

A New Paradigm in Canadian Franchise Law: The Dunkin' Donuts Case

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In *Dunkin' Brands Canada Ltd.*,^[1] the **Quebec** Court of Appeal upheld the trial court decision which held the franchisor liable for failing to protect its brand, but reduced the damages awarded to franchisees. The Quebec Court of Appeal rejected the franchisor's argument that the trial judge had imposed a new unintended obligation to protect and enhance the brand, outperform the competition and maintain market share. It concluded that the trial decision applied, rather than extend the franchisor's duty of good faith.^[2] The Quebec Court of Appeal made the following conclusions:

Express Terms of the Agreement

Explicit terms in the franchise agreements obliging the franchisor "to protect and enhance" its brand were not merely a "hoped-for-result" but a binding contractual obligation.^[3] While "the franchisor did not guarantee that the reputation of the brand would be enhanced, it undertook to adopt reasonable measures to that end."^[4]

Implied Obligations Incidental to the Nature of the Franchise Agreements

The franchisor's "obligations were based not just in the text of the franchise agreements but also on duties that it had implicitly assumed in respect of the whole network of franchisees".^[5] The franchise agreements "established a relationship of cooperation and collaboration between the franchisor and its franchisees, reflecting both common and divergent interests, over a long period of time."^[6] In other words, "the character of the specific franchise arrangement was an on-going one in respect of a system that the parties agreed to sustain as critical to the success of the brand."^[7] Given the role the franchisor assigned to itself in "overseeing the on-going operation of the network" and the uniform system of standards, the Quebec Court of Appeal held that it was fair to hold that the franchisor had implicitly agreed to undertake reasonable measures to help the franchisees, over the life of the arrangement, to support the brand.^[8] This included "a duty to assist them in staving off competition in order to promote the on-going prosperity of the network as an inherent feature of the relational franchise agreement."^[9]

Implied Obligation of Good Faith

The Quebec Court of Appeal confirmed that a franchisor's obligation of good faith "is not confined to the circumstances of franchisors that compete unfairly with their franchisees."^[10] Rather, a franchisor owes an obligation of good faith and loyalty to its franchisees requiring a franchisor, by reason of "superior know-how and expertise" upon which the franchisees rely, to support individual franchisees and the whole of the network through its on-going assistance and cooperation.^[11] This duty is "not on the basis of the duty to perform contracts in good faith but rather on the distinct theory of implied obligations" from the nature of the franchise agreement and equity.^[12] The nature of the agreement and equity "provide two distinct normative justifications



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for this implied obligation of good faith.”^[13]

Implied Obligations owed by the Franchisor to the Network of Franchisees

The Franchisor also had a duty to assist and co-operate that includes an obligation to take reasonable measures to protect them from the new market challenges presented by the entry of an aggressive competitor into the market. Beyond the duty not to take actions that would wrongfully cause them harm, the franchisor assumed, on the basis of this implied duty of good faith, a duty to assist and cooperate with the franchisees by taking certain active measures in support of the brand.

The agreements caused, through express language and by necessary implication, a duty owed to the franchisees collectively to take reasonable measures to support and enhance the brand. This included the duty to respond with reasonable measures to help the franchisees as a group to meet the market challenges of the moment and to assist the network of franchisees by enforcing the uniform standards of quality and cleanliness it holds out as critical to the success of the franchise. It is up to the franchisor to enforce the authority it has given itself under the franchise agreement. The undertaking to take reasonable measures to protect and enhance the network, can best be thought of as an implicit duty in each contract upon which an individual franchisee can take action in the event of breach.

Conclusion

Continuing to adopt a business as usual approach in the face of a competitive threat is not sufficient to satisfy the franchisor’s contractual obligations. The franchisor did not take reasonable measures, in particular, to protect and enhance the brand in the face of the competition. Had the franchisor taken proper measures to protect and enhance the brand and, notwithstanding those efforts, a competitor had encroached on some of the franchisees’ market share, the latter would have had no basis for complaint. It remains to be seen if this case, decided under the Civil Code in Quebec, will influence the evolution of the common law in the other provinces. Given the numerous cases which have firmly established the concept of good faith and fair dealing in the Common Law, as it applies to franchising, it would seem a safe bet that the Dunkin’ Donuts case will, in some form or other, work its way into the Common Law.

[1] 2015 CarswellQue 3066, 2015 QCCA 624, J.E. 2015-692, EYB 2015-250660.

[2] *Ibid* at para 76.

[3] *Ibid* at para 44.

[4] *Ibid* at para 86.

[5] *Ibid* at para 59.

[6] *Ibid* at para 62.

[7] *Ibid* at para 63.

[8] *Ibid* at para 64.

[9] *Ibid*.

[10] *Ibid* at para 69.

[11] *Ibid* at para 71.

[12] *Ibid* at para 70.

[13] *Ibid* at para 71.

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