

Proceed with caution: why *Dunkin' Brands* may be applied under common law

October 27 2015 | Contributed by [Lapointe Rosenstein Marchand Melançon LLP](#)

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Case

The Quebec Court of Appeal's unanimous decision in *Dunkin' Brands*(1) was rendered on April 15 2015 and upheld the Quebec Superior Court's decision with respect to the scope and extent of a franchisor's contractual obligations based on both explicit contractual terms and implicit principles established by law (see [Dunkin' Brands: Quebec court finds franchisor has duty to support its brand](#)).

The case involved a suit filed by 21 franchisees that were collectively operating 32 Dunkin' Donuts fast-food coffee and doughnut businesses after market leader Dunkin' Donuts was dethroned by competitor Tim Hortons. Following this market upheaval, Dunkin' Brands franchisees sought to terminate their franchise agreements and leases, and also sought damages from the franchisor on the grounds that it had failed to take sufficient action with respect to competitive forces in the market. The franchisees succeeded before the trial court, which concluded that the franchisor had breached its explicit contractual obligations, as well as obligations that are implicit in franchise agreements under Quebec law, and awarded the franchisees C\$16.4 million for loss of profits and investment, and other damages. The Quebec Court of Appeal generally upheld the trial court's decision, but reduced the damages awarded to the franchisees to approximately C\$11 million. The franchisor has applied for leave to appeal before the Canadian Supreme Court.

Wider implications

A cornerstone of the appeal court's decision is that a franchisor's duty to protect its brand and network goes beyond the explicit terms of the franchise agreement and requires the franchisor to take reasonably active steps when the franchise network faces significant market threats. This conclusion was largely based on the court's characterisation of the franchise relationship as collaborative, which heightened the standard of conduct against which was measured the franchisor's obligation to conduct itself in good faith with respect to its franchisees. Not only does a franchise relationship presuppose that the franchisor has invested in developing a brand and a business operating system and is prepared to oversee and direct the network's progress; there is also an expectation by franchisees that the franchisor will support them and provide ongoing assistance and cooperation over an extended period.

Perhaps more importantly, the principle of good faith is not typically viewed under Quebec civil law as yielding a particular result or outcome, but rather informs the manner in which parties to a contract must conduct themselves and provides the basis for considering the reasonableness and sufficiency of their actions in a given set of circumstances. In *Dunkin' Brands*, the circumstances at issue required the franchisor to take reasonable measures to protect its brand and its franchisees from competitive forces in the market, without requiring that it guarantee the success of such measures.

Given the fundamental nature of the appeal court's findings and their connection to the nature of franchise relationships generally, the findings will likely be analysed and some aspects may well be

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applied outside Quebec. This important decision forms part of an interesting convergence which is emerging between the duty for parties to conduct themselves in good faith under Quebec civil law and the duty of good faith in contractual performance in Canadian common law provinces.

Good faith

Good faith and the role of implied contractual terms are gaining traction under common law and were given a new slant when the Canadian Supreme Court stated that contractual parties have a duty to act honestly in contractual performance: in *Bhasin v Hrynew*(2) the Supreme Court explained that the duty to perform contracts honestly is but one manifestation of the "organizing principle of good faith performance in contracts".(3) This good-faith principle had already been recognised in common law provinces. For example, the Superior Court of Nova Scotia provided a detailed discussion of good faith in contracts in *Arton Holdings v Gateway Realty Ltd*,(4) which stated not only that "[t]he law requires that parties to a contract exercise their rights under that agreement honestly, fairly and in good faith", but also that bad faith is "conduct that is contrary to community standards of honesty, reasonableness or fairness". The Supreme Court's decision in *Bhasin* essentially confirmed that the fundamental principles of good faith and honesty govern all contracts, and further elucidated that the specific effects of these principles must be analysed in light of the nature of a given contract and the obligations that flow from it for the parties.

