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Exceptions to the binding force of a debtor's arbitration agreement on the Insolvency Practitioner

*Case note on Peace River Hydro Partners v. Petrowest Corp., 2022 SCC 41**

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Abstract

In this decision, the Canadian Supreme Court had to decide whether an insolvency administrator is bound by an arbitration agreement entered into by the insolvency debtor prior to the commencement of insolvency proceedings and, therefore, whether civil proceedings incompatible with this arbitration agreement must be stayed before the state courts. The court affirms the binding nature of arbitration in principle, but allows an exception in the event that the reference to arbitration would be incompatible with the conduct of proper and efficient insolvency proceedings.

Keywords

arbitration, arbitration in insolvency proceedings, insolvency practitioner bound by arbitration agreement, stay of civil proceedings, proper and efficient insolvency proceedings

I. Introduction

The decision of the Canadian *Supreme Court* in *Peace River Hydro Partners v. Petrowest Corp*.[1] deals with the internationally controversial relationship between arbitration law and insolvency law. Essentially, the question is whether the insolvency administrator (of *Petrowest*), who wants to pursue a claim belonging to the debtor's assets against a third party (*Peace River*) via litigation, is bound by an arbitration agreement concluded by the debtor. The court affirmed this in principle, but denied it in the specific case. It is a special case as it did not concern an insolvency administrator in the true sense, but a *receiver* regulated in section 243 (1) of the Canadian Bankruptcy and Insolvency Act, i.e. a receiver appointed by the court for all the debtor's assets at the request of a secured creditor. The reasoning of the judgement applies all the more to insolvency administrators, so that this rather technical difference can be disregarded here. The procedural connecting factor was section 15 of the Canadian Arbitration Act. According to subsection 1 of this provision - reproduced in the judgment at para. 92 - either party may apply for a stay of court proceedings if the dispute has been brought before a state court in breach of an arbitration agreement. Paragraph 2 compels the court to stay (principle) unless the arbitration agreement is "void, inoperative or incapable of being performed" (exception). The latter corresponds to the wording in Art. 8 para. 1

* English translation of a German text, first published in Zeitschrift für Schiedsverfahren (SchiedsVZ) 2023.

[1] 2022 SCC 41; available at https://www.canlii.org/en/ca/scc/doc/2022/2022scc41/2022scc41.html (last visited 24.01.2023).

UNCITRAL Model Law on International Commercial Arbitration[2], Art. II para. 3 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958[3] and in substance to the German § 1032 para. 1 ZPO. Against this background, the decision, supported by the majority opinion of five of the nine judges,[4] is of interest beyond the Canadian legal sphere and that of the common law.

II. Essential aspects of the decision

The Canadian *Supreme Court* has taken up the case with extraordinary thoroughness, comprehensively evaluating case law and literature, including that from abroad[5] . The decision reads like a textbook case on the relationship between arbitration and insolvency law.

A. Basics

The court begins its analysis with an introductory summary (para. 1 - 36) and basic considerations on competence-competence (i.e. a principle which assigns the competence to decide on its own competence to the arbitral tribunal), which the court does not see as an obstacle to decide for itself, in application of state norms, whether the case can be decided by an arbitral tribunal (para. 37 - 43).[6] This is followed by profound explanations of the distinguishing features of arbitration and insolvency proceedings and their divergence or convergence (para. 44 - 75).[7] Here, the difference between arbitration as an bilateral process and insolvency proceedings as collective proceedings is elaborated, preparing an argument that will later be essential for the decision of the case.

B. Reasons for the rejection of the stay

The actual main part of the judgment deals with the question of whether the civil proceedings commenced by the *Petrowest* insolvency administrator (*receiver*) and pending before the state courts must be suspended.

