ENFORCING THE BARGAIN OR BUYING YOUR WAY OUT? THE RIGHT TO SPECIFIC PERFORMANCE IN FRANCHISE AGREEMENTS VERSUS THE CONCEPT OF EFFICIENT BREACH

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I. INTRODUCTION

The ordinary remedy for breach of contract is an award of compensatory damages in an amount equal to what the non-breaching party expected to gain from the contract. But exceptions to this principle have emerged. In certain situations, courts have awarded punitive damages where the breach was committed in bad faith or in an otherwise reprehensible manner. More commonly, courts may grant equitable relief, including orders of specific performance, requiring the breaching party to continue to perform where damages alone will not adequately compensate the non-breaching party for its loss. In franchise disputes, particularly those involving terminations or non-renewals of franchise agreements, there are often pleas for injunctive relief to enjoin termination or non-renewal of the relationship.

The “efficient breach” doctrine—the idea that some breaches are salutary and to be encouraged—serves as a potential counterweight to the impulse to impose punitive damages, disgorgement or an order of specific performance in breach of contract disputes. As one court put it, “courts have used [the efficient breach] doctrine to emphasize that, in some circumstances, intentional breaches may be legitimate, and in those cases, courts should not authorize extreme remedies such as specific performance or allow punitive damages merely because a breach is intentional.”

Rather, the efficient breach doctrine posits that truly efficient breaches are beneficial and should be lauded and encouraged, not punished or enjoined.

As applied to franchising, the efficient breach doctrine raises important questions about situations franchise lawyers and their clients encounter on a daily basis. If a franchisor thinks a particularly underperforming franchisee should be replaced by another who will exploit the relevant market more aggressively and to such a degree that the franchisor will be better off even after compensating the original franchisee for its lost profits, should a court even consider injunctive relief enjoining a termination without cause? If the breach of a franchisee’s territorial exclusivity would result in such greater sales that the franchisor realizes a profit even after compensating the franchisee for its cannibalization damages, should the territorial violation be enjoined? And may a private equity company seeking to expand its portfolio by acquiring another franchise system be prevented from doing so simply because the acquisition may result in territorial conflicts across brands that can be compensated for? While there are few cases addressing these specific situations, the efficient breach theory requires counsel for franchisors and franchisees alike to consider whether, where one party’s performance is suboptimal or an acquisition opportunity presents itself, among other situations, economic efficiency warrants an intentional and calculated breach.

This paper explores the underlying theory of and questions raised by the efficient breach doctrine and examines situations in which courts have applied or considered it. The authors also suggest ways in which litigants might use the efficient breach doctrine to their advantage. Finally, this paper also examines how these principles play out in the context of the franchisor-franchisee relationship.

II. EFFICIENT BREACH OF CONTRACT: THE CONTEXT

An award of money damages is the traditional remedy for a breach of contract. Damages for breach of contract are, generally speaking, limited to the non-breaching party’s “expectation interest.” As explained in the introductory note to the Restatement (Second) of Contracts’s remedies section:

The traditional goal of the law of contract remedies has not been compulsion of the promisor to perform his promise but compensation of the promisee for the loss resulting from the breach.

The Uniform Commercial Code similarly expresses the traditional view that expectation damages are the standard remedy for breach of contract. The Restatement (Second) of Contracts defines expectation damages in § 347 as follows:

§ 347 Measure of Damages in General

Subject to the limitations stated in §§ 350-53, the injured party has a right to damages based on his expectation interest as measured by

(a) the loss in the value to him of the other party’s performance caused by its failure or deficiency, plus
(b) any other loss, including incidental or consequential loss, caused by the breach, less
(c) any cost or other loss that he has avoided by not having to perform.

Several limitations or exceptions to this traditional rule have emerged over the years. These include, among others, certain types of contracts, such as real estate contracts and contracts to marry; the failure of a public monopoly to discharge its obligations to the public; breach of a fiduciary duty; breach accompanied by fraudulent conduct; and bad faith refusal by an insurer to settle a claim. In addition, in exceptional circumstances other remedies may be available for breach of ordinary contracts. These include, most notably, punitive damages and, of particular interest in the franchising context, specific performance.

As suggested below, the relatively recent theory of “efficient breach” supports the traditional rule that money damages are the presumptive remedy for breach of contract. Indeed, it may have developed in response to an increased tendency among courts to award other remedies, like punitive damages or specific performance, in routine breach of contract cases. The theory holds that “properly calculated expectation damages increase economic efficiency by giving ‘the other party an incentive to break the contract if, but only if, he gains enough from the breach that he can compensate the injured party for his losses and still retain some of the benefits from the breach.’” Simply put, the theory’s premise is that, if the breaching party can compensate the promisee for its damages and still realize a gain from the breach,

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3 Id. at Ch. 16 introductory note.
4 See, e.g., U.C.C. § 1-305(a).
6 Id. (citing Restatement (Second) of Contracts, Ch. 16 introductory note (Am. Law. Inst. 1981)).
then the contract was economically inefficient and its breach is to be lauded and even encouraged.

III. TYPES OF EFFICIENT BREACH

Theoretically, the concept of efficient breach is uncomplicated: Where a party stands to benefit from breaching a contract, that party may pay the non-breaching party “expectancy damages” and breach, without fear of additional penalties. In practice, however, the application of efficient breach is thornier. Typically, the concept is raised by a breaching party as an affirmative defense when the non-breaching party is seeking punitive damages or equitable remedies.

To illustrate the problematic nature of the doctrine, we must first explore a few examples of efficient breach and the assumptions implicit in the doctrine’s application.

A. Two-Party Efficient Breach Model

1. Franchisor Sells Widgets to Franchisee, and Then Franchisor's Costs Rise Significantly

Two-party efficient breach is a simple scenario. Franchisor sells widgets to Franchisee pursuant to a contract. Franchisor’s costs to perform under the contract (i.e. the cost of the widgets) are $100. Franchisee agrees to pay Franchisor $120 for the widgets intending to sell the widgets for $150. Accordingly, Franchisor stands to gain $20 from the transaction, and Franchisee stands to gain $30 from the transaction. Some time after the contract is entered into, Franchisor’s costs rise to $160, so it stands to lose $40 from the transaction, while Franchisee still stands to gain $30 from the transaction. Franchisor wants to breach the contract.

2. Franchisor’s Options, Pursuant to the Efficient Breach Doctrine

The efficient breach doctrine justifies Franchisor’s desire to breach the contract if performance is no longer economically beneficial. Pursuant to the efficient breach doctrine, Franchisor can breach, as long as it pays Franchisee its expectation damages – $30. The breach is efficient because Franchisor will pay Franchisee $30, but will save itself $40 that it would lose if it had performed under the contract. According to the efficient breach doctrine, this is beneficial to society because it leaves the Franchisee in the same position it would have been in had Franchisor performed, leaves the Franchisor better off, and allows both parties to seek a better deal elsewhere or to re-negotiate given the changed circumstances.

3. Assumptions

At this point, all experienced franchisee attorneys will be formulating a series of objections to the so-called “efficient breach” described above. When attempting to efficiently breach a contract, attorneys for the breaching party must be aware of and be prepared to address the following assumptions.

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a. **Economic Gain**

First, this hypothetical assumes that the Franchisor’s breach is efficient. Repaying the Franchisee’s expectation damages only makes economic sense if Franchisor’s potential losses from performing exceed those damages. This is the case in the above example, because the Franchisor would have lost $40 if it performed whereas the Franchisee’s expectation damages are only $30.

However, this assumes that Franchisor’s calculations of Franchisee’s expectation damages is accurate, that there are no other damages for which Franchisor is responsible, and that Franchisor’s calculation of the expected cost of performance is also accurate. If, for example, the widgets were actually the Franchisor’s specially-branded candies, and the Franchisee intended to raise the price to $170 to sell the candies during an upcoming holiday season, then the Franchisor’s breach is no longer efficient and, in fact, it stands to lose more by paying the Franchisee’s expectancy damages than by performing under the contract.

b. **Expectation Damages Calculable**

Another assumption that is essential to the application of the efficient breach doctrine is that Franchisee’s expectation damages are knowable or disclosed. As stated above, the Franchisee may have undisclosed plans to sell the widgets for a higher price during a period of high demand, making it impossible for the Franchisor to accurately calculate whether its losses are greater than the Franchisee’s expectation damages. In addition to potentially eliminating any financial benefit the Franchisor stood to gain from its breach, the Franchisee may then attempt to claim even higher profits than it actually stood to realize by, for example, claiming that the period of high-demand justified a sale price of $180 for the widgets. The Franchisor now stands to lose $40 by performing or $60 by breaching.

As stated above, some courts have enforced protective doctrines to compensate for breach where the payment of damages is inadequate. For example, where damages are unknowable or difficult to calculate, some courts have imposed equitable remedies. In *Walgreen Co. v. Sara Creek Property Co., B.V.*, discussed in detail below, the court analyzed the costs and benefits of the application of equitable remedies and determined that the imposition of a permanent injunction was appropriate. The court reasoned that it was difficult to determine how much money Walgreen stood to lose in business over the course of ten years due to increased competition resulting from a breach of an exclusivity provision in its lease. The *Walgreen* court thus prevented Walgreen’s landlord from breaching.

It stands to reason that in more complex contracts, it is increasingly unlikely that a party will be wholly compensated by its expectation damages. For example, a party may make investments in reliance on the breaching party’s performance. In the hypothetical posed above, suppose the Franchisee leased a mall kiosk in order to sell the Franchisor’s widgets there. If the Franchisor fails to perform, the Franchisee will have lost its profits from the widget sales, and will also have to pay for its lease.

c. **Contract Terms**

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A final assumption, and one of particular relevance in the franchise world, is whether the contract defines damages as a result of a particular breach. Franchise contracts often contain liquidated damages provisions that seek to clarify each party’s obligations in the event of a franchisee’s breach during the term of the agreement. Without discussing the many variables related to enforceability of such provisions, a liquidated damages clause may undermine a franchisee’s ability to efficiently breach the contract (where, for example, the liquidated damages amount is higher than the franchisor’s expectation damages), or the liquidated damages clause may encourage a franchisee to efficiently breach (where, for example, actual damages are unknowable, a liquidated damages provision may provide clarity and allow a franchisee to accurately determine whether breaching makes economic sense).

Other contract terms can also impact the calculation of expectancy damages. If, in the hypothetical above, the contract provided that Franchisee was required to sell the widgets for a set price, Franchisor can likely rest assured that its calculation of Franchisee’s expectancy damages based on the breach is accurate.

B. Efficient Breach with Third-Party Inducement

1. New Franchisee Agrees to Buy the Franchisor’s Widgets for Significantly More Money

As above, Franchisor sells widgets to Old Franchisee pursuant to a contract. Franchisor’s costs to perform are $100, Old Franchisee agrees pay $120 intending to sell the widgets for $150, making Franchisor’s expected profits $20 and Old Franchisee’s expected profits $30. In a twist on this scenario, however, New Franchisee offers to buy the widgets for $200, intending to sell them for $300. New Franchisee wants an exclusive deal to sell the widgets. Franchisor, who stands to make $100 by selling to New Franchisee, wants to breach the contract and pay Old Franchisee its $30 expectation damages. Even after paying Old Franchisee’s expectation damages, Franchisor stands to make $70 from the transaction, a significant improvement.