Given that franchisees are often viewed as vulnerable parties and that franchise arrangements are generally considered long-term partnerships which require mutual cooperation and consideration, these characteristics will undoubtedly continue to have an impact on the manner in which franchisors and franchisees exercise their contractual rights and obligations in many jurisdictions. Vulnerable contractual parties have often been given special consideration under the common law, and common law courts may consider this central factor in interpreting the scope of the duties to act honestly and in good faith as they apply to franchisors and franchisees.

The duty of good faith in the context of franchise relationships has been discussed and applied in several common law cases, including *Shelanu v Print Three Franchising Corporation*, where the Ontario Court of Appeal found that a duty of good faith stems from the power imbalance between a franchisor and a franchisee: "In some instances, a duty of good faith may arise out of the nature of the relationship or the circumstances created by the other party."(5) The court further recognised that "a duty of good faith exists at common law in the context of a franchisor-franchisee relationship", (6) and emphasised that the circumstances of a particular case will inform whether the duty has been respected.

In *Trillium Motor World Ltd v General Motors of Canada Limited*,(7) the Ontario Superior Court suggested that the *Bhasin* decision sought to fill a gap in the general law of contracts without attempting to replace established jurisprudence in the franchise context. However, the court did specify that "[t]he principle of good faith, as it manifests in the franchise context, will reflect the circumstances of that context, including the power dynamics of the unique relationship between franchisor and franchisee".(8)

The Ontario Court of Appeal applied the findings in the *Bhasin* ruling in the context of implying terms to a letter of intent: writing for the court, Justice Pardu noted that nothing prevents a judge from interpreting a contract in a manner that is consistent with the duty of good faith, even if such an interpretation implies a contractual term in order to preserve business efficacy.(9) On the other hand, the British Columbia Court of Appeal has warned that terms cannot be implied by reason of the duties of good faith and honest performance where there is no indication that contracting parties agreed to an implied term or where the term sought to be implied was found to be inconsistent with the express terms of the contract.(10)

In light of the developing recognition that courts in Canadian common law provinces are considering contractual obligations and breaches through the lens of good faith performance, this trend may well continue, particularly in cases where one party's conduct is inherently unreasonable, unfair or otherwise offends the basic tenets of commercial dealings. These principles are not inconsistent with the concept of good faith under Quebec civil law and *Dunkin' Brands* may provide welcome guidance to common law courts in determining the types of conduct that may be acceptable for parties to a franchise arrangement, including where such conduct is not expressly addressed in the applicable

franchise agreement.

In practice, the fundamental principles of good faith and honesty must continue to inform the conduct of franchisors and franchisees in Canada. To give one concrete example, the effect of these principles on the conduct of renewal negotiations should be considered:⁽¹¹⁾ franchisors must avoid drastically changing tack during the course of renewal discussions and should not engage in conduct that could be seen as orchestrating an impasse in the renewal process. Franchisees should also note that duties of good faith and honesty will also apply to any attempt on their part to actively conceal material issues or knowingly mislead a franchisor, as particular manifestations of breaches of the duty to honestly perform the franchise contract.

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Endnotes

(1) *Dunkin' Brands Canada Ltd v Bertico Inc*, 2015 QCCA 624.

(2) 2014 SCC 71.

(3) *Ibid*, at paras 63 and 72.

(4) [1991] 106 NSR (2d) 180.

(5) [2003] 64 OR (3d) 533 (ONCA).

(6) *Ibid*.

(7) 2015 ONSC 3824.

(8) *Ibid*, at para 152.

(9) *Energy Fundamentals Group Inc v Veresen Inc*, 2015 ONCA 514, at paras 30-35.

(10) *Ibid*, at para 36; *Moulton Contracting Ltd v British Columbia*, 2015 BCCA 89, at para 78.

(11) Renewal negotiations were the central issue addressed in *Bhasin v Hrynew*, *supra*, note 2.

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