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Thomas Heintzman specializes in alternative dispute resolution. He has acted in trials, appeals and arbitrations in Ontario, Newfoundland, Manitoba, British Columbia, Nova Scotia and New Brunswick and has had numerous appearances before the Supreme Court of Canada.

Mr. Heintzman practiced with McCarthy Tétrault LLP for over 40 years with an emphasis in commercial disputes relating to securities law and shareholders' rights, government contracts, insurance, broadcasting and telecommunications, construction and environmental law. He was an elected bencher of the Law Society of Canada for 8 years and is an elected Fellow of the American College of Trial Lawyers and of the International Academy of Trial Lawyers.

Thomas Heintzman is the author of *Heintzman & Goldsmith on Canadian Building Contracts*, 4<sup>th</sup> Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

### **What Is The Effect Of *Res Judicata* On Arbitration?**

The recent decision of the British Columbia Supreme Court in *Boxer Capital Corp. v. JEL Investments Ltd.* raises some fascinating issues with respect to the application of the doctrine of *res judicata* to the arbitration process. The court effectively held that *res judicata* applies with all its force and effect to arbitration. For this reason, the court set aside an arbitral decision which did not follow or apply a previous arbitration decision and court decision arising in the same dispute.

The proceedings in this case also raise concerns about the ability of arbitration proceedings to deal with disputes on a cost and time effective basis. This dispute about \$750,000 arose in May

2008 and has already been through two arbitral hearings and several trips to the British Columbia courts, and this latest decision was rendered on December 27, 2013 five and a half years after the dispute arose.

### **The Background**

Boxer and JEL were parties to a property development agreement. Boxer had contributed more money to the project than JEL. The agreement contained a shot-gun agreement whereby one party could give notice that it would sell its interest to the other. Failing the receiving party's agreement to buy, the receiving party was required to sell at the same price. JEL gave notice in May 2008 that it was willing to sell its interest in the project for \$1.425 million. Boxer declined the offer so it was obliged to sell for that price to JEL. Boxer took the position that it was entitled to receive an amount from JEL which would equalize the difference in their respective capital contributions. Boxer said that JEL would have to pay an extra \$765,732.26 to compensate Boxer for the additional capital funds invested by it at the time the property was purchased. JEL said that it was not obliged to pay for that interest or capital contribution and that the monies it would pay as a result of the buy-sell process included whatever obligation it had to pay Boxer for its larger capital contribution.

### **The Arbitration and Court Proceedings**

The parties went to arbitration. In March 2009, the arbitrator found that JEL was obliged to buy Boxer's interest for \$1.425 million plus a capital adjustment payment of \$765,732.26. The arbitrator held that the obligation to pay the capital adjustment payment arose from an implied term in the agreement.

JEL did not comply with the arbitration award. So Boxer commenced an action to specifically enforce that award. In August 2009, the B.C. Supreme Court issued an order enforcing the arbitration award and incorporated the award into its judgment as a judgment of the court. The order directed JEL to pay the \$1.425 million amount and as well the \$765,732.26 capital adjustment amount. There was no appeal from this order.

In the meantime, JEL sought leave to appeal the 2009 arbitration award to the British Columbia Supreme Court. Leave to appeal was denied and JEL appealed to the B.C. Court of Appeal and in March 2011 the B.C. Court of Appeal allowed the appeal and granted leave to JEL to appeal from the 2009 arbitration award.

In that appeal, in August 2011 the B.C. Supreme Court held that JEL had validly acquired Boxer's shares pursuant to the shotgun clause but the court set aside the part of the arbitrator's award that require JEL to pay the capital adjustment payment. The court agreed with Boxer that it was entitled to be paid the capital adjustment amount but held that Boxer was not entitled to that amount at the time of the buy-out but only when the project became profitable as a first charge on any profits. The court held that JEL did not purchase or acquire the disproportionate capital contribution made by Boxer, and that that contribution remained "in the project" to be paid out of the project pursuant to the agreement, if and when profits were earned. No appeal was taken from that decision.

The purchase by JEL of Boxer's interest proceeded and JEL paid the \$1.425million to Boxer. JEL took the position that Boxer no longer had any interest in the project. In December 2011, so Boxer commenced an action to enforce its right to the capital adjustment amount. JEL brought a motion to stay the action and in May 2012, the action was stayed and Boxer's claim was directed to proceed by way of arbitration.

The arbitration awards were dated August and December 2012. The arbitrator held that he was not bound by the prior arbitration award or decisions of the B.C. courts. The arbitrator held that Boxer was not entitled to a capital adjustment amount and that Boxer no longer had any interest in or claim arising from the project.

Boxer sought leave to appeal the 2012 arbitral decisions and in April 2013 leave was granted. JEL appealed to the B.C. Court of Appeal and in June 2013 that appeal was dismissed.

