Cassels

Sticky Fingers: Unclean Hands and Weak Case Undermine Dairy Queen Franchisee's Injunction

Colin Pendrith, Geoffrey B. Shaw, Jessica L. Lewis

October 9, 2018

Following a two-day urgent application in the Supreme Court of British Columbia, Dairy Queen Canada Inc. (Dairy Queen) successfully defended a franchisee's injunction to prevent Dairy Queen from enforcing the termination of a franchise agreement pursuant to a Mutual Cancellation and Release Agreement between the parties. A copy of the decision can be found here.

In dismissing the franchisee's injunction, the Court held that the Mutual Cancellation and Release Agreement presented a strong defence to the franchisee's claims, which included claims for relief forfeiture and breaches of the duty of good faith under the *Franchises Act*. This conclusion built upon the decision of *Dairy Queen Canada Inc. v. M.Y. Sundae Inc.*,[1] a 2017 summary trial decision that found a similar agreement to be enforceable and a complete defence to the franchisee's claims in that action.

This decision affirms the efficacy of Mutual Cancellation and Release Agreements as a means of bringing floundering franchise relationships to a conclusion.

Background

The franchisee was operating a Dairy Queen in West Vancouver under a franchise agreement of indefinite duration that was made in 1999. Amongst other things, the franchise agreement required the franchisee to modernize the store at least every 10 years, maintain current master brand logo standards and provide financial documentation to the franchisor.

Over the course of the franchise relationship, the franchisee had difficulties complying with various obligations under the franchise agreement. As the Court explained: "It is probably fair to say that the plaintiffs have not been model franchisees."

The Defaults and Mutual Cancellation and Release

Following a series of extensions and negotiations, in particular concerning the modernization of the store, the franchisee was noted in default for three separate breaches of the franchise agreement. These defaults, which were issued in June and September, 2017, included the failure to complete the modernization by the prescribed deadline, to update its master brand logo, and to deliver certain financial documents requested by the franchisor, including annual profit and loss statements.

After the franchisee failed to cure these defaults within the allotted time periods, as a final opportunity to avoid immediate termination, Dairy Queen offered to enter into a Mutual Cancellation and Release Agreement.

This agreement was offered to the franchisee on October 16, 2017, and signed on November 28, 2017. In lieu of immediate termination, it provided the franchisee with an opportunity to continue operating if it cured all defaults by an extended deadline of December 31, 2017. In the event that the defaults were not fully cured by the year-end deadline, the franchisee would be granted an additional six months to sell the business assets. If the franchisee did not sell the assets by June 30, 2018, the Franchise Agreement would be automatically cancelled and terminated as of June 30, 2018.

The franchisee had not cured the defaults by the year-end deadline and the franchise agreement was set to automatically terminate on June 30, 2018.

The Franchisee Launches an Injunction

On June 12, 2018, the franchisee commenced litigation to enjoin Dairy Queen from enforcing termination under the Mutual Cancellation and Release and sought a declaration that the franchise agreement remained in full force and effect.

The franchisee asserted that the duty of good faith and fair dealing precluded Dairy Queen from terminating the franchise agreement because the franchisee had substantially completed the modernization by the year-end deadline. The franchisee also argued that it should be granted relief against forfeiture of the franchise agreement pursuant to s. 2 of the *Law and Equity Act*.[2]

An injunction hearing was scheduled for June 25, 2018. In response, Dairy Queen brought a cross-application for a *quia timet*, injunction restraining the franchisee from continuing to operate beyond the June 30, 2018 termination date.

The Interlocutory Injunction

The Court made instructive comments concerning each element of the well-known *RJR-MacDonald* test for an interlocutory injunction, specifically that:

1. there is a serious issue to be tried;
2. the applicant will suffer irreparable harm absent the injunction; and
3. the balance of convenience favours the granting of the injunction.

(a) Serious Issue to be Tried

In considering the first stage of the injunction test, the Court was critical of the strength of the franchisee's claims. At the outset, the Court focused on the recent decision of *Dairy Queen Canada Inc. v. M.Y. Sundae Inc.*[3], which considered a similar Mutual Cancellation and Release. In that case, the agreement was approved and enforced by the Supreme Court of British Columbia. Because the franchisee did not raise any questions of duress or otherwise challenge the enforceability of the Mutual Cancellation and Release Agreement, the Court agreed that the *M.Y. Sundae Inc.* provided "formidable defences" to the franchisee's claim.

