

Surprise! Rescission notice can be served in a pleading

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Introduction

In its recent decision in *2352392 Ontario Inc v Msi*,⁽¹⁾ the Ontario Court of Appeal dealt with the issue of whether a notice of rescission of a franchise agreement is valid if it is contained within a pleading. Consistent with franchise disclosure legislation in other jurisdictions, Ontario's Arthur Wishart Act (Franchise Disclosure) 2000⁽²⁾ requires franchisors to provide adequate pre-contractual disclosure to potential franchisees, failing which a franchisee may be entitled to rescind its franchise agreement. When properly invoked, rescission by a franchisee imposes extensive obligations on the franchisor, which may be liable to reimburse the franchisee for costs relating to the franchise.⁽³⁾

It is well known that courts have typically interpreted and applied the act and other similar legislation in a favourable manner towards franchisees, ensuring that issues of form or procedure do not hinder the enforcement of their substantive rights.

This issue was central to the Ontario Court of Appeal decision in *2352392 Ontario Inc*, which upheld the validity of a notice of rescission within a pleading. The court concluded that although best practice dictates that a franchisee should deliver its notice of rescission to the franchisor before commencing litigation so as to allow the franchisor the opportunity to comply without the need for litigation, such notice may be constituted by or otherwise included in a pleading itself, provided that it otherwise complies with the requirements of the act.

Facts

In 2012 the franchisee entered into a franchise agreement with the franchisor to acquire and operate a Works Gourmet Burger restaurant in Toronto, Canada. Prior to the parties executing the agreement, the franchisor provided the franchisee with two disclosure documents, purporting to comply with the disclosure obligations specified in the Arthur Wishart Act (Franchise Disclosure).

The franchisee's restaurant was not financially successful. In fact, the franchisee ultimately defaulted on its financing facility granted by the Royal Bank of Canada (RBC), which sued the franchisee in 2013, leading the franchisor to terminate the franchise agreement and take possession of the franchise.

The franchisee retained legal counsel to defend against the RBC proceedings and commenced a third-party claim against the franchisor for rescission of the franchise agreement on the basis that the disclosure documents were so materially deficient as to constitute no disclosure at all. The franchisor, in turn, argued that the franchisee could not claim rescission since it had not delivered the required written notice under the act. The franchisee subsequently issued a claim for negligence against its former attorney, who took the position in defence that the claim instituted against the franchisor itself constituted the required notice of rescission under the act.

In 2019 the motion judge sitting for the Ontario Superior Court of Justice held that a pleading could not itself constitute or contain the notice of rescission required under the act; however, this decision was successfully appealed by the franchisee's former counsel.

Decision

The Ontario Court of Appeal held that the act must be interpreted in a generous manner towards franchisees,

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with a view to redressing the imbalance of power in the franchisor-franchisee relationship. Accordingly, the court found that a pleading can comply with the requirements of the act regarding notices of rescission. Of note, the court held that the purpose of a written notice of rescission is to advise the franchisor that the franchisee is rescinding and clarified that such notice is not a precondition to litigation.

Although the franchisor did not present either of these arguments to the court, the decision specifically mentioned that the language of the franchisee's claim against the franchisor was not too imprecise to constitute proper notice to the franchisor; nor did the manner in which notice had been given prejudice the franchisor in any way. Concluding that giving notice of rescission in a pleading is not the recommended procedure, the court nonetheless found that precluding a franchisee from proceeding in this manner when it is not prohibited by the act would favour form over substance, thereby impeding the proper enforcement of franchisees' substantive rights.

The franchisee's pleading claiming rescission was therefore found to constitute valid notice of rescission pursuant to the act.

Comment

Given the similarity between the Arthur Wishart Act (Franchise Disclosure) and franchise disclosure legislation in other jurisdictions, it is likely that this finding will be applied generally in similar cases elsewhere.

While the Ontario Court of Appeal upheld the validity of a notice of rescission contained in a pleading in this case, it is clear that the recommended practice remains issuing a written notice of rescission prior to litigating. In fact, bringing a claim for rescission without giving notice beforehand is risky for franchisees, based on the court's comments suggesting that franchisors may attack a notice consisting of or otherwise contained in a pleading if the language is imprecise (so as to compromise its characterisation as proper notice) or if the franchisor is prejudiced by the notice being given solely through the pleading. Further, the court noted that a notice of rescission is ordinarily meant to advise the franchisor of the franchisee's desire to extricate itself from the franchise relationship and to allow the franchisor the opportunity to comply with its obligations flowing from such rescission, potentially without the need for litigation.⁽⁴⁾ The court also cited its previous decision that a franchisee's right of action for damages will not actually arise unless the franchisor fails to comply with its obligations following receipt of a notice of rescission.⁽⁵⁾ As a result, this decision should not be relied on to guide franchisee litigation strategy with respect to rescission claims.

For franchisors, this decision reinforces the importance of being diligent with respect to legal disclosure obligations, as courts evidently continue to be extraordinarily accommodating with respect to enforcing franchisee rights in this context.

Finally, it is important to note that this decision was the result of unusual circumstances, and the conclusions as to the validity of the rescission notice consisting of or otherwise contained in a pleading were sought by the franchisee's original attorney and not the franchisee itself. As such, the judiciary may have taken into account the attorney's potential liability in its consideration of the relevant facts and ultimate determination that a notice served by a pleading will be effective as concerns a franchisor.

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Endnotes

(1) 2020 ONCA 237.

(2) SO 2000, c 3.

(3) 2122994 Ontario Inc v Lettieri, 2017 ONCA 830; Section 6(6) of the act.

(4) *Supra*, note 1, par 12.

(5) 2130489 Ontario Inc v Philthy McNasty's (Enterprises) Inc, 2012 ONCA 381, par 39.