Relational and Discrete Contracts and Remedies Requiring Supervision: Same Principles?

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The argument that the equitable remedy of specific performance should not be available because of supervision problems is generally persuasive. The nature of a contract and the appropriateness of the remedy of specific performance, as opposed to damages are closely intertwined concepts. The remedy is more readily available for discrete contracts. The franchise contract, a commercial contract is also referred to as an ongoing relational contract and the remedy is generally more limited in Australia and New Zealand compared to other jurisdictions. Supervision possibilities should be balanced in light of the performance expectations of the party entitled to the relief.

INTRODUCTION

Generally the principles of contract law apply to all contracts, but contracts differ substantially in nature. Some are classified as commercial contracts but there are other classifications such as employment, agency and consumer contracts. To ensure fairness, in certain cases Parliament has passed legislation to protect the party in the unequal position. Also, the courts endeavour to take into account any differences in the bargaining powers of the parties. Relational and discrete classifications have been utilised by the courts, but not all contracts fall into specific categories as the ultimate result depends on the facts of the case. Contracts categorised as relational include franchise agreements[1] joint ventures[2], employment contracts[3] and agency agreements[4]. Discrete or transactional contracts are those relating to a single event that are characterised by simultaneous exchanges, such as agreements for sale and purchase. The nature of the contract and the appropriateness of the remedy of specific performance, as opposed to damages, are closely intertwined concepts.

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1 *Bilgola Enterprises Ltd v Dymocks Franchise Systems (NSW) Pty Ltd* [2000] 3 NZLR 169 (Court of Appeal).

2 *McLachlan v Mercury Geotherm Ltd (in rec)* [2006] UKPC 27; (2006) 7 NZCPR 135.

3 *Johnson v Unisys Ltd* [2001] UKHL 13; [2003] 1 AC 518; [2001] 2 WLR 1076; [2001] 2 All ER 801.

4 *Stanley v Fuji Xerox New Zealand Ltd* [1997] High Court. Auckland CP479/96, (5 November 1997).

The difficulty of courts supervising contracts has always been a major block to the enforcement of contracts. As was stated by Dixon J in *J C Williamson Ltd v Lukey and Mulholland,* "specific performance is inapplicable when the continued supervision of the Court is necessary in order to ensure the fulfilment of the contract."[5] A franchise relationship which is built on trust requires reciprocity, therefore, specific performance would not be appropriate if the relationship falls apart. However, this is not of invariable application as in some jurisdictions the remedy has been available.

In *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd,* Justice Finn used the classification 'relational contract' to describe 'a contract that involves not merely an exchange, but also a relationship, between the contracting parties.'[6] His Honour noted 'as is well accepted, that particular rules of contract law have greater or less ease of application in relational contract settings.'[7] He suggested that "account should be taken of such contracts as we shape and develop contract law."[8] Does equity take account of such contracts in considering the remedy of specific performance?

This paper will consider with particular emphasis on Australia and New Zealand, the relational classification of franchise contracts and whether the remedy of specific performance should be more readily available in light of the expectations of the party entitled to the remedy.

The Relational Classification

Ian Roderick Macneil[9] and Stewart Macaulay[10] are credited with inventing relational contract theory in the 1960s. In his introductory comments to a paper in 1985, Macneil stated: 'My students, for example, all know that I invented relational contract, and I daresay Stewart Macaulay's students all know that he invented relational contract. Charles Fried knows that relational contract was invented by the Devil.'[11]

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5 *J C Williamson Ltd v Lukey and Mulholland* (1931) 45 CLR. 282, 297-298.

6 *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 163, [224].

7 Ibid.

8 Ibid.

9 See for example Ian R Macneil, 'The Many Futures of Contracts' (1974) 47 *Southern California Law Review* 691; 'Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law' (1978) 72 *Northwestern University Law Review*854; 'Relational Contract Theory: Challenges and Queries' (2000) 94 *Northwestern University Law Review* 877.

10 Stewart Macaulay, 'Non-contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55.

11 Ian R MacNeil, 'Relational contracts: What we do and we do not know'1985 *Wisconsin Law Review* 483.

Traditionally a contract is viewed as a discrete transaction. Macneil defines a discrete contact as 'one in which no relation exists between the parties apart from the simple exchange of goods.' He adds 'every contract, even such a theoretical transaction involves relations.'[12]

Macneil's view of contracts is that they lie on a continuum with the relational spectrum of contractual behaviour at one end and the non-relational contracts, typified by discrete transactions, at the other. Ultimately he takes the view that all contracts are relational but some are more relational than others. Goetz and Scott take a more promise-based approach. The contract is 'relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations.'[13] Their theory differs from that of Macneil but effectively they adopt similar solutions for situations outside the contract. What must be emphasised is that none of these theories specifically analyses one type of relational contract but rather they consider relational contracts as a class.

References in case law to the relational classification are sparse, whereas there is no shortage in academic writings as to the relational classification of franchises. In *Dymocks Franchise Systems (NSW) Pty Ltd v Bilgola Enterprises Ltd* Hammond J described the franchise as a 'relational contract in which a working, ongoing relationship is set up for the mutual benefit of both parties. And, from an economic point of view, what is central is the joint maximisation of economic benefits.'[14] The Privy Council did not adopt His Honour's terminology but it did acknowledge that franchises are 'not ordinary commercial contracts but contracts giving rise to long-term mutual obligations in pursuance of what amounted in substance to a joint venture and therefore dependent upon coordinated action and cooperation.'[15] In *David v TFAC Ltd*, the protective policy of the Fair Trading Act 1986 (NZ) was not applicable on the facts. The Court of Appeal characterised the franchise as based on 'commercial transactions involving substantial independently-advised parties negotiating from positions of equality.'[16]

The Franchise Structure

The franchise contract has been given various classifications ranging from relational contract to commercial, and it has been described as being closely analogous to an employment contract. In the New Zealand Court of Appeal case

12 Ian R Macneil, *The new Social Contract* (Yale University Press, New Haven and London, 1980), 10.

13 Charles J Goetz and Robert E Scott, 'Principles of Relational Contracts' 67 *Virginia Law Review* 1089.

14 *Dymocks Franchise Systems (NSW) Pty Ltd v Bilgola Enterprises Ltd* (1999) 8 TCLR 612 (High Court), 652-653.

