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Substance Over Form in the Enforcement of Franchisees' Statutory Rescission Rights: the Anomalous Case of Notice by Pleading

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By Michael Statham

In a decision released on March 23, 2020,[1] the Ontario Court of Appeal favoured substance over form in finding that a franchisee could properly discharge its obligation to give written notice of rescission of a franchise agreement under Ontario's *Arthur Wishart Act (Franchise Disclosure), 2000*[2] (the "***Wishart Act***") by way of a claim asserted in a court pleading, rather than being required to first deliver a freestanding notice outside the context of litigation. In allowing the appeal from a lower court decision holding that a pleading was insufficient written notice of rescission under the *Wishart Act*,[3] the Court of Appeal concluded that procedural anomalies in the giving of notice cannot have the ultimate effect of depriving franchisees of the opportunity to enforce their statutory rights.

The Factual Background

The franchisee operated a Works Gourmet Burger restaurant franchise in Toronto for a brief period in 2013. The franchise was not financially successful. The franchisee's bank sued the franchisee for defaulting on a business loan that had been taken out in connection with the acquisition and operation of the franchise. The franchisee, in turn, retained a lawyer to defend the bank's claim and to commence a third party claim against the franchisor and others. As against the franchisor, the franchisee claimed (among other relief) rescission of the franchise agreement under the *Wishart Act* for the franchisor's alleged failure to meet its statutory disclosure obligations to the franchisee.[4]

In its defence to the third party claim, the franchisor contended that the franchisee's rescission claim under the *Wishart Act* was statute-barred as the franchisee had failed to deliver the required notice of rescission under section 6(3) of the statute within the two-year period provided for in section 6(2). Section 6(3) of the *Wishart Act* directs that:

Notice of rescission shall be in writing and shall be delivered to the franchisor, personally, by registered mail, by fax or by any other prescribed method, at the franchisor's address for service or to any other person designated for that purpose in the franchise agreement.

Later, a new lawyer acting on behalf of the franchisee issued a new claim against the franchisor asserting that the third party claim itself (which had been delivered within the two-year period) constituted valid written notice of rescission under the *Wishart Act* and, as such, the franchisee's rescission claim was not statute-barred. At around the same time, the franchisee also sued its former lawyer, alleging that he had been negligent in failing to properly exercise the franchisee's statutory right of rescission through delivery of proper written notice within the two-year period. In so doing, the franchisee sought to hold its former lawyer responsible in the event that the franchisor was correct in asserting that the original third party claim did not constitute proper notice of rescission under the *Wishart Act*.

The franchisor ultimately brought a motion to determine the discrete question of law as to whether the third party claim constituted the required written notice. The franchisee advanced the same position as the franchisor – that the third party claim was not proper notice – yielding an unusual scenario in which franchisor and franchisee were fully aligned on the interpretation of the *Wishart Act* against the position advanced by the franchisee's former lawyer.

The Decision of the Motion Judge

The motion judge held that a pleading could not constitute the written notice required under section 6(3) of the *Wishart Act*. The proposition that "…a statement of claim [is] a different creature both in form and purpose than a notice under subsection 6(3)"[5] lay at the heart of the motion judge's Reasons. In support of this proposition, the motion judge relied on the Court of Appeal's 2012 decision in *2130489 Ontario Inc. v. Philthy McNasty's (Enterprises) Inc.*,[6] a case in which the issues were: (i) when a franchisee's cause of action arose for damages flowing from a franchisor's failure to comply with the statutory obligations under section 6(6) of the *Wishart Act* that are triggered by the receipt of a notice of rescission;[7] and (ii) whether the franchisee commenced its claim in time prior to the expiry of the two-year limitation period. The Court in *Philthy McNasty's* found that the franchisee's claim had been commenced in time on the basis that: "[u]ntil the franchisor decides to not fulfill the obligations in section 6(6), the franchisee has no cause of action for compensatory damages."[8]

From this, the motion judge concluded that:

…since a notice under subsection 6(3) serves a different purpose from a pleading, this Third Party Claim in the case at bar cannot constitute such a notice. It is plain and obvious the Third Party Claim which is based upon a cause of action dependant upon a failure of the franchisor to abide by its obligations under subsection 6(6), cannot constitute notice since there is no cause of action until such notice has been given. Logically, the Third Party Claim cannot serve the same function as notice.[9]

The Court of Appeal Allows the Appeal

The Court framed the issue at the outset by asking "[i]s 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?"[10] The Court's answer was no.

