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No Injunction For You – Recent Victory for Franchisors Seeking to Terminate Franchise Agreements

Franchisees often challenge termination decisions by starting a lawsuit and seeking an interlocutory injunction to restrain termination of the franchise agreement pending a determination of the law suit at trial. To succeed on an interlocutory injunction, a franchisee must show that: 1) it has raised a serious issue to be tried; 2) it will suffer irreparable harm if the injunction is not granted; and 3) the balance of convenience favours granting the injunction. Because the threshold for establishing a serious issue to be tried is very low (the court does not review the merits of a franchisee's allegations in detail – it merely assesses whether they are frivolous) and courts often find the loss of a franchise to constitute irreparable harm, interlocutory injunctions are frequently granted.

A recent decision from the Ontario Superior Court, however, provides guidance as to when the courts will refrain from granting interlocutory injunctions to franchisees.

Background Facts

In *Azmoon Trading Inc. v. Caffe Demetre Franchising Corp.*, 2018 ONSC 2868 ("*Azmoon*"), the franchise agreement was for an initial term of 10 years with two options to renew for additional terms of five years each. The second renewal option was subject to certain conditions, including that the franchisee must not be in default of the franchise agreement and that it renovate its facility to the

franchisor's then current image standards. When the franchisee indicated its desire to exercise the second renewal option (which ran from May 2016 to May 2021), the franchisor took the position that the franchisee was in default of several terms of the franchise agreement and that substantial renovations (costing between $350,000 and 450,000) would be required to bring the facility up to current standards.

The parties engaged in months of negotiations over the extent and cost of renovations that would be required. The franchisee sought to significantly reduce the scope and cost of same. Negotiations broke down when the franchisee indicated it was willing to spend a maximum of $85,000 on the renovations (it offered to do the more substantial renovations being demanded by the franchisor, but only in exchange for a 10 year renewal term). At this point, the franchisor served a notice of termination citing the franchisee's non-compliance with the franchise agreement as the basis for termination (in addition to failing to complete the renovation, the franchisee had also failed to make the requisite advertising expenditures).

In response, the franchisee sued alleging that the franchisor was in breach of contract and the *Arthur Wishart Act (Franchise Disclosure), 2000* and sought an interlocutory injunction to restrain the franchisor from terminating until the issues could be determined at trial.

Court Dismisses Interlocutory Injunction Because Franchisee Failed to Demonstrate Irreparable Harm

At the hearing of the interlocutory injunction, the parties agreed that the franchisee had satisfied the first branch of the test (a serious issue to be tried). The court accordingly started its analysis with the second branch of the test.

The court began by noting that irreparable harm refers to the nature of the harm to be suffered, not the magnitude of the harm. To establish irreparable harm, a franchisee must show it would suffer harm that cannot be quantified in monetary terms or cured by a payment of damages.

The franchisee relied on a long line of previous cases that stand for the proposition that the termination of a franchise involving loss of

business, profits and reputation/goodwill, and that puts several employees out of work, constitutes irreparable harm. In *1323257 Ontario Ltd. v. Hyundai Auto Canada Corp.*, 2009 CanLII 494 (ONSC), for example, the court held that irreparable harm exists when a franchisee will suffer permanent market loss or irrevocable damage to its business reputation by being forced to shut down and put 25 employees out of work. Similarly, in *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada,* 2005 CanLII 16616 (ONSC) the court found that a franchisee who made a significant investment in the franchise, financially and personally, would suffer irreparable harm if forced to abandon the business (and thereby lose all of its investment and the opportunity for future profits) before its claim could be adjudicated at trial. And in *1318214 Ontario Ltd. v. Sobeys Capital Inc.*, 2010 ONSC 4141 the court held that if an injunction were not granted the franchisees would lose the business that they purchased and were operating with their families and that they expected to develop over the term of the franchise, something that damages would not remedy.

The *Azmoon* court, however, distinguished this case from those relied upon by the franchisee and held that it had failed to establish irreparable harm. The court did so for the following reasons:

1. At the time of the injunction hearing, there were only three years left in the term of the franchise agreement (the agreement was not renewable beyond 2021);

2. The franchisee had been trying to sell the franchise since 2015. The court concluded from this that the franchisee's principal must have made suitable arrangements to deal with the non-compete contained in the franchise agreement in the context of a potential sale of the business;

3. The franchisor was willing to operate the franchise on termination, thereby addressing the franchisee's concerns about a potential loss of reputation arising from an abrupt termination;

4. The franchisee maintained financial records over its 18 years of operation and the franchisor will maintain financial records while operating the business, so the court concluded that if the franchisor

is ultimately found liable for improper termination assessing damages would not be difficult; and

5. Given that there was only three years left on the second renewal term, any loss of the franchisee's goodwill will be limited and will revert to the franchisor at the end of the term in any event.

Consequently, the court held that the franchisee could be adequately compensated in damages if its claim is ultimately upheld.

The court also went on to find that the balance of convenience favoured no injunction. It did so in part because the franchisor had voluntarily agreed not to enforce its notice of termination for 18 months to permit the franchisee time to sell its business (and which gave the franchisee a *de facto* extension of the agreement without being required to meet the conditions for renewal), and also because a trial could not be completed until sometime in 2019 – more than half-way through the five-year term of the last renewal period.

Key Take-Aways

The *Azmoon* decision illuminates a number of considerations that franchisors should focus on before issuing a notice of termination to assess the likelihood of the franchisee obtaining an interlocutory injunction restraining termination.

Clearly in *Azmoon*, the fact that the franchisor was willing to operate the location following termination, and that only three years were left on the franchise agreement, were important to the court. In cases where a franchisor is unwilling or unable to operate the franchise and/or where the franchise agreement has a lot of life left in it (for instance, if it is renewable indefinitely or for a significant number of years), franchisees will be much more likely to overcome the irreparable harm hurdle.

Moreover, when dealing with the balance of convenience part of the injunction test, the *Azmoon* court noted that the franchisee had failed to tender any evidence to address its alleged breach of the advertising provisions of the franchise agreement. Franchisors fighting off interlocutory injunctions would accordingly be well

advised to highlight any breaches of their franchise agreement that franchisees have failed to address or deal with in their evidence.

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a cautionary note

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