15 *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] 1 NZLR 289 (Privy Council), [63].

16 *David v TFAC Ltd* [2009] NZCA 44; [2009] 3 NZLR 239; (2009) 9 NZBLC 102,562 , [61].

Skids Programme Management Ltd v McNeill,[17] at issue was a restraint of trade clause in a franchise agreement. The Court did not consider it was necessary to try to categorise franchise contracts but noted that a franchise contract may be closer to an employment contract[18] than a vendor/purchaser contract:

> Unlike the position in a vendor/purchaser context where the grantor of the restraint of trade clause has received a sum of money from the grantee, the grantor of the restraint of trade clause in a franchise context has in fact paid money itself to the grantee, rather than receiving money. [19]

However, this is not of universal application and depending on the facts the franchise may be closer to a vendor / purchaser contract. Lord Steyn in his judgment in the House of Lords decision *Johnson v Unisys,*[20] was of the view that the employment contract was not a commercial contract but could possibly be described as a relational contract.

Strictly speaking, the franchise is not a business but a method or structure for doing business. Isaac Singer is regarded as being the founder of franchising after he utilised a distribution method for his sewing machines in 1851, but McDonalds founder Ray Kroc is generally credited with being the founder of business-format franchising. McDonalds is a prime example of business-format franchising. The franchisee's business will resemble that of the franchisor in that the franchisee is licensed to use the entire business concept for the management and operation of the business. With the development of this concept franchising expanded rapidly, particularly in the food industry.

Worldwide, business-format franchising has been an extremely successful commercial relationship. Some jurisdictions such as the United States, Australia[21] and South Africa[22] have extensive legislation governing the relationship, but others such as the United Kingdom and New Zealand have no specific legislation governing franchises.

The 1997 report of the Australian House of Representatives Standing Committee on Industry, Science and Technology outlined the nature of the system:

> [U]nder the system, the franchisor, holding property rights over a marketing system, business service or product (identified by a brand

17 *Skids Programme Management Ltd v McNeill* [2013] 1 NZLR 1.

18 Cf *Husain v McDonald's Corp* 2012 Cal App 515 (Cal Ct App Apr 30, 2012). The Court held that a franchise, a close personal working relationship is not a contract for personal services.

19 *Skids Programme Management Ltd v McNeill* [2013] 1 NZLR 1, [50].

20 *Johnson v Unisys* [2003] 1 AC 518, [20].

21 The *Franchising Code of Conduct* is contained in the Schedule to *Trade Practices (Industry Codes – Franchising) Regulation 1998* prescribed under Pt IVB of the *Competition and Consumer Act 2010 (Cth).*

22 Consumer Protection Act 68 of 2008.

> name or trademark) enters a contract or agreement with the franchisee and grants, under certain conditions, the right to use a business brand name or trademark and the right to produce or distribute the franchisor's product or service.
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> Substantial benefits exist for both franchisees and franchisors under the system. The franchisor derives income from any initial franchising fee and from access to a continuing cash flow through product sales and from licence fees without having to provide additional capital or to directly manage the franchisee. The franchisor gains from access to established business systems, developed products or services, training and business advice, group advertising and lower risk.[23]

Academics emphasise various relational characteristics for the franchise contract, such as the "off the contract" interaction.[24] In her seminal article, Hadfield states that 'the parties are not strangers; much of their interaction takes place "off the contract," mediated not by visible terms enforceable by a court, but by a particular balance of cooperation and coercion, communication and strategy'. [25] Terry also emphasises the "off the contract interaction which requires 'a deliberate measure of communication, co-operation, and predictable performance based on mutual trust and confidence.'[26]

Spencer discusses the relational franchise as being:

> [d]efined by features of incompleteness and longevity. Relational contracts must be flexible, sometimes to the point of being vague. There is often a high level of discretion accorded to the parties, and such contracts therefore rely heavily on reciprocity and on trust that develops over time between the contracting parties. [27]

23 House of Representatives Standing Committee on Industry, Science and Technology Finding a Balance: Towards Fair Trading in Australia, 83/1997, <http://www.aph.gov.au/Parliamentary_Business/Committees/House_of_Representatives_Committees?url=report_register/bycomlist.asp?id=168>

24 Gillian K Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts' (1990) 42 *Stanford Law Review* 927, 928.

25 Ibid.

26 Andrew Terry 'Franchising, Relational Contracts and the Vibe' (2005) 33 *Australian Business Law Review* 289, 291.

27 E Spencer Submission 39 to Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Franchising Code of Conduct, September 2008 at p7. In the New Zealand High Court case, *Barrie v Nature Discoveries Ltd* [2012] NZHC 209, [129] – [130] Simon France J rejected the submission 'that the relationship of franchisor and franchisee is inherently fiduciary in nature....The franchisor/franchisee relationship is not one which engenders expectations of trust, loyalty and confidence, and an expectation that the franchisor will not act out of self-interest.' However, His Honour considered that it could not be ruled out. Particular aspects might attract fiduciary obligations. A possibility was where, for example, a franchisor controlled supply and had the sole power to negotiate the purchase of goods from a supplier. But the whole relationship was not inherently fiduciary.

The main qualifying characteristics of franchise contracts are incompleteness and the length of the contract, but should this make a difference in terms of equitable remedies? The "off the contract" interaction would militate against specific performance but in certain situations, such as the franchisor unreasonably refusing to consent to a transfer, the remedy would be appropriate. In such a case it would be beneficial for a franchisee to enforce provisions of the contract, particularly post-termination provisions.

