Date of Release: January 13, 1992 **No. C9l5858**

Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

BETWEEN:)

)

MERIT KITCHENS LTD.) **REASONS FOR JUDGMENT**

)

PETITIONER)

) **OF THE HONOURABLE**

AND:)

)

WINMARK HOLDINGS LTD.) **MR. JUSTICE THACKRAY**

PATMAR INDUSTRIES LTD. and)

TANGENT LAND CORPORATION)

) **(IN CHAMBERS)**

RESPONDENTS)

Counsel for the Petitioner: M.P. Carroll

Counsel for the Respondents: F.G. Potts

Heard at Vancouver: December l7, l99l

This motion was brought pursuant to Rule 10 (1) (b) for a declaration that certain alleged undisclosed liabilities arising out of a purchase agreement entered into in September, 1989, between the petitioner and the respondents and others, be determined pursuant an arbitration clause in the purchase agreement.

BACKGROUND

On September 17, 1989, the petitioner purchased the assets of the respondent, Tangent, and certain shares and receivables belonging to the respondent, Patmar. Pursuant to the purchase agreement, the respondents warranted that the financial statements correctly described the assets, liabilities and financial condition of Tangent. Further, that there were no liabilities other than those disclosed in the financial statements, the purchase agreement or the schedules thereto.

The petitioner submitted that Tangent had incurred liabilities which were not disclosed. The respondents agreed to indemnify the petitioner against all liabilities not assumed by the petitioner and against damages from any misrepresentation, breach of warranty or nonfulfillment of any covenant.

The purchase agreement contains an arbitration clause which reads as follows:

l3.0l In the event of any dispute arising in connection with the existence of a claim for which indemnification is sought by the Purchaser or for which the exercise of the right of set off against Winmark is exercised as provided in article l2, the matter in dispute shall be referred in the first instance to the auditors of the Purchaser and the Vendors for determination. If the said auditors cannot agree on a determination of the matter in dispute within l0 days next after the reference to them, the matter in dispute shall be referred to a single arbitrator under the Commercial Arbitration Act of British Columbia for determination, which shall be binding upon the parties hereto.

ln a letter dated January 29, 1991, the petitioner claimed amounts totalling $125,264.75 from the respondents. The petitioner alleged that the amount represented undisclosed liabilities. One of the claims (the Dominion Construction project) was based on an allegation that the respondents knew that union labour would have to be used in one contract. This increased the cost to the petitioner by some $48,000. Another (the GRGN project) cost the petitioner $56,000 for items not included in the cost sheet to the customer. The third claim arose out of the Bogner contract. The petitioner claimed that the contract price did not include all of the cabinets which the petitioner was obliged to deliver to the customer. The extra cost was some $21,000.

The petitioner submitted that each of these constituted an undisclosed liability in breach of the warranties set out in paragraphs 9.01 (j) and (ad) of the purchase agreement. These read as follows:

9.0l Representations relating to Merit Assets

Merit, Patmar and Winmark jointly and severally represent and warrant to the Purchaser, who has in reliance thereon entered into this Agreement, and which representations and warranties shall survive the Closing and shall not be affected by delivery of any document or by any investigation, verification or approval by the Purchaser, but shall continue thereafter in full force and effect after the Closing Date, that:

(j) Forward Commitments. All outstanding forward commitments by or on behalf of Merit for the purchase or sale of inventory have been made in accordance with established price lists of Merit or its suppliers, or if otherwise, then in accordance with Merit's normal business custom in varying therefrom, which commitments have not more than 6 months to run except as disclosed in the Schedule of Material Contracts.

(ad) Liabilities Disclosed. There are no liabilities of Merit of any kind whatsoever, whether or not accrued and whether or not determined or determinable, in respect of which the Purchaser may become liable on or after the consummation of the transactions contemplated by this Agreement other than:

(i) liabilities disclosed in the financial statements referred to in this Agreement;

(ii) liabilities disclosed or referred to in this Agreement or in the Schedules hereto;

(iii) liabilities incurred in the ordinary course of the Merit Business since the date of the Financial Statements delivered to the Purchaser.

In a separate letter also dated January 29, 1991, the petitioner claimed from the respondents the sum of $19,000 for bonuses paid to employees. The petitioner said that pursuant to a "separate agreement", it was entitled to reimbursement. It further suggested that this claim, together with the others, be determined "by an arbitrator."

On February 14, 1991, Mr. E. L. Lewin, solicitor for the respondents, replied to both letters. He responded to "the request for substantiation of the $55,739.69 plus interest" which the respondents had "previously demanded" from the petitioner. He recommended that the auditors for each party meet to discuss the composition of this figure which was part of the purchase price. As to the claims of the petitioner, he said that they "are unfounded" and that it was not the respondent's "intention to resort to an unnecessary arbitration".

