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Québec Court of Appeal Affirms Duty to Protect and Enhance Brand

The Quebec Court of Appeal affirmed the trial decision in Dunkin Brands Canada Ltd v. Bertico Inc. establishing a duty on franchisor Dunkin Brands to take reasonable steps to protect and enhance the brand in the face of competition. The effect of the decision will have a lasting and potentially far reaching impact on the duties of parties to franchise agreements.

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At its peak, Dunkin' Donuts had roughly 200 stores throughout Québec and was the dominant donut franchise in the Province. The plaintiff franchisees operated 32 of those stores for varying periods of time. In the mid-1990s, Tim Horton's entered the Québec market. The effect was a dramatic decline in Dunkin' Donuts sales.

In 2006, the franchisees brought an action for breach of contract claiming losses of $9 million. After a 71 day trial, the trial judge allowed the claims and awarded damages of $16 million.

Dunkin' Brands appealed. As the Court of Appeal described it:

> In the preamble to its 60-page factum on appeal, Dunkin' Brands Canada Ltd. (the Franchisor) sets a dramatic tone for its argument before this Court. The judgment of the Superior Court ordering it to pay $16.4 million in damages for breach of contract to a group of its Dunkin' Donuts franchisees (the Franchisees) is styled as "unprecedented in the annals of franchise law, not only in Quebec and Canada but also in the United States". The Franchisor says the court mistakenly imposed on it "a new unintended obligation to protect and enhance the brand, outperform the competition and maintain indefinitely market share". After having "almost completely ignored" the evidence it adduced over a lengthy trial, the Franchisor says the judge wrongly characterized its contractual obligations as having an intensity of "result", which "effectively guarantees the financial success of all Dunkin' Donut

> Franchisees".

The Court of Appeal concluded that the Trial Judge did not err in imposing a duty to protect and enhance the brand:

> The obligation of means to protect and enhance the brand imposed on the Franchisor is not incompatible with the explicit terms of the contracts. But, just as importantly, the judge's interpretation of the duties owed to the Franchisees rests on the whole of the agreements, including the implicit obligations based on the nature of the franchise arrangement and, in particular, the implied obligation of good faith incumbent on both parties.

The Appellants argued that the Trial Judge erred in the interpretation of the contract. The Court of Appeal rejected this saying:

> In other words, in characterizing the essential obligation of the Franchisor as a duty to protect and enhance the brand, the judge did not assign a new and unintended obligation on the Franchisor, but he drew on the explicit terms, supplemented by implicit obligations flowing from the nature of the agreement that, in both cases, reflected the intention of the parties.

In addition, the Court of Appeal concluded that this duty was reinforced by the duty of good faith:

> In addition, the judge quoted extensively from the Provigo judgment to explain that the Franchisor owed an obligation of good faith towards the Franchisees, including a duty, in cooperation with them, to respond and adjust to new market conditions (para. [53]) This duty of good faith – an implied obligation in these terms as the judge rightly held – serves to reinforce his view that even where it is not stipulated as such, the Franchisor had the obligation under the 1992 and 2002 agreements to take reasonable measures to support the brand.

The Québec decision will potentially have a profound impact on franchise litigation in Canada's common law jurisdictions. The newly-recognized duty to protect and enhance the brand is unlikely to be seen as a unique feature of Québec law, given that the case was grounded in contractual interpretation and the duty of good faith, a duty that applies to franchisor-franchisee relationships across the country. The precise contours and extent of the duty to protect the brand remain uncertain and will

no doubt be the subject of further litigation as franchisors grapple with this potentially significant new obligation.

*Research contributed by Kate Costin, 2015 summer student