1) To this end, after some general remarks on the stay (para. 76 - 90) and on section 15 of the Arbitration Act (para. 91 - 95), it is first established that the respondents (*Peace River*) are not precluded from raising the defence of there being an arbitration agreement on the ground that they filed an application for an extension of the time for replying to the claimant's lawsuit in the civil proceedings before the state courts (para. 96 - 99).[8]

2) The court then turns to the central question, namely whether the insolvency administrator (*receiver*) is bound by an arbitration agreement concluded by the debtor (para 100 - 118). Here it is elaborated very fundamentally and completely convincingly that the insolvency administrator, similar to an assignee and other legal successors, enters into the legal relationships of the debtor or exercises them - depending on the structure of national law - and must therefore take them over with all their characteristics, including any arbitration agreements, as they were

[2] See *Bantekas* in: Bantekas/Ortolani/Ali/Gómez/ Polkinghorne, UNCITRAL Model Law on International Commercial Arbitration, Cambridge: Cambridge University Press 2020, p. 148 et seq.
[3] For this, see, among others, fn. 5 below.
[4] The minority opinion (para. 190 - 199) comes to the same conclusion, but diverges in its reasoning; cf. also para. 182 - 185.
[5] Examples: The reference at para. 134, 144 et seq. to *Kröll*, The 'Incapable of Being Performed' Exception in Article II(3) of the New York Convention, in: Gaillard/Di Pietro/Leleu-Knobil (eds.), Enforcement of Arbitration Agreements and International Arbitral Awards: The New York Convention in Practice, London: Cameron May 2008, p. 323 et seq.; also the reference in para. 144 to *Schramm/Geisinger/Pinsolle*, Article II, in: Kronke et al. (eds.), Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention, Alphen aan den Rijn: Kluwer Law International, 2010, 37 et seq.
[6] For German law, for example, cf. BGH Neue Juristische Wochenschrift (NJW) 2005, 1125 f.; *Huber*, Zeitschrift für Schiedsverfahren (SchiedsVZ) 2003, 73, 75; *Münch*, Zeitschrift für Zivilprozess (ZZP) 128 (2015), 307, 308.
[7] See also *Bork*, Arbitration in Insolvency, EIRJ-2022-5.
[8] With regard to section 1032 of the Code of Civil Procedure, BGH, Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ) 147, 394, 396 also focuses on the factual motions made at the oral proceedings.

previously structured by the debtor. Therefore, the principle expressed in Germany in § 404 BGB, among others, that claims do not become better or worse because of a legal succession, also applies in this respect.

3) The *Supreme Court* can now turn to the effectiveness of the arbitration agreement itself (para. 119 - 158). To this end, a significant passage of the judgment first examines whether the insolvency administrator can unilaterally withdraw from an arbitration agreement otherwise binding on him or her under the insolvency law rules on executory contracts (para. 119 - 125). At the lower instance, the *Court of Appeal for British Columbia* had affirmed this based on the surprising reasoning that the principle of separation applicable to the relationship between the main contract and the arbitration agreement allows the insolvency administrator to adhere to the main contract but to withdraw from the arbitration agreement.[9] *The Supreme Court* rightly considers this to be a misconception (*cf*. also para. 166 *et seq*.), as it is neither tenable under arbitration law nor under insolvency law. The theory of separation only states that the validity of an arbitration agreement is in principle to be assessed independently of the validity of the main contract. However, it is not a "cherry picking tool" that would allow the insolvency administrator to assume the claim on behalf of the insolvency estate but unilaterally revoke the binding nature of the arbitration agreement. Nothing different applies here for Canadian law than for example German law.[10]

Instead, the central question is whether the opening of insolvency proceedings can suspend the arbitration agreement (para. 126 - 158). To this end, it is first elaborated in the judgment that if an arbitration agreement exists, the stay under section 15(1) Arbitration Act is the rule and the continuation of the civil proceedings under section 15(2) Arbitration Act is the exception, which must therefore be interpreted narrowly (para. 133 *et seq*.). On this basis, the court attempts to strike a balance between arbitration and insolvency proceedings by holding that an arbitration agreement is not generally invalidated by the commencement of insolvency proceedings, but that it must be measured against the objective of orderly and efficient insolvency proceedings in the specific circumstances of the individual case (para. 129).

