lavery
Lawyers

Franchisors' duty to act in good faith and related implicit obligations: Dunkin' Donuts ordered to pay nearly $18M to some of its franchisees

April 20, 2015

The Court of Appeal of Quebec has issued an important judgment pertaining to a franchisor's implicit obligations towards its franchisees.

In June 2012, the Superior Court of Quebec ordered Dunkin' Donuts Brands Canada Ltd. ("**Dunkin' Donuts**") to pay an amount of $16.4M (plus interests and costs) to 21 of its franchisees in Quebec on the basis that the franchisor had breached its fundamental obligation under the franchise agreements he had entered into with its franchises to adequately protect and enhance the Dunkin' Donuts brand in Quebec.

In a unanimous decision released on April 15, 2015, the Court of Appeal of Quebec confirmed the trial judgment, finding no errors of law in the trial judge's analysis of the franchise agreements nor any palpable and overriding errors of fact in his findings of fault or respecting the causal link between the breaches of contract by Dunkin' Donuts and the franchisees' losses. However, the Court of Appeal reduced the award to $10.9M (plus interests and costs) to take into consideration errors in calculation and unpaid royalties, which were due by the franchisees despite Dunkin Donuts' contractual fault.

Summary of the Facts
In less than a decade, more than 200 Dunkin' Donuts stores in Quebec closed, and Dunkin' Donuts' market share in Quebec plummeted from 12.5% in 1995 to 4.6% in 2003.

Expanding from 60 stores in 1995 to 308 by 2005, Tim Hortons captured the lion's share of growth in the coffee and donut fast food market, thus materially contributing to the collapse of Dunkin' Donuts in Quebec during this period.

Despite the franchisees' numerous alerts, the franchisor failed to meet its duty of good faith towards its franchisees by neglecting to take reasonable measures to support and protect the Dunkin' Donuts brand in Quebec.

The Court of Appeal Decision
The Court of Appeal came to the conclusion that the franchise agreements between Dunkin' Donuts and its franchisees explicitly imposed on Dunkin' Donuts an obligation of means to take reasonable

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.

measures to protect and enhance its brand. The Court of Appeal further confirmed that the nature of a franchise agreement is one of a long term collaborative agreement. Accordingly, it imposes on the franchisor an implicit obligation to provide franchisees with the continuous collaboration and support that they legitimately expect in order to protect and enhance the brand, maintain high and uniform standards within the franchise system and, generally, preserve the integrity of the franchise system as a whole.

While rejecting Dunkin' Donuts' arguments, the Court of Appeal reaffirmed that the intensity of a franchisor's obligation towards its franchisee is one of means, and not one of result. A franchisor does not have an obligation of result requiring it to outperform the competition or to guarantee the profitability of its franchisees. However, franchisors are bound by a duty of good faith, from which flows an obligation to take positive actions to protect franchisees from market challenges. In other words, had Dunkin' Donuts taken reasonable measures to counter Tim Hortons' or another competitor's expansion, the franchisees would have had no basis for complaint.

Comments

The *Dunkin' Donuts* decision does not create new obligations for franchisors in Quebec and is the logical continuation of the 1997 Court of Appeal decision in the *Provigo* case[1] which is recognized as the leading authority in franchise law in Quebec. It is nevertheless an important decision insofar as the Court of Appeal clarifies the extent of the implicit obligations of a franchisor. Since 1994, the *Civil code of Quebec* imposes on franchisors a duty to act in good faith which was interpreted in *Provigo* as an obligation for a franchisor to assist and support the franchisee in its operations. While a franchisor is justified to impose on its franchisees important restrictions as to how to operate and administer their franchise business for the purpose of maintaining uniform standards of quality and a strong brand across the franchise system, the franchisor must, in exchange, provide its franchisees with the appropriate infrastructure to sustain the execution of such requirements. Accordingly, the franchisor's obligation to take reasonable measures in order to protect and enhance the brand constitutes an implicit obligation of franchise agreements and form part thereof. In light of the clarifications made by the Court of Appeal as to the concept of assistance and support to which referred the *Provigo* decision, we can reasonable expect that other components of the infrastructure generally required from a franchisor, such as an adequate protection of trademarks, the qualification and initial training of franchisees, the efficiency of the supply chain and ongoing operational support, will be challenged in the future.

Lessons for Franchisors

> While a franchisor is not bound by an obligation of result towards its franchisees, it must take positive measures (i) to protect the integrity of its franchise system, namely the notoriety of its trademarks and concept, and (ii) maintain an infrastructure that will sustain the viability of the franchise system.
> As to any explicit obligation, a franchisor should review the performance covenants provided in its franchise agreement and make sure that it can live up to the standards which it imposed on himself.

---

[1] *Provigo Distribution inc.* v. *Supermarché A.R.G. inc.*, 1997 CanLII 10209.

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.