Generally, the franchise agreement will cover renewal, and in all probability strict conditions will apply which may include the payment of a renewal fee. Renewals are important for a franchisee as the inability to renew may mean a loss of anticipated returns, with this being an area where specific performance would be a particularly appropriate remedy. Australia recently introduced an amendment to its Franchising Code of Conduct requiring franchisors to notify franchisees, at least six months before the franchise ends, whether or not the franchise will be renewed. New Zealand franchisors have no such obligation, as New Zealand has no relevant legislation, nor does the Code of Practice of the Franchise Association of New Zealand have such a requirement.

Renewals and the lack of renewal continue to create difficulties for the parties. The lack of renewal could cause hardship for a franchisee who has invested substantial amounts in setting up the franchise. If the franchisor refuses to renew and then sells to a third party the benefit of that investment is lost to the first franchisee. Franchisors can update their agreements in limited circumstances. In some cases the amendment has not assisted clarification of what the exact changes would be,[28] which introduces a lack of precision for the Court. As will be discussed below, this difficulty highlights one of the reasons against specific performance.

The recent Australian Review of the Franchising Code of Conduct[29] contained various recommendations including 11[30] and 12[31] relating to the transfer renewal

28 See submission of the Franchising Law Committee, Queensland Law Society to the 2013 Review of the Franchising Code of Conduct, [24].

29 Alan Wein Review of the Franchising Code of Conduct, 30 April 2013.

30 11. That subclause 20(4) of the Code be amended to read:
- a. The franchisor is taken to have given consent to the transfer or novation if the franchisor does not, within 42 days after the request was made, or all information reasonably required by the franchisor under the franchise agreement has been provided, whichever is the latter, give to the franchisee written notice:
- (i) that consent is withheld; and
- (ii) setting out why consent is withheld.
- b. The franchisee should take all reasonable steps to provide all information required under the franchise agreement to enable the franchisor to be able to properly evaluate the request. [Amendments underlined]

31 12. The Code be amended to state that, if all of the following conditions are satisfied:
- a. The franchisee wishes to have the franchise agreement renewed on substantially the same terms;
- b. the franchisee is not in breach of the agreement;
- c. the agreement does not contain provisions allowing a franchisee to make a claim for

or end of a franchise agreement. Recommendation 9 which covered good faith (and confidentiality of contact details for ex-franchisees) recommended that The Code be amended to include an express obligation to act in good faith' [and that] 'such an obligation should …. expressly exclude an argument that a franchisor has not acted in good faith because there is no term in a franchise agreement specifying a right of renewal.'

Specific performance – the exceptional remedy

It is well–established that specific performance is an exceptional remedy available in equity only as a discretionary remedy where damages would be an inadequate remedy. In his dissenting judgment in the Court of Appeal in *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd,* Millett LJ expressed the matter in this way:

> Equitable relief is discretionary and exceptional. Courts of equity have never enforced the performance of all contracts, whatever their nature. Over the centuries rules of practice have evolved so that the parties can know in advance which contractual obligations will be specifically enforced and which sound in damages only. The leading principle is usually said to be that equitable relief is not available where damages are an adequate remedy. In my view, it would be more accurate to say that equitable relief will be granted where it is appropriate and not otherwise; and that where damages are an adequate remedy it is inappropriate to grant equitable relief. [32]

In *Co-operative Insurance Society v Argyll Stores*[33]*,* the appellant Argyll Stores (Holdings) Ltd (Argyll) was the major lessee in a shopping centre. After sixteen years of the thirty-five year lease, it decided to close its Safeway supermarket because it was losing money. Co-operative Insurance Society (CIS) was concerned about the impact on the centre and the remaining businesses, and sought specific performance. Argyll was specifically ordered to perform the covenant. The majority of the Court of Appeal made a final injunction ordering Argyll to keep the premises open. The tenant's obligations were sufficiently defined and it was not in its interest to run the business inefficiently. All the Judges took a poor view of Argyll's conduct. Leggatt LJ noted it had acted 'with gross commercial cynicism' on Argyll's part, and he stated:

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compensation in the event that the franchise is not renewed;

d. the franchisee abides by all confidentiality clauses in the agreement and does not infringe the intellectual property of the franchisor; and
e. the franchisor does not renew the franchise agreement;

any restraint of trade clauses in the franchise agreement which prevent the franchisee from carrying on a similar business in competition with the franchisor, are not enforceable by the franchisor against the franchisee.

32 *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1996] Ch. 286, 304.

33 Ibid

> This is not a court of morals, but there is no reason why its willingness to grant specific performance should not be affected by a sense of fair dealing."[34]

Lord Justice Millett, dissenting, acknowledged the importance of 'the commercial expectations of the parties at the time when they entered into their contractual obligations.'

On appeal, the House of Lords unanimously reversed the decision of the Court of Appeal. It held that the contract was not specifically enforceable because the discretionary remedy would not be ordered if it required a person to carry on a business. Lord Hoffmann penned the decision and upheld Millett LJ's dissenting judgment in the Court of Appeal, which emphasised the commercial expectations of the parties to the contract.

His Lordship outlined the applicable principles and noted that the refusal to grant specific performance in the case of a defendant being required to carry on a business includes reasons other than damages being an adequate remedy. Constant supervision by the court included the possibility of repeated applications to the court due to the supervision requirements and the limited means of enforcing specific performance. The quasi-criminal contempt weapon if a party breaches the order is a heavy-handed enforcement mechanism. His Lordship noted the ruinous impact of committal proceedings on a commercial reputation and the financial effects of litigation on the parties and the judicial system resources. Possible repeated applications could arise in cases where a party sought specific performance to carry on an activity such as running a business. The same possibility was not likely where a party was required to achieve a stated result, such as building contracts and repair covenants. Specific performance will be more readily available in the latter case, providing there are no other bars to granting the remedy. There was the possibility of substantial costs being incurred when a party was required to return to court. In some cases a plaintiff could be enriched by the defendant paying to be released from the order. His Lordship observed that from a wider perspective:

> [i]t cannot be in the public interest for the courts to require someone to carry on business at a loss if there is any plausible alternative by which the other party can be given compensation. It is not only a waste of resources but yokes the parties together in a continuing hostile relationship.[35]

The reasoning is open to attack as it seems to weigh heavily in favour of the defendants and it ignores the performance aspect of contracts.[36]

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34 Ibid 295

35 Ibid 15-16.

36 See discussion below. A possible alternative could be cost of cure damages where appropriate.

Spry,[37] who prefers the approach of the Court of Appeal, criticises the fact that Lord Hoffmann's reasoning is not 'a proper application of equitable principles' and that a commercial approach has been adopted. The defendant's deliberate breach and prospective prejudice to the plaintiff and third parties were matters in favour of granting specific performance. Certainly, the courts have since *Argyll* ordered specific performance when justice so demands which requires a balancing of policy factors, in addition to taking into account hardship and prejudice.