In the *Supreme Court*'s view, various aspects are relevant here, which, although not individually and each separately, can together lead to the arbitration agreement being irrelevant when viewed as a whole and taking into account the individual case to be decided. For example, the arbitration agreement is regularly unenforceable in the case of actions *against* the debtor, as individual proceedings against the debtor are no longer possible (para. 140 *et seq*.) - an argument that falls short from the comparative point of view insofar as the corresponding rule (e.g. § 87 InsO under German law) concerns *every* individual enforcement of claims, not only those by way of arbitration, and arbitration proceedings may very well ensue after the claim has been filed in the insolvency proceedings and an objection to this filing has been raised.[11] Moreover, according to the *Supreme Court*, there are various circumstances that may result in impracticability (para. 155 *et seq*.). In particular, the concrete effects on the conduct of proper and efficient insolvency proceedings, possible disadvantages for the parties and the urgency of a decision are to be considered.

[9] *Petrowest Corporation v. Peace River Hydro Partners*, 2020 BCCA 339 (available at https://www.canlii.org/en/bc/bcca/doc/2020/2020bcca339/2020bcca339.html - last visited 24.01.2023), para. 45 *et seq*.

[10] On the latter, cf. *Bork*, Zeitschrift für Schiedsverfahren (SchiedsVZ) 2022, 139, 142 et seq.

[11] On this point, *Bork*, Zeitschrift für Schiedsverfahren (SchiedsVZ) 2022, 139, 147 et seq.

On this basis, the court then assesses the specific case (paras 159 - 188). In doing so, the court decides in favour of the admissibility of a stay against the arbitration proceedings (paras. 172 - 185), because under the special circumstances of the individual case, arbitration proceedings impair the conduct of orderly and efficient insolvency proceedings and prevent the insolvency administrator from increasing the value of the insolvency estate and creating legal certainty at an early stage. The decisive factor was that there had to be four different, overlapping, and separately financed arbitration proceedings with seven different parties on the facts to be assessed, possibly leading to divergent results, and not all parties had submitted to arbitration, so that, in addition, normal civil proceedings were necessary anyway. Under these circumstances, it would be preferable to resolve all legal relationships in one single, significantly faster and cheaper procedure before the state courts.

III. Criticism

The Canadian *Supreme Court* has entered dangerous waters with this decision. Under no circumstances should it be concluded from this judgement that the opening of insolvency proceedings over a party's assets generally leads to the invalidity or unenforceability of an arbitration agreement. The court therefore rightly emphasises at the outset that this is an exceptional decision that cannot be generalised and is based on the very specific circumstances of the concrete case (para. 10). It must be highlighted that not a word is said to suggest that arbitration proceedings are generally more expensive or slower than (Canadian) state proceedings, and even if they were, that could not justify disregarding the arbitration agreement, even in the context of insolvency proceedings. By way of comparison, under German section 1032(1) ZPO, it is only recognised that the arbitration agreement may become unenforceable if the insolvent party is unable to afford the costs of the arbitration.[12] Otherwise, there is no reason to refrain from conducting arbitration proceedings merely because a party to the arbitration agreement is insolvent.

With the "conduct of orderly and efficient insolvency proceedings" as the standard of review, the court opens a Pandora's box. There are good reasons to assume that such an extreme case could have been decided similarly under German law, because it is recognised that an arbitration agreement becomes unenforceable within the meaning of section 1032 (1) ZPO if a necessary party to the dispute is not bound by the arbitration agreement.[13] Whether these conditions existed here cannot be safely inferred from the facts of the case. In any case, the impracticability would then have its reasons in the arbitration agreement and not in the insolvency of one of the parties, i.e. it has nothing to do with the "conduct of proper and efficient insolvency proceedings". The latter is such a vague criterion, opening up space for unnecessary "side issues" distracting from the actual subject matter of the dispute, that it is better not to tread this slippery slope.

[12] BGH, Entscheidungen des Bundesgerichtshofs in Zivilsachen (BGHZ) 145, 116, 119 et seq.
[13] Cf. only OLG Hamm NJW-RR 2013, 522, 523; *Münch* in: Münchener Kommentar zur ZPO, München: C. H. Beck, 6th ed. 2022, § 1029 para. 79; *Voit* in: Musielak/Voit, ZPO, München: Verlag Franz Vahlen, 20th ed. 2023, § 1029 para. 12.