

International Commercial Arbitration: Too Costly Private Justice?

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Cases Considered:

[*Resin Systems Inc. v. Industrial Service & Machine Inc.*, 2008 ABCA 104](#)

The Court of Appeal's Memorandum of Judgment in *Resin Systems Inc. v. Industrial Service & Machine Inc.* offers a rare, albeit small, glimpse into the arena of international commercial arbitration. It tells us something about the cost of this type of private justice; one of the major differences between courts and arbitration is that contractual arbitrators are not paid for by taxpayers, but are privately paid for. The judgment also illustrates an unusual lack of deference to arbitration on the part of the Court of Appeal and a lack of faith in an arbitrator's ability to control the fairness and efficiency of arbitration proceedings through the allocation of costs.

Resin Systems Inc. sued Industrial Service & Machine Inc. (ISM) in the Court of Queen's Bench of Alberta. ISM applied to that Court for an order staying Resin's action and referring the parties to arbitration. ISM's referral application relied upon the following arbitration clause in the parties' purchase agreements:

Except as modified by this Agreement, any claim or controversy arising out of or relating to this Agreement, shall be determined by binding arbitration in accordance with the Court of Arbitration of the International Chamber of Commerce and its rules.

In the fall of 2006, Resin had initiated the arbitration of its dispute with ISM by submitting a request for arbitration to the International Chamber of Commerce (ICC). ISM defended, a single arbitrator was appointed, and a hearing was scheduled for Denver, Colorado in December 2007. The arbitration was therefore proceeding apace until the ICC requested \$87,500 from each party as the provisional advance on costs, which occurred in February 2007. The total of \$175,000 in costs was based on the \$27 million claimed by Resin; the International Chamber of Commerce calculates arbitral and administrative costs as percentages of the amount claimed.

ISM refused to pay any part of the provisional advance demanded by the ICC, arguing that Resin had grossly inflated those costs by claiming damages in the amount of \$27 million. According to ISM, that amount was ten times greater than the contractual limit on damages set out in the parties' purchase agreements, a limit ISM pegged at \$2,852,000. Resin took the position that the

arbitration process was frustrated and in June of 2007 commenced its action in Alberta. After Resin sued, the ICC advised the parties that the time for ISM to pay its share of advanced costs had expired and invited Resin to pay ISM's share. For reasons not set out in the judgment, Resin refused to pay the entire \$175,000 advance on the costs of the \$27 million arbitration it had initiated.

A \$175,000 advance on arbitrators' and ICC administrative costs may seem like a great deal of money, especially when these types of expenses are not incurred when the parties use the courts. According to the ICC, however, these costs are only a small percentage of the money paid out by those who arbitrate under the ICC's auspices. Arbitrators' fees and expenses amount to only 16% of a party's expenses and the administrative expenses of the ICC a meager 2%. A full 82% of a party's costs are costs borne to present their case, including lawyers' fees and expenses and expenses related to witness and expert evidence. See "Techniques for Controlling Time and Costs in Arbitration," a Report from the ICC Commission on Arbitration, available [here](#).

The parties had agreed to be bound by the Rules of the Court of Arbitration of the ICC, available [here](#). In the matter of advances on costs, Article 30(2) of those Rules provides that "the Court shall fix the advance on costs in an amount likely to cover the fees and expenses of the arbitrators and the ICC administrative costs. . . ." Article 30(3) provides that the "advance on costs fixed by the Court shall be payable in equal shares by the Claimant and the Respondent. . . . However, any party shall be free to pay the whole of the advance on costs in respect of the principal claim or the counterclaim should the other party fail to pay its share." Finally, Article 30(4) provides that "[w]hen a request for an advance on costs has not been complied with, the Secretary General may . . . set a time limit, . . . on the expiry of which the relevant claims . . . shall be considered as withdrawn.

On the basis of the facts and ICC Rules in the preceding two paragraphs, Justice D.I. MacLeod of the Court of Queen's Bench had found that the arbitration agreement between the parties was "inoperative" and refused ISM's referral application. The Court of Appeal (Justices Keith Ritter, Clifton O'Brien and Patricia Rowbotham) concluded that Justice MacLeod was entitled to make that finding and dismissed the appeal.

Alberta's *International Commercial Arbitration Act*, R.S.A. 2000, c. I-5, enacts as provincial legislation the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 330 U.N.T.S. 3 ("New York Convention") and the *UNCITRAL Model Law on International Commercial Arbitration*, U.N. Doc. A/40/17 (1985) ("Model Law"). Article II(3) of the former and Article 8(1) of the latter are very similar. Both require a court to refer a matter to arbitration at the request of one of the parties "unless it finds that the said agreement is null and void, *inoperative* or incapable of being performed (emphasis added)."

There is no consensus on the meaning of the word "inoperative" or the type of situations it covers. For example, *Russell on Arbitration*, 22nd ed. (London: Sweet & Maxwell, 2003), at paragraph 7-018, states:

It will be inoperative where, for example, the arbitration agreement has been repudiated or abandoned or it contains such an inherent contradiction that it cannot be given effect

Redfern and Hunter, in the *Law and Practice of International Commercial Arbitration*, 3rd ed. (London: Sweet & Maxwell, 1999) at paragraph 3-71, say: “[A]n arbitration clause is inoperative where it has ceased to have effect as a result, for example, of a failure by the parties to comply with a time-limit, or where the parties have by their conduct impliedly revoked the arbitration agreement.” Neither really addresses whether one party may unilaterally cause an arbitration agreement to become inoperative. What if one party fails to comply with a time-limit or, as in this case, a request for costs in advance? Is ISM’s refusal to pay its share of the advance on costs to be seen as a repudiation of the arbitration agreement that was accepted as such by Resin?

