Cassels

Ambiguity and Other "Grave" Concerns in Arbitration Agreements: The Ontario Superior Court of Justice Examines Arbitration In The Franchise Context

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In a recent decision, *Graves v. Correactology Health Care Group Inc.*,[1] the Ontario Superior Court of Justice dismissed a motion to stay a franchise dispute action in favour of arbitration, and provided an analysis of the required scope and ambit of arbitration provisions in Ontario franchise agreements.

Key Facts

The three plaintiffs were students in the Correactology Practitioner Program (Program) at the Canadian Institute of Correactology (the Institute).

The students were advised that upon completing the Program they would be required to complete licensing examinations to become accredited by the Canadian Association of Correactology Practitioners (the Association). They would also be required to enter into a Licence Agreement with Correactology Health Care Group Inc. (CHCG) to operate a “correactology center.” Notably, the Program was not registered under the *Private Career Colleges Act, 2005* (PCCA).

Each student signed an Enrollment Agreement with the Institute, a Licence Agreement (on behalf of a company to be incorporated) with CHGC, and a Confidentiality Agreement with CHGC.

In the course of preparing a business plan for the Program, the students consulted a lawyer. Upon learning of this, the defendants abruptly suspended the Program and expelled the students on the basis that they had breached the Confidentiality Agreement.

The plaintiffs subsequently commenced the action, alleging fraudulent misrepresentation, conspiracy, restraint of trade, and breach of contract. The plaintiffs further alleged that the Program is a sham and an unregistered private career college, and that the Licence Agreement is a franchise agreement that did not comply with the requirements of the *Arthur Wishart Act (Franchise Disclosure), 2000*[3].

The defendants were the Institute, the Association, CHCG, and individual directors of CHCG and/or the Association. They brought a motion to stay the action in favour of arbitration, based on arbitration clauses in the Enrollment Agreement and Licence Agreement. The Court dismissed the motion for the reasons set out

below.

No Clear Intention to Refer All Disputes to Arbitration

The Enrollment Agreement and the Licence Agreement contained broad arbitration clauses. However, they also contained contradictory jurisdiction clauses. The Enrollment Agreement required parties to submit to the exclusive jurisdiction of the courts of Ontario, and the Licence Agreement required parties to bring any actions in the Superior Court of Justice in Sudbury.

The inconsistency between the arbitration and jurisdiction clauses rendered the agreements ambiguous. The Court resolved the ambiguity in favour of the plaintiffs based on principles of statutory interpretation. It held that the Enrollment Agreement was a contract of adhesion and applied the principle of *contra proferentum* to interpret the agreement in favour of the plaintiffs. With respect to the Licence Agreement, the Court observed that the enforcement of the arbitration clause would have rendered the jurisdiction clause redundant, which is to be avoided.

For those reasons, the Court held that neither the Enrollment Agreement nor the Licence Agreement reflected a clear intention to refer all disputes to arbitration.

The Dispute Exceeded the Scope of the Arbitration Clauses

The Court noted that it is preferable for an arbitrator to determine his or her jurisdiction and whether a dispute falls within the scope of an arbitration clause. However, a court may determine those issues if the challenge involves a pure question of law or a question of mixed fact and law, where only a superficial consideration of the documentary evidence is required.

The Court determined that the dispute exceeded the scope of the arbitration clauses. The plaintiffs advanced broad claims of fraud, misrepresentation, and breaches of the *Wishart Act* and the *PCCA*. Those claims were only “tangentially related to” the Enrollment Agreement and the Licence Agreement.

The Court cautioned that a party cannot simply allege fraud to avoid the application of an arbitration clause. Whether an allegation of fraud prevents the application of an arbitration clause will be a matter of interpretation in each case. In this case, the allegations were significant, bringing into question the legality of the defendants’ system as a whole.

The Court also distinguished between an agreement that may be rescinded from one that is void *ab initio* because it is illegal. An arbitration clause within an agreement that is void *ab initio* will not apply because it was never validly agreed to. If proven, the plaintiffs’ allegations of fraud and allegation would have meant that the agreements, and the arbitration clauses, were void *ab initio*.

The Court further noted that the dispute arose when the defendants accused the plaintiffs of breaching their Confidentiality Agreements. However, because the Confidentiality Agreements did not contain an arbitration clause, a dispute over the disclosure of confidential information would not be subject to arbitration.

The Refusal to Grant a Stay or a Partial Stay

(a) Invalidity of the Arbitration Clause is a Serious Issue

Pursuant to section 7(2) of the *Arbitration Act, 1991*,[4] a court may refuse to stay an action in favour of arbitration where, among other things, the arbitration agreement is invalid. A court may exercise that discretion if it makes a "*prima facie* determination that invalidity is a serious issue."

The invalidity of the arbitration clauses was a serious issue in this case. The plaintiffs' evidence suggested that the Institute was effectively operating as a private career college without being registered under the PCCA. Similarly, the Association purported to certify qualifying graduates as "correactology practitioners," which is not a regulated profession under the *Regulated Health Professions Act, 1991*.[5] Thus, the Court noted that, even if the defendants' business was not found to be a "sham," there would still remain a serious concern regarding the validity of the business. As a result, the court made a prima facie determination that the invalidity of the arbitration clauses was a serious issue.

(b) Partial Stay Not Reasonable Because the Claims are Closely Intertwined and Not All Parties Are Bound by the Arbitration Clauses

Pursuant to section 7(5) of the *Arbitration Act, 1991*, where an action involves claims that are subject to arbitration and claims that are not, the court may grant a partial stay, but only where it is reasonable to separate the matters.

In this case, the Court determined that it was not reasonable to separate any matters that may have been subject to the arbitration clauses from those that were not, because the allegations of fraud were closely intertwined with all other issues.

In addition, the individual defendants and the Association were not parties to the Enrollment Agreement or the Licence Agreement. As a result, they were not entitled to invoke the arbitration clauses within those agreements to seek a stay of the action as against them. The Court declined to exercise its discretion to grant a partial stay of the action, so as to permit the action to continue as against only them and not the other defendants. The Court held that a partial stay would not be reasonable because the claims against all defendants involved similar facts and issues. In such circumstances, "a court should... its exercise discretion to allow the entire matter to proceed in the one forum of the court."

Key Takeaways

The decision provides an important reminder to drafters of commercial agreements to ensure consistency amongst dispute resolution provisions, including arbitration clauses and jurisdiction clauses. Ambiguities resulting from any inconsistencies may preclude the drafter from relying on an arbitration clause.

The decision also highlights the need for parties to carefully consider the appropriate forum in which to pursue or defend claims that may be subject to an arbitration agreement. Parties ought to consider, among other things, the scope of the arbitration agreement, the parties involved in the dispute, and whether serious concerns may be raised regarding the validity of the arbitration agreement.

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[1] 2018 ONSC 4263.
[2] *Private Career Colleges Act, 2005*, SO 2005, c 28, Sch L.
[3] S.O. 2000, c. 3 (the "*Wishart Act*").
[4] *Arbitration Act, 1991*, SO 1991, c 17.
[5] *Regulated Health Professions Act, 1991*, SO 1991, c 18.
