Stay out of it: Sophisticated parties can contract out of arbitration legislation

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Introduction

On August 30 2017 the Supreme Court of Newfoundland and Labrador dismissed(1) an application by the province under Sections 14 and 34(2)(a)(iii) of the Arbitration Act.(2) The court held that the parties had legally contracted out of the act, narrowing the circumstances in which a court could set aside an arbitral award. The decision furthers the general theme of recent Canadian jurisprudence – including the Supreme Court of Canada's decisions in *Creston Moly Corp v Sattva Capital Corp*(3) and the more recent *Teal Cedar Products Ltd v British Columbia***(4)** – which has emphasised party autonomy and deference to reasonable arbitral decisions. The decision confirms that sophisticated parties can craft a dispute resolution process that deviates from the strictures of provincial and federal legislation, as long as the agreed process does not unduly infringe on the courts' inherent jurisdiction and provides for a process that protects the principles of fundamental justice.

Facts

The Hibernia Development Resource Project is an offshore petroleum extraction project located off the coast of Newfoundland and the largest petroleum extraction project to be undertaken in the province to date. Given the project's size and the costs incurred to construct it (C$5.9 billion), the costs associated with carrying operating insurance for the project became the subject of a royalty dispute between the province and the project's working interest owners (hereinafter the 'respondents'). With differing views on the interpretation and application of three agreements – namely, the royalty agreement, the ownership and unanimous shareholders agreement and the allocation agreement – the province held that certain operating insurance costs incurred by the respondents could not be deducted when determining the royalties paid to the province. The respondents disagreed. Ultimately, the parties submitted the dispute to arbitration, pursuant to the extensive dispute resolution provisions, including scheduled arbitration agreements and an arbitration code drafted by the parties, which was based on the United National Commission on International Trade Law Model Law.

The royalty dispute arose because in 2001, in keeping with standard industry practice, each of the respondents began acquiring operating insurance for the project directly on

an individual basis. Previously, operating insurance had been purchased by the project's operator for the benefit of all of the respondents and charged to the joint account maintained for the project. In 2011 the province took the position that the respondents' operating insurance could not be deducted for royalty purposes after the respondents had begun directly acquiring their operating insurance, as such owner-acquired operating insurance did not meet the requirements of Section 29.7 of the royalty agreement for deductibility. The dispute was submitted to a panel chosen by the parties in October 2013 and the arbitration was heard in September 2015. The panel's unanimous award in favour of the respondents was issued in December 2015 and the province's application to set aside that award was heard by the court in March 2017. The court's decision was released on August 30 2017.

Decision

The issues before the court in the context of the province's application were whether:

- the permitted scope of review by the court was governed by the Arbitration Act or the arbitration code agreed to by the parties in Schedule G of their allocation agreement. This issue required the court to decide whether the parties could contract out of the broader scope of review in the act;
- the parties intended to contract out of the act; and
- contracting out of the act in the circumstances was contrary to public policy.

In determining that the scope of review in the arbitration code governed the application, the court concluded that although completely contracting out of the court's inherent jurisdiction was impermissible, the way in which the arbitration code restricted the court's jurisdiction merely narrowed the scope of curial review by agreement. The court held that – especially in the context of well-advised and sophisticated parties – an agreement to narrow the circumstances in which a court can set aside an award does not unduly infringe on the court's inherent jurisdiction and is in keeping with the attainment of the act's aims.

With respect to the second issue, the court concluded that although the scope of judicial review set out in Section 14 of the Arbitration Act was not expressly excluded in the arbitration code, the totality of the contractual provisions, by necessary implication, excluded the operation of that statutory scope of review. Further, the court found that the parties' choice of the arbitration code's scope of review over that in the act was made with full knowledge of its effect and evidenced an unequivocal intention to do so.

In resolving the third issue, which it also did in the respondent's favour, the court held that the parties' agreements were not contrary to public policy as they:

- recognised the policy values of restricting court intervention in commercial arbitrations; and
- preserved the court's ability to set aside awards in circumstances of excess jurisdiction and breach of procedural fairness.

The latter finding is the policy consideration at play and the former promotes party autonomy in arbitrations, encouraging courts to respect what parties agree to in their agreements. Ultimately, the court held that the well-advised and sophisticated parties

deliberately contracted out of the broader scope of judicial review in Section 14 of the act.

Despite the fact that the court resolved the enumerated issues in favour of the respondents, it still considered the award on the assumption that Section 14 of the act governed the set aside application and specifically considered the term 'misconducted' as used therein.(5) The court considered a number of appellate and Supreme Court of Canada decisions interpreting the term 'misconduct', but ultimately concluded that regardless of the scope of review applied, the province's application would still fail. The court went on to consider the province's position that the arbitral panel had exceeded the jurisdictional limits of its mandate. The court ultimately concluded that this was a case of a party (ie, the province) attempting to convert dissatisfaction with the award into a matter of jurisdiction and seeking to relitigate the merits of the arbitration case. While the court provided examples of true jurisdictional errors – namely, situations where an arbitral panel had decided issues that were not in front of it and where an arbitral panel had attempted to rewrite the contract between the parties instead of interpreting it, as the parties had asked the panel to do – it concluded that the panel in this case had merely interpreted the agreements in accordance with its mandate.

The court also held that any alleged errors were reviewable on a reasonableness standard, which was appropriate in the context of commercial arbitrations between sophisticated parties and a panel with substantial expertise. In dismissing the alternative arguments raised by the province, the court concluded that:

- the award was reasonable;
- the interpretation of the agreements was justifiable; and
- the conclusions arrived at were within the range of acceptable outcomes, possessing the requisite justification, transparency and intelligibility.

The province's application was therefore dismissed with costs.

Comment

This decision is yet another example of the Canadian courts' reluctance to interfere with arbitral proceedings and awards. It confirms that parties may craft unique arbitration processes, provided that they preserve the courts' inherent jurisdiction and principles of fundamental justice. While it is yet to be seen how far this proposition can be taken and to what extent parties can craft novel and creative dispute resolution processes, the court's focus on party autonomy gives parties the freedom to create a process that will best fit their particular circumstances. Parties should seek input from counsel about the potential benefits of detailed versus more general dispute resolution provisions.

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