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M.J.B. Enterprises Ltd. v. Defence Construction (1951), [1999] 1 S.C.R. 619 and
Double N Earthmovers Ltd. v. Edmonton (City), 2007 SCC3, [2007] 1 S.C.R. 116-2007-01-25 Supreme Court of Canada

Does The *Competence-Competence* Principle Apply To Third Parties To An Arbitration Agreement?

The competence of an arbitral tribunal to determine its own competence has become firmly rooted in Canadian law. But what happens when the tribunal has to decide issues which directly affect third parties?

In *Ontario v. Imperial Tobacco Canada Limited*, the Court of Appeal for Ontario recently held that, in that circumstance, the principle does not require the court to allow the arbitral tribunal to first rule on its competence. This decision is of considerable importance because it involved the disputed confrontation of multiple court actions. It may signal the future attitude of Canadian courts in favour of the resolution by courts, and not arbitrators, if jurisdictional disputes arise out of court proceedings.

The governments of Canada and the provinces brought an action against Imperial Tobacco as a result of cross-border smuggling. That action was settled by a Comprehensive Settlement Agreement ("CSA"). Under the CSA, Imperial Tobacco agreed to pay $350 million to the governments over 15 years in exchange for a release relating to any claims arising out of the smuggling of tobacco or Imperial Tobacco's failure to pay taxes on smuggled or imported tobacco.

The release in the CSA contained two protections for Imperial Tobacco.

First, in the event of a claim by a one of the releasing entities, the release could be relied upon as a complete defence (the "release issue").

Second, if Imperial Tobacco incurred any liabilities in any way connected to or arising out of the released claims, then the payments by Imperial Tobacco to the governments were to be proportionately reduced, and in the event of dispute, were to be paid into an escrow fund (the "escrow fund issue").

The CSA stated that any disputes between the parties were to be arbitrated under the federal *Commercial Arbitration Act.* The notice of arbitration was to be given by either the government of Canada or Imperial Tobacco, and not by the provinces, but the arbitration was to be between the parties to the CSA.

Imperial Tobacco was then sued in a class action by the Ontario Flue-Cured Tobacco Growers' Marketing Board (the "Tobacco Board"). The class action was on behalf of tobacco farmers. The action alleged that Imperial Tobacco had unlawfully paid lower prices to the Tobacco Board for tobacco exported from Canada and smuggled back into Canada. The action claimed $50 million as being the difference between what Imperial Tobacco paid and what it ought to have paid for exported tobacco.

Imperial Tobacco then gave notice under the CSA that it would pay the amounts claimed in the class action into the escrow fund. Imperial Tobacco took the position that the Tobacco Board was an entity claiming through a releasing entity and that the Tobacco Board's claim was a claim relating to or arising from the released claims. If Imperial Tobacco was correct, and if the Tobacco Board was bound by the CSA, then the release might well be effective against the Tobacco Board as well as the governments.

In response, the government of Ontario brought an application in the Ontario Superior Court for a declaration that Imperial Tobacco was not entitled to withhold annual payments to

Ontario, taking the diametrically opposed view as to the effect of the release in relation to the Tobacco Board's claim.

Imperial Tobacco then brought a motion to dismiss Ontario's application on the ground that Ontario's claim was required to be determined by arbitration. The Superior Court judge granted the motion and dismissed Ontario's application, holding that Ontario's claim must be determined by arbitration.

By a majority, the Court of Appeal for Ontario allowed the appeal in part, and directed that Ontario's application with respect to the escrow fund issue proceed to a hearing. However, the reasons of the majority and minority are not necessarily on the same waive length so far as the reasons for doing so are concerned.

The minority judge, Justice Juriansz, held that the principle of *competence-competence* applied to all elements of the jurisdictional dispute. Whether or not Ontario or the Tobacco Board were parties to the CSA and the arbitration agreement in the CSA, and whether or not the Tobacco Board's claim fell within that agreement, were not pure questions of law. Accordingly, he held that the jurisdictional issues raised by those questions should first be determined by the arbitral tribunal in accordance with the principle of *competence-competence.*

The majority agreed that the *competence-competence* principle was at issue. The majority also agreed that, so far as the escrow fund issue, that dispute directly affected Ontario and did not affect the Tobacco Board. In its view, this issue only involved the question of whether Ontario was bound by the CSA, and did not involve any question of whether the Tobacco Board was bound by the CSA. Accordingly, the challenge to the arbitrator's jurisdiction concerning the right of Imperial Tobacco to pay the monies into the escrow fund was required to be first dealt with by the arbitral tribunal.

However, the majority arrived at a different conclusion relating to the release issue, namely the right of Imperial Tobacco to rely upon the release in relation to the Tobacco Board's action. In the majority's view, that issue raised the question of whether the Tobacco Board was a party to the CSA and its arbitration provisions, and therefore bound by the arbitral proceedings and result. In the majority's view, that was a jurisdictional issue of a pure legal nature which, under the *competence-competence* principle, the court could resolve itself without referring it to the arbitral tribunal.

The majority arrived at this conclusion as follows:

> "Here, no one contends that the Tobacco Board is a party to the Agreement and its arbitration provisions….There is equally no doubt that the Tobacco Board has a vital interest in the question raised by the application…The answer could provide [Imperial Tobacco] with a complete defence to its action, or could eliminate that possibility. The arbitrator cannot resolve that question posed by the application because the Tobacco Board is not a party to the Agreement or its arbitration provisions. The arbitrator has no jurisdiction to determine the Tobacco Board's rights. The question asked of the court

must... be determined in a forum in which the Tobacco Board has the right to participate. Hence the application should not be stayed in preference to arbitration."

Here, the majority concluded that the jurisdictional issue was so clear and indeed admitted that it need not be determined by the arbitral tribunal at all. However, this conclusion seems odd in the circumstances. The majority seems to have disposed of the issue by the assumption made in raising it.

First , if it was so clear that the Tobacco Board was not a party to the CSA, then one wonders what the jurisdictional dispute was all about in the first place. In his decision, Justice Juriansz squarely raises the issue as to whether the Tobacco Board was a party to or bound by the CSA. If the Tobacco Board was so clearly not a party to or bound by the CSA, and if Imperial Tobacco had admitted that fact, then one could be confident that the arbitral tribunal would so hold, and that any decision of that tribunal would not be binding on the Tobacco Board in any event.

Second, it would seem better to have one tribunal deal with both the release and escrow fund issues at the same time. It is not clear how those two rights could be separated, and how a court or arbitral tribunal could find that the Tobacco Board's claim falls within the CSA for one of those rights and not for the other. Indeed, having arrived at its conclusion, one wonders why the majority did not direct both issues to be determined by the court, to save time and money and avoid conflicting decisions.

Whatever the merits of the jurisdictional dispute may be, this decision of the Ontario Court of Appeal is just the next chapter in the evolving Canadian story about the principle of *competence-competence*.

This chapter is about a jurisdictional dispute generated by one court action at the front end (the governments' action against Imperial Tobacco) and another court action at the back end (the Tobacco Board's class action). This chapter tells us that when the dispute is so firmly rooted in court proceedings, and when the plaintiff in one action has no clear right to participate in the arbitration of the dispute, then a court will be concerned about due process and fairness. The court will be reluctant to allow any jurisdictional disputes about the intersection of those two court cases to be dealt with by an arbitrator, even in the first instance.

Arbitration - Third Parties - Competence - Class Action

Ontario v. Imperial Tobacco Canada Limited, 2011 ONCA 525

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