subcontract agreements ("Subcontract Agreements"), the majority of which contained arbitration clauses ("Arbitration Agreements"), which were not identical. Not long after the project started, Petrowest started facing financial challenges. On August 15, 2017, the Alberta Court of Queen's (now King's) Bench granted a receivership order over Petrowest's assets and property. On August 29, 2018, notwithstanding the Arbitration Agreements, the receiver brought a civil claim in the Supreme Court of British Columbia to collect funds that Peace River allegedly owed to Petrowest.

Peace River applied to stay the receiver's claims under section 15 of the BC Arbitration Act. This provision permits a party to a legal proceeding to obtain a stay if the proceeding was commenced by a counterparty "in respect of a matter agreed to be submitted to arbitration" where the party seeking a stay has not taken any step in the proceeding and where the arbitration agreement is not otherwise void, inoperative or incapable of being performed.

The BC Supreme Court dismissed the application in 2019. Despite finding that the requirements for a stay under section 15 of the Arbitration Act were met, the chambers judge reasoned that the Court had inherent jurisdiction to override the Arbitration Agreements to achieve the proper administration of the debtor's estate through a single proceeding (paras. 35-42). The BC Court of Appeal dismissed Peace River's appeal, rejecting the lower court's exercise of inherent

jurisdiction. Instead, it determined the matter through the doctrine of separability (paras. 47-49, 55), holding that "it [was] open to the receiver to disclaim the arbitration agreements notwithstanding that it has adopted the containing contracts for the purpose of suing on them" because of "the receiver's particular powers and position, and the separability of the arbitration agreements."

On appeal, the Supreme Court of Canada, therefore, had to determine: "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 [Bankruptcy and Insolvency Act]".

The Supreme Court's judgment

The Supreme Court (with majority and concurring opinions written by Justice Côté and Justice Jamal respectively) dismissed the appeal and confirmed the dismissal of Peace River's original stay application.

The Court determined that an application pursuant to section 15 of the Arbitration Act should be granted where the requirements of section 15(1) are met, unless the arbitration agreement is deemed void, incapable of being performed or inoperative under section 15(2). On the facts, it found that the section 15(1) requirements were met, but that a stay of proceedings should not have been granted applying section 15(2) – this being the case because the Arbitration Agreements were inoperative.

1. Technical prerequisites for a mandatory stay of court proceedings

In determining whether a stay was merited under section 15(1), Justice Côté identified four "technical prerequisites", which, if met, meant that the "mandatory stay provision is engaged". These comprised:

- the existence of an arbitration agreement;
- the commencement of court proceedings by a "party" to the arbitration agreement;
- the court proceedings were in respect of a matter that was subject to the arbitration agreement;
- no "step in the proceedings" having been taken by the party seeking the stay.

While the first and third prerequisites were undisputedly met, the fourth question required the Court to determine whether Peace River took a step in the court proceedings started by the receiver when it undertook to file a defence or requested an extension of time to do so. The Court accepted the reasoning of the chambers judge to conclude that they did not.

In relation to the second prerequisite, the receiver contested that it was a party to the Arbitration Agreements. The Court rejected this argument, noting that "an entity connected with a signatory to a contract containing an arbitration agreement may become bound as a 'party' by operation of law" (para. 105). In this regard, the Court confirmed that a party claiming through and under the named party to a contract cannot seek its benefits while avoiding its burdens (paras. 106, 109, 163). Because the receiver is considered to have stepped into the "contractual shoes" of Petrowest, it became bound to the Arbitration Agreements by operation of law (paras. 108-109, 162-164).

In this discussion, the majority concluded that the Court of Appeal had erred in applying the doctrine of separability. In doing so, it appears to repel criticism that its ultimate decision might be seen as casting off the operation of general principles of arbitration practice in Canadian law. In particular, the majority noted that separability only applies where the validity of the main contract or the arbitration agreement itself are being challenged, neither of which applied on the facts. Justice Côté was also reticent to endorse what she saw as the potential implication of allowing separability or disclaimer to enter the analysis, considering that it would "permit all court-appointed receivers to avoid pre-existing arbitration agreements with impunity" and that this would be inappropriate "in view of the clear legislative and judicial preference in favour of party autonomy and arbitral jurisdiction" (para. 169).

2. The statutory exceptions

With section 15(1) engaged, the Court had to determine whether any of the exceptions under section 15(2) applied, such that Petrowest's application for a stay had been properly dismissed.

This required the Court to consider the import and content of the three statutory exceptions: that is, where an arbitration agreement is (i) void *ab initio* (ii) incapable of being performed, meaning unable to be set into motion because of a physical or legal impediment beyond the parties' control, or (iii) inoperative, which had no common law definition (135-145).

Only the third statutory exception was in play. However, given the absence of a controlling definition, the Court had to consider *what* would make the Arbitration Agreements "inoperative" before it could decide *whether* they were so. The majority and concurring opinions differed in their analysis on this question (paras 138-143, 191-193).

In the concurring opinion Justice Jamal answered this question by looking at how the receivership order affected the Arbitration Agreements. He found that the bankruptcy court had authorised the receiver to sue in court to collect the accounts receivable and to disclaim the debtor's contracts. To him, this meant that the receiver had been authorized to disclaim the Arbitration Agreements from the outset (paras. 196-197).

