

A WORD OF WARNING TO FRANCHISORS – ADR PROVISIONS MAY POSTPONE THE LIMITATION PERIOD FOR RESCISSION

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In the recent Ontario Court of Appeal decision in *PQ Licensing S.A. v. LPQ Central Canada Inc.* ("**PQ Licensing**"), the Court considered whether the mandatory mediation process prescribed by a franchise agreement impacted the limitation period applicable to a franchisee's rescission claim. The Court found that the franchisee's claim for rescission was not barred even though the franchisee had delivered its notice of rescission nearly a decade prior. This decision hinged on the alternative dispute resolution provisions set out in the franchise agreement.

Background

In 2009 the franchisee delivered a notice of rescission asserting that the franchisor had breached its disclosure obligations under s. 5 of the *Arthur Wishart Act (Franchise Disclosure), 2000* ("**AWA**"). The franchisor disputed the validity of the rescission notice. In 2011, the franchisee then commenced an action for rescission. The franchisor objected, relying on the provisions of the franchise agreement which required disputes between the parties to be mediated and then arbitrated. The franchisee did not commence an arbitration and the action stagnated.

Two years later the franchisor moved to dismiss the action on the basis that the limitation period for the arbitration had expired. The court decided that the question of whether the limitation period had expired should be determined by an arbitrator. The franchisee served a notice of arbitration, and an arbitrator was appointed.

The arbitrator was asked to decide whether the arbitration was out of time because the franchisee had not commenced its claim within two years of the date the franchisor disputed the notice of rescission, and decided against the franchisor. The arbitrator interpreted the alternative dispute provisions in the franchise agreement in light of the *Limitations Act, 2002* ("**Limitations Act**") and the AWA, and found that the parties plainly agreed to a comprehensive scheme for the resolution of their disputes. He found that the franchise agreement required the parties to first mediate their dispute as a precondition to arbitration. As a result, he held that the limitation period for the franchisee's claim for rescission did not begin to run until after the mediation

prescribed by the franchise agreement had taken place. As this had not yet occurred, the arbitrator accordingly concluded the claim was not barred by a limitation period.

Court of Appeal Decision

The franchisor unsuccessfully appealed the arbitrator's decision, first to the Ontario Superior Court and subsequently to the Court of Appeal. The Court of Appeal upheld the arbitrator's decision. The Court of Appeal noted that the central question was not when the franchisee knew it had a claim, but when the franchisee ought to have reasonably known that arbitration - which was the dispute resolution mechanism agreed between the parties - was the appropriate means to resolve the claim. The Court of Appeal confirmed the arbitrator's conclusion that the parties would only know that arbitration was appropriate when the mandatory mediation process had been exhausted. The Court agreed that it was open to the arbitrator to conclude that the franchise agreement's language required mediation to occur as a condition precedent to litigation and that this had the effect of suspending the running of the limitation period under the *Limitations Act*.

One of the franchisor's key arguments on appeal was that delaying the commencement of the limitation period could give franchisees the option to conceal their claim and then commence mediation years later. The Court disagreed. The Court confirmed the arbitrator's finding that the franchise agreement still required the franchisee to provide immediate notice of any alleged breach or violation of the agreement and that the franchisee would still be bound by the contract's time limit for notice and the time limits in the AWA.

As a separate issue, the franchisor also argued that since the mediation provisions in the franchise agreement required the mediation to take place in Delaware, it violated section 10 of the AWA and as such the whole mediation provision should be struck. The arbitrator severed only the requirement to mediate in Delaware, and not the requirement to mediate. On appeal, the Court confirmed that the arbitrator's severance of the Delaware requirement was reasonable, and that it would have been unreasonable for the arbitrator to exclude the entire mediation clause - which was an integral component of the franchise agreement - in circumstances where the franchisor had relied on the parties' obligation to mediate the dispute.

Key Take-Aways for Franchisors

The *PQ Licensing* decision underscores the importance of well-drafted and regularly reviewed alternative dispute resolution provisions in franchise agreements. Although alternative dispute resolution provisions are generally favoured by franchisors seeking the timely resolution of disputes, this case illustrates that such provisions can have unintended consequences on limitation periods. Where a franchise agreement provides that either party may commence the alternative dispute resolution process once a dispute has been raised, the franchisor should ensure it does so in order to trigger the running of the limitation period.

In particular, franchisors should consider the following questions in light of *PQ Licensing*:

1. What method(s) of alternative dispute resolution actually suit(s) your franchise, and why?
2. Does your franchise agreement provide clear time limits for a franchisees' obligation to notify you of a breach and for mediation and/or arbitration processes?
3. What types of remedies do you have to address a franchisee who is delinquent in pursuing their legal claims through the agreed dispute resolution mechanisms?

PQ Licensing is a timely reminder to review the dispute resolution provisions of your franchise agreement with your legal counsel to ensure they achieve the intended objectives.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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