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PLURALISM APPLIED: A CONCORDANT APPROACH TO SELECTING CONTRACT RULES

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Contract rules can be justified by utilitarian theories (such as efficiency theory), which are concerned with promoting rules that enhance societal wealth and utility. Contract rules can also be justified by rights-based theories (such as promissory and reliance theories), which are concerned with protecting the contractual freedom and interests of the individual parties to the contract. Or, contract rules can be analyzed through the lenses of a host of other theories, including critical legal theory, bargain theory, and so on. Because no single, unitary theory can ever explain the complex body of laws and societal conventions surrounding contracts, the best rule to govern any particular situation is the one that can be justified by multiple normative theories. Such an approach would stand the best chance of achieving consensus, and would acknowledge the insight of pluralism theorists—that no single unified theory can explain the civil law. This Article applies a concordant approach to selecting contract rules to address the question of whether a parent company should be held liable in tort for directing the termination of a contract entered into by its subsidiary.

Under ordinary circumstances, a simple breach of contract does not give rise to tort liability and punitive damages; one cannot tortiously interfere with one's own contract. But the courts around the country are deeply divided on the question of whether parent companies are immune from tort liability for inducing a subsidiary to breach a contract. Some courts hold that because the parent and subsidiary share common interests, the parent is completely immune from tort liability, just as though it were a party to the contract (Category 1). Some courts take the similarly formalistic approach that because the parent and subsidiary are technically separate entities, the parent enjoys no immunity from tort liability (Category 2). Some courts impose tort liability only if the parent acted against the business interests of the parent and subsidiary or committed an independent tort (Category 3). Some courts impose tort liability

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even if the breach of contract was in the business interest of the parent and subsidiary if the parent company's actions were "wrongful," which can be something less than tortious behavior (Category 4).

This Article presents an exhaustive survey and categorization of these conflicting rules and then applies normative contract theory to determine which is the best approach. In particular, the two most dominant contract law theories of our time are applied to the issue: efficiency theory and rights-based theory.

Applying efficiency theory to the problem at hand, this Article begins with the proposition that, in order to facilitate efficient breaches of contract, no tort liability should be imposed. However, once one takes into account the underlying false assumption of efficiency theory that commercial actors always act rationally, allowing for tort liability to be imposed in those situations where the parent does not act out of business judgment makes sense.

When rights-based theory is applied to this issue, it raises questions as to whether breach should be penalized to honor the promise made to the non-breaching party and to protect the non-breaching party's reliance on that promise. However, rights-based theory would also argue for protecting the parent company's autonomy by allowing it to reject a promise it never accepted and to decline to honor reliance it never induced—but only if the parent is acting out of rational business interest. Accordingly, the parent company should be afforded autonomy in choosing to terminate a contract it did not bargain for (so long as it pays compensatory damages). If the parent company's actions are not taken for rational business reasons, but rather for reasons of spite, malice, or oppression, then the law should punish and deter such behavior.

I. INTRODUCTION

One cannot tortiously interfere with one's own contract.[1] Rather, according to the Restatement of Torts, only "[o]ne who intentionally and improperly interferes with the performance of a contract . . . between another and *a third person*" is liable in tort for causing a breach of contract.[2] This stands to reason in a society grounded in freedom of contract because "along with the celebrated freedom to make contracts goes a considerable freedom to break them as well."[3] Accordingly, courts do not generally punish or make an example of parties who breach a contract through the award of punitive damages.[4] The breaching party should be ordered to compensate the victim of the breach for the harm caused

1. *See* Knickman v. Midland Risk Servs.–Ill., Inc., 700 N.E.2d 458, 461–62 (Ill. App. Ct. 1998) ("Plaintiff does not dispute the basic rule that an entity cannot be liable in tort for interfering with its own contract.").

2. RESTATEMENT (SECOND) OF TORTS § 766 (AM. LAW INST. 1979) (emphasis added).

3. E. ALLAN FARNSWORTH, CONTRACTS § 12.1, at 756 (3d ed. 1999).

4. *See id.* § 12.8, at 787 n.17 (alteration in original) (citing Addis v. Gramophone Co. [1909] AC 488 (HL) 494 (appeal taken from Eng.) ("[D]amages for breach of contract [are] in the nature of compensation, not punishment.")).

by the broken promise,[5] but society does not seek to punish and deter breach of contract in the same way that it seeks to punish and deter torts.[6]

This black letter rule can be justified by two dominant theories of contract law: efficiency theory and rights-based theory.[7]

Efficiency theory generally addresses problems in contract law by asking which solution increases overall social welfare by resulting in the most efficient use of resources and an increase in societal wealth.[8] Efficiency theorists argue

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5. Such compensation can take various forms. It can be compensation for the victim's expected gains under the contract (expectation damages), compensation for the victim's expenses incurred in reliance on the contract (reliance damages), or disgorgement of value the victim has given to the breaching party pursuant to the contract (restitution damages), plus any consequential damages caused by the breach. *See* RESTATEMENT (SECOND) OF CONTRACTS § 344 (AM. LAW INST. 1981) (Purposes of Remedies); *id.* § 347 (Measure of Damages in General); *id.* § 349 (Damages Based on Reliance Interest); *see also* L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 53–54 (1936) (discussing the restitution interest, the reliance interest, and the expectation interest).

6. FARNSWORTH, *supra* note 3, § 12.8, at 787 ("No matter how reprehensible the breach, damages are generally limited to those required to compensate the injured party for lost expectation, for it is a fundamental tenet of the law of contract remedies that an injured party should not be put in a better position than had the contract been performed.").

7. Stephen A. Smith explains that normative contract law theories can be divided into utilitarian theories, which justify contract rules as serving society generally, and rights-based theories, which justify contract rules as upholding the rights of the individual parties to a contract. STEPHEN A. SMITH, CONTRACT THEORY 106–07 (2004). According to Smith, the "best known and most important group of utilitarian justifications of contract law" are efficiency theories. *Id.* at 107. Among rights-based theories, Smith posits that the dominant theories are promissory theory, reliance theory, and transfer theory, but that promissory theory is the most 'orthodox' and "provide[s] the best answer to the analytic question" of how to describe the justification for particular contract rules. *Id.* at 142–43, 142 n.48. For the purpose of this Article, I discuss rights-based theory as a general concept, but focus primarily on promissory theory and reliance theory. Different terminology and categories are also available and can be quite useful. *See, e.g.*, Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 271–91 (1986); SMITH, *supra* at 142 n.48 (dividing contract law theories into "party-based" theories (comprised of will and reliance theories), "standards-based" theories (comprised of efficiency and fairness theories), process-based theories (comprised of the bargain theory of consideration), and Barnett's own "consent-based" theory (which he describes as a rights-based theory and which Stephen A. Smith cites to as a transfer theory)). According to Alan Schwartz and Robert E. Scott, on the other hand, the world is divided up into efficiency and autonomy theory (which appears to be a term for rights-based theories). Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 543 n.1 (2003). For convenience, this Article generally employs Stephen A. Smith's terminology.

8. SMITH, *supra* note 7, at 107. Robert A. Hillman refers to this variety of efficiency theory as "'neoclassical' law and economics," to be distinguished with a more recent efficiency theory that focuses on "transaction costs and their effect on choice of contract governance structures." ROBERT A. HILLMAN, THE RICHNESS OF CONTRACT LAW: AN ANALYSIS AND CRITIQUE OF CONTEMPORARY THEORIES OF CONTRACT LAW 214 & n.9 (Aulis Aarnio et al. eds., 1997) (quoting Ian R. Macneil, *Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus,"* 75 NW. U. L. REV. 1018, 1022 (1981)).

that greater wealth or utility will sometimes result if a party breaches a contract than if the contractual promise is fulfilled.[9] This happens when the gains to be made under an alternative contract (or through no contract at all) will be greater than the cost of compensating the victim of the breach for the harm to its expectation under the contract.[10] It follows that efficiency theory favors a rule against punitive damages for a simple breach of contract.[11] Punitive damages would deter these "efficient breaches" and result in a waste of the wealth and utility they would otherwise create.[12]

Unlike efficiency theory, which is primarily concerned with how contract law can promote social welfare, rights-based theory views contract law as protecting the rights of the individual parties to the contract.[13] In particular, contract law should protect the right of individuals to bind themselves through contracts (i.e., freedom of contract) by enforcing the promises enshrined in contracts, or by protecting the reliance interest individuals have in contracts.[14] The pioneer of the promissory theory of contracts, Charles Fried, wrote that "[t]he obligation to keep a promise is grounded not in arguments of utility but in respect for individual autonomy and in trust."[15] It follows that if a party breaks a contractual promise, the only way to protect freedom of contract is for the law to enforce that promise; the breaching party "should be made to hand over the equivalent of the promised performance."[16] The appropriate remedy for breach of contract is expectation damages because "[t]he expectation standard gives the victim of a breach *no more or less* than he would have had had there been no breach—in other words, he gets the benefit of his bargain."[17] Fried explains why damages for breach of contract should be *no less* than compensatory damages under a rights-based theory.[18]

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9. *See* John H. Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277, 291 (1972); Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 291–92 (1970).

10. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 151 (Vicki Been et al. eds., 8th ed. 2011).

11. SMITH, *supra* note 7, at 418.

12. *Id.*

13. *Id.* at 107.

14. As noted above, Smith divides rights-based theories into three major categories: promissory theory, reliance theory, and transfer theory. *See supra* note 7. This Article will focus on promissory theory and reliance theory.

15. CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 16 (1981).

16. *Id.* at 17.

17. *Id.* (emphasis added).

18. *See id.* at 17–27.

Daniel Markovits and Alan Schwartz complete the picture by explaining why a rights-based theory of contract counsels against *supra-compensatory* damages for breach of contract, such as punitive damages.[19] Markovits and Schwartz hypothesize that a contract is a dual promise: "either to trade goods or services to buyers or to make a monetary transfer to buyers, equal to the value the buyers would realize from receiving the goods or services [i.e., an expectation value]."[20] It follows that compensatory, expectation damages are favored over supra-compensatory, punitive damages because they do not impose an obligation greater than what the contracting parties agreed to and thereby protect the breaching party's freedom of contract.[21]

Hence, there are strong theoretical arguments across dueling theories of contract law to justify the old chestnut of a principal that there are no punitive damages for a simple breach of contract.[22] And it follows from this that one cannot tortiously interfere with one's own contract.[23] Breach of contract is permitted, not punished.[24]

But what of the more complicated situation where a parent company directs its wholly owned subsidiary to breach a contract? This might happen for a variety of reasons. When a parent acquires a subsidiary, the subsidiary brings with it various baggage, some good, some bad, including ongoing contractual obligations with other companies. The parent may seek to terminate the contract for legitimate, business related reasons. For example, the parent may be able to negotiate better terms with a different supplier, or may be able to satisfy the contract needs internally. On the other end of the spectrum, the parent may terminate a subsidiary's contract out of personal malice or spite

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19. Daniel Markovits & Alan Schwartz, *The Expectation Remedy and the Promissory Basis of Contract*, 45 SUFFOLK U. L. REV. 799, 811 (2012).

20. *Id.* at 808.

21. *Id.* at 811.

22. There is a more recent body of scholarship questioning this first principal of contract law. Daniel Markovits and Alan Schwartz note that "[a] growing chorus of increasingly prominent critics argues against limiting contract remedies to vindicating a disappointed promisee's contractual expectations." Markovits & Schwartz, *supra* note 19, at 805–06 (citing Richard R.W. Brooks, *The Efficient Performance Hypothesis*, 116 YALE L.J. 568 (2006); Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 CAL. L. REV. 975 (2005); Melvin A. Eisenberg, *The Disgorgement Interest in Contract Law*, 105 MICH. L. REV. 559 (2006); Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989); Seana Shiffrin, *Could Breach of Contract be Immoral?*, 107 MICH. L. REV. 1551 (2009); Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007)). Grappling with this questioning of first principals is beyond the scope of this Article, which takes as a given premise that contract law does and should seek to compensate, rather than punish, a simple breach of contract.

23. *See* Knickman v. Midland Risk Servs.–Ill., Inc., 700 N.E.2d 458, 461–62 (Ill. App. Ct. 1998).

24. FARNSWORTH, *supra* note 3, § 12.8, at 787.

toward the victim of the breach, even if doing so is not in the best interest of the shareholders. Somewhere in between is the situation where a parent acquires a subsidiary for the purpose of terminating the subsidiary's contracts with competitors of the parent. Once the acquisition is made, this would appear to be in the business interest of the parent and subsidiary. To the extent such behavior harms competition, it would presumably be in the realm of antitrust law to deter such behavior. Is it nonetheless a tort that courts should punish under a theory of intentional interference with contract?

The courts are deeply divided on these questions, with conflicting views among the states' highest courts and among the federal courts of appeals applying state law.[25] Part II of this Article analyzes notable rulings from around the country to arrive at the conclusion that there are at least four different approaches to the question of whether and when a parent company may terminate the contract of a subsidiary.

A. Category 1 Cases: Absolute Immunity

Some courts hold that because the parent and subsidiary share common interests, the parent is, in practical effect, a party to the contract and should enjoy complete immunity from tort liability. I refer to these cases as Category 1 cases.[26]

B. Category 2 Cases: Absolute Liability

Other courts adhere to the formalistic rule that because the companies are technically separate, a parent enjoys no protection from such tort liability. This Article refers to this technical, black letter approach as Category 2.[27]

C. Category 3 Cases: The Rational Business Interest Approach

A third group of cases apply the rule that the parent is immune from tortious interference with contract if it is acting in the business interest of the parent and subsidiary companies in terminating the contract at issue and if it does not commit an independent tort. Under this rule, if the parent acts out of irrational malice or personal animus toward the victim of the breach in a manner that is against the business interests of the parent and subsidiary, it should be punished. But if the parent company directs the termination of a subsidiary's contract for rational business reasons, then it is not liable in tort unless, of course, its actions

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25. *See infra* Part II.
26. *See infra* Section II.A.
27. *See infra* Section II.B.

constitute an independent tort (such as fraud). I refer to these cases as Category 3 cases.[28]

D. Category 4 Cases: The Multi-Factored Approach

And then there is California, the pioneer of Category 4 cases. California cases provide that "the privilege of a parent or subsidiary corporation to interfere with the contractual relationship of the other 'is *at most* a qualified one dependent for its existence upon the circumstances of the case.'"[29] California cases require parent companies to prove two elements in order to enjoy immunity for directing the termination of a subsidiary's contract: that the parent "(a) does not employ improper means, and (b) acts to protect his interest from being prejudiced by the relation."[30] Hence, even if a parent acts in the best business interest of the parent and subsidiary in terminating a subsidiary contract, tort liability will still lie if the parent uses "improper means." Improper means is not explicitly defined. Unlike with Category 3 cases, improper means can be something less than an independent tort and less than a violation of the antitrust laws. I refer to these cases as Category 4 cases.[31]

The vagueness of Category 4 cases arises from the fact that the standard emerges out of the multi-factored test provided by Section 767 of the Restatement (Second) of Torts, entitled "Factors in Determining Whether Interference is Improper."[32] That section does not address the situation of a parent and subsidiary company, but considers a variety of non-exclusive factors to determine if any actor's intentional interference with a contract is improper, including "the relations between the parties."[33] Courts following this approach

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28. *See infra* Section II.C.

29. GHK Assocs. v. Mayer Group, Inc., 274 Cal. Rptr. 168, 185 (Cal. Ct. App. 1990) (emphasis added) (quoting Culcal Stylco, Inc. v. Vornado, Inc., 103 Cal. Rptr. 419, 421–22 (Cal. Ct. App. 1972)).

30. Asahi Kasei Pharma Corp. v. Actelion Ltd., 169 Cal. Rptr. 3d 689, 703 (Cal. Ct. App. 2013) (quoting Sade Shoe Co. v. Oschin & Snyder, 209 Cal. Rptr. 124, 127 (Cal. Ct. App. 1984) (citing RESTATEMENT (SECOND) OF TORTS § 769 (AM. LAW INST. 1939))).

31. *See infra* Section II.D.

32. RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1979).

33. *Id.* The Section provides as follows:

> In determining whether an actor's conduct in intentionally interfering with a contract or a prospective contractual relation of another is improper or not, consideration is given to the following factors:
>
> (a) the nature of the actor's conduct,
>
> (b) the actor's motive,
>
> (c) the interests of the other with which the actor's conduct interferes,
>
> (d) the interests sought to be advanced by the actor,
>
> (e) the social interests in protecting the freedom of action of the actor and the contractual interests of the other,

caution that the parent-subsidiary relationship is but one factor, which does not preclude consideration of the other six factors that are listed in the Restatement.[34] Because these other factors include such things as "the nature of the actor's conduct" and "the actor's motive," the parent can be liable even if it acted out of business judgment and even if its actions were not independently tortious, merely because its behavior is adjudged "improper."[35]

E. The Concordant Approach to Applied Normative Contract Theory

Which of these four legal rules is justified by normative contract law theory? Such a question is exceedingly complicated because no single theory of contracts can explain or justify all of the conflicting rules and societal conventions of contracts.[36] As Alan Schwartz and Robert E. Scott observe, "Contract law has neither a complete descriptive theory, explaining what the law is, nor a complete normative theory, explaining what the law should be."[37]

For example, among the categories of contract theories are utilitarian theories, which describe and advocate for contract rules that benefit society as a whole, rather than the individual parties to the contract.[38] Most prominent among utilitarian theories are efficiency theories, which focus on enhancing the overall wealth and utility of society's resources.[39] But even among efficiency theories there are different approaches. Traditional efficiency theory maintains that contract law should facilitate voluntary exchanges that result in transferring resources to where they have the highest value.[40] More recent, efficiency theory focuses on which contract rules reduce transaction costs in the allocation of resources.[41]

Another group of contract law theories are rights-based theories, which describe and advocate for contract law rules that protect the autonomy and

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> (f) the proximity or remoteness of the actor's conduct to the interference and
>
> (g) the relations between the parties.