2. Assumptions

a. Economic Gain and Damages Calculable

Again, Franchisor’s option to efficiently breach the contract depends on whether it makes economic sense to pay Old Franchisee’s expectation damages which, based on the facts above, it does. Again, however, this assumes that the Old Franchisee’s damages are knowable or disclosed.

b. Contract Terms

As discussed above, contract terms may make efficient breach a more attractive option for Franchisor. If, for example, Franchisor and Old Franchisee’s contract contains a liquidated damages provision defining Old Franchisee’s damages in the event of a breach, then Franchisor can rely on its calculation of Old Franchisee’s expectation damages and proceed accordingly.

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9 See, e.g., McChesney, supra note 7, at 146-48.
However, what if the contract with Old Franchisee provides for specific post-termination remedies? Will those undermine or encourage an efficient breach? For Franchisor, post-termination remedies will not likely undermine efficient breach. For Franchisee, however, the post-termination remedies could prove problematic. A prohibition against competition, for example, might prevent Franchisee from breaching the franchise agreement and pursuing a more lucrative opportunity, even if Franchisee agrees to pay expectancy damages (and even if those damages are defined by a liquidated damages provision).

3. **Does Promisee Purchase an Asset (Promissor’s Performance) by Entering into the Contract?**

Further complicating the efficient breach with third-party inducement scenario is the concept of “use value” and “exchange value” damages. For example, our hypothetical above assumes that Franchisor retains the right to sell the widgets to New Franchisee after it already sold the widgets to Old Franchisee. Any attorney representing Old Franchisee would likely argue that after the contract was signed, Old Franchisee had ownership of the widgets, increasing the value of the widgets to Old Franchisee, and prohibiting Franchisor from re-selling them to a new party.

Applying this theory to the hypothetical, an attorney representing Old Franchisee would argue that Old Franchisee’s “use value” damages pursuant to its contract with the Franchisor were $30, but because Old Franchisee had an ownership right to the widgets after the contract was executed, Old Franchisee has the right to profit off of the sale of the widgets. Old Franchisee may argue that it has the right to any profits earned by the Franchisor by virtue of the sale to New Franchisee. The profits from the sale to the New Franchisee represent Old Franchisee’s “exchange value” damages. If Franchisor must repay Old Franchisee’s “use value” damages and its “exchange value” damages, the breach is no longer efficient.

4. **Old Franchisee’s Options When Faced with an Efficient Breach by Franchisor**

In this scenario, Old Franchisee’s most obvious option in litigation is to sue for damages above and beyond expectancy or “use value” damages, as described above. However, Old Franchisee may also sue the Franchisor for specific performance of the contract or sue New Franchisee for tortious interference.

When faced with a claim for damages above and beyond expectancy damages, a breaching party can use the efficient breach doctrine as an affirmative defense, arguing that the pursuit of a more lucrative contract justifies the breach, and, in further support of its defense, that the non-breaching party is in the same position or an improved position after the breaching party’s payment of expectation damages.

When faced with a claim for tortious interference, the party that induced the breach may defend itself by framing its motives for the breach in a way that is acceptable to the court. There is a great deal of ambiguity as to what motives are acceptable to justify inducement of a breach, however. One court may deem a breaching party’s actions as “opportunistic” and, thus, not efficient. Another court may characterize those same actions as being in furtherance of a

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10 See Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 751 (7th Cir. 1988).
“permissible financial goal[ ]”\(^\text{11}\) allowing the breach and awarding only expectancy damages. In *Bhole Inc. v. Shore Investments, Inc.*,\(^\text{12}\) discussed in more detail below, the court determined that a third-party’s takeover of a lease and subsequent breach of that lease was not tortious interference, in part because the third-party’s actions were in good faith pursuit of the profit-seeking activities of the first party to the contract and therefore was neither malicious nor in bad faith.

**IV. COMMON OBJECTIONS TO EFFICIENT BREACH AND THE COURTS’ BALANCING ACT**

There are several practical objections to the application of the efficient breach doctrine.\(^\text{13}\) For example, as referenced above, the application of efficient breach assumes that expectation damages are measurable (and that the calculation is low cost for the courts).

In addition to the practical concerns referenced above, there are several theoretical objections to its application. Objectors argue that ordinary contracting parties do not anticipate efficient breach and, thus, do not negotiate appropriately. Moreover, most parties do not understand that their contract contains an implicit buyout option, and believe they are entitled to the performance bargained for—in fact, there is some interest in requiring performance of a contract’s terms that cannot be remedied by monetary damages. Others still believe that encouraging efficient breach may have a societal impact of making future contracts less certain.\(^\text{14}\)

In applying efficient breach principles to breach of contract cases, courts balance these practical and theoretical objections with a desire to promote efficient contracts and reduce onerous litigation where breaches are deemed efficient. As a result, the application of efficient breach has several limitations.


\(^\text{12}\) *Id.*

\(^\text{13}\) See, e.g., Avery Katz, *Virtue Ethics and Efficient Breach*, 45 Suffolk U. L. Rev. 777, 785-791 (2012) (collecting authority on efficient breach, and asserting that objections to the argument for efficient breach fall into one or more of three categories: (1) those that assess the morality of efficient breach based on whether it produces good or bad consequences; (2) those that assess the morality of efficient breach based on whether it respects rights, fulfills duties and promotes autonomy, and disregards whether the act leads to good or bad consequences; and (3) objections based on so-called “virtue ethics” which assess efficient breach on whether it is grounded in or promotes the development of good moral character).

\(^\text{14}\) See, e.g., *In re Grace*, No. 7-04-14547SA, 2008 WL 1766752, at *7 & n.16 (Bankr. D.N.M. Apr. 14, 2008). The *In re Grace* court held that defendant “wisely” had not argued efficient breach and cited authority for the proposition that

Healthy business relationships help the market function efficiently and encourage market activity. Such relationships are almost always disrupted by a breach, whether it is efficient or otherwise. Of course, if a party can get a better deal elsewhere, there is no harm in asking the other party to accept a sum of money in substitution for performance; to talk is not to breach. However, if efficient breaches are encouraged, what effect does such encouragement have on trust among actors in the market? Efficient breach theory encourages “breach first, talk afterwards.” How would the market appraise the negative drag of law-inspired distrust? There are many reasons why contracts are enforced. Economic efficiency is only one of them. The business community rejects efficient breach theory as a justification for willful breaches; the courts should also.

*Id.* (citing Arthur Linton Corbin & Joseph M. Perillo, *Corbin on Contracts § 55.15 at 79-80*).
A. The Manner of Breaching May Render a Breach Inefficient

1. Failure to Inform Promisee of Promisor's Intention to Breach or to Offer to Pay Expectation Damages May Render a Breach Inefficient

How one commits an efficient breach of contract matters. In *Conagra, Inc. v. Nierenberg*, Conagra, a grain-elevator operator, contracted to purchase from a local wheat farmer 12,500 bushels of wheat at a price of $5.01 per bushel. At the time, the price of wheat was steadily rising on a daily basis by as much as 20 cents per bushel. Several days later Conagra sent the farmer an order confirmation, which the farmer failed to countersign and return. At that point, the price of wheat had risen to $5.60 per bushel. Four days after receiving the order confirmation, the wheat farmer resold the wheat to another buyer at $5.85 per bushel. Based on his counsel's advice that he was not obligated to sell to Conagra, the wheat farmer failed to inform Conagra of his decision to breach the sale contract. Conagra sued the wheat farmer to recover its expectancy damages. The trial court found for the wheat farmer on the basis of the farmer's statute of frauds defense. On appeal, the Supreme Court of Montana reversed, holding that an enforceable contract existed.

The Montana Supreme Court noted that Conagra's ordinary practice to buy grain by phone and then sue to recover its expectancy damages if the seller-farmer breached encouraged rather than discouraged farmers to breach where wheat prices were rising. But such a breach, the court stated, "is not necessarily a *bad* thing; to the contrary, courts as well as scholars have for more than two decades heralded such an ‘efficient breach’ as an essential free-market tool that maximizes net economic gain." However, a party to a contract has a justified expectation that the other will "act in a reasonable manner and not outside of ‘accepted commercial practices’ in not only its performance of a contract but in its ‘efficient breach’ as well.”

The court stated that the wheat farmer “would have been justified, and in fact should be commended, if in fact he chose to dishonor a contract with Conagra, where grain prices were moving steadily upward.” The court observed that, had the farmer breached the Conagra contract on the day he received the order confirmation (at which point the price of wheat was $5.60 per bushel), Conagra's expectancy damages would have been fixed at $0.59 per bushel. The farmer could then have resold the wheat four days later at $5.85 per bushel, increasing his net per-bushel sales price by $0.15.

The farmer’s mistake, the court reasoned, was his failure to inform Conagra of his breach on the day he received the order confirmation so that his obligation for Conagra's expectancy damages would be fixed. Instead, and ostensibly on advice of counsel, the farmer “acted outside of ‘accepted commercial practices’ by not informing Conagra of his breach and then later acted deceptively when Conagra called to determine when the wheat would be

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15 301 Mont. 55, 7 P.3d 369 (2000).

16 *Conagra, Inc. v. Nierenberg*, 301 Mont. at 78, 7 P.3d at 384 (emphasis in original).

17 *Id.*

18 *Conagra, Inc. v. Nierenberg*, 301 Mont. at 79, 7 P.3d at 385.
delivered. “Such a breach cannot, and should not, be excused or encouraged under any theory,” the court concluded.

Similarly, in *Norfolk Southern Railway, Co. v. Basell USA, Inc.*, a manufacturer contracted with a railway company whereby the manufacturer agreed to use the railway to ship a certain percentage of its traffic from a particular facility in exchange for discounted shipping rates. Later, the manufacturer contracted with another railway for transportation of product from another facility and from the facility for which it had contracted with the first railway. As a result, the manufacturer failed to tender the full percentage of traffic promised to the first railway, and the railway sued seeking restitution.

As a defense to the claim that its breach was committed in bad faith, the manufacturer argued that its “business decision” to enter into the second shipping contract was an “efficient breach,” and therefore “does not mean that . . . the decision was made in bad faith.” The court rejected the argument. “‘The theory [of efficient breach] holds that properly calculated expectation damages increase economic efficiency by giving the [breaching party] an incentive to break the contract if, but only if, he gains enough from the breach that he can compensate the injured party for his losses and still retain some of the benefit from the breach.’” Courts use the doctrine to emphasize that in some circumstances, intentional breaches may be legitimate, and in those cases, courts should not authorize extreme remedies such as specific performance or allow punitive damages merely because the breach is intentional. But that theory, the court ruled, was inapplicable here. Had the manufacturer sought to efficiently breach the first shipping contract, it would have disclosed the fact of the second contract, requested termination of the first, and offered to compensate the first railway for its lost profits. Instead, it “subverted the parties’ contract so that it could benefit from both carriers’ discounted rates at the same time.” The court therefore rejected the manufacturer’s effort “to hide behind the theory of efficient breach as an after the fact justification for its conduct.”

