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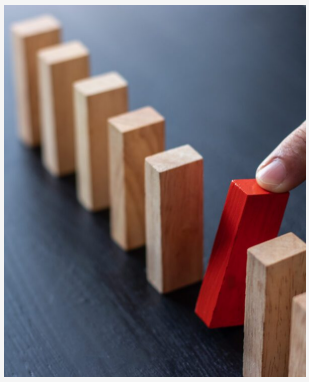
You (may not) get what you bargained for: a receivership order displaces an arbitration clause in Mundo Media



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Arbitration is a consensual method of dispute resolution in which the parties can customize their process and even select their own decision-maker. Insolvency is the diametrically opposite scenario, where disputes involving the debtor are involuntarily consolidated before a single insolvency court. These two worlds collided before the Ontario Court of Appeal in *Mundo Media Ltd (Re)* (2022 ONCA 607).[1] According to the Court, the insolvency overrode the arbitration clause.

Mundo Media's receiver applied to force SPay Inc. (SPay) to pay its accounts receivable owing to Mundo Media. SPay sought a stay, arguing that the dispute should be referred to arbitration pursuant to a contractual arbitration clause, and that in any case SPay would exercise set-off rights for the whole of the accounts receivable claim — so regardless of the outcome of the dispute, Mundo would receive no cash payment.

The Court was faced with a choice: either enforce an arbitration clause, giving effect to the parties' bargain and sending a dispute outside the insolvency court, or override the arbitration clause and have the dispute adjudicated before the insolvency court, giving effect to the "single proceeding" model. In *Mundo Media*, the single-proceeding model prevailed.

Takeaways

- **Parties do not always get the arbitration they bargained for**. Domestic and international arbitration legislation in Canada reveals a legislative intent to respect party autonomy except in "limited circumstances". When parties enter an arbitration clause in Canada, they expect "an autonomous, self-contained, self-sufficient process pursuant to which the parties agree to have their disputes resolved by an arbitrator, not by the courts."[2] *Mundo Media* illustrates the "limited circumstances" in which party autonomy is not respected and parties are not permitted the dispute resolution mechanism they bargained for. However, both courts were careful to limit *Mundo Media* to its facts. It remains to be seen when Canadian courts will honour the parties' bargain in the face of other insolvency scenarios.

- **A set-off claim may draw the claimant into insolvency court**. The "single proceeding" model is a core tenet of insolvency law providing that all litigation concerning the insolvent should be dealt with under the umbrella of one insolvency proceeding, rather than being fragmented into separate proceedings. In this case, SPay's set-off claim *against* Mundo Media was sufficiently connected to force the claim to be resolved under the single-proceeding model. The courts stopped short of holding that *all* set-off claims against an insolvent party will be adjudicated under the single-proceeding model, but the courts did not explore when set-off claims would be resolved outside of the single proceeding.
- **Arbitration vs. insolvency: the saga continues**. *Mundo Media* is another chapter in the ongoing saga of insolvency courts grappling with alternative dispute resolution procedures. The British Columbia Court of Appeal recently considered a similar issue in *Petrowest Corporation v. Peace River Hydro Partners* (2020 BCCA 339).[3] The Supreme Court heard an appeal in this case in January 2022 and its decision is eagerly awaited by arbitration and insolvency practitioners alike.

The decisions

The issue in *Mundo Media* was whether a receiver had to assert a debtor company's claim against a counterparty in arbitration proceedings in New York, or whether the claim could be dealt with in the Ontario receivership proceedings alone. A receiver was appointed over the property and assets of Mundo pursuant to section 243 of the *Bankruptcy and Insolvency Act* (the BIA). The receiver moved for an order compelling SPay to pay Mundo's outstanding invoices, which were Mundo's largest accounts receivable and principal asset. SPay sought a stay on the basis of the arbitration clause contained in the parties' contracts requiring any disputes "arising out of or relating to" the agreements, including the arbitrability of any disputes, to be arbitrated in New York under New York law.[4]

The motion judge dismissed the request for a stay, holding that the Ontario court had jurisdiction. He reached his conclusion despite Article 8(1) of the UNCITRAL Model Law on Commercial Arbitration (Model Law) incorporated by reference in the *International Commercial Arbitration Act* (ICAA),[5] which requires a court to refer a matter to arbitration upon a party's request if the parties and the matter in dispute are subject to an arbitration agreement.[6] Justice Penny held that the effect of a receivership order was to displace the arbitration clause. There was no conflict between Article 8(1) of the Model Law and section 243 of the BIA since the Model Law contains a limitation on the mandatory language ("shall … refer the parties to arbitration unless…").