Id.

34. *See* Paramount Farms Int'l, L.L.C. v. Ventilex B.V., 2016-Ohio-1150, 61 N.E.3d 702, at ¶ 39 (citing RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1979)).

35. *See infra* Section II.D.

36. HILLMAN, *supra* note 8, at 2 ("[N]o unitary theory adequately captures the entire contract-law field.").

37. Schwartz & Scott, *supra* note 7, at 543.

38. SMITH, *supra* note 7, at 106–07.

39. *Id.* at 107.

40. HILLMAN, *supra* note 8, at 214 (citing RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 10–11 (Richard A. Epstein et al. eds., 4th ed. 1992)). Hillman refers to this approach as "'neo-classical' law and economics." *Id.*

41. *Id.* at 214 n.9 (citing Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 233–34 (1979)).

interests of the individual parties to the contract.[42] Even among these theorists there is a debate as to whether contract rules should primarily protect the sanctity of the promise,[43] the reliance interest created by the contract,[44] the individual interest in the transfer of rights created by the contract,[45] or all of these in addition to other interests depending on the contract rule in question.[46]

Beyond these two categories of contract theory, there are many others. For example, this brief account has not considered the dominant "bargain theory" of the nineteenth century that grounded contract law in the exchange of consideration.[47] Nor does this Article consider an important theory that emerged in the late twentieth century: Critical Legal Studies, which argues that contract law is indeterminate, inconsistent, and subjective.[48] In the guise of an objective system of rules, contract law serves only to maintain existing power relations and the unfair distribution of wealth to the elites in society.[49]

In the face of this cacophony of theories,[50] one is tempted to embrace the realism of Critical Legal Theory and conclude that the choice of any particular rule will be a grab for power clothed in the guise of a unifying theory. Doing so does not assist in the practical task of determining which of several available contract rules is preferable for a given situation; it is, rather, a rejection of the possibility of objectivity for the good of the public or the protection of the parties to a case. This insight may or may not be correct. Either way, it does not help with the task of selecting a rule.

Another approach would be to justify one particular theory as the best theory and then apply that theory. Oliver Wendell Holmes wrote that lawyers confront a vast body of common law going back hundreds of years from many jurisdictions.[51] Holmes called these past decisions "the oracles of the law,"

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42. SMITH, *supra* note 7, at 140.

43. *See generally* FRIED, *supra* note 15, at 7–27.

44. *See* Fuller & Perdue, *supra* note 5, at 54.

45. *See* Barnett, *supra* note 7, at 319.

46. *See, e.g.*, GRANT GILMORE, THE DEATH OF CONTRACT (1974).

47. Barnett, *supra* note 7, at 287 (citing A. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT 316 (1975)); *see* GILMORE, *supra* note 46, at 13–18.

48. Lawrence B. Solum, *On the Indeterminacy Crisis: Critiquing Critical Dogma*, 54 U. CHI. L. REV. 462, 470 (1987).

49. *See* ROBERTO MANGABEIRA UNGER, THE CRITICAL LEGAL STUDIES MOVEMENT: ANOTHER TIME, A GREATER TASK 121 (2015); Morton J. Horwitz, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 953–56 (1974).

50. There are other theories that have not been mentioned. For example, Hillman also discusses contextualism and neoformalism. HILLMAN, *supra* note 8, at 125–71. As another example, Smith discusses additional utilitarian theories, such as promoting distributive justice, promoting valuable relationships, or promoting autonomy. SMITH, *supra* note 7, at 136–39.

51. Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 457 (1897).

because "[i]n these sibylline leaves are gathered the scattered prophecies of the past upon the cases in which the axe will fall."[52] In light of these circumstances, Holmes felt that "[f]ar the most important and pretty nearly the whole meaning of every new effort of legal thought is to make these prophecies more precise, and to generalize them into a thoroughly connected system."[53] But this approach is both impossible and unsatisfactory. It is impossible because the many rules of contract law cannot be reconciled into a thoroughly connected system. And if we select a unitary theory to justify one rule or the other, then we will not satisfy adherents of the host of other theories, that we have selected the proper rule.

This is why Hanoch Dagan writes that "[t]he lure of private law monism can and should be resisted."[54] Instead of clinging stubbornly to one particular theory, "[p]rivate law theory should take seriously the existing structural pluralism of private law and celebrate, rather than suppress (as variations on a common theme) or marginalize (as peripheral exceptions to a robust core), the multiple forms typifying private law."[55] In another article, Dagan applies his structural pluralism to describe contract law as "an umbrella for diverse contract institutions, which stand for diverse ideals of the various types of social relationships and economic functions contracts serve."[56]

Robert A. Hillman also insists that "no unitary theory adequately captures the entire contract-law field," and argues that this demonstrates the richness of contract law rather than the cynical gathering of power to elites (as critical legal theorists might argue).[57] Hillman "emphasize[s] contract law's richness and importance and question[s] the utility of overly abstract unitary theories."[58] Hillman writes that contract law largely succeeds in "suitably promot[ing] the formation and enforcement of private arrangements and ensures some degree of fairness in the exchange process," but not because it can be explained by a single unifying theory.[59] Rather, "contract law largely succeeds because it is

52. *Id.*

53. *Id.* at 457–58.

54. Hanoch Dagan, *Pluralism and Perfectionism in Private Law*, 112 COLUM. L. REV. 1409, 1411 (2012).

55. *Id.* at 1411–12 (alteration in original).

56. Hanoch Dagan, *Autonomy, Pluralism, and Contract Law Theory*, 76 LAW & CONTEMP. PROBS. 19, 37 (2013). Erez Aloni has done important work applying structural pluralism in the area of family law. Erez Aloni, *The Puzzle of Family Law Pluralism*, 39 HARV. J.L. & GENDER 317, 317 (2016).

57. HILLMAN, *supra* note 8, at 2.

58. *Id.* at xiii.

59. *Id.* at 2.

the product of the legal system's reasonable and practical compromises over conflicting values and interests."[60]

The pluralism of scholars, such as Dagan and Hillman, is largely an attempt to explain existing law. Can pluralism be applied in a normative way to assist in selecting a particular rule among several options? An alternative approach to applying one particular normative contract theory is to attempt to select the rule that is justified by multiple contract law theories. Such an approach recognizes the insight of pluralism, that private law is an institution that represents a compromise between diverse interests and values in a diverse society, and seeks to select the rule that thereby has the best chance of achieving consensus.[61] I call this the "concordant approach" to applied normative theory. Elsewhere I have argued that in selecting among rules to govern patent law, one should err on the side of selecting a rule that favors innovation and competition over the patent monopoly, because this approach is supported by multiple dominant patent law theories: disclosure theory, commercialization theory, prospect theory, patent race theory, and signaling theory.[62]

This Article applies the concordant approach to this issue of contract law discussed above: When should a parent company be liable in tort for interfering with the contract of a subsidiary company? Rather than selecting between a utilitarian approach and a rights-based approach, this Article analyzes the question under the dominant theories from each school of thought: efficiency theory, promissory theory, and reliance theory. Passing the various rules through the filter of utilitarian *and* rights-based considerations makes sense because, to quote Robert C. Clark, "A good society depends on both autonomy and heteronomy, each present in large measure."[63]

F. Efficiency Theory Applied

Part III of this Article applies efficiency theory to the question of when a parent company should be liable in tort for interfering with the contract of a subsidiary company. In order to facilitate efficient breaches of contract, a parent company should generally be privileged to direct its subsidiary to

60. *Id.*

61. *See* Dagan, *supra* note 54, at 1421–22.

62. Samuel F. Ernst, *Protecting the Boundaries: Unclaimed Consideration in the Patentee's Social Contract*, 18 TUL. J. TECH. & INTELL. PROP. 1, 12–26 (2015).

63. Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703, 1726 (1989). Robert A. Hillman's work lends support to a concordance approach. Hillman writes, "Contract law is complex, contradictory, and, ultimately, inconclusive on what the relationship of these [contract theory] principles is and should be. Moreover, by ignoring or downplaying counter-principles and theories, some theorists camouflage contract's complexity and hence disguise its true nature." HILLMAN, *supra* note 8, at 7.

terminate a contract. If the parent and subsidiary companies will profit more from a substitute contract or from no contract at all than they would from fulfilling the contract, then society should not punish the parent for directing the breach of contract so long as it compensates the victim of the breach for its expectation damages.[64]

A principal criticism of efficiency theory is that it rests on the questionable assumption that commercial actors act rationally in the interest of the business.[65] In fact, people often act against their economic self-interest due to a range of factors, including: social conventions and pressure, altruism, misinformation, and risk aversion or attraction.[66] Alan Schwartz and Robert E. Scott argue that this criticism is less valid in the context of contracts between companies, like the contracts discussed in this Article, than it is with respect to contracts involving individuals.[67] Schwartz and Scott argue that companies generally act to maximize wealth because they are directed by shareholders, whose principal incentive is to maximize profits.[68] But even if we accept that in the vast majority of cases parent companies will only terminate subsidiary contracts for rational, business reasons, it makes sense to have an exception imposing tort liability in those (perhaps rare) situations where parent companies act irrationally out of malice or personal animus or when they commit an independent tort (such as fraud).