2. **Even When Breaches are Deemed Inefficient, the Courts May Still Refuse to Award Punitive Damages or Specific Performance Where the Breach Does Not Damage the Plaintiff and Results in Increased Profits to the Defendant**

*Patton v. Mid-Continent Systems, Inc.* involved a dispute between two truck stop operators and a provider of credit cards used by truck drivers to charge fuel and related expenses incurred at truck stops. The truck stop operators entered into franchise agreements with the credit card provider giving them exclusive territorial rights. The agreements authorized

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19 Id.
20 Id.
22 Id. at *7 n.6.
23 Id. (quoting E.I. DuPont de Nemours & Co. v. Pressman, 679 A.2d 436, 445 (Del. 1996)).
24 Id.
25 Id.
26 841 F.2d 742 (7th Cir. 1988).
the provider to franchise additional truck stops in their respective territories only if the truck stop operators, having been informed that additional coverage was required and given the “first opportunity” to meet the requirement, failed to obtain the additional facilities required. 27 Several years later, the credit card provider granted an additional franchise to another truck stop located within the franchisees’ territory. The franchisees sued and were awarded, in addition to compensatory damages, $2,250,000 in punitive damages, which the court reduced to $100,000. The credit card provider appealed.

On appeal the court addressed the tension between the fact that “liability for breach of contract is, prima facie, strict liability,” and controlling Indiana law that allowed punitive damages to be awarded “in suits for breach of contract if, ‘mingled’ with the breach, are ‘elements of fraud, malice, gross negligence or oppression.’” 28 Ordinarily, the court noted, the promisor who fails to perform as agreed will be liable for the breach even though the failure was “beyond his power to prevent and therefore in no way blameworthy.” 29 Moreover, “[e]ven if the breach is deliberate, it is not necessarily blameworthy.” 30 Thus, where the promisor discovers that his performance is worth more to someone else, “efficiency is promoted by allowing him to break his promise, provided he makes good [on] the promissee’s actual losses.” 31 But, “[i]f he is forced to pay more than that, an efficient breach may be deterred, and the law doesn’t want to bring about such a result.” 32 Teasing out the point, the court posed the following scenario:

Suppose that by [granting the encroaching franchise], [the franchisor] increased its own profits by $150,000 and inflicted damages of $75,000 on the plaintiffs. That would be an efficient breach. But if [the franchisor] had known that it would have to pay in addition to compensatory damages $100,000 in punitive damages, the breach would not have been worthwhile to it and efficiency would have suffered because the difference between [the franchisor]’s profits of $150,000 and the plaintiffs’ losses of $75,000 would (certainly after the plaintiffs were compensated) represent a net social gain. 33

The court noted that not all breaches are involuntary or otherwise efficient. Some are “opportunistic,” such as where a promisor exploits the inadequacies of compensatory damages (like below market pre- and post-judgment interest rates and the fact that attorneys’ fees are ordinarily not recoverable). 34 And while acknowledging that “this is not how the legal test is phrased[,]” the court suggested that this “opportunism” “seems [to be] the common element in most of the Indiana cases that have allowed punitive damages to be awarded in breach of contract cases[.]” 35

27 Id. at 746.
28 Id. at 750 (quoting Travelers Indem. Co. v. Armstrong, 442 N.E.2d 349, 359 (Ind. 1982)).
29 Id.
30 Id.
31 Id.
32 Id.
33 Id. at 750-51.
34 Id. at 751.
35 Id.
The court concluded that there was no evidence that the franchisor’s decision to grant the encroaching franchise was opportunistic or even deliberate. The plaintiffs’ territories were unclearly delineated, so the grant of the franchise was not even deliberate, the court held. The franchisor’s subsequent refusal to rectify the encroachment once brought to its attention “converted an innocent breach into a deliberate one[,]” but there was no evidence that the breach was “malicious, fraudulent, oppressive, or even grossly negligent.” Moreover, “the breach did little, perhaps no, damage to either plaintiff, and it is therefore quite possible that it was an efficient breach in the sense that it increased [the franchisor]’s profits by more than it caused anyone[’s] losses.” If so, the court concluded, “the refusal to rectify the breach, while deliberate, would not justify an award of punitive damages.”

*Patton* is an important decision. Suppose a franchisor has granted a franchisee an exclusive territory and promised that, for so long as the franchisee is not in default, it would not grant an additional franchise for the operation of another franchise within the franchisee’s exclusive territory. If the franchisor determines that the franchisee, while not in breach of its obligations under the franchise agreement, has nevertheless failed to exploit the full potential of its exclusive market, can it violate the franchisee’s exclusive territory rights and grant an additional franchise within that territory? *Patton* suggests that it might do so, provided the franchisor is prepared to compensate the franchisee for its lost profits (assuming the business was profitable to begin with).

Certainly, such a decision would be characterized under *Patton*’s terminology as “deliberate” rather than “innocent.” But the efficient breach doctrine is concerned by definition with breaches that are *not* innocent in the sense that, as in *Patton*, the promisor initially “stumbled into the breach.” Efficient breach doctrine assumes a deliberate, conscious and intentional breach has been committed for reasons, the theory posits, that are to be lauded and encouraged rather than punished. *Patton* recognized that the franchisor’s refusal to rectify the encroachment converted an originally innocent breach into a deliberate one, but it did not matter. Under the statutory formula at issue, “deliberate” was still not “malicious, fraudulent, oppressive, or even grossly negligent.”

3. **Where a Third-Party Inducer of an Efficient Breach is Motivated by “Permissible Financial Goals” the Breach is Efficient**

*Bhole, Inc. v. Shore Investments, Inc.* illustrates one court’s treatment of efficient breach with third-party inducement. In *Bhole*, the Delaware Supreme Court stated, albeit without explanation, that the efficient breach doctrine impacts the merits of the tortious interference claims asserted in the case. *Bhole* involved a lease dispute between the landlord of a Rehoboth Beach, Delaware liquor store and its lessee’s successor. Several years into the seven-year lease, a third party decided to establish a liquor store in Rehoboth Beach. To that end, the third-

36 *Id.*

37 *Id.*

38 *Id.*

39 *Id.*

40 67 A.3d 444 (Del. 2013).
party purchased the lessee and its existing liquor business, assumed the lessee's obligations under the lease, and then moved the business to a larger facility located next door that the third party already owned. After continuing to pay rent under the lease for an additional five months, the third-party then terminated the lease.

The landlord sued the third-party for breach of the lease. It also sued the third-party, affiliated entities and their principal for tortious interference with the lease. The trial court awarded the landlord damages for breach of the lease in an amount equal to the rents due for the remaining term of the lease. It also held in favor of the landlord on its tortious interference claims and awarded additional punitive damages of $25,000.

On appeal, the court reversed the tortious interference judgment. It noted that, under Delaware law, a claim for tortious interference with contract claim requires proof of “(1) a contract, (2) about which defendant knew, and (3) an intentional act that is a significant factor in causing the breach of such contract, (4) without justification, (5) which causes injury." Where a corporate defendant is alleged to have interfered with an affiliate’s contractual obligations, the plaintiff must show that “the corporate defendant ‘was not pursuing in good faith the legitimate profit seeking activities of [its] affiliated enterprise [ ’] that was a party to the contract.” And “there can be no non-contractual liability of the affiliated corporation . . . unless the plaintiff pleads and proves that the affiliate sought not to achieve permissible financial goals but sought maliciously or in bad faith to injure plaintiff.” Thus, to establish a tortious interference with its lease, the landlord had to show that the affiliated defendants “acted maliciously or in bad faith.”

The court first held that the third party who assumed the lease could not be liable both for breach of the lease and for tortiously interfering with it. This holding is consistent with the well-recognized principle that one cannot tortiously interfere with one’s own contract. In so holding the court observed that the third party “efficiently breached the [lease with plaintiff] in order to maximize its profits by operating a large liquor store out of the [larger adjacent location] instead of a small liquor store out of the [leased premises].” The court further held that neither the affiliated entities nor the principal could be liable for tortious interference because there was no evidence they interfered with the lease maliciously or in bad faith.

The Bhole decision is as interesting for what it seems to have assumed as for what it in fact held. Franchisors of multiple franchised brands may take actions that benefit one system

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41 The central issue presented on appeal was the appropriate measure of damages for breach of a lease where (i) the non-breaching party has sued before the lease expired, and (ii) the lease did not contain an acceleration clause, an issue of first impression in the Delaware Supreme Court. The court noted that some jurisdictions had held that the recovery may include all unpaid rent up to the date the complaint was filed, while others allowed the recovery of rents due up to the date of trial, and at least one secondary source cited by the court suggested that rents due through trial should be recoverable. Rather than decide it, the court remanded to the lower court to decide the issue in the first instance.

42 Id. at 453 (internal quotation marks omitted).

43 Id. (quoting Shearin v. E.F. Hutton Grp., Inc., 652 A.2d 578, 591 (Del. Ch. 1994)).

44 Id. (internal quotation marks omitted).

45 Id.

46 Id.
and not the other, or that impact the systems differently.\textsuperscript{47} For example, in \textit{Gossard v. Adia Services, Inc.},\textsuperscript{48} a franchisee of one franchised brand sued its franchisor’s parent claiming that the parent’s acquisition of a competing franchised system amounted to tortious interference with its territorial rights where an existing location of the competing brand was within the franchisee’s protected territory. The federal court magistrate ruled that no evidence established that the parent “induced” or “otherwise caused” the territorial violation.\textsuperscript{49} On appeal, the Eleventh Circuit framed the issue before it as whether, under Florida law, the parent “otherwise caused [its subsidiary] to violate the franchise agreements” by acquiring the competing franchise system.\textsuperscript{50} Finding no Florida case law on point, the Eleventh Circuit certified that issue to the Florida Supreme Court.

The Florida Supreme Court observed that the evidence established the franchisee and its franchisor had an agreement that neither the franchisor nor its parent or any affiliate would compete with the franchisee within his protected territory. The parent was aware of the agreement at the time it acquired the competitive franchise system. As a result of the acquisition, the competing franchisor became the franchisor’s affiliate. Therefore, the court stated, “by purchasing [the competing franchisor], [the parent] knowingly caused [the franchisor] to be in breach of its ‘promise’ to [the franchisee] that neither a parent nor affiliate of [the franchisor] would provide similar health care services within [the franchisee’s] territory.”\textsuperscript{51}

The court went on to hold that “these allegations establish a prima facie case of tortious interference under [a prior decision of the court].”\textsuperscript{52} The franchisor’s actions met the “otherwise caus[ed]” formulation of the tort under Florida law.\textsuperscript{53} Accordingly, the Florida Supreme Court answered the certified question in the affirmative.\textsuperscript{54}

It is important, however, to understand precisely what the \textit{Gossard} court assumed to be the evidence on which it answered the question certified to it. The court summarized its ruling as follows: “[W]e answer the question in the affirmative \textit{provided there is evidence proving the elements of tortious interference with a business relationship we set forth in \textit{Ethan Allen, Inc. v. Georgetown Manor, Inc.}, 647 So.2d 812 (Fla. 1994).}”\textsuperscript{55} In other words, the court assumed, but did not find, that each tortious interference element had been established. Importantly, it did not hold, but rather assumed, that the parent intentionally and unjustifiably interfered with the franchisee territorial rights simply by acquiring the competitive franchisor.


