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litigation group bulletin

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Ontario Court of Appeal Clears the Way for Arbitration of Franchise Disputes

Arbitration is increasingly displacing traditional litigation as the dispute resolution mechanism of choice for many businesses, including franchisors and franchisees.

One of the uncertainties facing franchisors and franchisees following the enactment of the Ontario *Arthur Wishart Act (Franchise Disclosure), 2000* (the "Franchise Act") is the extent to which franchise disputes may be arbitrated. The Ontario Court of Appeal's recent decision in *MDG Kingston Inc. v. MDG Computers Canada Inc. ("MDG")* provides some useful guidance in this area.

The Franchise Act provides franchisees with certain "rights of action" and various remedies against franchisors, including the right to rescind or annul a franchise agreement. The *MDG* decision considers how such remedies can be enforced procedurally – and whether they may be resolved by arbitration.

The Facts of the *MDG* Case

The plaintiff was a franchisee who had operated a retail computer store under the MDG franchise since 2000 (prior to the enactment of the Franchise Act). In February of 2005, the parties replaced their initial franchise agreement with a new franchise agreement. The franchisor did not provide the disclosure document required by the Franchise Act when the new franchise agreement was entered. Both franchise agreements contained mandatory arbitration clauses.

Business did not go well after the parties entered into the new franchise agreement. By February 2007, the franchisee purported to rescind the franchise agreement, relying on an allegation that the franchisor failed to provide the disclosure required by the Franchise Act. The franchisor took the position that the dispute should be referred to arbitration, as provided by the language of the franchise agreement.

The Court of Appeal's Decision

As the court noted, the issue raised by the appeal is a classic one: does an arbitration clause become inoperative when the agreement containing that clause is rescinded or terminated? Prior to this case, no Ontario court had considered this issue in the franchising context.

The Court of Appeal analyzed the relevant provisions of both the Ontario *Arbitration Act*, 1991 (the "Arbitration Act") and the Franchise Act, as well as the arbitration clause in the franchise agreement itself, in addressing this question.

The court noted that s. 7 of the Arbitration Act requires it to stay all actions in favour of arbitration, subject only to certain exceptions (ss. 7(2) permits the court to refuse a stay in certain circumstances, such as where the arbitration agreement is "invalid"). The court also noted that s. 17 of the Arbitration Act gives arbitrators the authority to rule on their own jurisdiction and whether an arbitration clause survives termination of the main agreement in which it is found.

The court then made the following observations:

- *The franchisee was not alleging fraud or that the franchise agreement was void from the very beginning. It concluded, therefore, that the franchise agreement was not "invalid";*
- *The rescission remedy provided for in the Franchise Act would not, if granted, make the franchise agreement "invalid" from the very beginning;*
- *Nothing in the Franchise Act suggested that an arbitration clause in a franchise agreement could not survive rescission of the rest of the agreement; and finally,*
- *The Franchise Act does not limit or restrict the right of parties to agree to resolve disputes by arbitration (instead of in court).*

The court found that the arbitration clause was not "invalid" simply because the franchise agreement might ultimately be rescinded for want of proper disclosure. The court therefore stayed the action in favour of arbitration. According to the Court of Appeal's decision, arbitration is the proper forum for determining both the limits of the arbitrator's jurisdiction, and the merits of the franchisee's claim for rescission.

The *MDG* case stands for the proposition that the normal rules regarding arbitration clauses apply, even in disputes between parties under the Franchise Act. The decision also confirms a continuing judicial trend to endorse the use of alternate dispute resolution mechanisms.

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Written by Brad Hanna and Myriam Seers

A Cautionary Note

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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About McMillan LLP's Litigation Group

Our Litigation Group deals with all types of business disputes. Our teams are regularly chosen to tackle high profile, complex legal issues that require sophisticated, intelligent advice. From provincial regulators to federal tribunals to international panels. From trial courts to Courts of Appeal to the Supreme Court of Canada. From litigation to negotiation to mediation and arbitration. There is no business dispute we can't handle.

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