Accordingly, the rule of the Category 3 cases makes the most sense from the perspective of efficiency theory. Category 1 cases fail to punish and deter those breaches of contract that are economically inefficient or that implicate the promissory and reliance rights of the promisee. Category 2 cases punish and deter all breaches of contract directed by the parent company, and thus result in preventing many efficient breaches. Category 4 cases punish and deter many breaches that are in the business interest of the parent and subsidiary, where the parent company is perceived to be acting "improperly," as defined by the vague and largely irrelevant factors set forth in the Restatement of Torts.[69] Only

64. *See infra* Part III.

65. *See, e.g.*, Jay M. Feinman, *Relational Contract and Default Rules*, 3 S. CAL. INTERDISC. L.J. 43, 52 (1993); Mark G. Kelman, *Trashing*, 36 STAN. L. REV. 293, 307 (1984).

66. *Cf.* Samuel F. Ernst, *Patent Exhaustion for the Exhausted Defendant: Should Parties be Able to Contract Around Exhaustion in Settling Patent Litigation?*, 2014 U. ILL. J.L. TECH. & POL'Y 445, 469–70 (2014) (explaining that parties do not act out of rational self-interest in settling litigation).

67. Schwartz & Scott, *supra* note 7, at 550.

68. *Id.* at 550–51.

69. *See* RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1979); *see also infra* Section II.D.

Category 3 cases allow the parent to induce efficient breaches of contract, while punishing the parent for irrational or independently tortious behavior.[70]

G. Rights-Based Theory Applied

Part IV of this Article argues that the category 2 approach is also justified by rights-based promissory and reliance theories. Promissory theory protects the freedom of individuals to enter into contracts by enforcing contractual promises.[71] But in order to protect individual autonomy, promissory theory recognizes that contractual promises should only be respected if they are voluntary on both sides.[72] Accordingly, as a general proposition, promissory theory would advocate that a parent company should not be bound by a contract that it never entered into and that is now against the business interest of the parent company and its newly acquired subsidiary.

Similarly, reliance theory posits that contractual promises should be respected to protect the reliance interests of the parties to a contract.[73] However, it is only fair to force a party to respect another's reliance interest if that party made the promise that induced reliance.[74] If the parent company never made the contractual promise that induced reliance, it is generally unfair to punish the parent company for breaking that promise if doing so is in the business interest of the parent company.[75] Accordingly, both promissory and reliance theory would support a general rule that shields a parent company from punitive tort liability for directing the termination of a subsidiary's contract.

However, as with efficiency theory, an exception must be made for parent companies who act out of malice or personal animus, rather than to protect the business interests of the parent and subsidiary. If a parent company is acting in bad faith and outside of its business interest, respect for the autonomy and reliance of the victim of the breach requires that the parent company be punished for inducing its subsidiary to breach a contract.[76] This exception is required by the concern of rights-based theory that parties act in good faith in carrying out contractual obligations.[77]

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70. *See infra* Section II.C.

71. FRIED, *supra* note 15, at 16.

72. *Id.* at 43.

73. *See* Fuller & Perdue, *supra* note 5, at 56–57.

74. HILLMAN, *supra* note 8, at 45 ("[R]eliance theorists accentuate the fairness of redressing detrimental reliance on a promise.").

75. *See id.* at 218–20.

76. *See* FRIED, *supra* note 15, at 16.

77. *Id.* at 85.

II. The Courts are Split on Whether a Parent Corporation Can Be Liable in Tort for Tortiously Interfering with the Contract of a Subsidiary

A. *Category 1: Decisions Formalistically Rejecting Tort Liability (Georgia, Michigan, and the Texas Split)*

When a company acquires a subsidiary, it inherits employees, product lines, facilities, and it also inherits contracts between the subsidiary company and third parties. In reorganizing the subsidiary company to meet its business interests, the parent company may direct the termination of one or more of the subsidiary's contracts. Whether this is treated as tortious interference with contract would rationally depend on the particular circumstances. Did the parent direct the termination for rational reasons to protect the business interest of its shareholders? For example, because an existing requirements contract can now be replaced by the parent supplying the goods or because the parent can negotiate a better contract for the subsidiary with someone else? Did the parent company terminate the contract in question to squelch competition from the victim of the breach? (Also a legitimate business interest so long as it does not run afoul of the antitrust laws.) Or did the parent direct the termination of the contract even though it might harm the business interests of the subsidiary or parent, out of personal animus or spite or as part of a scheme to commit fraud?

Unfortunately, whether the parent's act is punished as a tort depends less on these particular circumstances than it does on which body of law happens to govern the dispute. Some companies find themselves in jurisdictions that formalistically reject any tort liability for a parent that terminates the contract of a subsidiary.[78] These Category 1 cases reason that because the parent and subsidiary share a unity of interest, the parent is no stranger to the contract and can therefore orchestrate its breach without incurring punitive damages.[79]

In *Servo Kinetics, Inc. v. Tokyo Precision Instruments Co.*, the plaintiff Servo Kinetics (SKI) had a contract with Tokyo Precision Instruments (TSS) under which SKI had been distributing TSS electrical valves for over ten years in the North American market.[80] This relationship ended when Moog, Inc.

78. *See* Servo Kinetics, Inc. v. Tokyo Precision Instruments Co., 475 F.3d 783 (6th Cir. 2007); Cleveland Reg'l Med. Ctr., L.P. v. Celtic Props., L.C., 323 S.W.3d 322 (Tex. App. 2010); H.S.M. Acquisitions, Inc. v. West, 917 S.W.2d 872 (Tex. App. 1996); Am. Med. Int'l, Inc. v. Giurintano, 821 S.W.2d 331 (Tex. App. 1991).

79. *See* cases cited *supra* note 78.

80. 475 F.3d at 787.

acquired a controlling interest in TSS in 2002.[81] Roughly ten days after Moog acquired TSS, TSS sent a letter to SKI providing notice that it was terminating the agreement.[82] SKI brought claims against TSS and its parent, Moog, for breach of contract and also a claim against Moog for tortious interference with contract.[83]

In analyzing the breach of contract claims, the Sixth Circuit, applying Japanese law, necessarily had to consider whether the contract was breached for a "commercially legitimate motive" because the contract stated that the contract could not be terminated "without good reason."[84] The court concluded that there was a dispute of fact as to whether the contract was terminated for the legitimately commercial reason that TSS was in poor financial condition or for the perhaps illegitimate motive that Moog did not want SKI to compete with Moog in selling valves to the same customers.[85] The court further concluded that there was a dispute of fact under Michigan law as to whether TSS was a "mere instrumentality" of Moog to justify piercing the corporate veil and allowing Moog to be liable for any breach of contract by TSS.[86] Hence, the breach of contract claims were remanded for trial to determine if TSS and its parent Moog would be liable for compensatory contract damages.[87]

The Sixth Circuit's treatment of the tortious interference claim was quite different. Applying Michigan law, the Sixth Circuit affirmed the dismissal of the claim on summary judgment because "SKI cannot demonstrate that Moog was a third party to the TSS-SKI contract."[88] The court held that under Michigan law, tortious interference with contract requires "(1) a contract; (2) a breach; and (3) instigation of the breach without justification by the defendant."[89] However, the claim could be disposed of without analyzing these elements because Michigan law also provides that "tortious interference with contract requires proof . . . that the defendant was a 'third-party' to the contractual relationship."[90] The court concluded as a matter of law that there was a "unity of the parties" because Moog completely controlled TSS.[91]

81. *Id.* at 788.

82. *Id.*

83. *Id.* at 789.

84. *Id.* at 790–91.

85. *Id.* at 793.

86. *Id.* at 799.

87. *Id.* at 802.

88. *Id.* at 800–01.

89. *Id.* at 800.

90. *Id.* (alteration in original) (quoting Willis v. New World Van Lines, Inc., 123 F. Supp. 2d 380, 396 (E.D. Mich. 2000)).

91. *Id.* at 801.