\textsuperscript{48} 723 So. 2d 182 (Fla. 1998).

\textsuperscript{49} \textit{id.} at 184.

\textsuperscript{50} \textit{id.}

\textsuperscript{51} \textit{id.}

\textsuperscript{52} \textit{id.} at 185.

\textsuperscript{53} \textit{id.}

\textsuperscript{54} \textit{id.}

\textsuperscript{55} \textit{id.} at 183 (emphasis added).
It was on this basis that the court in *Mkt Reps S.A. de C.V. v. Standard Chartered Bank International (Americas) Ltd.*\(^{56}\) distinguished *Gossard*. The *Mkt Reps* court distinguished between an intent to *interfere* and an intent simply *to act*; where there was no evidence of an intent to interfere and only evidence of an intent to act, the tortious interference claim fails. *Mkt Reps* distinguished *Gossard* on the ground that *Gossard* assumed evidence of an intent to interfere existed. Where there is no evidence of an intent to interfere, there is no tortious interference claim.

*Mkt Reps* does not, however, entirely allay concerns over the holding in *Gossard*. The fact that the parent in *Gossard* knew of the franchisee’s territorial rights and knew its acquisition of the competitive franchisor would result in a breach of the franchisor’s territorial obligations may have provided a basis for the *Mkt Reps* court to distinguish the case before it. But anyone acquiring a franchise system should know the terms of the franchise agreements in a system it already owns and of those in the system it is acquiring. Therefore, like the parent in *Gossard*, it should know of any potential territorial or other conflicts its acquisition might cause. What remains uncertain, at least under Florida law, is whether the buyer’s knowledge that the acquisition will interfere with a franchisee’s territorial rights constitutes an intent simply to act or an intent to interfere.

Although the *Bhole* court did not explicitly address the issue addressed in *Gossard*, the *Bhole* court appears to have at least assumed that, had there been evidence of malice or bad faith, the third party’s affiliate and/or principal might have been liable for tortious interference with the lease. The case is notable for this reason alone. But, the court’s observation concerning the purpose of the third party’s breach of the lease and its characterization of that breach as an “efficient” one suggest that where the underlying breach is in furtherance of “permissible financial goals,” there will be no tortious interference liability. “Permissible financial goals” and malice or bad faith need not be mutually exclusive, at least where it may result from mixed motives. The question that *Bhole* leaves is: Can one be held liable for tortious interference with a contract where the underlying breach was efficient?

It would appear so. In *Huynh v. Vu*\(^{57}\), the court considered the impact and proper standards applicable to the so-called “manager’s privilege.” The manager’s privilege is “‘[t]he privilege to induce an otherwise apparently tortious breach of contract . . . to further certain social interests deemed of sufficient importance to merit protection from liability.’”\(^{58}\) In determining that a manager’s privilege constituted a defense to the tortious interference claim, and that the “predominant motive test” was the proper standard for determining whether the defense was established, the court noted that that standard “best meets the economic considerations applicable to the tort of interference with contract.”\(^{59}\) The court stated that “the right of a contracting party to breach a contract and pay damages (nominally referred to as ‘expectation damages’), instead of being required by law to perform, has driven legal economists to extol the principle of efficient breach of contract as ‘[o]ne of the most enlightening insights of law and economics.’”\(^{60}\) “Providing a manager with immunity where the advice to

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\(^{56}\) 520 F. App’x 951 (11th Cir. 2013).

\(^{57}\) 4 Cal. Rptr. 3d 595 (Cal. Ct. App. 2003).

\(^{58}\) Id. at 604 (quoting *Olivet v. Frischling*, 164 Cal. Rptr. 87, 91-92 (Cal. Ct. App. 1980)).

\(^{59}\) Id. at 607.

\(^{60}\) Id. at 608 (citations omitted).
breach is given predominantly to benefit the principal is consistent with the efficient breach theory: The principal/promisor is thus enabled to obtain and rely on the manager’s advice in making a judgment whether its interests are best served by performance, or by breach and the payment of damages to the promise[.]61 the court concluded.

Because the manager’s privilege discussed in Huynh is a defense to a tortious interference claim, the case at least implicitly suggests that the inducement of an efficient breach will give rise to a claim for tortious interference, which the manager then may defend by invoking the privilege. But the reasoning in Huynh, specifically that the privilege is consistent with the efficient breach theory, might have led the court to go a step farther and hold that, where the underlying breach is efficient, the inducement of the breach cannot give rise to tort liability. Where the manager’s privilege is established, the result is the same.

There is no mandate as to whether malice or intent to interfere will defeat a defense of efficient breach. In fact, the Huynh court itself acknowledged that “the question of whether the privilege is absolute or qualified is ‘somewhat muddled in California law’ resulting in a ‘knot of authority’ on the issue.”62 It is the authors’ position that courts should adopt a more consistent approach by recognizing that, where the underlying breach is efficient, the breach cannot give rise to tort liability of a third party who may have induced it.

B. How Do Courts Balance the Desire to Encourage Efficient Breach with the Desire to Discourage Opportunistic or Problematic Conduct?

The imposition of tortious interference liability or the award of attorneys’ fees or punitive damages for breach of contract claims all act to penalize, or even nullify, the concept of efficient breach. Notwithstanding this, courts recognize that, at times, the non-breaching party may not be fully-compensated by its expectancy damages63 and that a degree of leeway in imposing additional penalties on the breaching parties in those cases is justified.

1. The Shifting Risk Analysis

In Northern Indiana Public Service Co.,64 the Northern Indiana Public Service Company (“NIPSCO”), an electric utility, entered into a contract with Carbon County Coal Company (“CCCC”), which ran a coal mine in Wyoming. Pursuant to the contract, NIPSCO purchased 1.5 million tons of coal every year for 20 years, at a set price, subject to various provisions for escalation. The price was essentially fixed in favor of CCCC. NIPSCO benefitted from having an assured supply of low-sulphur coal, so it was willing to guarantee the price and the quantity it would purchase.

61 Id.
62 Id. at 605 (quoting Aalgaard v. Merchs. Nat'l Bank, Inc., 274 Cal. Rptr. 81, 86-87 (Cal. Ct. App. 1990)).
63 See, e.g., McChesney, supra note 7, at 139 (citing William M. Landes & Richard A. Posner, Joint and Multiple Tortfeasors: An Economic Analysis, 9. J. Legal Stud. 517, 552-55 (1980)) (arguing in favor of the imposition of tort remedies to ensure recovery where, for example, there is a danger that a breaching party will be judgment-proof or the sum involved is too small to warrant suit).
64 799 F.2d 265 (7th Cir. 1986).
In 1983, NIPSCO requested permission from the Indiana Public Service Commission to raise its rates. The request was granted, but NIPSCO was directed to make a good faith effort to find lower cost electricity. When NIPSCO made such an effort, it discovered that it was able to buy electricity more cheaply from other sources than what it was paying to generate electricity from coal purchased from CCCC. Accordingly, NIPSCO decided to stop accepting coal deliveries from CCCC.

NIPSCO sued seeking a declaration that it was excused from its obligations under the contract under the force majeure clause or pursuant to the doctrines of frustration or impossibility. CCCC countersued. After a trial, the court entered a judgment in accordance with the jury’s $181 million verdict against NIPSCO, and rejected CCCC’s claim for specific performance in lieu of damages. After the damages award, CCCC’s mine shut down, as NIPSCO was its only customer. Both NIPSCO and CCCC appealed.

On appeal, the court rejected NIPSCO’s proposed application of the doctrines of frustration, impossibility/impracticability and force majeure, stating that all such doctrines exist to “shift[] risk to the party better able to bear it, either because he is in a better position to prevent the risk from materializing or because he can better reduce the disutility of the risk (as by insuring) if the risk does occur.” Where a contract explicitly assigns a particular risk to one party or the other, impossibility and related doctrines cannot be used to shift an already assigned risk. Thus, since NIPSCO assumed the risk of rising coal costs in order to ensure a steady supply of coal, it could not later shift the risk to CCCC. In other words, in assuming the risk of changes in the market, NIPSCO was thereafter prevented from pursuing permissible financial goals by breaching the contract to obtain cheaper energy. Simply put, while the fact that a breach was efficient may militate against an equitable remedy or imposition of punitive damages, it is no defense to liability for compensatory damages.

With respect to CCCC’s request for specific performance, the court of appeals held that specific performance was only available if damages were inadequate. CCCC’s loss was easily determined by multiplying the contract price by the quantity over the life of the contract, less the costs of mining the coal. CCCC argued that monetary damages were insufficient because without the NIPSCO contract the mine would close, and the resultant loss of jobs for all of the miners and satellite business owners would not be remedied by the monetary award. The court of appeals rejected this argument, holding that the miners and satellite business owners were not parties to the contract, so their losses were irrelevant. The court of appeals took its analysis one step further, holding that because mining coal was no longer an economical means to produce fuel than continuing to require its production pursuant to an order for specific performance “would impose costs on society greater than the benefits.” The court characterized NIPSCO’s breach as “efficient” in that it “brought to a halt a production process that was no longer cost-justified.”

The court stated:

65 Id. at 278 (providing the below illustrative hypothetical) (citations omitted):

Suppose a grower agrees before the growing season to sell his crop to a grain elevator, and the crop is destroyed by blight and the grain elevator sues. Discharge is ordinarily allowed in such cases. The grower has every incentive to avoid the blight; so if it occurs, it probably could not have been prevented; and the grain elevator, which buys from a variety of growers not all of whom will be hit by blight in the same growing season, is in a better position to buffer the risk of blight than the grower is.

66 Id. at 279.

67 Id.
The reason why NIPSCO must pay [CCCC]'s loss is not that it should have continued buying coal it didn’t need, but that the contract assigned to NIPSCO the risk of market changes that made continued deliveries uneconomical. . . . With continued production uneconomical, it is unlikely that an order of specific performance, if made, would ever actually be implemented. If . . . the cost of a substitute supply . . . to NIPSCO is less than the cost of producing coal from [CCCC]'s mine, NIPSCO and [CCCC] can both be made better off by negotiating a cancellation of the contract and with it a dissolution of the order of specific performance. 68

2. The Imposition of Attorneys’ Fees

In Avis Rent A Car System, LLC, 69 a group of rental car companies (the “RACs”) sued the City of Dayton after the City breached a contract it felt was an unacceptable burden on its resources. The RACs entered into Concession Agreements with the City that allocated a particular number of parking spaces to pick up and return rental cars. In anticipation of the construction of a new garage, the City and the RACs also entered into new lease agreements (the “Ready/Return Agreements”), which had a 20-year term, but “automatically terminate[d]” the Concession Agreements. 70 The RACs understanding, and the City’s intention, at the time the Ready/Return Agreements were entered into, was that the parties would eventually renegotiate and enter into successor agreements to the Concession Agreements that would correspond to the 20-year lease term of the Ready/Return Agreements.

