Rethinking Arbitration Clauses – Are They More of a Headache Than They Are Worth? – A Case Comment on Novatrax International Inc. v. Hägele Landtechnik GmbH

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Most of our business clients will be familiar with the concept of arbitration clauses found in their commercial agreements. An arbitration clause is an agreement between the parties to forgo taking any dispute that may arise to court. Rather, the parties are to refer the dispute to an arbitrator, who is hired by the parties to act like a judge (some of them are retired judges) and will preside over an out-of-court private trial and decide the dispute. Such clauses are intended to help parties resolve disputes that may arise during the course of their relationship in a speedy, cost-effective, private and final way (rights of appeal are usually limited).

While such clauses appear to be a good idea in theory, in practice they can often lead to more headaches and expense than if there were no arbitration clause at all and the parties had to resort to the ordinary courts.

The recent decision of the Court of Appeal for Ontario in *Novatrax International Inc. v. Hägele Landtechnik GmbH,* 2016 ONCA 771 provides a prime example of how arbitrations can complicate, rather than simplify matters. The result in that case is that there may now be more than one proceeding to resolve the dispute – an arbitration, *plus* a court case.

The appellant in that case, Novatrax, had an Exclusive Sales Agreement ("ESA") with Hägele Landtechnik GmbH ("Hägele") whereby Novatrax was granted the exclusive right to market and sell Hägele's industrial reversible fans in North America. Hägele purported to terminate the ESA for cause, cut out Novatrax and began selling its products in North America directly through a new company it incorporated, Cleanfix North America Ltd. ("Cleanfix"). Novatrax sued Hägele in the Ontario Superior Court of Justice for damages for breach of the ESA. It also named

Hägele's principals, Karl Hägele and Benjamin Hägele as defendants, as well as Cleanfix. The Hägeles and Cleanfix were not signatories to the ESA.

The ESA contained an arbitration clause that read as follows:

The contractual parties agree that German law is binding and to settle any disputes by a binding arbitration through the "Industrie und Handelskammer" (Chamber of Commerce) in Frankfurt.

The defendants brought a motion to the court to stay (stop) the action on the basis that the arbitration clause required Novatrax to sue by way of private arbitration in Frankfurt. Novatrax opposed the motion on the basis that it was not required to proceed by way of arbitration because the individual Hägeles and Cleanfix were not parties to the ESA and therefore they could not be forced to arbitrate. The judge hearing the motion stayed the entire claim against all defendants in favour of arbitration in Frankfurt. Novatrax appealed.

In a 2-1 split decision, the Court of Appeal dismissed the appeal and upheld the motion judge's decision. Justice Brown, writing for the majority, held that enforcement of the arbitration clause required that all of the claims brought in the Ontario action be stayed, even as against those defendants who could not be compelled to participate in the arbitration because they were not signatories to the ESA containing the arbitration clause. He found that the language of the clause was broad enough to include, within the term "any disputes", claims relating to any stage of the ESA's life-cycle, including the wrongful termination and breach of duty of good faith claims pleaded by Novatrax. A key underpinning of the majority's decision appears to have been the finding that Novatrax's claims against the individuals and Cleanfix were intertwined with the claims against Hägele. That is, Cleanfix was sued because it was a corporation created to further the common purpose of the defendants, and the individuals were sued because of their relationship to Hägele. Since the claims raised by Novatrax arose out of the same transactions and occurrences and raised common questions of fact and law linked to the claims against Hägele, all of the claims must be dealt with together.

In her dissenting opinion, Justice Feldman would have set aside the stay of the claims against the non-parties to the arbitration clause and allowed those claims to proceed. She was of the view that the stay unjustifiably deprived Novatrax of its right to litigate those claims in Ontario under Ontario law.

From Novatrax's perspective, the effect of the majority's decision appears to force it to arbitrate claims with parties with whom it never agreed to do so. The majority of the Court of Appeal rejected that argument, citing that the practical effect of the stay of the entire action was that if the other defendants refused to participate in the arbitration, the question of whether Hägele wrongfully terminated the ESA would be decided *first* in an arbitration. Depending on the outcome of that issue, Novatrax could then decide whether to continue its claim against the defendants (the claim was stayed, not dismissed, so Novatrax would be free to ask for an order lifting the stay and allowing the claim to proceed). The result is the possibility of a multiplicity of proceedings in different jurisdictions relating to the same issues involving related parties. Add to

that the significant expense and delay involved in arguing the motion and the appeal about whether the claim should be stayed or not, and from a practical point of view, this was not a good outcome for Novatrax.

The result highlights the pitfalls of arbitration clauses and should give pause to parties and their counsel before deciding to include them in their commercial agreements. An arbitration clause that seems desirable when the deal is done and everyone is getting along may become a serious nuisance and impediment years later once the relationship has broken down. While such clauses are intended to provide for a more efficient, timely, cost-effective, private and final dispute resolution process, instead, they can only serve to make things more complicated, costly and just as public as court proceedings. Worse still, a dispute over whether to arbitrate or go to court diverts precious time and resources away from resolving the real underlying dispute.

Another common example of arbitration clauses becoming impediments to dispute resolution are those that provide for a three-member arbitral panel rather than a single arbitrator. The clause may sound like a good idea because it is intended to minimize the chance of error, since three arbitrators will be considering and deciding the matter together. However, suppose the contract under-performed and, ten years later, was not worth anywhere near what had been anticipated at the outset. It may no longer be cost-effective to hire three arbitrators to resolve the dispute. Unless both parties agree to use one arbitrator instead, the parties will be stuck with having to pay for three.

An alternative approach to arbitration would be to leave arbitration clauses out of commercial agreements altogether. Instead, when a dispute arises, the parties and their litigation counsel can consider whether a voluntary, after-the-fact arbitration may be appropriate. By that time, the parties will know what the issues are and what parties need to be at the table, and can custom tailor their arbitration to the circumstances. Of course, this requires the co-operation of counsel and their clients. While a collaborative approach is preferable in principle, it can sometimes be hard to achieve in practice. Litigation is, by its nature, adversarial, and getting parties and their counsel to agree on anything, let alone to arbitrate and give up the right to go to court, can be a challenge. However, good counsel and reasonable clients should be able to overcome this obstacle in most cases.

When including arbitration clauses in commercial agreements, parties and their lawyers would be well advised to treat such clauses as more than afterthoughts found in the boilerplate language at the end of agreements, and to take some time to consider the desirability and scope of such clauses. If they do so, they can save themselves significant time and expense down the road.