"[T]here was functionally only one corporation, Moog, which could not induce a breach in what was in effect its own contract."[92] Hence, Moog could terminate the contract for any reason and under any motivation, just as though it were a party to the contract. In disposing of the tortious interference claim, the court had no need to consider the factual disputes regarding Moog's and TSS's motivations that were relevant to whether there was a breach of contract.[93] Because the parent corporation's "interests are unified with the interests of the controlled corporation," there could be no tortious interference with contract and resultant punitive damages under any circumstances.[94]

Georgia apparently has the same black-letter approach as Michigan to this question. In *Lyman v. Cellchem*, the Georgia Court of Appeals noted that "[t]his Court in the past contemplated that, under some circumstances, a parent corporation might be a stranger to its subsidiary's business relations such that a claim against the parent for tortious interference could lie."[95] The court decided that the Georgia Supreme Court had subsequently "disapproved" of this approach by stating in a different context that "*all parties* to an interwoven contractual arrangement [or business relationship] are not liable for tortious interference with *any of the contracts or business relationships*."[96] Although the Georgia Supreme Court did not address the particular situation of a parent terminating the contract of a subsidiary, the Court of Appeals extended the Supreme Court's reasoning to that situation, holding "that as a matter of law, a parent corporation cannot be a stranger to its subsidiaries' business or contractual relations, and that no claim can be sustained against a parent for tortious interference with such relations."[97] Applying this bright-line approach, the court threw out a jury verdict holding a subsidiary liable for tortiously interfering with the contract of its parent corporation.[98] The court made plain that the subsidiary's motives in interfering with the contract were irrelevant.[99] Even though it was "clear that Appellants were not blameless in their machinations involving Cellchem," and even though the subsidiary's action constituted a breach of its fiduciary duties, there could be no claim for tortious

92. *Id.*

93. *Id.* at 800–01.

94. *Id.*

95. 779 S.E.2d 474, 480 (Ga. Ct. App. 2015) (citing SunAmerica Fin., Inc. v. 260 Peachtree St., Inc., 415 S.E.2d 677, 684 (Ga. Ct. App. 1992)).

96. *Id.* (alteration in original) (quoting Atlanta Mkt. Ctr. Mgmt. Co. v. McLane, 503 S.E.2d 278, 283–84 (Ga. 1998)).

97. *Id.* (quoting *In re* Hercules Auto. Prod., Inc., 245 B.R. 903, 910 (Bankr. M.D. Ga. 1999)).

98. *Id.* at 481.

99. *Id.* at 479.

interference with contract because the subsidiary was no stranger to the contract as a matter of law.[100]

In Texas, there is a split of authority. Some divisions of the Texas Court of Appeals have adopted this absolute immunity approach, while one opinion has adopted the Category 3 approach described below.[101] An example of a Texas Category 1 case is *American Medical International, Inc. v. Giurintano*.[102] In *American Medical International*, the plaintiff was a hospital administrator who alleged, inter alia, that the parent company of the hospital where he was employed tortiously interfered with his employment contract.[103] The Texas Court of Appeals held that this claim should have been dismissed on the pleadings because a parent and subsidiary corporation "are so closely aligned that it is impossible, as a matter of law, for one to tortiously interfere with the other."[104] Hence, although the defendants' behavior was sufficiently tortious to uphold a jury verdict of intentional infliction of emotional distress, there could be no liability for tortious interference with contract simply because of the parent-subsidiary relationship.[105] Other Texas cases apply the same blanket rule.[106]

In applying this absolute rule, the Texas cases rely heavily on the U.S. Supreme Court's decision in *Copperweld Corp. v. Independence Tube Corp.*[107] In *Copperweld*, the Court decided that subsidiary and parent corporations are incapable of conspiring with one another to violate the Sherman Antitrust Act

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100. *Id.*

101. *See* Justin E. Myers, Comment, *Sneaking Around the Corporate Veil: Tattooing a Parent Corporation with Liability for Tortious Interference with its Subsidiary's Contract*, 35 TEX. TECH L. REV. 193, 195 (2004) ("In Texas, two schools of thought that argue whether a parent corporation can be held liable for tortious interference with its subsidiary's contractual relations have emerged from the courts. Some courts have indicated that a blanket ban exists on a parent corporation's liability for tortious interference with its subsidiary's contractual relations. Other courts have left open the possibility of a parent corporation's liability for tortious interference with its subsidiary's contractual relations."); *see also infra* Section II.C (discussing Valores Corporativos, S.A. de C.V. v. McLane Co., 945 S.W.2d 160, 168 (Tex. App. 1997)).

102. *See* 821 S.W.2d 331, 336 (Tex. App. 1991).

103. *Id.* at 335.

104. *Id.* at 336–37.

105. *Id.* at 344.

106. *See, e.g.*, Cleveland Reg'l Med. Ctr., L.P. v. Celtic Props., L.C., 323 S.W.3d 322, 346 (Tex. App. 2010) ("[B]y nature a parent company has a complete identity of financial interest with its wholly owned subsidiary and, therefore, as a matter of law cannot tortiously interfere with the contract of its wholly owned subsidiary."); H.S.M. Acquisitions, Inc. v. West, 917 S.W.2d 872, 883 (Tex. App. 1996) ("Keystone–PA had been a wholly owned subsidiary of Chester since September 1988. As such, Chester could not have tortiously interfered with Keystone–PA as a matter of law.").

107. 467 U.S. 752 (1984) (discussed in *Am. Med. Int'l, Inc.*, 821 S.W.2d at 336; *Cleveland Reg'l Med. Ctr., L.P.*, 323 S.W.3d at 347; *H.S.M. Acquisitions, Inc.,* 917 S.W.2d at 882).

because they have a unity of interest.[108] In this context, the Supreme Court reasoned as follows:

> A parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one. They are not unlike a multiple team of horses drawing a vehicle under the control of a single driver. With or without a formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder.[109]

This reasoning makes sense in the context of determining whether there is conspiracy liability under the Sherman Act. The parent-subsidiary relationship precludes free-market competition between the two companies and their actions cannot, therefore, be expected to comply with antitrust policy to preserve competition.[110] Accordingly, the Supreme Court reasoned that "[i]f a parent and a wholly owned subsidiary do 'agree' to a course of action, there is no sudden joining of economic resources that had previously served different interests."[111]

The Supreme Court's reasoning does not, however, apply to the question of whether a parent can commit a tort against a third party by directing its subsidiary to breach a contract with that third party. That question involves contract and tort law policy, not competition policy. Despite a parent company's unity of interest with its subsidiary company, the parent may well act tortiously against a third party in a way that does not protect the business interests of the parent and subsidiary, even if such behavior would not necessarily implicate competition policy.[112] Accordingly, the *Copperweld* decision is not controlling or even particularly persuasive authority with respect to the issue at hand.

B. Category 2: Decisions Formalistically Imposing Tort Liability Because the Parent and Subsidiary are Technically Separate Entities (The Minority Rule)

The rule of Category 2—that the parent enjoys no immunity from tort liability for terminating the contract of a subsidiary—may exist only in theory, or perhaps only in Florida.

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108. *Id.* at 771.
109. *Id.*
110. *Id.* at 770–71.
111. *Id.* at 771.
112. *See infra* Section II.C.

In *Oxford Furniture Companies v. Drexel Heritage Furnishings, Inc.*, the Eleventh Circuit, applying Alabama law, affirmed a jury verdict against Masco Corporation for its alleged tortious interference with the contract of its wholly owned subsidiary, Drexel.[113] Drexel had a contract with the plaintiff, Oxford Furniture Companies, whereby Oxford was the exclusive dealer of Drexel's furniture.[114] When another furniture distributor, McLeod, became upset about the exclusive nature of the Oxford contract and threatened litigation, Masco advised its subsidiary Drexel that it should continue to distribute through McLeod, a decision that Oxford considered a breach of contract.[115] The trial court found Masco liable for tortious interference with contract and awarded Oxford $250,000 in punitive damages on that claim.[116]

On appeal the Eleventh Circuit rejected Masco's claim that it was immune from tort liability because Drexel was its wholly owned subsidiary.[117] The court acknowledged that under Alabama law, "the alleged tortfeasor 'must be independent of, or a third party to,' the contract at issue."[118] However, "Alabama law also recognizes that a parent corporation is a distinct entity from its subsidiary and that the parent is not liable for the acts of its subsidiary unless the subsidiary is 'a mere adjunct, instrumentality, or alter ego of the parent corporation.'"[119] Because of this technical distinction between the two entities, and because there was no evidence that Masco was a party to the contract, Masco could be liable for tortious interference with contract and the jury verdict was affirmed.[120] The court did not inquire into Masco's purpose in interfering with the contract, whether it acted out of legitimate business interest, or whether its conduct constituted an independent tort. Rather, the technical separation between the parent and the subsidiary meant that the parent was a stranger to the contract and was therefore liable in tort for advising its subsidiary to breach the contract.

In *Peacock v. General Motors Acceptance Corp.*, the defendant was General Motors Acceptance Corporation (GMAC), General Motor's wholly owned subsidiary responsible for financing GM cars.[121] When the plaintiffs' Chevy car dealership went bankrupt, they sued GMAC for tortious interference with the contract between the plaintiffs and GM by virtue of GMAC attempting

113. 984 F.2d 1118, 1126 (11th Cir. 1993).