The High Court of Australia in *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia*[38] took a broad view of Lord Hoffmann's principles in *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd.*[39]. The High Court considered that what was involved was not an absolute restriction but a question of degree. Their Honours opined that the House of Lords accepted that the concept of constant supervision by the court by itself was 'no longer an effective or useful criterion for refusing a decree of specific performance'.[40] They referred to Lord Hoffmann's other propositions:

> First, a person who is subject to a mandatory order attended by contempt sanction (which 'must realistically be seen as criminal in nature') ought to know with precision what is required; and, second, the possibility of 'repeated applications for rulings on compliance' with orders requiring a party 'to carry on an activity, such as running a business over a more or less extended period of time' should be discouraged.

Spry criticises this High Court decision, and in particular the above joint-judgment statement to the effect that 'constant supervision by the court' is no longer a bar to specific performance, saying that the statement misrepresents the views of the House of Lords.[41] He argues that it is incorrect to say that the well-established principles have been abandoned.[42] The *Maritime Union of Australia* case can only be supported if it is explained by reference to the well-established principles. With respect, it is difficult to agree with the High Court of Australia, that 'constant supervision' is no longer a bar, rather than with the House of Lords which explained the meaning of the bar.

In New Zealand, the discretionary nature of the remedy was emphasised in *Attorney General for England and Wales v R*[43]. The principle in *Argyll Stores,*

37 I C R F Spry, *The Principles of Equitable Remedies* (Lawbook Co Sydney, 8th ed, 2010) 672.

38 *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union* (1998) 195 CLR 1.

39 *Co-operative Insurance Society Ltd v Argyll Stores Ltd* [1998] AC 1, 12.

40 Ibid 14-15 (Brennan CJ, McHugh, Gummow, Kirby and Hayne JJ).

41 Spry, above n 37, 674.

42 Ibid.

43 *Attorney General for England and Wales v R* [2002] 2 NZLR 91 (CA), [94] per Tipping J. This was an appeal against the refusal to grant an injunction to restrain R, a former member of the SAS a book about events in which he was involved in the Gulf War in 1991.The Court of Appeal held that R would be liable to account for all his profits. R's appeal to the

'specific performance is normally granted when damages or other financial relief would be inadequate,' was adopted in New Zealand in *Attorney General for England and Wales v R.*[44] Tipping J stated that it was a "general but not immutable principle" which "must be exercised in a principled way.'[45] The principle is "not immutable" but it is clear from Lord Hoffmann's judgment that in the case of businesses 'it is the settled and invariable practice of this court never to grant mandatory injunctions requiring persons to carry on business.'[46]

For some business arrangements, supervision is not an insurmountable hurdle. If there is sufficient detail there is unlikely to be numerous applications to the court, as keeping intact the reputation of both parties is a persuasive factor for business parties.

Application to franchises

Is specific performance an appropriate remedy in the case of a franchise? Would an order of damages be an adequate remedy or would it be a just outcome having regard to the expectations of the parties? A court will have no jurisdiction to order specific performance if damages are adequate: 'The question is whether relegating the plaintiff to damages would leave it in as favourable a position in all respects as would exist if the defendant's obligation were specifically performed.'[47] The application of specific performance to franchises in Australia and New Zealand is generally more limited compared to other jurisdictions.

A number of discretionary factors, some of which have already been mentioned, may be taken into account. An informative case on relevant discretionary matters in relation to a franchise is *International Advisor Services Pty Ltd v XYYX Pty Ltd.*[48] The plaintiff franchisee, International Advisor Systems Pty Limited (IAS) agreed to sell its franchisee business to the first defendant XYYX Pty Ltd. The cross-defendant Jonamill Pty Limited was the franchisor of Michel's Patisserie and lessee of the premises, which it licensed to IAS for the term of the franchise. Various matters were at issue including a claim for specific performance of the contract. Brereton J noted that the remedy is available in the case of a contract for the sale of business where goodwill does not attach to the premises.[49] On the evidence it was not established that damages were an inadequate remedy. There was a reasonable market for Michel's Patisserie franchises and it followed that IAS would have no difficulty selling the franchise. Alternatively, the damages assessment would be straightforward. Brereton J summarised additional discretionary matters for declining specific performance.

Privy Council was dismissed.

44 Ibid.

45 Ibid.

46 *Braddon Towers Ltd v International Stores Ltd* [1987] 1 EGLR 209 at 213 (Slade J).

47 *International Advisor Services Pty Ltd v XYYX Pty Ltd* [2008] NSWSC 2, [42].

48 Ibid [41] [43].

49 *Kennedy v Vercoe* (1960) 105 CLR 521, 528-9.

It was not straight forward as to whether Jonamill would consent to entering into a franchise agreement with XYYX Ltd. Any order would have to be conditional on Jonamill entering into the franchise agreement. Such a requirement is not an obstacle unless it is clear that the third party would refuse to do so and in this case Jonamill's agreement had to be seriously doubted as XYYX Ltd had cross-claimed for damages for misleading and deceptive conduct against Jonamill.

