

What You “Knead” To Know About Franchise Termination: The Saskatchewan Court of Queen’s Bench Decision in Vern’s Pizza

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A recent decision of the Saskatchewan Court of King's Bench, *Vern's Pizza Company Limited v 101011333 Saskatchewan Ltd.*, has provided some insight into the application of franchise agreement termination clauses and the duty of honest performance in the franchising context.¹

In this case, the Court granted summary judgment in favour of the franchisor in finding that the applicable franchise agreement was terminated upon expiry of a lease. The franchisor did not breach their duty of honest performance in respect of that termination because there was no dishonest or malicious intent. Conversely, the franchisee did breach both the franchise agreement and the *Trademarks Act* through its continued operation of the franchise despite the termination. However, since the franchisee paid all royalties as if the agreement were still in effect, the franchisor was not owed any further compensation.

Overview

Vern's Pizza Company Ltd. (the "Franchisor") and 101011333 Saskatchewan Ltd. (the "Franchisee") entered into an agreement in which the Franchisee would operate two pizza restaurants on premises leased by the Franchisee from third party landlords (the "Franchise Agreement"). The Franchise Agreement operated for over a decade until the landlord of one of the leased premises sold, which resulted in the lease ending. As a result of the loss of the lease, the Franchisor notified the Franchisee that the Franchise Agreement had terminated, but the Franchisee insisted that the agreement was still valid. The Franchisee continued operating the second location, paying all royalties as if the Franchise Agreement was still in force. The Franchisor continued accepting royalty payments for the second location while the parties were in dispute.

The disagreement rested on a contract drafting error. The termination clause did not include the addresses of both location premises, but instead the square-bracketed term “[address of the premises to be used as the restaurant],” an apparent missing entry in the standard form contract. However, the addresses of both locations were included in the definition of “Restaurant” in the same contract. The Franchisor argued that the parties intended both locations to be included in the contract term, while the Franchisee argued that the parties intended that both locations would operate as separate businesses.

The Court declared that the Franchise Agreement terminated when the lease at one of the two franchise locations expired, and issued a permanent injunction requiring the Franchisee to stop operating the location that was presently open.

The Interpretation of the Franchise Agreement

The Court applied standard contract interpretation principles in finding that the parties' intent in the Franchise Agreement was that the two locations would operate throughout the Franchise Agreement term. Ending the lease at one location had the result of ending the Franchise Agreement for both locations. The Court followed the guidance in *Schnell v. Stene (Heidinger Estate)*, 2022 SKQB 146 by considering the Franchise Agreement's plain and ordinary meaning, the context of the entire agreement and the surrounding circumstances.²

Even though the Franchise Agreement term did not include the franchise locations, the Court held that both were intended to be included by assessing the plain and ordinary meaning of the text. The square brackets referencing "restaurant" showed the intent to include both locations, since the term "restaurant" is defined to include both addresses, not a singular location.

The context of the entire agreement further suggested that the Franchise Agreement ended after the termination of the first lease since the locations are not individual franchises, but "merely restaurant locations within the franchise territory."

The surrounding circumstances also point towards including both locations, since both parties knew this was the intention from the start. If the locations were intended to be separate franchises, two agreements would have been formed. The Court made several important findings in making this determination:

- Contractual interpretation is an objective exercise and the subjective party intentions are irrelevant unless there was evidence both parties were aware of the subjective intention;
- Post-formation conduct should not be considered unless there are special circumstances where the subsequent conduct is "unequivocally consistent" with only one interpretation; and
- Implied terms will not be read into the agreement in situations where the text and context alone allow for a complete interpretation.

The Court did not consider the Franchisee's *contra proferentem* argument because this principle is a "tool of last resort and is only to be applied in the event a contradiction or ambiguity cannot be resolved to determine the intention of the author of the contract." Since the Court could determine the parties' intentions based on the Franchise Agreement's wording and surrounding circumstances, application of this principle was unnecessary.

Duty of Honest Performance

The Franchisee was not successful in claiming that the Franchisor breached the duty of honest performance. The Franchisor was entitled to place their interests above the Franchisee and rely on the rights provided in the Franchise Agreement, as the Court held that “there is no *duty to warn* of a term expiration” in this case. The Court reiterated key findings in the existing caselaw, noting:

- Evidence is required to infer “an intentional dishonest or malicious intent” through silence;
- The duty of honest performance does not impose fiduciary duties or a duty of loyalty on the Franchisor;
- Parties do not have a duty to advise other parties that the agreement term is expiring;
- Actively misleading conduct differs from non-disclosure that is permissible, since evidence of misrepresentation is required for a party to be misled; and
- A breach of honest performance may be found where there is evidence that one party was aware of another’s mistaken interpretation and they continued to remain silent, allowing the continuation of the mistake.³

The Franchisee’s Breach of the Franchise Agreement and the Trademarks Act

The Court held that the Franchisee breached both the Franchise Agreement and the *Trademarks Act* since they continued operating the second location after the Franchise Agreement ended. However, the Franchisor failed to establish a claim of passing off trademarks because they did not suffer actual damage from the Franchisee’s continued use of the Vern’s Pizza trademarks. Even though the agreement ended, the Franchisee continued to pay royalties equal to what was specified in the Franchise Agreement. These payments fully compensated the Franchisor, so no actual damages were found.

The Franchisor was unsuccessful in claiming any additional damages, considering the Franchisee’s continued payments of royalties in full and the Franchisor’s acceptance of these payments. The Court assessed several additional options for damages, finding each of them to be unavailable.

Takeaways

In summary, the Court’s analysis provides guidance for understanding the franchisor/franchisee relationship:

Cassels

- Care should be taken to ensure that a franchise agreement is sufficiently clear to avoid litigation regarding its interpretation;
- Courts will follow standard contract interpretation principles when interpreting franchise agreements, where the formal elements of the contract will be considered before any potential implied terms;
- The duty of honest performance may not involve a duty to warn of contract expiry, fiduciary duties, or a duty of loyalty on the franchisor. However, intentional dishonest or malicious intent, actively misleading the other contractual party, or knowingly allowing a continued mistake based on mistaken interpretation may be grounds for breaching the duty of honest performance; and
- Full payment of royalties, even after the franchisor claims the contract term has ended, may be sufficient to avoid damages regarding certain breaches of the *Trademark Act* and certain breaches of a franchise agreement.

The author gratefully acknowledges the contributions of articling student [Devon Campbell](#).

¹ [2024 SKKB 147](#) [Vern's Pizza].

² *Schnell v Stene (Heidinger Estate)*, 2022 SKQB 146 (CanLII), at para 29.

³ The Court relied extensively on: *Bhasin v Hrynew*, [2014 SCC 71](#), *CM Callow Inc v Zollinger*, [2020 SCC 45](#), and *Suffern Lake Regional Park Authority v Danilak*, [2022 SKQB 118](#).

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