Claims by a debtor against a third party will be heard in insolvency proceedings if the third party is not a "stranger to the bankruptcy".[7] The "determining factor" is the degree of connection of the claim to the insolvency proceedings.[8] Here, SPay was not a stranger because

- the receiver was seeking to realize on a significant Mundo asset for the benefit of all creditors
- SPay "intends to assert … its own claim against Mundo by way of the defence of set-off"

- "nothing turns on whether the money SPay claims to be owed under the Publisher Agreement is a counterclaim or set-off"[9]

It would be inefficient and unfair to Mundo's creditors to send the receiver "scurrying to multiple jurisdictions".[10]

The Ontario Court of Appeal dismissed SPay's motion for leave to appeal.[11]

The Court of Appeal held that it makes no difference if the third party seeks to reduce or eliminate the amount payable to the debtor by way of a set-off but does not issue a claim seeking those same monies from the debtor.[12] A third party's set-off claim to recover monies from a debtor may be of great significance to all creditors, and approaching the claim differently based on its form would defeat the purpose of the single-proceeding model.[13] The Court emphasized that the motion judge did not state that set-offs always or even often render a third party part of the single-proceeding model, but rather that the conclusions were based on the specific facts at issue.[14]

Notably, neither court adopted the British Columbia Court of Appeal's reasoning in *Petrowest*. *Petrowest* also considered whether a court-appointed receiver is bound by an arbitration clause in a debtor's contract adopted by the receiver. The British Columbia Court of Appeal applied the doctrine of separability and found that the receiver was not bound by the arbitration agreements and could rely on the substantive provisions of the contracts while simultaneously disclaiming the arbitration agreements. The motion judge in *Mundo Media* was not prepared to adopt the British Columbia Court of Appeal's reasoning in *Petrowest* given the serious question regarding the application of the doctrine of separability where a receiver is purporting to sue on an agreement containing an arbitration clause made by the debtor with a third party.[15]

The much-awaited *Petrowest* decision from the Supreme Court of Canada is likely to provide further clarity on the "limited circumstances" in which the single-proceeding model in insolvencies will override an arbitration agreement. *Petrowest* may also provide clarity on the scope of the doctrine of separability, which is a cornerstone principle in both domestic and international arbitration law. Separability — whether a party can disclaim, or separate, an arbitration clause without disclaiming the entire contract — is a fundamental question, and *Petrowest* may extend the Supreme Court of Canada's discussion of the separability doctrine in *Uber Technologies Inc. v. Heller*.[16] The Supreme Court's decision could influence whether Canada is perceived as an arbitration-friendly jurisdiction and may impact how counsel and parties globally view Canada as a potential seat for international arbitration.

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[1] *Mundo Media Ltd. (Re)*, 2022 ONCA 607 (*Mundo Media*).

[2] *TELUS Communications Inc. v. Wellman*, 2019 SCC 19, [2019] 2 SCR 144, at para 56, quoting *Inforica Inc. v. CGI Information Systems and Management Consultants Inc.*, 2009 ONCA 642, at para 14.

[3] *Petrowest Corporation v. Peace River Hydro Partners*, 2020 BCCA 339 (*Petrowest*).

[4] *Mundo Media*, para 4; *Royal Bank of Canada v. Mundo Media Ltd.*, 2022 ONSC 2147, paras

5–6 (*Mundo Media Motion*).

[5] *International Commercial Arbitration Act, 2017*, S.O. 2017, c. 2, Sched. 5; *Mundo Media*, para 18.

[6] *Mundo Media Motion*, para 7.

[7] *Mundo Media Motion*, para 27; *Mundo Media*, paras 6, 24.

[8] *Mundo Media*, para 25.

[9] *Mundo Media Motion*, para 34; *Mundo Media*, paras 7, 26.

[10] *Mundo Media Motion*, para 38; *Mundo Media*, paras 23, 27.

[11] *Mundo Media*, paras 10, 58.

[12] *Mundo Media*, para 45.

[13] *Mundo Media*, paras 46–55.

[14] *Mundo Media*, paras 55–56.

[15] *Mundo Media Motion*, paras 16–18.

[16] *Uber Technologies Inc. v. Heller*, 2020 SCC 16, at para 96.