Enforcing the Bargain or Buying Your Way Out? The Right to Specific Performance in Franchise Agreements Versus the Concept of Efficient Breach

Authors:
Fredric A. Cohen, Cheng Cohen, LLC
Mackenzie L. Dimitri, Einbinder Dunn & Goniea LLP
The Efficient Breach Doctrine

• Some breaches are beneficial.

• Which breaches might qualify? What criteria should be used?

• Counteracts “extreme remedies” such as punitive damages, disgorgement, or equitable remedies.

• Impact on franchising?
Context; Breach of Contract Damages, Generally

• Contract remedies, traditionally.

• Expectation Damages = Loss in value to promisee + Other loss caused by the breach - Cost or loss avoided by not having to perform.

• If breaching party gains enough to compensate promisee for losses there is incentive to breach.
Types of Efficient Breach; Two-Party Model

• Franchisor seeks to breach after costs rise.
• Options, pursuant to EBD.
• Assumptions:
  • Economic Gain and Damages Calculable. *Walgreen Co. v. Sara Creek Property Co.*, B.V.
  • Contract Terms.
Types of Efficient Breach; Third-Party Inducement

• New Franchisee induces breach by Franchisor by offering to pay more money for goods.

• Is performance an asset?

• Promisee’s litigation options – claims for damages, specific performance, and tortious interference.

• Franchisor uses EBD as an affirmative defense.

  • Beware of different court’s characterizations of “efficient.” C.f. Patton v. Mid-Continent Sys., Inc. with Bhole Inc. v. Shore Investments, Inc.
Common Objections

• Practical objections:
  • Expectation damages measurable.
  • Cost of calculating damages.

• Theoretical objections:
  • Parties do not negotiate with breach in mind (implicit buy-out option?)
  • Performance may not be remedied by monetary damages.
  • Societal impact.
How do Courts determine if breach is efficient?

• Communicating intent to breach and offering to pay expectation damages are evidence of good faith. See *Conagra, Inc. v. Nierenberg* and *Norfolk Southern Railway Co., v. Basell USA, Inc.*

• Bad faith breaches can be efficient if promisee is not damaged. *Patton v. Mid-Continent Systems, Inc.*

• Permissible financial goals. *Bhole, Inc. v. Shore Investments, Inc.*

• The “manager’s privilege.” *Huynh v. Vu.*
How do Courts encourage efficient breach but discourage opportunistic breach?

• Shifting risk analysis. *Northern Indiana Public Service Co.*
  • Where a contract assigns risk to one party, that party cannot later shift the risk and use EBD as a means to avoid liability.

• Attorneys’ fees. *Avis Rent A Car System, LLC.*
  • Imposing attorneys’ fees upon finding of bad faith is akin to smuggling a tort remedy into a contract proceeding. Even so, there is room for moral evaluations of breach.
Alternatives to EBD; Equitable Remedies

• Breach of contract remedies, traditionally.

• Equitable remedies, the big three:
  • (1) Specific Performance;
  • (2) Injunctions; and
  • (3) Rescission.

• Remedies other than expectation damages are the exception. See Restatement (Second) of Contracts.
Cost-Benefit Analysis of Equitable Remedies vs. Damages; The *Walgreens* Analysis.

• Imposing equitable remedies has two benefits: (1) shifts burden of determining cost of performance to the parties; (2) private negotiation is most accurate method of determining damages.

• Certain equitable remedies result in costs to court or third parties.
Equitable Remedies in Franchise Cases

• Franchise Agreements as bilateral personal services contracts.

• Specific performance of personal service contracts?

• Specific performance of particular covenants. *i.e.* post termination obligations.

• Mandatory injunctions; will courts impose a ‘forced marriage?’

• State relationship laws.
Practical Application

• Communicate intent to breach; offer expectancy damages upfront.

• Characterizations of client’s motivations in initial settlement discussions. *i.e.* *pursuing permissible financial goals.*

• Cost-benefit analysis.

• Are franchise agreements considered service contracts in your jurisdiction?