The petitioner's solicitors replied on February 20, 1991:

Your letter of February l4, l99l addressed to Merit Kitchens Ltd. and Pat Furlong has been referred to me for reply. We agree with your suggestion that Tangent's auditors meet with New Merit's auditors and Mr. Ratcliffe at the earliest available opportunity in order to review the claims raised in the two letters of Merit Kitchens Ltd. of January 29, l99l as well as the claim of Tangent Land Corporation in the amount of $55,739.69 referred to in your letter of February l4. If the auditors are unable to agree on the determination of these claims, we would ask that you agree to have them arbitrated in accordance with s. l3.0l of the Purchase Agreement of September l7, l989.

Attached is a draft letter to the auditors which we suggest be sent jointly by our two firms. As we would like the matter to be referred to the auditors prior to the end of the week, we would ask you to contact us immediately.

Mr. Lewin replied on February 21, 1991, and suggested an addition to the letter. The wording of the letter was thereby agreed upon by respective counsel. On February 22, 1991, the solicitors for the petitioner sent the letter to the auditors for the petitioner. It contained the following:

If you are unable to determine the claims within ten days they would be referred to arbitration pursuant to clause 13.01 of the Purchase Agreement of September 17, 1989.

In an affidavit sworn on September 11, 1991, Mr. Lewin agreed that he "was involved in settlement discussions and negotiations concerning the subject matter of the Petition herein". However, he went on to say:

In the course of the aforesaid discussions and negotiations, the possibility of arbitrating the alleged undisclosed liabilities was discussed. However, at no time did I specifically agree that the claims for alleged undisclosed liabilities would or should be arbitrated. Any such agreement which has been inferred on my part as a result of my agreement to the wording of the letter sent by counsel for the Petitioner to the auditors for the parties herein on February 22, l99l, is erroneous. What was agreed was that further discussion about a possible arbitration be held in abeyance, pending resolution of other outstanding matters between the parties.

In his affidavit Mr. Lewin makes note of the fact that in his letter to the petitioner's solicitor of February 21, 1991, he referred to the "possible arbitration of" the petitioner's claims. He then went on to say:

> At no time did I, or anyone at my law firm, receive instructions from our client to agree to a submission to arbitration in the matter of the alleged undisclosed liabilities. Our instructions were to pursue good faith best efforts to effect a settlement of all outstanding matters between the parties.

On April 2, 1991, the petitioner commenced a court action against Richard Dewinetz, principal of the respondents, for cabinets and counter-tops supplied by the petitioner to Mr. Dewinetz. On April 25, 199l, the respondent, Tangent, commenced an action against the petitioner for approximately $90,000. This amount is allegedly owing as a result of an adjustment to the purchase price. The petitioner filed an appearance.

PETITIONER'S SUBMISSION

The petitioner submitted that clause 13.01 of the purchase agreement applies to the claims and that the clause is binding upon the respondents.

The petitioner further submitted that the action which it commenced is for matters totally separate from the purchase contract. Consequently there was no waiver of the arbitration clause. Similarly, the entering of an appearance to the respondents' action is not a waiver of arbitration.

Counsel for the petitioner conceded that the respondents did not, in express words, agree that the claims would go to arbitration. However, he submitted that the agreement by the respondents' solicitor to the letter that was sent to the auditors should be interpreted as such agreement. Further, that the claims were referred to the auditors and the auditors were unable to agree on the determination. Therefore, "the matter shall be referred to a single arbitrator."

RESPONDENTS' SUBMISSION

The position of the respondents is that the three claims are simply the end result of unprofitable contracts. They do not represent undisclosed liabilities. The respondents said that on a plain reading of the arbitration clause, these claims are clearly not included.

Further, that the test in section 15 of the **Commercial Arbitration Act**, R.S.B.C. 1986 c. 3, is not the test to be applied. Section 15 of the **Commercial Arbitration Act** reads as follows:

l5. (l) Where a party to an arbitration agreement commences legal proceedings in a court against another party to the agreement in respect of a matter agreed to be submitted to arbitration, a party to the legal proceedings may, before or after entering an appearance and before delivery of any pleadings or taking any other step in the proceedings, apply to that court to stay the legal proceedings.

(2) In an application under subsection (l), the court shall make an order staying the legal proceedings unless it determines that the arbitration agreement is null and void inoperative or incapable of being performed.

(3) Notwithstanding that an application has been brought under subsection (l) and that the issue is pending before the court, an arbitration may be commenced or continued and an arbitral award made.

(4) It is not incompatible with an arbitration agreement for a party to request from the Supreme Court, before or during arbitral proceedings, an interim measure of protection and for the court to grant that measure.

The respondents submitted that prior to being entitled to invoke arbitration, the petitioner must show that a claim exists at law, and this requires a judicial interpretation of the relevant provisions of the purchase agreement.

The respondents further said that if the arbitration clause is applicable, then it was waived by the petitioner when it initiated an action. It is their position that even if the action was not specifically with regard to matters

detailed in the purchase agreement, it was designed to "resolve certain disagreements arising out of the relationship between them".

