



Dunkin' Donuts: Quebec's Court of Appeal considers a franchisor's duty to protect the brand

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On April 15, 2015, [the Court of Appeal of Quebec partially upheld a 2012 Superior Court judgment](#) in favour of franchisees of Dunkin' Donuts. The franchisees have been embroiled in a legal battle with the franchisor for more than a decade. The Court of Appeal panel in the case, (*Dunkin' Brands Canada Ltd. v. Bertico Inc.*¹) unequivocally affirmed the finding of fault as well as the finding of causation between the franchisor's failure to enhance and protect the brand from competition and the losses suffered by the franchisees. However, for reasons discussed below, it did reduce the damages award significantly, from \$16,407,143 to \$10,908,513.

Facts

Fearing "a gradual crumbling" of Dunkin' Donuts due to the "Tim Hortons phenomenon", the franchisees alerted the franchisor and asked for a rescue plan. The franchisor responded with a costly remodeling program, which came too late and failed to attract the minimum number of participants as it required the execution of a general release in favour of the franchisor. While the number of Dunkin' Donuts stores dropped from over 200 to 13 from mid-1990s to 2012, the number of Tim Hortons stores increased fivefold, going from 60 to more than 300 from 1995 to 2005. In May 2003, a group of franchisees sued the franchisor, claiming millions of dollars in lost profits for the previous three years, as well as the loss of investment value that resulted from the closure of their restaurants.

Overview of the Court of Appeal's findings

Applying the express terms of the franchise agreements in dispute, the Court of Appeal upheld the trial judge's determination that the franchisor undertook to "protect and enhance the value of the brand, beyond the time of the franchise start-up, through the assistance it provided to individuals and by ensuring that franchisees across the network maintain and improve standards of cleanliness and quality." The Court of Appeal made it clear, however, that such an obligation is one of "means" only, requiring the franchisor to undertake reasonable efforts.

General duty to protect and enhance the value of the brand

Applying [Article 1434 of the Civil Code of Quebec](#) (CCQ) in the context of franchising, the Court reiterated that the obligations owed by the franchisor are not only those explicitly stated in the agreements, but also "implicit obligations that flow from the nature of the franchise agreement", which obligations took on a contractual status in the circumstances of this case (i.e. a relationship of long-term collaboration between independent businesses).

Noting the role that the franchisor had contractually assigned to itself in overseeing the ongoing operation of the network and the uniform system of standards, the Court concluded that the franchisor's obligation to undertake reasonable efforts to protect and enhance the brand also stems, implicitly, from the franchise agreements, which encompassed a duty to assist the franchisees, individually and as a group, in remaining competitive in the market. In the Court's view, "not only would each franchisee receive assistance and benefit from the collaboration of the franchisor, but the franchisees were entitled to count on the franchisor to see that the system would be supervised and that the weaker links in the chain of franchisees be corrected or excised." Hence, for the benefit of its network, the franchisor has an implied obligation to deal with the "delinquent franchisees" and, if necessary, take appropriate steps to ensure compliance. A failure to do so could result in an actionable breach of an obligation, as in the case at bar.

The franchisor's good faith obligation

Referring extensively to its well-known *Provigo* ruling (1997), the Court of Appeal reiterated that the franchisor is also bound by an implied obligation of good faith, the applicability of which is not limited to cases where franchisors compete unfairly with their franchisees. In the Court's view, this implied obligation requires the franchisor, in virtue of superior know-how and expertise on which the franchisees rely, to support them individually and collectively as a network through ongoing assistance and cooperation. Applied to the case at bar, this meant that the franchisees were entitled to rely on the franchisor to take reasonable measures to protect them from competition. The Court recognized, however, that this implied obligation of good faith does not prohibit certain competition or divergent interests between the franchisor and its franchisees, nor does it require from the franchisor a degree of collaboration with its franchisees that "mandates altruistic business practices or self-sacrifice."

Business judgment rule does not apply

In affirming the finding of liability against the franchisor, the Court of Appeal rejected the argument that the business judgment rule should prevent it from second-guessing business decisions made in good faith by the franchisor. In the Court's view, it would be inappropriate in the present circumstances to extend the protection afforded to corporate directors to shield the franchisor from contractual liability to its franchisees.

Calculating damages

As a small but significant "moral victory" for the franchisor, the damages awarded to the franchisees were reduced by about \$5.5 million.

Loss of profits

Although the Court of Appeal considered the "comparable" method used by the trial judge to be a reasonable approach to the calculation of loss of profits (with Tim Hortons as the comparable business), it nevertheless reduced the franchisees' claim for lost profits by 10% to allow for imponderables or external factors, as was also done in the *Provigo* decision. The Court further reduced the lost profits by 15% given the trial judge's failure to take into account the competition that Dunkin' Donuts would have faced from Tim Hortons even if the franchisor had not committed a civil fault. The royalties and other fees the franchisees would have paid to the franchisor had the latter performed its obligations were also deducted from the damages awarded by the trial judge. Finally, the Court limited the franchisees' claim to the limitation period of three years.

Loss of investments

Unlike the claim for loss of profits, no expert evidence was adduced in support of the franchisees' claim for lost investments. Even though this created a quantification challenge for the Court, where the

evidence shows that some damages flow from a civil fault, it is the duty of the presiding judge to evaluate - or estimate - the damages as best as he can, based on admissible evidence. Applying the same principles as for the claim for lost profits, the Court of Appeal reduced the franchisees' compensation for lost investments by 25%.

Conclusion

Most of the principles applied in the *Dunkin' Brands* decision are derived from the Court of Appeal decision in *Provigo*, which remains a key judgment in Quebec franchise law. While it is expected that this recent Court of Appeal decision will be cited by unhappy franchisees in support of future claims against franchisors, the latter might use it as well in support of their ongoing efforts to seek compliance in their network given the Court's comments about the importance for the franchisors to deal with delinquent franchisees or "bad apples".

1. *Dunkin' Brands Canada Ltd. v. Bertico Inc.*, 2015 QCCA 624 (CanLII).
2. *Provigo Distribution Inc. v. Supermarché A.R.G. Inc.* (1997), [1998] R.J.Q. 47 (C.A.).

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