At the start of its analysis, the Court referenced the well-established principle that the *Wishart Act* is remedial legislation, to be interpreted "…in a generous manner to redress the imbalance of power in franchising relationships, while also balancing the rights of both franchisees and franchisors…"[11]. As identified below, this interpretive lens was critical to the Court's analysis of whether the motion judge's interpretation had the effect of denying the franchisee's substantive right to rescind the franchise agreement. For his part, the motion judge made no express reference in his Reasons to the law characterizing the *Wishart Act* as remedial legislation.[12]

In the Court's view, the purpose of the written notice requirement in section 6(3) of the *Wishart Act* is simply to advise the franchisor that the franchisee is rescinding the franchise agreement.[13] While communicating this advice in a pleading, rather than in a standalone notice delivered prior to the delivery of any pleading, may be, as the Court observed, an "anomalous" procedure and "…certainly not the ideal or recommended approach",[14] it is nevertheless a permissible means of giving such notice against the backdrop of the text and remedial objectives of the legislation.

More specifically, the Court found nothing in the text of the *Wishart Act* to indicate, as seems to have been accepted (at least implicitly) by the motion judge, that the purpose of the written notice requirement is to serve as a "precondition to litigation."[15] To the contrary, the Court considered that the legislative history of section 6 pointed in the opposite direction: that the notice requirement was intended to "…allow the parties to extricate themselves from [a franchise agreement] without litigation…" (should the franchisor accept the notice and comply with the requirements under section 6(6) of the Act),[16] without imposing a temporal

requirement that the franchisee first give written notice by means other than a pleading.

Further, the Court found that to the extent a pleading of rescission may be "premature" (in the sense that claims for the compensation and other payments provided for in section 6(6) of the *Wishart Act* precede the expiry of the statutory 60-day period afforded to the franchisor), such prematurity is a "procedural matter" that the parties may have to address in the action. It is not a basis on which to deprive a franchisee of its statutory right to rescind.[17]

Implications

In the end, absent directive language to the contrary in the statute, and mindful of the *Wishart Act's* status as remedial legislation directed at redressing the imbalance of power in franchising relationships, the Court was not prepared to uphold a finding that "…would have the effect of denying the franchisee's right to rescind."[18] While providing written notice of rescission for the first time in a pleading may not be the normal or preferable procedure in most cases, and would appear to foreclose any possibility of achieving "extrication without litigation" as referenced in the Court's Reasons, it is nevertheless a permissible way of proceeding under the statute. For the reasons discussed above, the Court was plainly uncomfortable with the prospect that the anomalous or unorthodox approach to written notice adopted by the franchisor's first lawyer in this case could have the fatal downstream effect of barring the franchisee's rescission claim altogether.

Finally, subject to the particular facts of any given case, the Court's decision offers a strong basis on which to conclude that giving written notice of statutory rescission in a pleading is not, in itself, a breach of a lawyer's standard of care in such matters.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

[1] *2352392 Ontario Inc. v. Msi*, 2020 ONCA 237 ("**Court of Appeal Reasons**").

[2] S.O. 2000, c. 3.

[3] 2019 ONSC 4055 ("**Motion Judge's Reasons**').

[4] Section 6(2) of the *Wishart Act* provides that "[a] franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document."

[5] Motion Judge's Reasons at para. 36.

[6] 2012 ONCA 381.

[7] Section 6(6) of the *Wishart Act* provides that the franchisor shall, within 60 days of the effective date of the rescission: (a) refund certain moneys received from the franchisee; (b) purchase certain inventory from the franchisee; (c) purchase certain other supplies and equipment that the franchisee had purchased; and (d) "compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts set out in clauses (a) to (c)."

[8] Cited in para. 39 of the Motion Judge's Reasons.

[9] Motion Judge's Reasons at para. 40.

[10] Court of Appeal Reasons at para. 10.

[11] Court of Appeal Reasons at para. 11.

[12] In para. 45 of his Reasons, the Motion Judge observed that permitting the third party claim to serve as valid notice of rescission under the *Wishart Act* would be unfair to the franchisor, and would undermine the legislative framework set up under section 6 of the Act.

[13] Court of Appeal Reasons at para. 12.

[14] Court of Appeal Reasons at para. 14.

[15] Court of Appeal Reasons at para. 12.

[16] *Ibid*.

[17] Court of Appeal Reasons at para. 14.

[18] *Ibid*.

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