114. *Id.* at 1121.

115. *Id.* at 1121–22.

116. *Id.* at 1122.

117. *Id.* at 1126.

118. *Id.* (quoting Harrell v. Reynolds Metals Co., 495 So. 2d 1381, 1387–88 (Ala. 1986)).

119. *Id.* (quoting *Ex parte* Baker, 432 So. 2d 1281, 1284 (Ala. 1983)).

120. *Id.*

121. 432 So. 2d 142, 143 (Fla. Dist. Ct. App. 1983).

to reclaim and obtain payment for vehicles the plaintiffs had purchased from GM.[122] The Florida District Court of Appeal held that plaintiffs could proceed with their claim, despite the fact that GMAC was nothing more than the wholly owned financing arm of GM.[123] The court's reasoning consisted largely of the observation that "GMAC is a distinct legal entity, and its being a wholly owned subsidiary of GM does not alter that status."[124] The court rejected GMAC's argument that it was privileged to act as it did because it was protecting its contractual rights and business interests.[125] "GMAC's privilege to protect its contractual interests is not absolute but is instead conditioned upon its employing means that are not improper."[126] Accordingly, even if GMAC could prove it was acting to protect legitimate business interests, it could still be held liable in tort for interfering with the contract of its parent company.

The rule of Category 2 is plainly a minority rule, with only these two cases applying Alabama and Florida law in adopting this approach. It is a highly formalistic approach that considers only the technical separation between the parent and subsidiary corporation, but fails to consider whether the two entities share a unity of interests and whether they are acting to advance their legitimate business interests. As I argue below, this formalistic approach lacks justification in either efficiency or rights-based theories of contract law.[127]

C. Category 3: Decisions Imposing Tort Liability only if the Parent Fails to Act in the Best Interests of the Parent and Subsidiary or Commits an Independent Tort (Alaska, Arkansas, Delaware, Illinois, Maryland, Missouri, New York, North Carolina, Pennsylvania, Tennessee, Washington, Wisconsin, and the Texas Split)

The plurality approach to this issue adopts a middle ground. Category 3 cases hold that a parent company is privileged to terminate the contract of a subsidiary if it is acting out of a legitimate business interest and does not commit an independent tort.[128] In theory, this approach shields efficient breaches of contract from punitive liability while also policing tortious conduct.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* at 143–44.

126. *Id.* at 144.

127. *See infra* Parts III, IV.

128. *See* Am. Protein Corp. v. AB Volvo, 844 F.2d 56 (2d Cir. 1988); Phil Crowley Steel Corp. v. Sharon Steel Corp., 782 F.2d 781 (8th Cir. 1986); Valores Corporativos, S.A. de C.V. v. McLane Co., 945 S.W.2d 160 (Tex. App. 1997); WMW Mach. Co. v. Koerber AG, 658 N.Y.S.2d 385 (N.Y. App. Div. 1997).

In *WMW Machinery Co. v. Koerber AG*, the Appellate Division of the New York Supreme Court affirmed a grant of summary judgment dismissing the claim for tortious interference brought by WMW Machinery Company (WMW) against K.A.K. Holding Co. (KAK).[129] WMW claimed that KAK tortiously interfered with contracts it had with three KAK subsidiary companies to act as the exclusive distributor of defendants' grinding equipment.[130] The Appellate Division held that the tortious interference claim was properly dismissed because "the parent or a subsidiary of the Manufacturers, have an economic interest in the Manufacturers sufficient to support a defense of economic justification."[131] The court held that the defendants had a legitimate business justification for terminating the contracts, "especially in light of WMW's failure to sell a single machine pursuant to the contracts for over 22 months."[132] The court stated that "[t]he imposition of liability in spite of a defense of economic interest requires a showing of either malice on the one hand, or fraudulent or illegal means on the other."[133] The tortious interference claim was properly dismissed because WMW "failed to raise a triable issue of fact as to whether the defendants were motivated by malice, or employed fraudulent or illegal means to terminate the contracts."[134]

The Second Circuit applied this New York rule to reverse a jury verdict of tortious interference with contract against Volvo for winding down the corporate affairs of its subsidiary, Beijer, Inc., in a way which resulted in the termination of Beijer's contract with the plaintiff, American Protein Corporation (American Protein).[135] The court held that under New York law, "terminating a corporate contract in furtherance of an equally important right to act in its own economic interests justifies what would otherwise be actionable."[136] The court held that the jury verdict against Volvo and its executives failed "as a matter of law," because "[t]here is no evidence on the record before us of malice toward American Protein."[137] Rather, "the evidence showed only that Volvo executives on the board of Beijer, Inc. endorsed

129. 658 N.Y.S.2d at 386.

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id. See* Koret, Inc. v. Christian Dior, S.A., 554 N.Y.S.2d 867, 869 (N.Y. App. Div. 1990) ("Dior–Paris, as the corporate parent, had a right to interfere with the contract of its subsidiary, in order to protect its economic interests.").

135. Am. Protein Corp. v. AB Volvo, 844 F.2d 56, 62–63 (2d Cir. 1988).

136. *Id.* at 63.

137. *Id.*

terminating Beijer, Inc.'s contract with plaintiff for the legitimate business reason that it was losing money."[138]

In short, the Category 3 cases envision a dichotomy whereby the parent's decision to terminate a subsidiary contract might be motivated by legitimate business reasons or by an illegitimate, irrational reason such as "malice." If the parent's actions are motivated by legitimate business reasons, then there is no tort liability unless the actions constitute an independent tort.[139]

The Texas courts are split on whether to apply this rule or the absolute immunity rule of Category 1.[140] In *Valores Corporativos, S.A. de C.V. v. McLane Co.*, the San Antonio Division of the Texas Court of Appeals adopted the Category 3 rule, deciding "that a parent's interference with its subsidiary's contractual relations is usually justified, [but] circumstances may arise in which the financial interests of neither [the parent nor the subsidiary] motivate the interference."[141] The court acknowledged that in adopting this rule, it was "declin[ing] to follow our sister courts."[142] Rather than adopting a rule of absolute immunity, the court held that "a parent corporation is privileged to interfere with its subsidiary's contractual relations 'when the contract threatens a present economic interest of its wholly owned subsidiary,' and the parent does not 'employ[] wrongful means or act[] with an improper purpose.'"[143] The Fifth Circuit Court of Appeals has interpreted Texas law to arrive at the same conclusion, holding that a plaintiff in this situation "cannot recover for tortious interference with contract or with business relations if the allegedly interfering third party acted to protect his own legitimate interest."[144]

The Category 3 test does not always immunize a parent from tort liability for terminating the contract of a subsidiary. In *Phil Crowley Steel Corp. v. Sharon Steel Corp.*, the Eighth Circuit applied Missouri law to affirm a jury verdict finding that NFV Company and Sharon Steel tortiously interfered with the contracts between their subsidiary company and the plaintiff, Phil Crowley Steel Corporation.[145] The court found that the parent companies were liable

138. *Id.*

139. Examples of potential independent torts include "threats, violence, trespass, defamation, misrepresentation of fact, restraint of trade, or any other wrongful act recognized by statute or the common law." Nitro Distrib., Inc. v. Alticor, Inc., 565 F.3d 417, 428 (8th Cir. 2009) (applying Missouri law).

140. *See supra* Section II.A (discussing Texas cases applying the rule of Category 1).

141. 945 S.W.2d 160, 168 (Tex. App. 1997).

142. *Id.*; *see supra* Section II.A.

143. *Valores Corporativos*, 945 S.W.2d at 168 (alteration in original) (quoting T.P. Leasing Corp. v. Baker Leasing Corp., 732 S.W.2d 480, 483 (Ark. 1987)).

144. Deauville Corp. v. Federated Dep't Stores, Inc., 756 F.2d 1183, 1196 (5th Cir. 1985).

145. 782 F.2d 781, 782 (8th Cir. 1986).

because they "did not act to protect an interest of NVF or Sharon that the Macomber-Crowley contracts potentially threatened."[146] Rather, the parents acted contrary to their interests in the subsidiary in order to assist another subsidiary company, Ohio Metal.[147] Tort liability was appropriate in this situation because "Macomber's contracts did not threaten any interests of NVF and Sharon such as to justify their interference."[148] Where a parent company does act in its legitimate commercial interest, however, Missouri law will shield it from tort liability for intentional interference with contract.[149]

The Rule of Category 3 has been adopted by a plurality of states that have confronted this issue. In addition to New York, Texas, and Missouri, the rule has been adopted by courts applying the laws of Alaska,[150] Arkansas,[151]

146. *Id.* at 784.