The majority addressed this approach briefly in its decision, noting, amongst other things, that it was not clear that the receivership order authorised the receiver to "take the benefits of the agreements while avoiding their procedural burdens, such as the obligations arising from their arbitration clause" or that the receiver's powers rendered the Arbitration Agreements inoperative in this case (para. 183).

It then had to determine itself what made an arbitration agreement "inoperative". It turned to arbitration authorities and determined the term to cover arbitration agreements that are technically valid but have ceased to have future effect or otherwise become inapplicable, such as for frustration, discharge by breach, waiver, or a subsequent agreement between the parties.

Although cautioning that the "exception for an inoperative arbitration agreement is to be narrowly interpreted" (para. 127) in order to preserve the underlying interests served by arbitration, Justice Côté reasoned that a court could "find an arbitration agreement inoperative where arbitration would compromise the orderly and efficient resolution of a receivership"(paras. 129-130). In her judgment, this interpretation was confirmed by the language of sections 243(1)(c) and 183(1) of

the Bankruptcy and Insolvency Act (the "BIA"), which provided for broad jurisdiction of superior courts in bankruptcy and insolvency matters generally, and in relation to receiverships specifically. While careful not to give license to an argument that all arbitration agreements in the receivership context are inoperative, Justice Côté relied on the oft-quoted principles in insolvency practice of what "justice dictates" and "practicality demands". That is, although the statutory wording was "inoperative", the majority's analysis suggested that its primary concern was with the limits to *operability in the circumstances* (para. 148).

In this light, Justice Côté identified a non-exhaustive list of factors to help navigate the twin demands of justice and practicality:

- the effect of arbitration on the integrity of the insolvency proceedings;
- the relative prejudice to the parties from the referral of the dispute to arbitration;
- the urgency of resolving the dispute;
- the applicability of a stay of proceedings under bankruptcy or insolvency law; and
- any other factor the court considers material in the circumstances (para. 155).

Applying these factors to Petrowest's situation, the majority considered that there were unique circumstances that justified declaring the Arbitration Agreements inoperative. These included that granting the stay would result in the receiver participating in at least four different arbitrations with at least seven different counterparties, all of which would be funded from Petrowest's estate to the detriment of the creditors. At the same time, there were certain claims that were not subject to an arbitration agreement and would have to be determined by a court in any event, thus giving rise to a potential multiplicity of proceedings and conflicting outcomes. Together, these facts meant that holding the receiver to the Arbitration Agreements would "compromise the orderly and efficient resolution of the receivership", possibly hindering its integrity. This would risk the receiver's ability to maximise recovery for creditors, which would in turn be contrary to the objectives of the BIA (para.173).

This conclusion is noteworthy given that the analysis at its outset notes the importance of party autonomy and freedom of contract and that overriding an arbitration agreement may prejudice the parties. That is, Justice Côté's decision suggests that the policy goals underlying arbitration legislation may play second fiddle to the role of the courts in achieving a fair and efficient administration of justice and resolution of disputes – here this was achieved through the rubric of an "inoperative" arbitration agreement. From one perspective, the undertones of this reasoning echo those of the plurality of the Supreme Court in *Uber v Heller* (Justice Côté dissented on this point in that case: *See* paras. 209, 236, 241 *et seq*).

Implications

The crossroad between insolvency and arbitration has been described as "*a conflict of near polar extremes: bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach towards dispute resolution.*"[1)] Courts across different jurisdictions strike different balances between these perceived extremes, often through the management of a stay of proceedings against a debtor that generally comes into play at the outset of an insolvency proceeding. For example, some courts will allow an arbitration notwithstanding an open insolvency if it relates to a dispute that is not core to the insolvency, and other courts will

allow an arbitration to proceed only if it would not impede the insolvency process.

It was anticipated that in the *Petrowest* case the Supreme Court would pronounce on this perceived conflict in the Canadian context, here arising between the role of the single proceeding model in Canadian insolvency practice and tenets of arbitration law, such as party autonomy and *competence-competence*. On its surface, the decision may be seen to do that, as it ultimately determined in favour of the former on the facts at hand.

That said, the decision should not be seen to be throwing overboard the sanctity of arbitration agreements in Canada. Indeed, it confirmed that arbitration agreements to which a debtor is a party are presumptively binding on a receiver who seeks to sue based on the underlying contracts. However, a statutory exception may be in play if proceeding with the arbitration would compromise the orderly and efficient conduct of the receivership. In this way, the decision is perhaps simply the latest reminder that Canadian courts do not consider arbitration agreements to create a dispute resolution process that exists in a vacuum. Whether by statute or operation of law, the courts in Canada play a key role in ensuring both access to, and the fair and efficient administration of, justice; they are unlikely to shy from that role when faced with it in the arbitration context.

** The views expressed herein are those of the author and do not necessarily reflect the views of Freshfields Bruckhaus Deringer LLP. The author thanks Mouna Maaz for her assistance.*

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References

?1 The United States Court of Appeal for the 2nd Circuit, In re United States Lines Inc. 197 F.3d 631, 640.

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