When a new city official was appointed in 2010, he determined that the Ready/Return Agreements were a bad deal. Accordingly, when the Concession Agreements expired, he notified the RACs that the Ready/Return Agreements were terminated and the City would require the RACs to obtain permits and annually pay fees of approximately $85,000 plus 10% of their gross revenue in order to continue operating. The RACs sued the City seeking injunctive relief and asserted claims that the City acted in bad faith.

The lower court held that the Ready/Return Agreements were not terminated and enjoined the City from instituting the “permits” to replace them. The lower court held that evidence of bad faith conduct could be used to justify an award of attorneys’ fees. In analyzing the RACs’ entitlement to attorneys’ fees, the court held that, under Ohio law, attorneys’ fees can be awarded based on bad faith conduct giving rise to a breach of contract claim. The City relied on the doctrine of efficient breach as a defense, arguing that imposing attorneys’ fees on a breaching party would undercut that party’s ability to calculate damages to determine where the economic benefits of a breach outweigh the costs of performance. The court, recognizing the danger in “smuggl[ing] a tort remedy into a post-judgment proceeding” and in “threaten[ing] to make hollow the Supreme Court of Ohio’s prohibition on punitive damages in breach of contract cases” held that awarding attorneys’ fees was a valid concern with “substantial appeal,” but nonetheless determined that there was “room in contract law for moral evaluations of breach.”

68 Id.
70 Id. at *2.
71 Id. at *10-11.
The Avis court, citing Patton, held that “[n]ot all breaches of contract are involuntary or otherwise efficient. Some are opportunistic; the promisor wants the benefit of the bargain without bearing the agreed-upon cost, and exploits the inadequacies of purely compensatory remedies.” 72 The court applied the “American Rule” definition of bad faith as follows:

A lack of good faith is the equivalent of bad faith, and bad faith, although not susceptible of concrete definition, embraces more than bad judgment or negligence. It imports a dishonest purpose, moral obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill will partaking of the nature of fraud. It also embraces actual intent to mislead or deceive another.73

Ultimately, the court held the City did not act in bad faith because it did not enter into the Ready/Return Agreements with the intent not to honor their terms, and it was not vengeful or motivated by a desire to do the RACs harm. The City believed its responsibility, as steward of a public asset, was to question how the Ready/Return Agreement impacted its resources, which the court held did not evidence a “dishonest purpose, moral obliquity, conscious wrongdoing,' or any other aspect of bad faith.”74

V. THE ALTERNATIVE TO EFFICIENT BREACH – EQUITABLE REMEDIES

A. Breach of Contract Remedies, Typically

As stated above, ordinarily the remedy for a breach of contract is an award of damages. The damages awarded in a standard breach of contract case are limited to the non-breaching party’s expectation damages. The theory of efficient breach provides that properly calculated expectation damages increase economic efficiency by allowing and even incentivizing a party to breach a contract where he stands to gain enough from the breach to compensate the non-breaching party and still profit. The application of punitive or equitable remedies impairs the breaching party’s ability to accurately calculate its expectation damages, which can lead to inefficient results.

Doctrines implicating the bad or predatory motivation of the breaching party can result in the imposition of punitive damages. For example, California courts have held that punitive damages are available in cases where an insurer willfully, maliciously, or egregiously denies coverage,75 but have declined to award punitive damages in cases involving the breach of an

72 Id. at *11 (quoting Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 750 (7th Cir. 1988)) (discussing exceptions under Indiana law that allow punitive damages in breach of contract cases).

73 Id. at *12 (quoting LEH Props., Inc. v. Pheasant Run Ass’n, No. 10CA009780, 2011 WL 378783, at *6 (Ohio Ct. App. Feb. 7, 2011)).

74 Id. at *13 (quoting LEH Props., Inc. v. Pheasant Run Ass’n, 2011 WL 378783, at *6).

employment contract because the “employment relationship is not sufficiently similar to that of insurer and insured to warrant judicial extension of the proposed additional tort remedies in view of the countervailing concerns about economic policy and stability, the traditional separation of tort and contract law . . . .”76 California courts have expressed reluctance to subject contracts to this additional regulation, holding that it would create reluctance to join in contractual relationships or increase the cost and effort of defining such relationships.77

B. **Equitable Remedies in Breach of Contract Cases**

Extenuating circumstances may result in the court’s imposition of equitable remedies in a breach of contract case. Equitable remedies are a distinct category of relief typically granted when money cannot adequately compensate the non-breaching party.

The three main equitable remedies are specific performance (requiring the breaching party to perform), injunctions (compelling a party to take or prohibiting a party from taking certain actions) and rescission (cancelling the contract).

The Restatement (Second) of Contracts emphasizes that remedies other than an award of the non-breaching party’s expectation damages are to be the exception, not the rule, stating that the courts’ goal has not traditionally been to require compulsory performance, but to compensate the promisee for its loss resulting from the breach.78 Where such compensation is an adequate substitute for the non-breaching party, then punitive or equitable remedies are generally not available.

C. **Equitable Remedies versus Damages—A Cost-Benefit Analysis**

In determining whether to issue a permanent injunction or other equitable relief in lieu of damages, courts may apply a “cost-benefit” analysis. In the franchise context, this typically arises where a franchisee facing termination of its franchise agreement asks a court to enjoin the franchisor from terminating. Depending on how much time remains on the franchise agreement’s term (and what contractual or statutory renewal rights the franchisee might enjoy), such a request, if granted, could result in a “forced marriage” of significant duration.

In *Walgreen Co. v. Sara Creek Property Co., B.V.*,79 the court laid out the cost-benefit analysis for injunctive relief in analyzing whether a landlord’s breach of a mall lease exclusivity provision warranted issuance of a permanent injunction barring the landlord from leasing vacant space to the plaintiff-tenant’s competitor. The landlord, Sara Creek, informed Walgreen that it intended to buy out the lease of its anchor tenant in the same mall, which Sara Creek feared was about to close its store, and lease the space to a Walgreen competitor. Walgreen sought a permanent injunction to enjoin Sara Creek from breaching Walgreen’s exclusivity rights in the mall. At the time, ten years remained on Walgreen’s lease term. The district court issued the permanent injunction and Sara Creek appealed.

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77 Id.

78 Id. at 445 (citing Restatement (Second) of Contracts, Ch. 16 introductory note (Am. Law. Inst. 1981)).

79 966 F.2d 273 (7th Cir. 1992).
On appeal, Sara Creek argued damages are the norm in breach of contract cases and that a damages award, not a permanent injunction, was the appropriate remedy here. The appellate court affirmed, noting that where a permanent injunction is sought, the choice between remedies requires a balancing of the costs and benefits of the alternatives. The appeals court observed that the benefits of substituting an injunction for damages are two-fold. First, “it shifts the burden of determining the cost of defendant’s conduct from the court to the parties.” The court explained:

If it is true that Walgreen’s damages are smaller than the gain to Sara Creek from allowing a second pharmacy into the shopping mall, then there must be a price for dissolving the injunction that will make both parties better off. Thus, the effect of upholding the injunction would be to substitute for the costly process of forensic fact determination the less costly process of private negotiation.

Second, that “private negotiation” is a more accurate method of determining damages. According to the court, “a premise of our free-market system, and the lesson of experience here and abroad as well, is that prices and costs are more accurately determined by the market than by government.” Stated differently, “[a] battle of experts is a less reliable method of determining the actual cost to Walgreen of facing new competition than negotiations between Walgreen and Sara Creek over the price at which Walgreen would feel adequately compensated for having to face that competition.

Moreover, the Walgreen court noted that permanent injunctions entail costs as well. Many require the issuing court’s ongoing supervision. Some impose costs on third parties. A permanent injunction can have the effect of creating a so-called “bilateral monopoly” in which, by reason of the permanent injunction’s terms, the parties may only deal with one another: “Walgreen can ‘sell’ its injunctive right only to Sara Creek, and Sara Creek can ‘buy’ Walgreen’s surrender of its right to enjoin the leasing of the other anchor tenant’s space to [Walgreen’s competitor] only from Walgreen,” the court observed.

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80 The appeals court distinguished between permanent and preliminary injunctions. Where a permanent injunction is sought, it is the plaintiff’s burden to show that damages are inadequate. In contrast, the movant for a preliminary injunction must show “irreparable” harm, that is, harm that is not rectifiable by a final judgment. That “has nothing to do with whether to grant a permanent injunction, which, in the usual case anyway, is the final judgment.” Id. at 275.

81 Id.

82 Id.

83 Id.

84 Id. at 275-76.

85 Id. at 276.

86 Id. (citing Roland Machinery Co. v. Dresser Indus., Inc., 749 F.2d 380, 391-92 (7th Cir. 1984)). To illustrate this point, the Walgreen court cited to North American Financial Group, Ltd. v. S.M.R. Enterprises, Inc., 583 F. Supp. 691 (N.D. Ill. 1984), in which the court denied a franchisee’s request for an order of specific performance on this basis.

87 Id. (citing Shondel v. McDermott, 775 F.2d 859, 868 (7th Cir. 1985)).

88 Id.
Conversely, “[t]he costs and benefits of the damages remedy are the mirror of those of the injunctive remedy,” the court continued.\(^{89}\) A damage award avoids the costs associated with the court’s ongoing supervision, third-party effects, and the cost of the bilateral monopoly a permanent injunction creates. But a damage award will also impose costs both in terms of “diminished accuracy in the determination of value” as well as “the parties’ expenditures on preparing and presenting evidence of damages” and the court’s time in “evaluating the evidence.”\(^ {90}\)

Applying the factors involved in the cost-benefit analysis here, the appeals court acknowledged that the determination of Walgreen’s damages would have been costly in forensic resources and inescapably inaccurate. Importantly, in reaching that conclusion, the court noted that ten years remained on Walgreen’s lease. “It is difficult to forecast the profitability of a retail store over a decade, let alone to assess the impact of a particular competitor on that profitability over that period[,]” the court concluded.\(^ {91}\)

By contrast, the costs imposed by the permanent injunction were negligible. The injunction was “a simple negative injunction—Sara Creek is not to lease space in [ ] [m]all to [the competitor] during the term of Walgreen’s lease—and the costs of judicial supervision and enforcement should be negligible.”\(^ {92}\) And third-party costs, \textit{i.e.} costs to the competitor and customers who might prefer to do business with the competitor than with Walgreen, “are registered indirectly”: “[t]he more business [the competitor] would have, the more rent it will be willing to pay to Sara Creek, and therefore the more Sara Creek will be willing to pay Walgreen to dissolve the injunction.”\(^ {93}\) The only substantial “cost” of the permanent injunction imposed was that it might set off a round of negotiations between Walgreen and Sara Creek over a buy out of the injunction, the court held.

