

Pleading with a Side of Rescission: Court of Appeal Holds that a Pleading Can Constitute a Notice of Rescission in Certain Circumstances

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May 4, 2020

In *2352392 Ontario v. MSI*,¹ the Court of Appeal for Ontario held that, in the specific circumstances of the case, a third party claim brought by a franchisee against a franchisor in a court proceeding was sufficient to constitute a notice of rescission for the purposes of section 6(3) of the *Arthur Wishart Act (Franchise Disclosure) 2000* (Wishart Act).² The Court of Appeal decision overturned the lower court decision of the Superior Court of Justice.³

Although the Court recognized that the Wishart Act appears to contemplate that a notice of rescission will be given outside the context of litigation, it held that a pleading can comply with the Wishart Act's requirements, and did in this case. The key facts which enabled this conclusion included the fact that the third party claim was issued in a separate, earlier action than the action before the court, that the franchisor had not argued that the pleading was too imprecise to constitute notice, and that there was no prejudice to the franchisor by the manner in which the notice was given. However, the Court also noted that proceeding in this manner was "anomalous" and not the "normal and preferable procedure."

Background and Procedural History

The plaintiff entered into a franchise agreement with the franchisor in December 2012 for the right to acquire and operate a location of The Works Gourmet Burger restaurant. The franchise failed within the first year of operation, leading the franchisor to take possession of the restaurant and to subsequently terminate the franchise agreement. Around the same time, the franchisee defaulted under a loan agreement used to finance its franchise, and the lender commenced an action against the franchisee for repayment of the loan. The franchisee defended the action and, in May 2014, commenced a third party claim against the franchisor claiming rescission of the franchise agreement pursuant to the Wishart Act and/or common law and a full refund of monies paid (the Third Party Claim) based on alleged disclosure deficiencies. The franchisee served the Third Party Claim on the franchisor in October 2014, being within two years from the execution of the franchise agreement.

In June of 2015, the franchisor defended the Third Party Claim. Among other things, the franchisor pleaded that the Third Party Claim was statute-barred as the franchisee had not delivered a notice of rescission, as

Cassels

contemplated by section 6(3) of the Wishart Act, within two years from the execution of the franchise agreement.

The franchisee subsequently commenced a new, separate action against the franchisor, taking the position that the Third Party Claim was itself a notice of rescission under the Wishart Act.

In July 2019, the Superior Court of Justice rendered a decision concluding that a pleading could not constitute a notice of rescission. Specifically, the court held that a pleading and a notice of rescission serve distinct purposes and are both functionally and temporally distinct: a pleading for rescission under the Wishart Act only crystallizes after a franchisor has failed or refused to compensate the franchisee in accordance with section 6(6) of the Wishart Act.

The Court of Appeal disagreed with these conclusions as applied to the specific facts of this case and overturned the lower court decision.

Decision

The Court noted that in effect, the notice of rescission and the claim for rescission were brought contemporaneously. It framed the question before it as: “Is there a reason to interpret the Act in a way that requires a separate notice, and does not allow the third party claim, issued within two years after entering into the franchise agreement as required by s. 6(2), to constitute the required notice?” and concluded that there was not.

The Court noted that, since the Wishart Act is remedial legislation, it should be interpreted in a generous manner to redress the imbalance of power in franchising relationships, while balancing the rights of franchisors and franchisees.

Section 6(2) allows a franchisee to rescind a franchise agreement within two years of entering into the franchise agreement if the franchisor did not provide the requisite disclosure document, provided that the franchisee delivers a notice of rescission. The Court concluded that the purpose of the notice is to advise the franchisor that the franchisee is rescinding the franchise agreement, not to function as a precondition to litigation.

The only formal or substantive requirements for a notice of rescission prescribed by section 6(3) are that it be in writing and delivered to the franchisor. The Court noted that while “it is fair to say that the Act appears to contemplate that notice will be given outside the context of litigation, a pleading can comply with the Act’s requirements. It did in this case.”

The Court’s conclusion in this regard was supported by the following facts:

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- the franchisor “did not take the position that the language of the third party claim was too imprecise to give notice to the franchisor”;
- “[t]his was not a case in which the franchisor was somehow prejudiced by the manner in which notice was given, nor did [the franchisor] submit otherwise”; and
- the franchisee was pursuing its claim for rescission in an action initiated by a new statement of claim, and not the action in which it had delivered the Third Party Claim.

With respect to the third point, the motion judge had found that the Third Party Claim was commenced prematurely and therefore could not constitute proper notice. In so doing, the motion judge relied on the holding in *2130489 Ontario Inc v. Philthy McNasty's (Enterprises) Inc.*⁴ that a cause of action for rescission does not arise until a franchisor fails or refuses to fulfil the obligations in s. 6(6) of the *Wishart Act*. The Court of Appeal did not dispute the possibility that the pleading was premature: instead, it noted that this issue was a procedural matter that may have to be addressed by the parties. In this case, the Third Party Claim had constituted written notice and the franchisee subsequently issued a new statement of claim.

While this procedure was “anomalous, and certainly not the ideal or recommended approach”, the Court concluded that it saw no basis to find that the third party claim could not constitute the written notice required under s. 6(3) of the Act – a finding that would have the effect of denying the franchisee’s right to rescind.”

Specifically, the Court concluded as follows:

...although written notice of rescission delivered by the franchisee to the franchisor before commencing litigation is the normal and preferable procedure, to preclude a franchisee from using a pleading to provide notice of rescission to a franchisor and to find that such a notice cannot comply with the Act when there is no such prohibition in the Act itself, would be to favour form over substance and create a barrier to enforcement of the rights of franchisees under the Act.

Accordingly, the Court reversed the motion judge’s decision below and permitted the claim for rescission to proceed.

Key Takeaways

While this case does mean that, in certain circumstances, a pleading can constitute a notice of rescission even if no previous written notice was provided, all hope is not lost for those franchisors who receive and wish to dispute the effectiveness of such notice. Specifically, the decision effectively preserves the ability of a franchisor to defend a rescission claim first raised in a pleading on the basis the franchisor was not provided proper notice or afforded the requisite 60 days to compensate the franchisee or communicate its refusal to do so. Indeed, the Court made it clear that the use of a third party claim to provide notice of

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rescission was “anomalous, and certainly not the ideal or recommended approach” and also stated that a written notice of rescission delivered prior to commencing litigation is “the normal and preferable procedure.”

1 2020 ONCA 237, <http://canlii.ca/t/j614p>

2 S.O. 2000 c. 3 (the "Wishart Act")

3 2019 ONSC 4055, <http://canlii.ca/t/j187t>

4 2012 ONCA 381, <http://canlii.ca/t/frln3>

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