147. *Id.*

148. *Id.*

149. *See, e.g.*, Nitro Distrib., Inc. v. Alticor, Inc., 565 F.3d 417, 428 (8th Cir. 2009) (applying Missouri law). The parent corporation had "a legitimate economic interest" in terminating contracts of its subsidiary and did not employ "independently wrongful [means], such as threats, violence, trespass, defamation, misrepresentation of fact, restraint of trade, or any other wrongful act recognized by statute or the common law," therefore, the parent was not liable for tortious interference with contract. *Id.*

150. Bendix Corp. v. Adams, 610 P.2d 24 (Alaska 1980). The Supreme Court of Alaska held that a parent was not liable for tortious interference with the contract of a subsidiary under the rule that "where there is a direct financial interest in a contract, the essential question in determining if interference is justified is whether the person's conduct is motivated by a desire to protect his economic interest, or whether it is motivated by spite, malice, or some other improper objective." *Id.* at 31.

151. T.P. Leasing Corp. v. Baker Leasing Corp., 732 S.W.2d 480, 483 (Ark. 1987) ("We think the correct rule is that a parent corporation's privilege permits it to interfere with another's contractual relations when the contract threatens a present economic interest of its wholly owned subsidiary, absent clear evidence that the parent employed wrongful means or acted with an improper purpose.").

Connecticut,[152] Delaware,[153] Illinois,[154] Maryland,[155] North Carolina,[156] Pennsylvania,[157] Tennessee,[158] Washington,[159] and Wisconsin.[160] As I argue

152. Boulevard Assocs. v. Sovereign Hotels, Inc., 72 F.3d 1029, 1036 (2d Cir. 1995) ("[A] parent company does not engage in tortious conduct when it directs its wholly-owned subsidiary to breach a contract that is no longer in the subsidiary's economic interest to perform.").

153. Wallace *ex rel.* Cencom v. Wood, 752 A.2d 1175, 1183 (Del. Ch. 1999) ("As for the Affiliates and Parents, 'there can be no non-contractual liability to the affiliated corporation' for tortious interference unless plaintiffs plead and prove that: (1) the Affiliates and Parents were 'interfering part[ies],' and (2) the Affiliates and Parents interfered 'not to achieve permissible financial goals but sought maliciously or in bad faith to injure plaintiffs.'") (alteration in original) (quoting Shearin v. E.F. Hutton Grp., Inc., 652 A.2d 578, 591 (Del. Ch. 1994)).

154. Knickman v. Midland Risk Servs.–Ill., Inc., 700 N.E.2d 458, 462–63 (Ill. App. Ct. 1998) (holding that parent company was not liable for tortiously interfering with a subsidiary's contract where the parent acted to protect its interests in the subsidiary); Stevenson v. ITT Harper, Inc., 366 N.E.2d 561, 571 (Ill. App. Ct. 1977) (holding that parent company was not liable for inducing the breach of a subsidiary contract because the parent's action "was motivated by reasonable business purposes and was the product of neither malice nor bad faith").

155. Alexander & Alexander Inc. v. B. Dixon Evander & Assocs., Inc., 650 A.2d 260, 272 (Md. 1994) ("A parent corporation is generally justified in requiring its subsidiary to modify economic arrangements, contractual or otherwise, if those arrangements do not benefit the parent.").

156. Broussard v. Meineke Disc. Muffler Shops, Inc., 155 F.3d 331 (4th Cir. 1998). The Fourth Circuit applying North Carolina law held that the parent company of a franchisor was immune from tort liability for directing the termination of franchise agreements because "parties having an interest in the activities of a corporation or the duty to advise or direct such activities should be immune from liability for inducing the corporation to breach its contract, assuming their actions are in pursuit of such interests or duties." *Id.* at 351.

157. Green v. Interstate United Mgmt. Servs. Corp., 748 F.2d 827, 831 (3d Cir. 1984) (applying Pennsylvania law to hold that a parent company was privileged to interfere with the contract of a subsidiary for the proper purpose of preventing the dissipation of corporate resources); Shared Commc'ns Servs. of 1800–80 JFK Boulevard, Inc. v. Bell Atl. Props., Inc., 692 A.2d 570, 575 (Pa. Super. Ct. 1997) (holding that parent companies could be liable for tortious interference with contract where they were "not acting to protect a 'legitimate concern'"). *But see* Nat'l Data Payment Sys. v. Meridian Bank, 212 F.3d 849, 857 (3d Cir. 2000) ("[T]he exact scope of the corporate parent privilege is unclear, and the Pennsylvania Supreme Court has not yet spoken on this issue.").

158. Waste Conversion Sys., Inc. v. Greenstone Indus., Inc., 33 S.W.3d 779, 783 (Tenn. 2000) ("A parent corporation acting contrary to its wholly-owned subsidiary's economic interests can be considered a third party to its subsidiary's contractual relationship and can be held liable for tortiously interfering with that relationship."). The Supreme Court of Tennessee has further held that the qualified privileged to interfere with the contract of a subsidiary does not apply when the parent owns less than 100% of the subsidiary. Cambio Health Sols., L.L.C. v. Reardon, 213 S.W.3d 785, 792 (Tenn. 2006).

159. Hansen v. Transworld Wireless TV–Spokane, Inc., 44 P.3d 929, 936 (Wash. Ct. App. 2002) (asserting that parent companies were not liable for tortious interference where they were acting to maximize shareholder value).

160. Allen & O'Hara, Inc. v. Barrett Wrecking, Inc., 898 F.2d 512, 516–17 (7th Cir. 1990) (asserting that parent company was not liable for tortious interference with the contract of a subsidiary where it acted to protect its business interests).

below, this plurality approach is justified by both efficiency theory and rights-based theories.[161]

D. Category 4: Decisions Imposing Tort Liability for "Improper" Behavior

In California, "the privilege of a parent or subsidiary corporation to interfere with the contractual relationship of the other 'is *at most* a qualified one dependent for its existence upon the circumstances of the case.'"[162] California provides little protection from tort liability to a parent seeking to terminate the contract of a subsidiary because it does not treat the parent-subsidiary relationship as a special circumstance in analyzing tortious interference claims.[163] Rather, California follows the Restatement of Torts sections applicable to all defendants to analyze this issue.[164] Parent corporations have the burden of pleading and proving as an affirmative defense that they are privileged to interfere with the contract of a subsidiary.[165]

To meet this burden, a parent corporation must prove that it: "(a) does not employ improper means, and (b) acts to protect his interest from being prejudiced by the relation."[166] This test is derived from Section 769 of the Restatement of Torts, which provides that one who has a financial interest in the business of a third person does not intentionally interfere with prospective business relations if he "does not employ improper means" and "acts to protect his interest from being prejudiced."[167] To determine what constitutes improper means, Section 769 points to "[t]he predatory means discussed in [Section] 767."[168] Section 767 is a generally applicable section that provides the

161. *See infra* Parts III, IV.

162. GHK Assocs. v. Mayer Group, 274 Cal. Rptr. 168, 185 (Cal. Ct. App. 1990) (emphasis added) (quoting Culcal Stylco, Inc. v. Vornado, Inc., 103 Cal. Rptr. 419, 421–422 (Cal. Ct. App. 1972)).

163. *Id.* at 184–85.

164. *Culcal Stylco, Inc.*, 103 Cal. Rptr. at 421 & n.3 (citing RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1939).

165. *GHK Assocs.*, 274 Cal. Rptr. at 185. This is in contradistinction to Category 3 cases, which put the burden on the plaintiff to prove that the parent company acted against its economic interest or committed an independent tort. *See, e.g.*, Wallace *ex rel.* Cencom v. Wood, 752 A.2d 1175, 1183 (Del. Ch. 1999) ("As for the Affiliates and Parents, 'there can be no non-contractual liability to the affiliated corporation' for tortious interference unless plaintiffs plead and prove that: (1) the Affiliates and Parents were 'interfering part[ies],' and (2) the Affiliates and Parents interfered 'not to achieve permissible financial goals but sought maliciously or in bad faith to injure plaintiffs.'" (alteration in original) (quoting Shearin v. E.F. Hutton Grp., Inc., 652 A.2d 578, 591 (Del. Ch. 1994))).

166. Asahi Kasei Pharma Corp. v. Actelion Ltd., 169 Cal. Rptr. 3d 689, 703 (Cal. Ct. App. 2013) (quoting Sade Shoe Co. v. Oschin & Snyder, 209 Cal. Rptr. 124, 127 (Cal. Ct. App. 1984) (citing RESTATEMENT (SECOND) OF TORTS § 769 (AM. LAW INST. 1939)).