Another reason stemmed from the principle that equity will not force parties into a personal relationship. On the facts, an order would indirectly compel XYYX Ltd (and Xin Yong) in a personal relationship for 7 years as a result of signing the franchise agreement. Also a vitiating factor may be a bar to specific performance where hardship amounting to injustice would be inflicted upon the defendant by holding him to the bargain. In this case, there was unilateral mistake by the defendant, which was not contributed to by the plaintiff. The hardship to the defendant even if the plaintiff is not at fault, may mean the remedy is declined 'if it is oppressive and far outweighs the inconvenience of leaving the plaintiff to a remedy in damages [*R D McKinnon Holdings Pty Ltd v Hind* [1984] 2 NSWLR 121; *Dowsett v Reid* (1912) 15 CLR 695].'[50] His Honour concluded that reselling presumably would not be a problem for IAS, whereas the burden on XYYX to pay the balance of the purchase price ($225,000) was disproportionate to leaving IAS to its remedy in damages.

International Advisor Services was adopted in *Spanline Weatherstrong Building Systems Pty Ltd v Tabellz Pty Ltd.*[51] Tabellz, a franchisee of Spanline, manufactured and supplied various Spanline products which are used in home improvement projects in the form of patios, roof awnings or covered verandahs, glass and screened enclosures and carports. In February 2002, the parties entered into a formal franchise agreement and the relationship was formally terminated in April 2010.The termination agreement included buy back provisions whereby Spanline had an exclusive option to purchase machinery at a price agreed or in accordance with the criteria set out in the relevant clause if agreement was not reached. Spanline sought specific performance, not to carry on the franchise but in relation to the sell-back of the 2001 machine. It also sought an order in the nature of specific performance requiring Tabellz to deliver up Spanline's intellectual property as well as transfer the telephone numbers used by Tabellz when it was a Spanline franchisee. Tabellz submitted that relief could only sound in damages relying on Young CJ in Eq's decision in *The Amble Inn Pty Ltd v Ryan* where specific performance was not granted as 'the contract involved goods and ordinarily equity does not grant specific performance unless unique chattels are involved.'[52] His Honour Griffiths J accepted that the category of 'unique chattels' was not closed. The machine could be replaced at a cost of $300,000 and was held not to be a "unique chattel". Griffiths J adopted the relevant principles and

50 Ibid [51].
51 *Spanline Weatherstrong Building Systems Pty Ltd v Tabellz Pty Ltd* [2013] FCA 1019.
52 *The Amble Inn Pty Ltd v Ryan* [2001] NSWSC 875 [42] - [43].

concluded that damages would be an adequate remedy. Tabellz's machine which could be replaced at $190,000 was held not to be a unique chattel.

It was held that Tabellz was in breach of its contractual obligation in not providing a fresh authorisation to the relevant telecommunications carrier to facilitate the transfer back to Spanline of the telephone number which was allocated to Tabellz when it was a Spanline franchisee. Tabellz was ordered to fulfil its contractual obligation.In the New Zealand High Court case *Coca-Cola Amatil (New Zealand) Ltd v The Edge Buying Group (Queenstown 2000) Ltd*[53], a supply agreement was at issue. *Argyll Stores* was not cited and it was held that specific performance of the contract was not appropriate as there was likely to be continuing difficulties between the parties.

In a later High Court case, *DSJ (PTE) Ltd v TPF Restaurants Ltd (Trading as Burger King)*[54], Giles J did not read *Argyll* as 'necessarily ruling out specific performance in every case. But, a strong case is required. .... It is a question of balancing competing equities to do overall justice.'[55] *TPF Restaurants Ltd (Trading as Burger King)*(TPF) entered into an agreement to lease commercial premises and to execute a lease in order to operate a Burger King outlet in Wellington for a 15 year term. *DSJ (PTE) Ltd* (DSJ) intended to refurbish the building but ultimately proceeded with a lesser refurbishment. Prior to entering the agreement, none of the directors of TPF inspected the premises. After inspection, the directors of TPF unsuccessfully sought to be released from the agreement. They cancelled the lease on the basis of misrepresentation under the Fair Trading Act 1986 (NZ). DSJ sought specific performance of the retail lease in the agreed form and an order directing TPF to fit out the basement area and to operate a Burger King restaurant. TPF argued that there were uncertainties, deficiencies and inconsistencies between the agreement and the lease. Giles J did not agree and referred to the comments of Rogers CJ in *Banque Brussels Lambert v Australian National Industries Ltd* that:

> [t]he whole thrust of the law today is to attempt to give proper effect to commercial transactions. It is for this reason that uncertainty, a concept so much loved by lawyers, has fallen into disfavour as a tool for striking down commercial bargains.[56]

One of the issues was that the trading hours were not specified and the phrase 'best retail methods' was uncertain. Giles J opined that the operating manual

53 *Coca-Cola Amatil (New Zealand) Ltd v The Edge Buying Group (Queenstown 2000) Ltd* [2002] High Court Invercargill, 25 June 2002, CP 27/01. The appeal application to the Court of Appeal was dismissed: *Coca-Cola Amatil (New Zealand) Ltd v The Edge Buying Group (Queenstown 2000) Ltd* CA 145/02. Specific performance was not in issue.

54 *DSJ (PTE) Ltd v TPF Restaurants Ltd (Trading as Burger King)*[1997] High Court, Auckland, CP 168/96, (23 December 1997).

55 Ibid 113; See D Brown, 'Specific Performance of "Keep Open" Covenants: Two Recent Cases' (1998) 4 *New Zealand Business Law Quarterly* 184.

56 *Banque Brussels Lambert v Australian National Industries Ltd* (1989) 2 NSWLR 501, 523.

of this New Zealand-owned and controlled franchise provided certainty over retailing methods. In line with the Court of Appeal statements in *Argyll,*[57] his Honour acknowledged that it would be highly unlikely that TPF would do other than endeavour to operate successfully.[58] The parties were equals and had freely negotiated the commercial agreement. While Giles J considered the terms were clear and certain, he concluded that the effect of an order would be unfair and unduly onerous upon TPF and reluctantly declined to order specific performance to establish and operate a Burger King outlet from the leased premises. His Honour awarded damages in lieu of specific performance of the covenant, essentially the rent and proportion of operating expenses lost by TPF. The defendant was also ordered to execute the form of the lease provided by the agreement to lease and to pay ongoing rent. His Honour stated:[59]

> I confess that with a marked degree of reservation and some considerable reluctance, I have come to the conclusion that an order for specific performance of the operating covenant would be unfair and unduly onerous upon TPF.