\textit{Walgreen} is important for several reasons. First, it carefully lays out the cost-benefit analysis applicable in the permanent injunction context, and identifies the costs and benefits courts are to weigh and balance. Practitioners should be sure to address these factors in seeking or opposing a request for a permanent injunction. Second, \textit{Walgreen} suggests that the length of time remaining on an agreement, in this case the lease, can impact the outcome. Here, the appeals court identified, as a cost associated with a damages remedy, the difficulty associated with determining the lost future profits of a retail store over the remaining ten-year term. Where there remains a similar length of time on the term of a franchise agreement, one would expect a franchisee threatened with termination to make a similar argument. And where that franchisee seeks only a “simple negative injunction”—“don’t terminate”—one might expect that franchisee to argue that the costs associated with continuing court supervision will be “negligible.” Of course, the obvious counter argument is that in the franchise context the permanent injunction will require the court’s ongoing supervisions of the relationship and the parties’ performance of their affirmative obligations to comply with their contractual commitments.

\(^ {89}\) Id.

\(^ {90}\) Id.

\(^ {91}\) Id. at 277.

\(^ {92}\) Id. at 277-78.

\(^ {93}\) Id. at 278.
Several considerations distinguish Walgreen from the typical franchise termination dispute. The first is the complete absence of any misconduct or poor performance on Walgreen’s part prompting the termination. In the franchise context, by contrast, there is usually some asserted misconduct, act or omission on the franchisee’s part giving rise to the termination. This is because most franchise agreements (and numerous state relationship laws) require good cause for termination.94 Second, unlike the landlord-tenant relationship, the franchisor-franchisee relationship is governed by a contract that is often characterized, at least in part, as one for personal services. By definition, therefore, the costs associated with ongoing court supervision will be far greater in the franchise context than in a lease dispute. The next section discusses how these points play out in the franchise context.

VI. APPLICATION OF EQUITABLE REMEDIES IN THE FRANCHISE CONTEXT

North American Financial Group, Ltd. v. S.M.R. Enterprises, Inc.95 highlights a critical difference between franchise agreements and other commercial contracts. In that case, the plaintiff claimed to have reached an agreement with the franchisor of the Fantastic Sam’s brand of family hair salons to purchase the rights to develop the Chicago market. The defendant-franchisor denied that a deal had been reached. The plaintiff sought an order of specific performance requiring the franchisor to convey the development rights on the terms of the alleged deal. The court refused.

As an initial matter, the court observed that it was far from clear that an agreement had in fact been reached. It noted that “[a] franchise generally is the product of an elaborate agreement,” yet the only term alleged here was the price for the development rights.96 However, even assuming a contract, the court stated, “there is absolutely no precedent for granting specific performance of a franchise contract.”97 The court explained:

A franchise agreement of the type contemplated here is at least partially a contract for personal services. “[T]he franchisee undertakes to conduct a business or sell a product or services in accordance with methods and procedures prescribed by the franchisor and the franchisor undertakes to assist the franchisee through advertising, promotion, and other services.”98

Two earlier iterations of the proposed deal made clear the defendant was to provide training and advertising support, the court noted. And the complaint alleged the deal ultimately reached also required the defendant to train the plaintiff and advertise for its benefit. Therefore, the court concluded, the alleged deal “would require the defendants to provide personal, specialized services to [plaintiff] for an unspecified time.”99

94 The question of whether a franchisor might commit an efficient breach by terminating a franchise agreement without good cause in furtherance of its financial interests is discussed below in Section VI.C.


96 Id. at 699.

97 Id.

98 Id. (citation omitted).

99 Id.
Because of the costs an order of specific performance would impose in terms of the court’s continuing supervision, the court denied the plaintiff’s request for specific performance. It stated:

If specific performance were granted, the Court would be placed in the untenable situation of a long-term supervisor, judging the quality of training and overseeing the breadth and efficacy of advertising. For that reason, it is hornbook law that a contract for personal services will not be specifically enforced as contrary to public policy.\(^\text{100}\)

The court’s opinion is interesting in two respects. First, the court characterized a franchise agreement as a *bilateral* personal services contract, pointing out that *both the franchisee* (by agreeing to operate a business or sell a product or service) *and the franchisor* (by assisting the franchisee through advertising, promotion and other services) agree to perform personal services. Second, the court used broad language in holding that an order of specific performance may not issue to enforce a personal services contract. The court’s holding that enforcement of a personal services contract by means of an order of specific performance is “against public policy” as a matter of “hornbook law” would suggest that a franchise agreement may never be enforced through specific performance.

A. **Specific Performance of Franchise Contracts**

Certain discrete rights or obligations created by or relating to franchise agreements may be the subject of orders of specific performance. A franchisee’s discrete post-termination obligations, such as a requirement that it return to the franchisor operations manuals and other confidential information, assign to the franchisor telephone numbers associated with the terminated franchise or abide by covenants not to compete, are routinely enforced. Agreements to buy or sell franchises have been the subject of specific performance orders as well. Although rare, temporary injunctions enjoining the termination of a franchise pending trial and final judgment have been issued. With notable exceptions, however, courts will not “force a marriage” by requiring parties to a franchise agreement to continue dealing with one another indefinitely or for the franchise agreement’s extended remaining term. The critical factor in deciding whether a specific performance remedy is appropriate seems to be the extent to which the issuing court will be required to provide continuing supervision over that performance.

1. **Specific Performance of Discrete Post-Termination Obligations**

Courts routinely issue even mandatory injunctions enforcing franchisees’ post-termination obligations.\(^\text{101}\) The obligations courts enforce include the assignment to the franchisor or its designee of telephone numbers formerly used in connection with the terminated franchised business,\(^\text{102}\) delivery to the franchisor of customer lists,\(^\text{103}\) delivery to the franchisor of

\(^{100}\) Id.


\(^{103}\) See, e.g., *id.* at *7; see also Domino’s Pizza Franchising LLC v. Yeager, 2010 WL 374116, at *5.*
possession of the former franchised location, equipment and inventory,\(^\text{104}\) and enforcement of covenants prohibiting post-termination covenants against competition.\(^\text{105}\) Enforcement of discrete obligations, like these sorts of post-termination obligations impose little, if any, regulatory burden on the issuing court.

2. **Specific Performance of Agreements to Sell Franchises**

In *Triple-A Baseball Club Associates v. Northeastern Baseball, Inc.*,\(^\text{106}\) the owner of a Double-A baseball club entered into an agreement with the owner of a Triple-A baseball club to swap teams. The Double-A team owner agreed to pay $2,400,000 for the Triple-A team, and the Triple-A team owner agreed to pay $400,000 for the Double-A team. The Eastern League, whose approval was required for the sale of the Double-A team, refused to consent to the sale. As a result, the owner of the Triple-A team refused to close on the sale of its team to the Double-A team owner. The court held that the Triple-A team owner was obligated to sell its team to the Double-A team owner. But the question that holding presented was "the remedy to which [the Double-A team owner was] entitled, damages or specific performance."\(^\text{107}\)

Having found no case addressing whether specific performance is appropriate with respect to the sale of a franchise under controlling Maine law, the court looked elsewhere. It observed that in *DeBauge Brothers, Inc. v. Whitsitt*,\(^\text{108}\) the Kansas Supreme Court held specific performance of a contract to sell a franchise to be appropriate because "[f]ranchises are by their very nature unique and exclusive, which is the source of their value to the possessor."\(^\text{109}\) The *Triple-A* court noted that in *Hogan v. Norfleet*,\(^\text{110}\) a Florida appeals court reached the same conclusion based on the rationale that "‘franchises and good will of a business or the value of a going business and profits involved cannot be ascertained and the estimation of value would be so indefinite recovery would not furnish a complete and adequate remedy at law.’"\(^\text{111}\) The court also noted that the Restatement (Second) of Contracts focuses on the inadequacy of legal remedies to determine the appropriateness of specific performance,\(^\text{112}\) as does Corbin on Contracts.\(^\text{113}\)

Based on general equitable principles governing the issuance of an order of specific performance and the guidance provided by these authorities, the court concluded that specific


\(^{106}\) 832 F.2d 214 (1st Cir. 1987).

\(^{107}\) Id. at 222.


\(^{109}\) *DeBauge Brothers, Inc. v. Whitsitt*, 212 Kan. at 760, 512 P.2d at 489.

\(^{109}\) 113 So. 2d 437, 439 (Fla. 2nd Dist. Ct. App. 1959).

\(^{110}\) *Triple-A Baseball Club Assocs. v. NE. Baseball, Inc.*, 832 F.2d at 223 (quoting *Hogan v. Norfleet*, 113 So. 2d at 439).

\(^{111}\) Id. (citing Restatement (Second) of Contracts § 360(b) cmt. c (Am. Law. Inst. 1981)).

\(^{112}\) Id. at 224 (citing Corbin, supra note 14, § 1142 at 117).
performance of the agreement to sell the Triple-A club was warranted. The agreement’s terms were unambiguous and therefore “there [wa]s no problem in drafting a clear order.” The owner of the Double-A team demonstrated its ability and willingness to perform and presented convincing evidence of its inability to purchase another Triple-A team. The Triple-A franchise had no “readily ascertainable market value,” it could not be “easily obtained” from other sources, and it was of “special interest” to the Double-A team owner. In short, the court ruled that because the Triple-A franchise was unique and “money damages, even if ascertained, could not 'obtain the duplicate or the substantial equivalent of the promised performance,'” specific performance was the appropriate remedy.

While Triple-A Baseball Club stands as authority for the issuance of an order of “specific performance of a contract for the sale of a franchise,” if the mandated sale of the franchise will result in an ongoing relationship between the parties, which was not the case in Triple-A Baseball Club or North American Financial Group, discussed above, suggests specific performance will be denied. As the Dunkin’ Donuts of America, Inc. court noted, “[a] request for specific performance of a franchise contract should be distinguished from a request for specific performance of a contract for the sale of a franchise, which may be granted,” at least, as North American Financial Group pointed out, where there will remain no ongoing relationship between the parties requiring the issuing court’s continuing supervision.

3. Specific Performance Resulting in a “Forced Marriage”

In virtually every case involving a request for specific performance maintaining a franchise relationship for the balance of the agreement’s term, the courts refuse such relief where it would require the court’s continuing supervision of the parties’ relationship and respective performances. Typically, these cases involve a franchisee’s efforts to enjoin its franchisor’s termination of the franchise. Importantly, specific performance often is denied without regard to whether the termination was proper or without good cause.

