

Will a franchisee's rescission claim stay or will it go? Mandatory mediation may result in stay of proceedings

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Introduction

It has become common practice to include alternative dispute resolution (ADR) provisions in franchise agreements. When poorly drafted, such provisions can lead to unforeseen circumstances for franchisors, as was evidenced by a recent decision from the Ontario Court of Appeal.

In *PQ Licensing SA v LPQ Central Canada Inc*, the court ruled that an ADR clause in a franchise agreement, which obliged the franchisor and the franchisee to refer to mediation prior to arbitration when resolving their franchise disputes, had the effect of staying the franchisee's rescission claim. Accordingly, the court ruled that the applicable two-year limitation period to exercise the franchisee's rescission right began to run only once the requirement to refer to mediation had been fulfilled and, as a result, the franchisee's claim was not statute-barred.

Facts

In 2008 PQ Licensing SA (the franchisor) and LPQ Central Canada Inc (the franchisee) entered into a franchise agreement for the opening and operation of a certain number of bakery franchises located in the provinces of Ontario and Quebec. On 11 August 2009 the franchisee served a notice of rescission to the franchisor, alleging that the franchisor had failed to fulfill its disclosure obligations in accordance with Ontario franchise law (the Arthur Wishart Act). The franchisor refuted the validity of the franchisee's rescission claim on 8 October 2009.

The franchisee then brought suit against the franchisor almost two years later on 6 October 2011. The franchisor objected on the basis that the franchise agreement between the parties required them to proceed with mediation followed by arbitration in order to settle any disputes. The franchisee rejected the franchisor's proposal to submit the matter to mediation in January 2012, claiming that the ADR provisions contained in the franchise agreement were voided by the franchisor's alleged contractual violations.

The court action was administratively dismissed for inaction in 2013. In response to the franchisee's motion to revive the action, the franchisor attempted to have the franchisee's action dismissed as being statute-barred. The court stayed the proceedings on the basis of the mandatory ADR provisions and decided that the issue of the limitation period should also be determined by the arbitrator. Consequently, the franchisee served a notice of arbitration to the franchisor on 7 October 2013, four years after the franchisor had initially opposed the franchisee's claim for rescission. **(1)**

Decision

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The arbitrator interpreted the ADR provisions in the franchise agreement to mean that the parties were required to submit their dispute to mediation as a condition precedent to arbitration. According to the arbitrator, this two-step mechanism had the effect of suspending the applicable two-year limitation period until the mediation regime had been complied with and as such, the franchisee's claim was not statute-barred.(2)

The arbitrator disagreed with the franchisor's position that this interpretation would result in permitting the franchisee to delay arbitration indefinitely – either party could have started the limitation period by insisting on mediation. In this case, the arbitrator found that the mediation requirement was satisfied 60 days after mediation was rejected by the franchisee in January 2012.(3)

The franchisor then unsuccessfully appealed the arbitrator's decision to the Ontario Superior Court and the Ontario Court of Appeal. The Court of Appeal noted that, pursuant to the Ontario statute of limitations, legal proceedings must be initiated within two years of the "discovery" of a claim, with such discovery occurring, *inter alia*, when the claimant gains knowledge of the fact that legal proceedings would be an "appropriate means" to resolve the claim. According to the court, the parties "discovered" that they would have to resort to arbitration only once it became clear that no mediation would occur. As a result, the court agreed with the arbitrator's decision and concluded that the franchisee's rescission claim was not time-barred and could proceed given that the limitation period had begun to run only in January 2012. In reaching this conclusion, the court applied the deferential standard of reasonableness applicable to the review of arbitration decisions.(4)

The franchisor further contended that the court's interpretation of the ADR provisions enabled the franchisee to arbitrarily manipulate the time of discovery of its potential claims, unbeknown to the franchisor. The court rejected this argument based on the fact that pursuant to the franchise agreement, the franchisee was required to provide immediate notice to the franchisor of any alleged breach or violation as well as to respect the notice periods provided in the franchise agreement – obligations with which the franchisee had complied.(5)

Comment

The franchisee did not contest the fact that, were it not for the precondition of mediation in the franchise agreement, its rescission claim would have been discovered four years prior to the arbitration proceedings being commenced, and would therefore have been time-barred.(6)

Despite the notices of rescission and objection thereto in 2009, the franchisor hoped that the dispute would be abandoned. When the franchisee commenced court proceedings almost two years later in October 2011, the franchisor finally proposed mediation, which was refused by the franchisee. Once again, rather than pursue the resolution of the dispute, the franchisor hoped that the court proceedings would be abandoned. This complacency, in light of express and mandatory ADR provisions in the franchise agreement, resulted in extending the statute of limitations for the franchisee's claim, despite the franchisee ultimately refusing to mediate.

This decision serves as a stark reminder to franchisors to ensure that ADR provisions contained in a franchise agreement are properly drafted so that commencement of disputes thereunder trigger the running of the applicable limitation period. By properly drafting the ADR provisions in their franchise agreements and strictly enforcing them when disputes arise, franchisors can have greater control over the resolution of their disputes with franchisees and avoid any unanticipated outcomes.

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Endnotes

(1) *PQ Licensing SA v LPQ Central Canada Inc*, 2018 ONCA 331 (CanLII), paragraphs 4-7 .

(2) *Ibid*, paragraphs 12-17 .

(3) *Ibid*, paragraph 16.

(4) *Ibid*, paragraphs 35-39.

(5) *Ibid*, paragraphs 42-44.

(6) *Ibid*, paragraph 46.

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