The appeal from the 2012 arbitration decisions was allowed in December 2013. In case you are still following this saga, the proceedings have now been before two arbitrators, before the B.C. Supreme Court five times and before the B.C. Court of Appeal twice. And appeals to the B.C. Court of Appeal and Supreme Court of Canada are still possible.

### **2013 Decision of the B.C. Supreme Court**

The B.C. Supreme Court held that the parties to the 2012 arbitration were bound by the principle of *res judicata* arising from the 2009 arbitration and the 2011 decision of the B.C. Supreme Court. Both those decisions had found that Boxer was entitled to the capital adjustment amount. The only difference between those decisions was in relation to the timing of the payment of that amount and whether it was required to be paid at the time of the buy-out (as the 2009 arbitrator found) or at the time the project became profitable (as the 2011 judge found). Accordingly, the arbitrator had erred in holding that those decisions were not binding upon him.

The B.C. Court essentially found that the 2012 arbitrator was not at liberty to go behind – or “deconstruct” as the 2012 arbitrator said - the 2011 decision of the B.C. Court. It said:

“Both [the 2009] Arbitrator and [the 2011 judge] interpreted the agreement and found, for different reasons, that the \$1.425 million did not include the disproportional capital amount and yet, [in] his first partial award, [the 2012] Arbitrator stated:... ‘I am not bound by [2011 judge’s] reasoning...With great respect to [the 2011 judge], J., I do not agree with his interpretation of the COA on this issue.’

In my view it was an error of law for [the 2012] Arbitrator to "deconstruct" [the 2011 judge’s] reasoning and interpretation of the COA so as to "arrive at an opposite conclusion" regarding the ownership of the disproportionate capital, specifically whether it was included in the undisputed \$1.425 million. This was the exact same issue as the one considered by both [the 2009] Arbitrator and the [2011 judge]...”

The 2013 judge also held that the 2012 arbitrator erred in exercising discretion not to enforce the principle of *res judicata*. It said:

“Secondly, I disagree that it would be manifestly unfair and would work an injustice to JEL to apply the doctrine of issue estoppel in this case. Discretion must be exercised judicially. In my view, discretion judicially exercised should lead to the opposite conclusion to that reached by [the 2012] Arbitrator. The proper exercise of discretion would work as a grave injustice to Boxer ...if the doctrine of issue estoppel were not applied in the circumstances of this case.”

## **Discussion**

The *res judicata* issue is an extremely important one for the law of arbitration. That is because arbitration - or at least domestic arbitration - exists within a legal framework that includes two systems, courts and arbitrators. The principle of *res judicata* is one means by which that relationship is governed as the courts can over-rule an arbitral tribunal if it does not abide by a prior court decision. To maintain the proper balance between the two systems, it could be argued that the court should have due respect for the arbitral system and not impose an unduly strict regime of *res judicata* on arbitrators, and arbitrators should have due respect for the court's decisions and make decisions which respect the integrity of those decisions.

### **What can we learn from the present decision?**

First, the decision of an arbitral tribunal about *res judicata* will be reviewed on a standard of correctness. That is exactly what the 2013 judge has held. No respect for judgment or error will be accorded to the arbitral tribunal on this issue.

Second, it seems clear from this decision that the principle of *res judicata* does apply to arbitral decisions. Nobody asserted to the contrary in this case and the court clearly applied that principle.

Third, the principle of *res judicata* applies with the same strictness as it does to a court. Again, no-one apparently argued that there should be some leeway for the arbitral tribunal, on the ground that arbitration is a less formal and legal system than the court system. Neither side argued that there was a public policy rationale for a less lenient approach to *res judicata* in arbitrations than in court proceedings. There is no hint of leniency in this decision.

Fourth, the courts will expect arbitral tribunals to give a broad and purposeful interpretation and effect to the court's prior decisions. In this case, the court appears to have been impatient with the 2013 arbitrator's effort to fully understand the 2011 decision of the court. The court did not accept that the arbitrator had any jurisdiction to disagree with that decision or to be technical with its interpretation.

And fifth, the courts will expect the parties to exhaust their appeal rights from an arbitral decision before asserting in a subsequent proceeding that the arbitral decision or the court's review of it was wrong. In the present case, the failure of JEL to appeal the finding of the 2011 judge that Boxer had a remaining entitlement to the capital adjustment amount was fatal to its

efforts to uphold the 2013 arbitral award finding that Boxer had lost its entitlement to that capital adjustment amount.

Proponents of arbitration may wonder if there are better ways to find speedy justice. The parties selected arbitration presumably to avoid the costs and delays of the court system. That objective was not achieved in the present case.

***Boxer Capital Corp. v. JEL Investments Ltd.* 2013 CarswellBC 3913, 2013 BCSC 2366**

**Arbitration - Res Judicata – Standard of Review - Shot-gun agreements**

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**February 10, 2014**

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