A leading case on point is Burger Chef Systems, Inc. v. Burger Chef of Florida, Inc. There, a Florida appellate court reversed the lower court’s injunction preventing the franchisor from terminating the parties’ franchise agreement. The court recognized the “individual characteristics of a franchise,” the “personal efforts and commitment on the part of the Franchisee to market the Franchisor’s products,” the “consideration given by Franchisee for the exclusive right to market Franchisor’s product” and the “singular personal service performed by a Franchisee in establishing the product of a Franchisor.” But, the court held, for an order of specific performance to issue there must be mutuality of obligation. Since the franchisee’s

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114 Id.
115 Id.
116 Id. (quoting Corbin, supra note 14, § 1142 at 117).
117 Dunkin’ Donuts of Am., Inc. v. Minerva, Inc., 956 F.2d 1566, 1575 n.5 (11th Cir. 1992) (emphasis in original).
119 Dunkin’ Donuts of Am., Inc. v. Minerva, Inc., 956 F.2d at 1575 n.5 (emphasis in original).
120 317 So. 2d 795 (Fla. 4th Dist. Ct. App. 1975).
121 Id. at 797.
obligations under the franchise agreement involved the performance of “personal services to [the] Franchisor,” and personal services “are not subject to a suit for specific performance[,]” mutuality of obligation was lacking, and therefore, specific performance was an improper remedy, the court ruled.122 Simply put, since the franchisor could not force the franchisee to continue to perform, it could not be forced to perform either.

Many of the reported decisions denying a franchisee’s request for an order of specific performance that would effectively “force a marriage” with its franchisor turn on this characterization of the franchisee’s obligations as personal services, which a court may not enforce by specific performance. Thus, for example, in Burger King Corp. v. Weaver123 and Burger King Corp. v. Agad,124 franchisees seeking to enjoin their franchisor’s termination of their franchise agreements were denied a specific performance remedy. In each case, the court cited to the Burger Chef Systems case for the proposition that franchise agreements are “personal services” contracts that may not be enforced by an order of specific performance.125 And both Weaver and Agad relied on the holding in North American Financial Group,126 discussed above, that franchise contracts are personal services contracts that may not be enforced by a specific performance order.

Even where an order of specific performance would require the issuing court to supervise performance for a relatively short period time, courts are reluctant to issue such orders. In Mercedes-Benz USA LLC v. Concours Motors, Inc.,127 for example, the importer and distributor of new Mercedes-Benz cars in the United States (“MBUSA”) sued one of its dealers for breach of an alleged agreement to build a dealership facility devoted exclusively to Mercedes-Benz cars. MBUSA sought an order of specific performance requiring the dealer to build the facility. The court granted summary judgment in the dealer’s favor, concluding that the dealer had not breached a side-letter to the parties’ dealership agreement calling for construction of the brand-exclusive facility.

However, the court went on to say that, even if the dealer had breached the side-letter, “I would still grant summary judgment on MBUSA’s breach of contract claim because the remedy elected by MBUSA—specific performance—is an inappropriate remedy.”128 To issue a specific performance order, the court explained, “I would have to supply all of the essential details. I would, for example, have to establish construction deadlines, identify the requirements of a site for [the dealer] to purchase, and determine whether [the dealer’s] design reasonably satisfies

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122 Id.
123 798 F. Supp. 684 (S.D. Fla. 1992). After having initially denied Burger King’s summary judgment motion on Weaver’s breach of an implied covenant claim, the Weaver court later granted Burger King’s summary judgment on that claim and the Eleventh Circuit subsequently affirmed that ruling. See generally Burger King Corp. v. Weaver, 169 F.3d 1310 (11th Cir. 1999).
125 Burger King Corp. v. Weaver, 798 F. Supp. at 692; Burger King Corp. v. Agad, 911 F. Supp. at 1506.
128 Id. at *7.
MBUSA’s facility criteria.”

And, the court stated, an order of specific performance would require “judicial supervision of an ongoing (and likely acrimonious) relationship.”

An interesting aspect of the decision is the court’s consideration that the dealer’s refusal to build the brand-exclusive facility, assuming there had been a breach, may have been an efficient breach “which the law does not want to deter, and that therefore MBUSA’s remedy should be damages”—which MBUSA had waived—“rather than specific performance.” The court noted that MBUSA had presented no evidence “showing that the benefits of constructing the new facility would outweigh the costs.”

The strong trend of holdings that franchise agreements are, at least in part, personal services contracts that may not be enforced by means of an order of specific performance may not apply in all contexts. A recurring scenario involves franchisees’ or their trustees’ efforts to assume or assign franchise agreements while in bankruptcy. In *In re Sunrise Restaurants, Inc.*, for example, a Burger King franchise filed a Chapter 11 petition and sought to assume and then assign its franchise agreements. Burger King opposed the proposed assumption and assignment on the grounds that, under 11 U.S.C. § 365(c)(1)(A), the franchise agreements were non-assignable personal services contracts, and under applicable state law, the transfer required Burger King’s consent, which Burger King refused to give. The court held that “[t]here is hardly any question that the relationship between [the] parties was nothing more than a strict business transaction to furnish economic gains to both contracting parties.” On that basis, the court overruled Burger King’s objection to the assumption and transfer.

Similarly, in *In re Tom Stimus Chrysler-Plymouth, Inc.* Chrysler opposed the debtor’s motion to assign its dealership agreement on the ground that the agreement was a personal service contract which required the dealership to be managed by the debtor’s principal. In granting the motion over Chrysler’s objection, the court observed that “several courts have construed § 365(c)(1) to prohibit the assignment of an executory contract only where the contract is truly personal and is based on a special knowledge skill or talent,” and that the court itself had previously held (in *In re Sunrise Restaurants*) that franchise agreements are not personal services contracts. The court thus overruled Chrysler’s objection and held the dealership agreement to be assignable.

Perhaps in response to cases like *In re Sunrise Restaurants* and *In re Tom Stimus Chrysler-Plymouth*, at least one franchisor took a different approach in opposing the assumption of a franchise agreement by its franchisee in bankruptcy. In *In re Kazi Foods of Michigan*,

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129 Id.
130 Id.
131 Id. at *8.
132 Id.
134 Id. at 153.
136 Id. at 679.
KFC opposed its franchisee’s efforts to assume its franchise agreements not on the
basis that they were personal services contracts, but instead on the basis that as a matter of
federal trademark law the franchisee could not assign the franchise agreements without KFC’s
consent. KFC argued that the assumption by a debtor-in-possession entails an assignment that
requires its consent as a matter of federal trademark law. The franchisee argued that the
assumption entailed no assignment because it was the franchisee and it merely sought to
assume its existing contracts. The court observed that substantial case law supported both
parties’ positions, but concluded after careful consideration that “KFC is correct in its view” and
on that basis denied the franchisee’s motion to assume the franchise agreements. 138

In Husain v. McDonald’s Corp., 139 the court seized on these bankruptcy court decisions
deciding to characterize franchise agreements as personal services contracts to reach the
conclusion, contrary to North American Financial Group, Burger Chef Systems, and similar
cases, that specific performance might be an appropriate remedy for the breach of a franchise
agreement. In that case, a McDonald’s franchisee with 12 units sought an order of specific
performance requiring McDonald’s to renew one of its units upon expiration. McDonald’s
opposed the franchisee’s preliminary injunction motion, arguing that franchise agreements are
“contracts for the personal services of the franchisee not subject, as a matter of law, to the
remedy of specific enforcement by either party in the event of a breach.” 140

In so arguing, McDonald’s relied on Woolley v. Embassy Suites, Inc., 141 where the
California Court of Appeals reversed a preliminary injunction enjoining an owner of numerous
hotels from terminating management agreements under which Embassy Suites managed the
owner’s hotels. The court of appeals concluded that the management contracts were personal
services contracts that could not be enforced by an order of specific performance.

The Husain court found Woolley distinguishable. In contrast to the management
agreements at issue in Woolley which called for services “as ‘distinctly personal and non-
delegable’ as the services of an actor or artist,” 142 the McDonald’s franchise agreement
“explains the essence of the ‘McDonald’s System’ is to ensure comprehensive control by
McDonald’s over every material aspect of the restaurant’s operations so the uniformity of the
McDonald’s customer experience could be assure at every one of its locations[.]” 143 Moreover,
the court cited to In re Sunrise Restaurants as support for the proposition that franchise
agreements are not personal services contracts and declined to follow Burger Chef Systems
and its progeny, finding the Burger Chef Systems opinion “devoid of any analysis supporting its
per se rule that no contract involving an element of personal service, including franchise
agreements, can be subject to specific performance.” 144

138 Id. at 890.
140 Id. at 376.
142 Husain v. McDonald’s Corp., 140 Cal. Rptr. 3d at 376 (quoting Woolley v. Embassy Suites, Inc., 278 Cal. Rptr. at
727).
143 Id. at 377.
144 Id. at 379.
B. Mandatory Injunctions in a Franchise Context: Different Judicial Approaches

One of the leading cases involving a franchisee’s request to enjoin a franchisor’s termination of the franchise *pendent lite* is *Original Great American Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd.* 145 After the franchisor terminated the franchise agreement based on the franchisee’s “rampant violations[,]” the franchisee continued selling cookies using the franchisor’s names and marks, and using unapproved product purchased elsewhere. 146 The franchisor sued for breach of contract and trademark violations and sought a preliminary injunction. The franchisee counterclaimed alleging that the termination violated the franchise agreement and the applicable state relationship law, and sought a preliminary injunction directing the franchisor “to restore” its franchise. 147 The lower court granted the franchisee’s motion and denied that of the franchisor.

The Seventh Circuit Court of Appeals reversed. First, the court found the franchisee’s claimed irreparable harm—its inability to continue to service its debt without the income the franchise generated—to be “a wobbly footing for a finding of irreparable harm,” especially given that the franchisor had offered to allow the franchisee to assign its franchise (and use the proceeds to pay off the debt). 148 In contrast, the harm to the franchisor—“being forced to continue doing business with a franchisee who not only committed rampant violations of the franchise agreement but also infringed the franchisor’s trademarks”—“is irreparable harm” that the franchisor “cannot eliminate [] by obtaining an award of damages . . . because no one supposes [the franchisee] capable of paying substantial damages.” 149 Furthermore, the court noted that the preliminary injunction “requires the parties to maintain a cooperative relationship for its duration by enjoining the [franchisor] ‘from failing and refusing to sell cookie batter, accessories and promotional items as needed and requested by [the franchisee].’” 150 Therefore, the injunction “imposes a continuing duty of supervision on the issuing court, and this can be a drain on scarce judicial resources. Courts should be, and generally are, reluctant to issue ‘regulatory’ injunctions, that is, injunctions that constitute the issuing court an ad hoc regulatory agency to supervise the activities of the parties,” the court held. 151

*Original Great American Chocolate Chip Cookie Co.* illustrates that where a termination is deemed proper, courts will decline to grant franchisees injunctions. On the other hand, where a franchisee makes the necessary preliminary showing of likelihood of success on the merits, courts may find irreparable harm and issue a preliminary injunction *pendent lite* in spite of the possible welding together of two antagonistic parties for the duration of the case. 152

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145 970 F.2d 273 (7th Cir. 1992).
146 Id. at 277.
147 Id. at 275.
148 Id. at 277.
149 Id.
150 Id.
151 Id.
An early and oft-cited example of the latter scenario is Semmes Motors, Inc. v. Ford Motor Co.153 Semmes involved the termination of a Ford automobile dealership in Scarsdale, New York. The dealer had owned and operated the dealership for over 20 years. The dealer’s principal had also been active in the formation of a Ford dealer association whose main purpose was “the protection of dealers from abuse of the franchise system run by Ford.”154 The dealer claimed its termination was in retaliation for its role in forming the association. Ford claimed its termination was in response to the dealer’s fraud. The lower court granted the dealer’s motion to enjoin the termination of its dealership pending the outcome of this and related litigation in another federal court. On appeal, the Second Circuit affirmed that ruling.

