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LITIGATION

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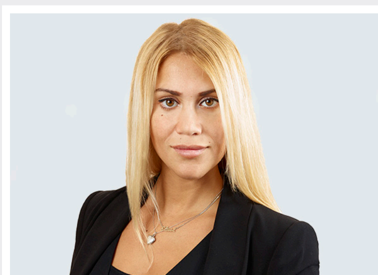
Strong Support for Arbitration, Even in the Face of Allegations of Fraudulent Misrepresentation



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The importance of drafting clear arbitration clauses in an agreement was addressed in the recent Ontario Court of Appeal decision of *Haas v. Gunasekaram*, 2016 ONCA 744 *["Haas"]*. In this case, the plaintiff brought an action alleging that he was induced to sign a shareholders' agreement respecting an Italian restaurant located in Toronto based on fraudulent misrepresentations regarding the restaurant's business prospects and management, after the restaurant failed. Haas sought to recover his investment of $200,000.

The shareholders' agreement contained an arbitration clause. As such, the defendants moved to stay the action under section 7 of the *Arbitration Act*, S.O. 1991, c. 17 [the *"Act"]*, in favour of the arbitration clause. The motions judge refused to stay the action. The defendants appealed the motion judge's decision.

The Court of Appeal's Decision

The Court of Appeal decided to stay the action in favour of the arbitration clause.

In its decision, the Court considered that both legislation and case law favours giving effect to arbitration agreements. Section 7 of the *Act* contains mandatory language requiring a court to stay an action when there is an arbitration agreement, whereas its predecessor legislation provided a court with more discretion. Section 7 of the *Act* states:

> 7(1) If a party to an arbitration agreement commences a proceeding in respect of a matter to be submitted to arbitration under the agreement, **the court** in which the proceeding is commenced **shall**, on the motion of another party to the arbitration agreement, **stay the proceeding**.

This requirement to give effect to an arbitration agreement is furthered by Section 17 of the *Act* whereby an arbitration agreement that forms part of another agreement (such as in the *Haas* case), shall, for the purposes of ruling on jurisdiction, be treated as an independent agreement that may survive even if the main agreement is invalid.

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In considering to stay an action under section 7 of the *Act*, the judge must consider the following:

> (1) Is there an arbitration agreement?
>
> (2) What is the subject matter of the dispute?
>
> (3) What is the scope of the arbitration agreement?
>
> (4) Does the dispute arguably fall within the scope of the arbitration agreement?
>
> (5) Are there grounds on which the court should refuse to stay the action?

In *Haas*, the question of whether there was an arbitration agreement was not contentious. Haas argued that the subject matter of the dispute, fraud and tort claims, were outside the scope of the shareholders' agreement and should not be captured by the arbitration agreement, whereas the defendants argued that the subject matter of the dispute was whether they performed their obligations under the shareholders' agreement.

The Court addressed the categories of misrepresentations alleged to have induced Haas to sign the shareholders' agreement, which included the history of the location of the restaurant, the return on investment, the commitment and operation of the management team, the capitalization (i.e. that the investors, including the defendants, would invest more money into the restaurant) and the communication with Haas (that no material change in the business would be made without Haas' consent).

Ultimately, it was found that the categories of misrepresentations largely related to the failures of the defendants to perform obligations under the shareholders' agreement and that Haas would have to rely on the terms of the shareholders' agreement and related documents to establish the misrepresentations. Therefore, the motions judge erred in characterizing Haas' claims as relating only to fraudulent misrepresentation.

With respect to scope, the Court held that the arbitration agreement was broad:

> If at any time during the currency of this Agreement, or after the termination hereof, **any dispute, difference or question shall arise**, or any failure to agree as specifically hereinabove referred to, shall occur among the parties hereto or certain of them, **respecting this Agreement or anything herein contained then every such dispute, difference or question or failure to agree** shall be referred to a single arbitrator to be appointed by the parties to the dispute within ten (10) days of such referral...

The next part of the test was then addressed, i.e. whether the dispute fell within the scope of the arbitration clause. The Court held that the motion judge erred in the following ways:

1. Tort claims do not automatically fall outside arbitration agreements

The motions judge made an assumption that tort claims fall outside of the scope of the arbitration agreement. It recognizing this error, the Court of Appeal cited the case of *Matrix Integrated Solutions Ltd.* v. *Naccarato*, 2009 ONCA 593, 97 O.R. (3d) 693, wherein Sharpe J.A. canvassed several cases in which courts have required parties to proceed to arbitration where the disputes involved tort claims (i.e. *Dalimpex Ltd. v. Janicki,* (2003), 64 O.R. (3d) 737 and *Kaverit Steel and Crane Ltd. v. Kone Corp*. (1992), 87 D.L.R. (4th) 129). Justice Laskin has also cautioned the Court to be wary of cases where a party seeks to avoid an arbitration agreement by pleading a tort (*Piko v. Hudson's Bay Company* (1998), 41 O.R. (3d) 729 (C.A.), at para. 9).

2. Fraud does not necessarily vitiate an arbitration agreement

The motions judge assumed that a claim based in fraud vitiates an arbitration agreement. The Court considered *Ash v. Corp. of Lloyd's*. (1992), 9 O.R. (3d) 755 (C.A.) at para.9, wherein it was stated that the strategy of alleging fraud, while depriving a party of the contracted choice of arbitration, would impair such arbitration clauses, which was considered to be "too important in international commerce to permit that anomalous result to flow". The B.C. case of *James v. Thow*, 2005 BCSC 809, 5 B.L.R. (4th) 315 also stayed an action because the issues raised in the pleadings, including fraudulent

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misrepresentation, breach of trust, breach of fiduciary duty and fraud, fell within the scope of the arbitration agreement.

The Court of Appeal held that fraud does not necessarily vitiate everything in cases involving arbitration agreements, and it is a matter of interpretation. Where an arbitration agreement contains broad language, such as in the *Haas* case, claims for fraud are not automatically excluded because the validity of the contract is in question.

3. The law favours the enforcement of arbitration agreements

The Court held that the motions judge erred in failing to defer to the law's preference of enforcing arbitration agreements and letting arbitrators decide the scope of their authority. According to statute and case law, an arbitrator should determine whether they have jurisdiction to hear the dispute when the language of the arbitration agreement is broad, i.e. not the court.

With respect to the final question to be answered, whether there were grounds on which the Court should refuse the stay, *Haas* argued that the arbitration agreement is invalid and the stay should therefore not be granted.

Ultimately, the Court of Appeal found that there were no grounds to refuse the stay of the action, and granted the defendants' appeal.

Conclusion

The Court of Appeal in *Haas* has reiterated the Courts' support for arbitration and the preference to give effect to arbitration clauses. As such, when negotiating an agreement, parties should be aware that incorporating an arbitration clause will likely result in arbitration in the case of a dispute between the parties. Avoiding arbitration may prove to be a difficult task.

Haas highlights the importance of precise drafting of arbitration agreements. Moreover, parties should use broad language in an arbitration clause if the intention is that all disputes, from the interpretation of the contract to the performance of the contract, should proceed to arbitration.

For further advice in drafting arbitration clauses in commercial agreements, contact Elissa Ferrari at eferrari@torkinmanes.com or 416-777-5362.

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