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Stay refused: Ontario court rules arbitration clause in international commercial contract inoperative

By Stephen Thiele and Howard Wolch

Founded in the 1920s, Gardiner Roberts LLP has grown to become a strategically placed mid-sized business law firm with a diverse client base which includes several of Canada's largest banks, public companies including mining, high tech and software companies, real estate enterprises, lenders and investors.

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Courts are not the only place where parties can have their civil disputes resolved. Parties can mutually agree to have their disputes resolved by a mediator or by an arbitrator. An agreement to mediate or arbitrate can be reached after a dispute arises or can be made beforehand, in anticipation of disputes, through the inclusion of an arbitration clause in a written contract. In situations involving international commercial contracts, the arbitration clause will generally also direct the forum or jurisdiction where the arbitration will be held. Notwithstanding that parties may have agreed to arbitrate a dispute in a specific forum, a party can still seek to have their disputes resolved by a court. However where a court action is commenced, the other side can bring a motion to stay the action in favour of arbitration.

CSI Toronto Car Systems Installation Ltd. v. Pittasoft Co.

As recently determined by Justice Sharma in *CSI Toronto Car Systems Installation Ltd. v. Pittasoft Co.*, 2021 ONSC 5117, on such a stay motion, the court, in a case involving an international contract, will be required to consider and apply the UN Model Law on International Commercial Arbitration as adopted in Ontario under the *International Commercial Arbitration Act* (the **"ICAA"**). In addition, the court will be required to determine whether there is a "strong cause" to deny the stay.

In *CSI Toronto*, the parties had entered into an agreement for the distribution of dashboard car cameras in Canada. CSI Toronto, a Canadian company, was the distributor and Pittasoft, a Korean company, was the supplier. The agreement contained the following arbitration clause:

> In case of a dispute between the parties as to the interpretation or performance of this Agreement, or any provision hereof, such dispute shall be finally settled by an arbitration held in Seoul, Korea under the Commercial Arbitration Rules of Korean Commercial Arbitration Board by one arbitrator appointed in accordance with such Rules.

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The parties got into a dispute in connection with the supply of cameras and pricing and eventually the supplier posted a message on its website which CSI Toronto found to be defamatory. CSI Toronto brought a defamation claim against the supplier in Ontario (the **"First Action"**).

In response to the defamation action, the supplier threatened to bring a court proceeding in Korea if the defamation action was not withdrawn. The distributor remained steadfast. The supplier defended the defamation action and then commenced a court proceeding in Korea for, among other relief, breach of contract. In the Korea action, the supplier made no mention of the arbitration clause.

Unaware that the supplier had started a breach of contract action in Korea, the distributor also brought a breach of contract action in Ontario against the supplier and a claim for inducing breach of contract and intentional interference with contractual relations against another distributor (the **"Second Action"**). The Second Action was brought in order to prevent the expiry of Ontario's two year limitation period for the breach of contract and tort claims.

CSI Toronto then brought a motion to essentially have the two Ontario actions combined either through consolidation or an amended proceeding.

The supplier, in turn, withdrew its Korean court proceeding (which had been started 15 months earlier), without mentioning the arbitration clause in its withdrawal, and sought, in Ontario, to stay the breach of contract and inducing breach of contract/intentional interference with contractual relations claims based on the arbitration clause. The supplier argued that the arbitration clause was a forum selection clause and that CSI Toronto was required to show "strong cause" why the arbitration clause should not be enforced. CSI Toronto argued that the supplier was estopped from relying upon the arbitration clause, that the second distributor could not be bound by the arbitration clause since it was not a party to the contract between CSI Toronto and the supplier and that the arbitration would lead to an unacceptable multiplicity of proceedings.

Decision of the Court

Article 8(1) of the Model Law provides as follows:

> A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

Justice Sharma agreed with CSI Toronto's contention that the supplier's "first statement on the substance of the dispute" was in the Korean court proceedings in which it alleged breached of contract and that the arbitration clause had been rendered inoperative by the supplier's initiation of its own court action in Korea.

The court noted that in *Dyna-Jet Ltd. v. Wilson Taylor Pte Ltd.*, a 2016 decision of the Singapore High Court, cited in *Heartronics Corp. v. EPI Life Pte Ltd.*, a 2017 decision of the Singapore High Court, the following had been determined in connection with the meaning of "inoperative" as used in the Model Law:

> An arbitration agreement is inoperative, at the very least, when it ceases to have contractual effect

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> under the general law of contract. That can occur as a result of a number of doctrines of the law of contract such as discharge by breach, by agreement or by reason of waiver, estoppel, election or abandonment.

Justice Sharma found that the supplier's conduct of threatening to commence a proceeding in a Korean Court, acting on that threat and commencing proceedings in Korea, which required the distributor to hire a lawyer in Korea to respond to that action constituted estoppel by conduct. At paragraph 31, Justice Sharma stated: "Since that proceeding alleged breach of contract, which would otherwise have been subject to arbitration under the Sales Agreement, [the supplier] cannot now revert back to the arbitration clause as if its prior conduct had not occurred."

The supplier's withdrawal of the Korean action could not cure its earlier reliance on seeking relief in the Korean court, particularly since during the 15 month period that its court action was extant, the supplier never sought relief before an arbitrator.

Justice Sharma concluded that since the arbitration clause was no longer operative, there was "strong cause" to not enforce the arbitration clause.

The "strong cause" test was established by the Supreme Court of Canada in *Z.I. Pompey Industrie v. ECU-Line N.V.*, 2003 SCC 27. It imposes a burden on a plaintiff "to satisfy the court that there is good reason it should not be bound by a forum selection clause."

The distributor was thus entitled to continue with its proceeding in Ontario.

To regularize the proceeding, the court ordered that the Second Action would constitute the statement of claim in the First Action and that the Second Action would accordingly be dismissed. This meant the distributor was entitled to pursue its defamation, breach of contract and inducing breach of contract/ intentional interference with contractual relations claims all in one proceeding.

Representation by Gardiner Roberts LLP

CSI Toronto was represented by Howard Wolch, a partner and litigation lawyer at Gardiner Roberts LLP.

Mr. Wolch was assisted in the preparation of the written argument filed against the motion to stay the proceeding by Stephen Thiele, a partner and the Director of Legal Research at Gardiner Roberts LLP.

Contact us

If you have a litigation matter and are in need of legal advice, please do not hesitate to contact **Stephen Thiele**, at 416.865.6651 or via email at sthiele@grllp.com or **Howard Wolch**, at 416.865.6669 or via email at hwolch@grllp.com

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