In considering the franchisee's claim for relief from forfeiture, Dairy Queen argued that relief from forfeiture is unavailable in a situation where a termination occurs automatically by mutual agreement (rather than a unilateral termination for a breach). The Court agreed, finding the automatic termination mechanism under the Mutual Cancellation and Release to be "akin to an option that automatically expires on a specified deadline or a failure to comply with conditions precedent to the exercise of such an option". The Court concluded that, in such circumstances, relief from forfeiture is, indeed, unavailable.

In its analysis of the claim for breach of the duty of good faith and fair dealing, the Court focused on the fact that the duty is limited to the "performance or enforcement" of a franchise agreement. In this case, Dairy Queen was "not exercising any right under the Mutual Cancellation and Release Agreement, nor is it engaging in any unfair dealing or bad faith behaviour by refusing further extensions after a mutually stipulated termination has occurred."

This finding that there was no performance or enforcement was premised on the fact that the termination was automatic and by mutual agreement. As such the agreement did not require Dairy Queen to perform or enforce the agreement in order to effect the termination. In such circumstances, the duty of good faith and fair dealing was inapplicable.

The Court concluded that if the threshold requirement was a strong *prima facie* case, then the franchisee would surely not meet this standard. Even applying the lower threshold of whether the plaintiffs' claim is neither vexatious nor frivolous, the Court explained that the franchisee "barely scrapes across that threshold."

(b) Irreparable Harm

While the Court acknowledged that putting a party out of business and terminating a means of livelihood can amount to irreparable harm. The Court also noted Dairy Queen's argument that "the plaintiffs had earlier agreed to sell their franchise for $250,000 which, although the transaction did not come to fruition, confirms that the value of the business can be quantified and that any purported losses suffered by the plaintiffs are compensable in damages."

In response to the franchisee's arguments that its losses would be difficult to quantify (and were therefore

"irreparable"), the Court confirmed that an unquantifiable loss is not the same as a loss that is difficult to assess, as follows:

When considering the nature of irreparable harm sufficient to sustain an injunction, the court will bear in mind that unquantifiable loss is not necessarily the same as loss that is difficult to assess. The court regularly conducts complicated and challenging assessments of financial loss in a variety of commercial, breach of contract and tort cases, including losses based on uncertain future events, fluctuating market conditions, and various other contingencies. This includes situations where the aggrieved party has been put out of business or rendered unemployable as a result of catastrophic events such as wrongful receiverships, destruction of property or serious personal injury.

(c) Balance of Convenience

The Court considered various factors in assessing the balance of convenience, including whether the franchisee was coming to court with "clean hands." In holding that "the submissions that the applicants do not have the requisite clean hands seems well founded." The Court considered several factors including:

- the franchisee could have brought its injunction much earlier and created an urgent situation by not doing so until days before the termination date;
- the franchisee failed to produce any evidence that his accountants were the reason for his delayed ability to cure defaults; and
- the franchisee admitted he did not prepare the annual profit and loss statements or file income tax returns for the last few years.

The Court was not convinced that the balance of convenience favoured the granting of the injunction in favour of the franchisee.

Dairy Queen's Cross-Application for a *Quia Timet* Injunction

The Court refused to grant Dairy Queen's cross-application for an injunction at the time of the hearing. The Court was not convinced that there is a high probability that the plaintiffs would continue to operate as a Dairy Queen retail store in breach of the Mutual Cancellation and Release Agreement. However, the Court left it open for Dairy Queen to reapply at a later date should the circumstances warrant.

Key Takeaways

Where a franchisor has the right to unilaterally terminate a franchise agreement due to a franchisee's breach, franchisors should consider whether offering a mutual cancellation and release agreement would provide a better means of winding down a troubled franchise relationship. These agreements are versatile and can be used to craft mutually beneficial outcomes for both the franchisor and the franchisee exiting the

system. In this respect, offering a mutual cancellation and release agreement can be demonstrative of the franchisor's good faith towards the franchisee.

It may be helpful for the termination under the mutual cancellation and release agreement to occur automatically, rather than as a result of the franchisor exercising a discretionary right. In the case of an automatic termination, it will be more difficult for the franchisee to argue that either the duty of good faith and fair dealing or relief from forfeiture stand in the way of the termination.

Dairy Queen was represented at the hearing by Colin Pendrith and Carly Cohen, with support from franchise litigators Geoff Shaw and Danielle DiPardo, as well as Jessica Lewis of the Cassels Vancouver office.

If you have any questions concerning the *Dairy Queen* decision please contact Colin Pendrith, Carly Cohen, Geoffrey B. Shaw, Danielle DiPardo, Jessica L. Lewis or any other member of the Cassels Franchise Group.

---

[1] 2017 BCSC 358 (CanLII).
[2] RSBC 1996, c. 253.
[3] 2017 BCSC 358, aff'd 2017 BCCA 442.