In support of this position, the respondents relied upon **Karlsen Shipping Company Limited v. Sefel J. & Associates Ltd.** [1973] 3 W.W.R. 122 (Alta. S.C.). The arbitration clause provided "That should any dispute arise...the matter in dispute shall be referred to" arbitration. The applicant commenced an action by statement of claim. The respondent filed a counterclaim and the applicant conducted a cross-examination of an officer of the respondent. The Court held that these steps by the applicant were a waiver of the right to arbitration. By filing a defence and counterclaim, the respondent accepted the waiver.

The respondents also referred to **O'Hara, Bennett Estate v. Wawanesa Mutual Insurance Company** [1991] 1 W.W.R. 16 (Alta. C.A.) and to **Fofonoff v. C and C Taxi Service Limited** (1977), 3 B.C.L.R. 159 (B.C.S.C.) as to what constitutes a step in a proceeding.

The respondents are of the opinion that the petitioner has not adhered to the purchase agreement. The respondent referred to **Sinclair Canada Oil Co. v. Great Northern Oil Co.** (1966), 59 D.L.R. (2d) 298 (Sask. Q.B.). MacDonald, J. held that if a buyer does not proceed in accordance with the terms of the contract, then it is not entitled to arbitration.

As to the contention of the petitioner that counsel for the respondents should be taken to have agreed to arbitration, the respondents said that such is not the case. Further, that Mr. Lewin thought that the matter being referred to the auditors was pursuant to section 3.04 of the purchase agreement. This section is entitled "Closing Balance Sheets" and provides that if the auditors are not able to resolve a matter in dispute, it "shall be referred for determination to a national accounting firm acceptable to [the auditors] to act as an expert and not as an arbitrator."

CONCLUSIONS

I find that the petitioner has not, by its conduct, disentitled itself to arbitration. I do not accept the respondents' contention that the petitioner has waived arbitration by commencing an action. In **Karlsen** (supra), the arbitration clause was wider than in the case at bar and covered "any dispute". In **O'Hara** and **Fofonoff** (supra), the matters in litigation were the same as those for which arbitrations were sought. The petitioner's action against Mr. Dewinetz is for cabinets and counter-tops invoiced from dates commencing in December of 1990. The claims in the action are distinct from the purchase agreement.

The entry of an appearance by the respondent in the petitioner's action is not a step in the action which results in the petitioner waiving arbitration. (**Stancroft Trust Limited v. Can-Asia Capital Company Limited** (1990), 43 B.C.L.R. (2d) 341).

The petitioner wants an arbitrator to review the claims and to say whether or not they represent liabilities that were not disclosed. This, in my opinion, is within the contemplation of the purchase agreement. Section 12.01 provides that the respondents will indemnify and hold harmless the petitioner from "any and all liabilities...existing at the time of closing and which are not agreed to be assumed by the petitioner", and from "any and all damage or deficiencies resulting from any misrepresentation, breach of warranty or nonfulfillment of any covenant...".

In **Roy v. Boyce** (1991), 57 B.C.L.R. (2d) 187 (S.C.B.C.) Fraser, J. agreed with English authorities that:

The wording of s. 15 appears to take away the discretion of a superior court of plenary jurisdiction to deflect an arbitration to which the parties have agreed.

He found that:

> The thrust of the **Commercial Arbitration Act** is unambiguously toward viability of arbitration.

Sinclair (supra), referred to **Altwasser v. Home Ins. Co. of New York** [1933] 2 W.W.R. 46 wherein Martin, J.A. said:

> The authorities are to the effect that, when once it appears that the agreement for arbitration covers the claim stated in the action, it is the prima facie duty of the Court to allow the forum, which the parties have agreed to, to settle the matter in dispute, and the onus of showing that the case is not a fit one for arbitration is upon the person who opposes the stay of proceedings:...While the Courts are guided by the principle that persons who make an agreement for arbitration should be bound by its terms, they do not lose sight of the principle that the jurisdiction of the Courts is not to be ousted by agreement between the parties; and in cases where it is thought better that the matters at issue should be decided by the Courts rather than by arbitration, the action is allowed to proceed and a stay of proceedings is refused..

I do not think that it would be "better that the matters at issue should be decided by the Courts". I find that the arbitration clause prevails.

I further find that counsel for the respondents agreed to arbitration. Counsel for the petitioner set out the petitioner's claims in the letters of January 29, 1991. He specifically commented that these represented undisclosed liabilities. In reply Mr. Lewin referred to the matter of closing balances and suggested that they be reviewed by the auditors.

In reply to that letter, counsel for the petitioner suggested that the auditors meet "to review the claims raised in the two letters [of January 29, 1991] as well as the claim of [the respondents] in the amount of $55,739.69 referred to in your letter of February 14." The letter to the auditors specifically stated that "the claims...would be referred to arbitration pursuant to clause 13.01 of the purchase agreement". Mr. Lewin accepted this wording.

I do not accept the respondents' contention that Mr. Lewin was agreeing to no more than "non-arbitration" procedures under section 3.04 of the purchase agreement. In my opinion the arbitration procedure was initiated with the concurrence of counsel for the respondents.

This matter is ordered to proceed to arbitration.

"A. D. Thackray, J."

January 13, l992

Vancouver, B.C.