His Honour could see 'little point in forcing parties who are now at loggerheads into the close relationship that performance of the trading covenant would require...'.[60] The business was a new venture and although it would be run according to the franchisor's manual, that would not reduce arguments and differences between the parties and there could be a need for the parties to constantly return to the Court in its supervisory capacity. However, with respect, it seems unlikely the parties would return to the Court as any such action would result in costs to the parties and would presumably be avoided for that reason. If such ongoing court action did happen, then according to Berryman's argument,[61] the Court could at that point cancel the order and assess damages. DSJ did not have to mitigate as the cancellation was invalid. In this case it was a commercial agreement between parties of equal bargaining strength and both received legal advice. Giles J stated that:

> Where, as here, there was no valid basis for cancellation or complaint, there is no reason in equity why the defendant should have the advantage

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57 Roch LJ considered that it was, 'inconceivable that they would not operate the business efficiently.' Leggatt LJ 'if the premises are to be run as a business, it cannot be in the defendants' interest to run it half-heartedly or inefficiently. . .' Although the argument was accepted by the majority in the Court of Appeal, the House of Lords did not agree.

58 See also the Canadian decision *566719 Ontario Ltd v New Miracle Food Mart Inc* (1994) ,41 R P R (2d) 22, 34 (Oni Ct Gen Div).

59 *DSJ (PTE) Ltd v TPF Restaurants Ltd (Trading as Burger King)* [1997] High Court, Auckland, CP 168/96, (23 December 1997), 113, 114

60 Ibid.

61 Jeff Berryman 'Recent Developments in the Law of Equitable Remedies; What Canada can do for you' (2002) 33 *Victoria University of Wellington Law Review* 5, 84. See discussion, Jeff Berryman and Robyn Carroll, "Coercive Relief – Reflections on Supervision and Enforcement Constraints" (2014) paper submitted to UWALRev for special issue on Remedies

> of being relieved of its obligation when the terms of the contract are clear and certain. So to do is to transfer the burden back to the innocent party, the plaintiff in this case. [62]

Clearly the *pacta sunt servanda* principle (parties who have freely negotiated contractual terms can expect their bargain must be enforced) was of relevance, but at the end of the day economic considerations reigned and damages were awarded. The decisions of the House of Lords and the Court of Appeal in *Argyll* illustrate the two approaches.

Berryman and Carroll convincingly argue that dealing with issues of commercial uncertainty is the core business for commercial courts and the courts should tolerate some degree of uncertainty. The granting of an order would test the difficulties argued by the defendant, as their concerns would be confirmed if supervision is required.[63]

In the recent Alberta case, *760437 Alberta Ltd v Fabutan Corporation*[64] the court granted specific performance of a franchisee's 10 year right of renewal, despite what reads as a bitter dispute and a complete breakdown in the relationship. A brother and sister controlled the franchisor and franchisee companies respectively. Ms McNabb owned two tanning salon franchise locations and from time to time she made loans to her brother and the Fabutan-related companies. The breakdown originated with an email sent by Mr McNabb to all Fabutan franchisees which implied that Ms McNabb had cheated in a contest organised by Fabutan. Ms McNabb responded, there was a chain of emails and ultimately Ms McNabb requested that all loans she had made to Mr McNabb be repaid. Their father Frank McNabb, who had previously owned the franchise with his now-divorced wife, entered the dispute. When Ms McNabb requested a renewal of the South Trail studio' Mr McNabb did not follow the normal procedure. Instead, he telephoned the next day and advised he would not be renewing the franchise. After a series of communications he did agree to renew but not on the same basis as the standard agreement. Ms McNabb sent an email which included the statement: 'I will not sign any form of agreement that you or your legal counsel [sic] have or will prepare.[65]

In Romaine J's view, whether or not there was a 'loss of trust and confidence'[66] was a factual issue. In her Honour's view, the Court was faced with a family squabble and the relationship could continue.
The contract was governed by the Alberta Franchise Act, which imposes on each party to a franchise agreement a duty of fair dealing in its performance

62 *DSJ (PTE) Ltd v TPF Restaurants Ltd (Trading as Burger King)* [1997] High Court, Auckland, CP 168/96, (23 December 1997) 107.
63 See also n 61.
64 *760437 Alberta Ltd v Fabutan Corporation* 2012 ABQB 266.
65 Ibid [46].
66 Ibid [92].

and enforcement.[67] This duty meant that the franchisor was required to give consideration to the interests of the franchisee in the exercise of its discretion. Romaine J, in a lengthy judgment, set out the 'destructive' communications between the brother and sister but concluded that the battles were essentially a squabble between the siblings rather than between Fabutan and Ms McNabb. Her Honour held that Fabutan had not established good cause to terminate the franchise agreement nor to refuse the renewal. Mr McNabb had acted in 'bad faith' in the course of negotiating the agreement to renew. He acted so as to 'substantially nullify the bargained objective of benefit contracted for by the other, contrary to the original purpose and expectation of the parties.'[68] Ms McNabb was not above criticism for her behaviour but her conduct did not disentitle her to specific performance of the right to renew. Her Honour was not persuaded that the business relationship had deteriorated to such an extent that it could not continue.

Ms McNabb was entitled to specific performance of her right to renew the franchise contract. The renewal would be a minor part of Fabutan's business which was run by Mr McNabb. At one point, his sister was franchisee of nine outlets. There was a clear intention in the franchise agreement that the franchisee had the right to renew on the basis of the standard terms of renewal in force at the time. Fabutan had not established good cause to refuse the renewal. Other franchisee owners also joined the email traffic but Romaine J took the view that they would have been aware it was a family relationship problem rather than a business relationship problem. It is difficult to see how a family squabble between franchisor and franchisee would be less destructive than the breakdown of the usual franchise relationship.

In the case of a franchise there is no reason why the court cannot spell out, with as much precision as the initial agreement, what the defendant must do. Some degree of imprecision is permissible however,[69] and this discretionary factor must be considered with all other factors.