Central to its affirmance was the appeals court’s observation that, as the lower court had concluded, “the balance of the hardships tips decidedly toward plaintiff.”155 The court deemed Ford’s contention that the dealer had failed to show irreparable harm from the termination “wholly unpersuasive.”156 The court acknowledged that the dealer’s past profits “would afford a basis for calculating damages for wrongful termination, and no one doubts Ford’s ability to respond.”157 Nevertheless, “the right to continue a business in which William Semmes had engaged for twenty years and into which his son had recently entered is not measurable entirely in monetary terms; the Semmes want to sell automobiles, not to live on the income from a damages award.”158 “[A] ‘judgment for damages acquired years after his franchise has been taken away and his business obliterated is small consolation to one who, as here, has had a Ford franchise’ for many years,” the court stated.159

In contrast to the dealer’s irreparable harm, the harm “to Ford in continuing the Semmes dealership pendent lite was relatively small[,]” the court held.160 Ford did not claim the dealer did not represent Ford in its market, and the record indicated that the dealer’s submission of false claims—the basis for the termination—“has been greatly reduced, if not eliminated.”161 Ford argued that it would be irreparably harmed “by forcing it to continue to be represented in an important vehicle market by a dealer which it has discovered to be unworthy of trust and by


153 429 F.2d 1197 (2d Cir. 1970).

154 Id. at 1199.

155 Id. at 1205 (internal quotation marks omitted).

156 Id.

157 Id.

158 Id.

159 Id. (quoting Bateman v. Ford Motor Co., 302 F.2d 63, 66 (3d Cir. 1962)).

160 Id.

161 Id.
preventing it for years from making or implementing decisions affecting the Scarsdale area."  

The court rejected this argument noting that “whether Semmes is in fact unworthy of trust in one of the very points at issue, and there need be no delay of years unless Ford wills it so.”

C. Equitable Remedies in States with Franchise Relationship Laws

Several states have passed relationship laws intended to protect existing franchisees’ rights and to restrict certain powers of franchisors, including the franchisor's right to terminate the franchise relationship.163 Some of these state relationship laws require good cause for termination.164 Certain statutes define good cause, but the definition varies from state to state. For example, in Minnesota “good cause” is defined as failure by the franchisee to substantially comply with the material and reasonable franchise requirements imposed by the franchisor.165 In Iowa, however, “good cause” for termination is defined as cause based “upon a legitimate business reason” and “includes the failure of the franchisee to comply with any material lawful requirement of the franchise agreement,” but the Iowa statute prohibits terminations by the franchisor that are deemed “arbitrary or capricious.”166

In franchise litigation, a franchisor’s ability to use the doctrine of efficient breach as a defense to a breach of contract claim seeking exemplary damages or equitable relief may be limited by these relationship laws' good cause requirements. By contrast, relationship laws are not likely to impair the rights of franchisees to utilize an efficient breach defense.

Case law interpreting the “good cause” requirement in each state will be essential to determining whether a franchisor can use the doctrine as a defense. Courts in various jurisdictions with “good cause” requirements have nonetheless determined that the following conduct constitutes a justifiable basis for termination: (1) underreporting sales or failing to report sales or pay royalties; (2) failing to maintain standards and other contractual requirements; (3) failing to meet sales and other performance requirements; (4) commercial conflicts of interest; (5) behavior that damages the franchisor’s brand reputation; (6) a franchisor’s withdrawal from its business, either in a particular line of products or a specific geographic area; and (7) incurable conduct by the franchisee.167

In general, the application of state relationship laws tends to favor franchisees. However, as demonstrated herein, if a franchisor is able to meet the requirements of state relationship laws by demonstrating “good cause” for termination, then the franchisor may find itself with a clear road to utilizing an efficient breach defense.

162 Id.

163 See, e.g., MINN. STAT. ANN. § 80C.14(3)(b) (West); see, e.g., N.J. STAT. ANN. § 56:10-5 (West); see, e.g., IOWA CODE ANN. § 523H.7(1) (West); see generally Kerry L. Bundy & Robert M. Einhorn, Franchise Relationship Laws, Fundamentals of Franchising 183-232 (Rupert M. Barkoff et al. eds., American Bar Association 4th ed. 2015).

164 See Bundy & Einhorn, supra note 163, at 183-196 (citing various state franchise laws requiring good cause for termination).

165 MINN. STAT. ANN. § 80C.14(3)(b).

166 IOWA CODE ANN. § 523H.7(1).

167 See generally Bundy & Einhorn, supra note 163, at 183-202.
VII. ADDITIONAL THOUGHTS ON PRACTICAL APPLICATION OF THE EFFICIENT BREACH DOCTRINE

For academics, the efficient breach doctrine creates a moral and ethical conundrum that has been explored in depth. From a practical standpoint, the case law resolves little of the doctrine’s ambiguity. In practice, efficient breach appears to be best asserted as an affirmative defense. When asserting the defense, practitioners should be mindful of their jurisdiction and should incorporate some of the lessons set forth in the case law presented herein, as follows.

First, as the Conagra\textsuperscript{168} and Norfolk Southern Railway\textsuperscript{169} cases illustrate, courts are likely to look more favorably on parties that communicate their intent to efficiently breach a contract and offer expectancy damages upfront. Accordingly, proactively creating a paper trail detailing the breaching party’s overtures prior to the breach may support an efficient breach defense. However, where practitioners are concerned as to the risk of potentially repudiating a contract or defending a claim of anticipatory breach, they should take care to frame their overtures as potential settlements of a dispute, as opposed to threats to breach. In so doing, practitioners can use efficient breach to create leverage for the renegotiation of contract terms. When faced with a potential breach and an offer of compensatory damages, the non-breaching party may very well be open to negotiating more favorable terms. Promisees whose adversaries assert an efficient breach defense might take advantage of these negotiations by leveraging any ambiguities in calculating damages (\textit{i.e.}, by arguing that they are entitled to “exchange damages” in addition to “expectancy damages” among other things). Where damages are difficult to calculate, a court may well opt to impose an equitable remedy.

Second, practitioners seeking to assert an efficient breach defense should characterize their client’s motivations according to the controlling law in their jurisdiction. Unfortunately, there is no bright-line test governing what constitutes “permissible financial goals” and what constitutes “dishonest purpose, bad faith, or moral obliquity,” but practitioners should seek to frame their client’s goals in a way that best allows their client to pursue a better deal.\textsuperscript{170} Practitioners should be aware of their client’s potential assumption of risk in the contract, and how that might prevent their client from attempting to reassign that risk later.\textsuperscript{171} Promisees seeking to avoid an efficient breach should attempt to frame the breaching party’s actions in a way that appears opportunistic, manipulative or predatory, and should emphasize any facts showing that the breaching party accepted risks inherent in the deal.

Third, practitioners should run through the cost-benefit analysis set forth by the Walgreen court,\textsuperscript{172} taking into account factors such as the term remaining on the contract, the

\textsuperscript{168} Conagra, Inc. v. Nierenberg, 301 Mont. 55, 7 P.3d 369 (2000).


\textsuperscript{170} Compare Bhole Inc. v. Shore Invests., Inc., 67 A.3d 444 (Del. 2013) (holding that third party’s assumption of lease and subsequent breach of lease in favor of a more lucrative contract was in pursuit of “permissible financial goals” and thus efficient) and Avis Rent A Car Sys., LLC v. City of Dayton, No. 3:12-CV-399, 2015 WL 5636897 (S.D. Ohio Sept. 25, 2015) (holding that a city official’s intention to pursue the best possible deal for the city and attempt to minimize a waste of resources was efficient) with Patton v. Mid-Continent Sys., Inc., 841 F.2d 742 (7th Cir. 1988).

\textsuperscript{171} See generally N. Ind. Pub. Serv. Co. v. Carbon Cnty. Coal Co., 799 F.2d 265 (7th Cir. 1986) (holding that even where defendant sought better use of public resources and the breach would result in a more economical benefit favored by society, that defendant was precluded from using efficient breach as a defense where it assumed the risk of changing markets and thus, could not avail itself of a better deal).

\textsuperscript{172} Walgreen Co. v. Sara Creek Prop. Co., B.V., 966 F.2d 273 (7th Cir. 1992).
level of court supervision required to enforce an equitable remedy such as specific performance or injunctive relief, and whether damages can be accurately calculated. With regard to whether damages can be accurately calculated, parties should consider the concept of efficient breach when drafting franchise documents utilizing tools such as liquidated damages provisions with a mind toward efficient breach.

Fourth, all practitioners should be aware of the arguments for and against construing franchise agreements as service contracts in their jurisdiction. Likewise, practitioners should be mindful of any applicable franchise relationship laws.

VIII. CONCLUSION

The efficient breach theory recognizes that in certain circumstances a breach of contract is salutary and should be encouraged, and posits that the remedy for an efficient breach should be limited to an award of the non-breaching party’s expectation damages, namely, what it would have received had the contract been performed. But application of the theory remains encumbered by considerations of the breaching party’s motives, by statutorily imposed enhanced damages for breaches tainted with evil motive or fraud, by laws requiring that there be good cause for termination, and the common difficulty to ascertain with sufficient certainty the non-breaching party’s injury. And the theory raises secondary questions, such as the potential tort liability of third parties who induce an efficient breach, what may have motivated the inducement, and the fine distinction between intent to act and intent to interfere.

These questions will be answered in time, and those answers are important to franchising. Like all contracting parties, franchisors and franchisees alike would benefit from the ability to extricate themselves from relationships that are no longer advantageous knowing with certainty what the cost will be to do so. Courts (and legislatures) have been slow to recognize the efficient breach theory and its implications in terms of available contract remedies. In making intentional and calculated decisions to breach inefficient contracts, parties and their counsel should consider whether the contemplated breach is in fact salutary, be prepared to communicate clearly the breaching party’s rationales, and help courts understand why all are best served by limiting to the remedy what the other party expected to gain from the deal.

173 See, e.g., Burger Chef Sys., Inc. v. Burger Chef of Fla., Inc., 317 So. 2d 795 (Fla. 4th Dist. Ct. App. 1975) (holding that franchise systems are personal service contracts, and thus, extensive court supervision would be required to enforce an order of specific performance).

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Fredric A. Cohen is a co-founding member of Cheng Cohen LLC in Chicago, Illinois. Ric represents franchisors in litigation and arbitration in courts and arbitral forums across the country. In his spare time he cooks.
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