The Court of Appeal equated “inoperative” with “unworkable” but did not otherwise discuss the meaning of the word. Instead, the Court relied on the fact the parties had agreed to be bound by the ICC Rules of Arbitration and on the fact those Rules made it mandatory for each party to pay their share of the advance on costs, but discretionary for any one party to pay the entire advance.

ISM had argued that Resin could choose to pay the entire advance on costs so that the arbitration could proceed and that the arbitration agreement was therefore not inoperative. The Court of Appeal held, however, that ISM was not entitled to rely on its own breach of the ICC Rules. They held that ISM’s claim that Resin had grossly inflated the costs by claiming damages ten times greater than that allowed by the parties’ agreements was without merit. Whether or not the contractual limits on damages were binding on Resin would have been an issue in the arbitration.

The Court of Appeal refers to its duty, under the New York Convention and the UNCITRAL Model Law, to refer the parties to arbitration at the request of one of the parties to the arbitration agreement. However, the Court then appears to inject some equitable considerations into Article II(3) of the former and Article 8(1) of the latter, when it states (at para. 16):

[I]t is implicit that the party making the request is prepared to proceed with the arbitration in accordance with the arbitration rules to which that party has agreed. We question whether the request can be regarded as *bona fide* if the party making it is insistent on *flaunting* a mandatory rule requiring payment of its share of the advance costs. In any event, the refusal to pay the costs makes the arbitration unworkable, and thereby inoperative, as there is no obligation on the other party to fund the defaulting party’s share. Non payment in these circumstances results in the claims in the arbitration as being considered to be withdrawn. (Emphasis added.)

In the next paragraph, the Court of Appeal characterizes ISM’s conduct as “audacious.” The idea that a party requesting a stay of a court action and a referral to arbitration must act *bona fides* is not set out in either the New York Convention or the UNCITRAL Model Law. The *International Commercial Arbitration Act*, to which both of those international instruments are attached as

Schedules, does provide in section 12(1) that the courts are to interpret the Act “in good faith, in accordance with the ordinary meaning to be given to the terms of the Act in their context and in the light of its objects and purposes.” As the Alberta Court of Appeal noted in *Kaverit Steel and Crane Ltd. et al. v. Kone Corp. et al.*, 87 D.L.R. (4th) 129 at 139, “[i]t is common ground that the evident purpose of Alberta’s acceptance of the Convention is to promote international trade and commerce by the certainty that comes from a scheme of international arbitration.” The only requirement of good faith is one directed to the courts and their interpretation of the international instruments to fulfill their purpose. It must also be remembered that the meaning of the provisions in these international instruments is influenced not only by the common law legal tradition, but by other legal systems and, in particular, by the civil law.

In the case of *Kaverit Steel and Crane Ltd. et al. v. Kone Corp. et al.*, Kerans J.A. noted that the Court’s power to grant or withhold a reference under the *International Commercial Arbitration Act* is a very limited one. The trial judge in that case had held that an inconvenient reference was an “inoperative” one, but the Court of Appeal disagreed: “It may not operate conveniently, but it cannot be said to be inoperative (at pp. 138-9).” In this case, it may not have been convenient for Resin to pay the entire \$175,000 in advance costs, instead of only \$87,500, but should that have been enough to make the arbitration agreement inoperative?

Other problems with Court of Appeal’s decision in this case can be noted. For example, the decision of the Alberta Court of Appeal is out of keeping with the deference to arbitration on this type of issue signaled by the Supreme Court of Canada in *Dell Computer Corp. v. Union des consommateurs*, 2007 SCC 34 at paragraphs 68 to 77. Madam Justice Deschamps, writing for the majority, specifically looked at the degree of scrutiny a court should give an arbitration clause in considering a referral application. The key question is “whether it is the arbitrator or a court that should rule first on the parties’ arguments on the validity or applicability of an arbitration agreement.” Under Article 16(1) of the Model Law, an arbitrator “may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement” — the competence-competence principle. As Madam Justice Deschamps noted at paragraph 73:

The fact that art. II(3) of the New York Convention provides that the court can rule on whether an agreement is null and void, inoperative or incapable of being performed does not mean that it is required to do so before the arbitrator does, however.

Madam Justice Deschamps goes on, at paragraph 75, to note in *Dell* that there are different approaches to the court’s role on referral applications. She appears to give the nod to the “prima facie analysis test,” indicative of a deferential approach to the jurisdiction of arbitrators, by noting (at paragraph 77) that test “is gaining acceptance and has the support of many authors”:

Some authors argue that the competence-competence principle requires the court to limit itself to a prima facie analysis of the application and to refer the parties to

arbitration unless the arbitration agreement is manifestly tainted by a defect rendering it invalid or inapplicable....

The Alberta Court of Appeal in *Resin Systems Inc. v. Industrial Service & Machine Inc.* did not even question whether the courts or the arbitrator should be deciding ISM's referral application. Perhaps the Court thought it was abundantly clear that the arbitration agreement was inoperative and that it was justified in making a determination to that effect and dismissing ISM's application for referral.

As another example, the arbitrator appointed to hear the Resin and ISM dispute would have had the authority to award costs in whatever manner he considered appropriate. Article 31 of the ICC Rules of Arbitration so provides. In exercising their discretion in allocating costs, arbitrators should take into account any unreasonable behaviour by a party. According to the ICC's "Techniques for Controlling Time and Costs in Arbitration," the type of unreasonable behaviour encountered and disciplined through costs includes exaggerated claims and failure to comply with procedural orders. Thus, ISM's complaint about Resin exaggerating its claim and Resin's complaint about ISM failing to pay its share of the advance on costs are not exceptional problems in international commercial arbitration.