Berryman criticises the supervision arguments which:

> only surface after a finding that damages are an inadequate remedy…. It is even more intolerable that the problems are speculative and hypothetical and based on perceptions of judges about litigants generally rather than being particularized to the problems confronted by the individual adversaries before the court.[70]

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67 The Franchises Act, RSAC 2000, FO23, s 7.

68 *760437 Alberta Ltd v Fabutan Corporation* 2012 ABQB 266, [99].

69 See *Tito v Waddell (No 2)* [1977] Ch. 106, 322-3; *Co-operative Insurance Society Ltd v Argyll Stores* [1998] AC 1, 14.

70 Jeffrey Berryman, *The Law of Equitable Remedies* (Irwin Law, 2nd ed, 2013), 298. See discussion 292-301.

Once the order is made, the court has the control of the contract. In such a case, a party always has the option of returning to court to reassess the situation and if necessary then to compensate with a damages order. Certainly in the case of a franchise renewal, if a franchisor is ordered to renew a franchise it has a wider interest than the particular franchise before the court. It will want to ensure that the system's reputation does not suffer and no doubt it would co-operate with the franchisee to protect its own investment. If a franchisee has obligation to a franchisor and is ordered to remain open, it would also have a considerable investment to protect. Berryman cites various authorities from Quebec[71] and Scotland[72] which provide empirical verification that the supervision arguments are overblown.

Specific performance is an exceptional remedy and Lord Hoffmann's distinction of an activity, such as running a business in contrast to achieving a stated result does mean that franchises are likely to be regarded as an inappropriate subject for specific performance and this is reflected in the Australian and New Zealand franchise cases. It will depend on what is at issue whether the remedy is available. If a franchise relationship has terminated, specific performance will be appropriate for the return of a franchisor's intellectual property. If it is the franchise that is terminated then in many cases specific performance should be appropriate and this is highlighted by the New Zealand case, *DSJ (PTE) Ltd v TPF Restaurants Ltd (Trading as Burger King).*[73] Specific performance was not granted but for Giles J it was a 'fine balance.' Generally the operation of a franchise is well documented in the operations manual. If a franchisee was granted specific performance to renew a franchise, surely the co-operation of the franchisor would be guaranteed as otherwise it would be detrimental to the franchise system. The franchise is a special type of contract. It is a method of doing business and in some cases, specific performance would be the preferred remedy to protect the performance interest.

In the 1993 New Zealand case *Butler v Countrywide Finance Ltd,* Hammond J noted the traditional approach to specific performance had, in the previous decade or so, been increasingly criticised. His Honour opined that:

> [T]he law of civil remedies in this country is, as it should be, steadily evolving into a regime in which what is required of a Court is a context specific evaluation of which remedy is most appropriate in the circumstances of a given case, rather than doctrinaire or a priori solutions. The problem then becomes one of informed remedial choice. [74]

71 *Cie de Construction Belcourt ltée v Golden Griddle Pancake House Ltd* [1988] RJQ 716.

72 *Highland & Universal Properties Ltd v Safeway Properties Ltd* 2000 SC 297, [2000] SLT 414 (Scot Ct Sess).

73 *DSJ (PTE) Ltd v TPF Restaurants Ltd (Trading as Burger King)* [1997] High Court, Auckland, CP 168/96, (23 December 1997).

74 *Butler v Countrywide Finance Ltd* [1993] 3 NZLR 623, 631.

Specific performance is one way of protecting the reasonable expectations of the parties. The courts have in recent years extended other remedies so that the purpose of the contract is enforced. Berryman and Carroll provide examples of cases where the contracting parties have included provisions in their contracts stipulating a preference for specific performance. They advocate the desirability of the courts supporting the party choice of remedy. [75]

Specific performance and protection of the 'performance interest'

Lord Hoffmann noted that 'the purpose of the law of contract is not to punish wrong doing but to satisfy the expectations of the party entitled to performance.'[76]

Equitable relief is not available where damages are an adequate remedy. In contract law the primary remedy is expectation damages. Friedmann, who advocated protection of the performance interest in the introduction to his famous article[77], *"the performance interest in contract damages*" notes that although the basic ideology was rejected there had been considerable interest since the article was published; 'The irony is that while rejecting the article's basic approach, courts and scholars increasingly employ the terminology which it introduced.' In fact, the courts have emphasised the performance aspect but do not refer to it as 'performance interest', rather as an aspect of the expectation interest.

The 'performance interest' made its debut in New Zealand in the recent Supreme Court case, *Marlborough District Council v Altimarloch Joint Venture Ltd.*[78] Two of the judges, Elias CJ and Tipping J, disagreed as to the outcome but both referred to the 'performance interest.

Altimarloch purchased rural property for $ 2.675m, having been assured by the vendor's agent that resource consents would be transferred. The amount to be transferred would have been sufficient to irrigate the proposed grapevines but the representations were incorrect and the shortfall was not discovered until after settlement when the planting had been started. Because of the shortfall there was a $400,000 decrease in the property value. After settlement, Altimarloch purchased additional water rights for $320,000 but no further water rights were available. The vendors argued that the damages in contract should be on the $400,000 diminution of value and not the cost of cure, which necessitated building a dam at a cost of $1,055,907.16. The High Court and the Court of Appeal held that the cost of cure damages were appropriate.

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75 See above n 61.

76 *Co-operative Insurance Society v Argyll Stores* [1998] AC 1, 15.

77 Daniel Friedmann, 'The performance interest in contract damages' (1995) 111 *Law Quarterly Review* 628.

78 *Marlborough District Council v Altimarloch Joint Venture Ltd* [2012] NZSC 11; [2012] 2 NZLR 726.

Elias CJ considered previous cost of cure cases and the need to identify a specific justification for departing from the usual approach. Her Honour did not agree that the cost of cure was the appropriate measure. It was not a case where the parties stipulated for the construction of a dam, nor was it one "where the parties can reasonably have expected such result, at any cost".[79]

Tipping J discussed the compensatory rule in *Robinson v Harman*[80] and the fact that if an item is not readily substitutable, it is not always possible to put the plaintiff in as good a financial position as if the contract had not been broken.

> A performance measure rather than one which is strictly compensatory may then be necessary. The difference in subject-matter which underpins this approach is similar to the difference between cases where damages are an adequate remedy and those where the subject-matter is such that specific performance is the appropriate remedy for non-performance.[81]

His Honour referred to *Ruxley Electronics and Construction Ltd v Forsyth*[82] where it was made clear that a party to "a contract has not only a financial interest in the contract but also what may be described as a performance interest"[83], although the House of Lords did not use the term 'performance interest' or award damages on the cost of cure basis. Reference was also made to the Australian High Court case, *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd.*[84] It was held that cost of cure damages were appropriate where a tenant, in breach of its lease, had with 'contumelious disregard' for the landlord's rights replaced the foyer to the building. His Honour noted that the Court drew the same analogy with cases of specific performance 'and indicated that if the case was of that kind, performance damages would almost always be reasonable.'[85]

It can be argued that as a franchise is a relational contract specific performance should not be granted. In the recent California Court of Appeal case *Husain v McDonald's Corp,*[86] **a pragmatic approach was adopted and** the trial court's grant of a preliminary injunction was upheld. The franchisees were allowed to continue operating three McDonald's restaurants pending completion of the trial in this action. The Court held that a close working relationship was not automatically a contract of personal services. It was a strict business transaction based on the

79 Ibid [42].
80 *Robinson v Harman* (1848) 1 Exch 850 at 855, 154 ER 363 (Exch), 365.
81 *Marlborough District Council v Altimarloch Joint Venture Ltd* [2012] NZSC 11; [2012] 2 NZLR 726, [157].
82 *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344 (House of Lords).
83 *Marlborough District Council v Altimarloch Joint Venture Ltd* [2012] NZSC 11; [2012] 2 NZLR 726, [161].
84 *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* [2009] HCA 8; (2009) 236 CLR 272.
85 *Marlborough District Council v Altimarloch Joint Venture Ltd* [2012] NZSC 11; [2012] 2 NZLR 726, [166].
86 *Husain, v McDonald's Corp* 2012 Cal App LEXIS 515 (Cal Ct App Apr 30, 2012).

strict rules and conditions in the contract. In some jurisdictions,[87] the doctrine of non-derogation from grant has been extended to relational disputes. The effect of the doctrine, like the remedy of specific performance, is to protect the franchisee's contractual expectations. The doctrine of derogation from grant was explained by Lord Denning MR in *Molton Builders v City of Westminster LBC:*

> [it] is a general principle of law that, if a man agrees to confer a particular benefit on another he must not do anything which substantially deprives the other of the enjoyment of that benefit: because that would be to take away with one hand what is given with the other.[88]

In *Stone & Ashwell v Fleet Mobile Tyres* [89], Lord Justice Keene referred to the dicta of Nicholls LJ in *Johnston and Sons Ltd v. Holland*[90] which explained that the principle is 'not based on some ancient technicality of real property.' As Younger LJ observed in *Harmer v Jumbil (Nigeria) Tin Areas Ltd* [1921] Ch 200 at pp 225, it is a principle which merely embodies in a legal maxim a rule of common honesty. It was imposed in the interest of fair dealing". [91] In *Stone's* case, the franchisor implemented an e-commerce model which had a negative impact on the profitability of the franchisee's business. It was held that the franchisor had repudiated the franchise agreement and the restrictive covenant was no longer enforceable.

CONCLUSION

In *Argyll*, Lord Hoffmann notes that 'the purpose of the law of contract is not to punish wrongdoing but to satisfy the expectations of the party entitled to performance.'[92] The courts have in exceptional cases awarded cost of cure damages when the normal measure is inadequate. Specific performance is another remedy whereby the expectations of the parties entitled to performance are satisfied, and in certain cases it will be appropriate. The principles have been applied more readily in discrete contracts than in relational contracts. However, to satisfy the expectations of a party to a relational contract seeking the remedy it should be more readily applied. An order to run a business is regarded as a bar to specific performance because of the difficulties with supervision but a franchise does have a detailed manual and agreement and depending on the facts specific performance would be the perfect remedy.

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87 Australia see *JLCS Pty Ltd v Squires Loft City Steakhouse Pty Ltd* (2008) FCA 867 and United Kingdom see *Fleet Mobile Tyres v Stone & Ashwell* [2006] EWCA Civ 1209.

88 [1975] 30 P & C R 182, 186.

89 *Stone & Ashwell v Fleet Mobile Tyres* [2006] EWCA Civ 1209, [53].

90 *Johnston and Sons Ltd v. Holland* [1988] 1 EGLR 264 at 267M.

91 *J L Stanley v Fuji Xerox New Zealand Ltd* [1997] High Court, Auckland, CP 479/96, (5 November 1997), [58].

92 *Co-operative Insurance Society v Argyll Stores* [1998] AC 1, 15.

Whether or not the contract is classified as relational or transactional[93], supervision of the contract is usually taken into account in granting the discretionary remedy of specific performance. The experience in other jurisdictions[94] suggests that there is no special reason why a defendant should have difficulty complying with an order if the wording is sufficiently precise and there is no reason why that should not apply to a relational franchise contract, which will lay down strict rules and conditions.

Eisenberg [95] concludes that as 'there is no significant difference between contracts as a class and relational contracts, relational contracts must be governed by the general principles of contract law, whatever those should be.' In the case of business transactions, such as a franchise, the precise wording of the contract is of paramount importance. It is in the interests of both parties that it is accurate and precise so supervision would not be a bar to specific performance and the expectations of the party seeking a remedy can be satisfied. Specific performance should not be ruled out in franchise cases, but, it is a question of balancing competing equities to do overall justice.

93 See *Kurth v McGavin* [2007] 3 NZLR 614 (High Court).

94 See above n 66 and 67.

95 Melvin A. Eisenberg, 'Why There Is No Law of Relational Contracts' (1999–2000) 94 *Northwestern University Law Review 821.*