167. RESTATEMENT (SECOND) OF TORTS § 769 (AM. LAW INST. 1939).

168. *Id.* § 769 cmt. e.

following seven non-exclusive factors for the court to consider in determining whether a party acted improperly in intentionally interfering with a contract:

> (a) the nature of the actor's conduct,
> (b) the actor's motive,
> (c) the interests of the other with which the actor's conduct interferes,
> (d) the interests sought to be advanced by the actor,
> (e) the social interests in protecting the freedom of action of the actor and the contractual interests of the other,
> (f) the proximity or remoteness of the actor's conduct to the interference and
> (g) the relations between the parties.[169]

Only one of these factors takes into account the parent-subsidiary relationship (factor (g)), and Category 4 courts caution that "[t]his factor is but one of the several factors contained within Section 767."[170]

It is erroneous for California courts to follow these generally applicable sections in analyzing the specific situation of a parent's intentional interference with contract. Section 769 applies to persons who have "an interest in the nature of an investment" in the business, such as "[a] part owner of the business" or "a partner or stockholder."[171] And Section 767 applies to defendants accused of this tort generally.[172] Sections 767 and 769 simply do not speak to the special circumstance of the parent of a wholly owned subsidiary seeking to terminate the contract of a subsidiary.[173]

This was the conclusion of the Alaska Supreme Court in holding that it was error for the trial court to instruct the jury based on these Restatement Sections in a case involving a parent corporation's decision to terminate the contract of a subsidiary.[174] The Alaska Supreme Court first stated that Section 769 unambiguously does not apply to claims of tortious interference with an existing contract.[175] The court then went on to observe that "the comments and bulk of cases citing § 767 deal with torts by competitors and are of little help here."[176] This is because

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169. *Id.* § 769 (1979).

170. Paramount Farms Int'l, L.L.C. v. Ventilex B.V., 2016-Ohio-1150, 61 N.E.3d 702, at ¶ 39 (citing RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1979).

171. RESTATEMENT (SECOND) OF TORTS § 769 (AM. LAW INST. 1979).

172. *See id.* § 767.

173. *See id.* §§ 767, 769.

174. Bendix Corp. v. Adams, 610 P.2d 24, 30 (Alaska 1980).

175. *Id.* at 29–30.

176. *Id.* at 30.

> [t]here appears to be a significant distinction, however, between the interests of a person in his competitor's contracts and those contracts in which he has some direct financial interest. One who interferes with a competitor's contracts ordinarily has little to lose and much to gain by successfully causing a breach of contract. Encouraging contractual stability may require imposing legal liability to stop such behavior when it steps beyond limits acceptable to society. But in a case where a person has some direct financial stake in a contract, it appears logical that a person's own economic self-interest would discourage causing a breach of contract because there would be some personal loss.[177]

Accordingly, the plurality of jurisdictions follow the Category 3 rule, and hold that a parent is privileged to terminate the contract of a subsidiary without incurring punitive liability if it acts in its economic interest and does not commit an independent tort.[178]

The rule of Category 4 strays from these principles by imposing tort liability even in circumstances where a parent acts out of sound business judgment, if its actions are deemed to be "improper."[179] Because the definition of improper depends on the vague, multi-factored test of Section 767 of the Restatement, liability can be based on something less than tortious behavior.[180] Category 3 cases impose tort liability on a parent acting in its business interest only if it commits an independent tort, "such as 'misrepresentations of facts, threats, violence, defamation, trespass, restraint of trade, or any other wrongful act recognized by statute or common law.'"[181] Category 4 cases allow for punitive remedies against a parent acting in the business interest of the parent and subsidiary if the courts deem its actions merely "improper."

A stark example of Category 4 in action is the case of *Asahi Kasei Pharma Corp. v. Actelion Ltd.*[182] Actelion was a pharmaceutical company that acquired all of the stock in CoTherix, another pharmaceutical company.[183] CoTherix had an existing joint-development contract with the plaintiff, Asahi, to develop a pharmaceutical called Fasudil that would directly compete with Actelion's

177. *Id.*
178. *See supra* Section II.C.
179. *See supra* notes 164–68 and accompanying text.
180. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1979).
181. Waste Conversion Sys., Inc. v. Greenstone Indus., Inc., 33 S.W.3d 779, 784 (Tenn. 2000).
182. 169 Cal. Rptr. 3d 689 (Cal. Ct. App. 2013).
183. *Id.* at 693.

existing pharmaceutical product, Tracleer.[184] On the day that Actelion's acquisition of CoTherix was finalized, it notified Asahi "that it was discontinuing development of Fasudil for 'business and commercial reasons.'"[185] Asahi sued Actelion and its directors for intentional interference with contract and prospective economic advantage and obtained a jury verdict for over $500 million dollars in compensatory damages plus punitive damages against the directors of Actelion.[186] These damages did not include compensatory damages for simple breach of contract because breach of contract damages had already been awarded to Asahi in an international arbitration.[187] Rather, the remedies awarded to Asahi were to deter and remedy the torts of intentional interference with contract and prospective economic advantage.[188] The California Court of Appeal affirmed the judgment against Actelion and its directors.[189]

Actelion was liable in tort despite the fact that it acted for the indisputable business benefit of stopping a joint development relationship to develop plaintiff's drug that was in direct competition with Actelion and its newly acquired subsidiary.[190] The evidence at trial showed that Actelion terminated its newly acquired subsidiary's contract "because it saw Fasudil as a significant threat to its market dominance with Tracleer."[191] Accordingly, under the rule of Category 4, Actelion was liable in tort because it employed improper means in terminating the contract. The evidence of improper means did not amount to monopolization or other anticompetitive behavior in violation of the antitrust laws, and no causes of action were tried to the jury for an independent tort based on the decision to breach the contract.[192] Rather, it appears the Court of Appeal found evidence of improper means to support the jury verdict in the fact that Actelion refused to provide Asahi with assurance that the joint development agreement would continue in the period of time between the announcement of Actelion's acquisition of CoTherix and the final consummation of the merger.[193] Nor did Actelion inform Asahi during this period that it had already decided to terminate the agreement.[194] Accordingly, what would otherwise be

184. *Id.* at 694–95.
185. *Id.* at 696.
186. *Id.* at 693.
187. *Id.* at 697.
188. *Id.*
189. *Id.* at 714.
190. *Id.* at 701–05.
191. *Id.* at 695.
192. *Id.* at 700–01.
193. *Id.* at 695–96.
194. *Id.*

a simple breach of contract sounded in tort simply because Actelion declined to announce the breach of contract until after the acquisition of CoTherix was finalized.

Undoubtedly there would have been no tort liability in *Asahi* if the case had been tried in a Category 3 jurisdiction. The decision by Actelion to terminate the contract was made for the sound business reason that Actelion did not want its wholly owned subsidiary engaged in a project with a competitor to develop a drug in direct competition with Actelion.[195] Nor did Asahi attempt to prove at trial that Actelion's action constituted an independent tort or an antitrust violation.[196] *Asahi* is a case where a simple breach of contract, that had already been compensated in arbitration, was penalized with over $500 million in additional damages. This is the difference between Category 3 and Category 4.

It appears that the rule of Category 4 may be followed in two other states. In *Paramount Farms International v. Ventilex, B.V.*, the Ohio Court of Appeals held that the trial court improperly granted summary judgment dismissing the plaintiff's claim that a parent company intentionally interfered with the contract of a subsidiary without considering the multi-factored test set forth in Section 767 of the Restatement of Torts.[197] However, this decision is not reported in any official reporter, and the Sixth Circuit Court of Appeals has held that Ohio law would shield a parent company from tort liability where it acted to protect a legitimate commercial interest rather than out of malice.[198]

In *Hawk Enterprises, Inc. v. Cash America International, Inc.*, the Oklahoma Court of Civil Appeals similarly held that the trial court could not grant summary judgment dismissing such a claim without considering the seven factors set forth in Section 767 of the Restatement.[199] In doing so, however, the court explicitly recognized that the Oklahoma Supreme Court had not addressed the issue.[200]

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195. *Id.* at 693.

196. *Asahi Kasei Pharma Corp.*, 169 Cal. Rptr. 3d 689.

197. 2016-Ohio-1150, 61 N.E.3d 702, at ¶ 39 (citing RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1979)).

198. Canderm Pharmacal, Ltd. v. Elder Pharm., Inc., 862 F.2d 597, 601–02 (6th Cir. 1988).

199. 282 P.3d 786, 792–95 (Okla. Civ. App. 2012) (citing RESTATEMENT (SECOND) OF TORTS § 767 (AM. LAW INST. 1979)).

200. *Id.* at 792.

III. APPLYING EFFICIENCY THEORY, TORT LIABILITY SHOULD BE INCURRED IF THE PARENT CORPORATION FAILS TO ACT IN THE BEST INTERESTS OF THE PARENT AND SUBSIDIARY OR COMMITS AN INDEPENDENT TORT

Efficiency theory generally addresses problems in contract law by asking which solution increases overall social welfare by resulting in the most efficient use of resources and an increase in societal wealth and utility.[201] "[E]fficiency," Judge Posner writes, "denote[s] that allocation of resources in which value is maximized."[202]

According to efficiency theory, contract rules should be selected that are efficient in one of two ways.[203] A rule (or transaction) is Pareto-superior if it makes at least one person better off and no person worse off.[204] For example, a breach of contract is Pareto-efficient if it makes the breaching party better off and the non-breaching party is given whatever gain it expected to achieve if the contract had been performed. Stephen Smith writes that "[t]o determine if a rule is Pareto-efficient, it is sufficient to ask if everyone did, or would, agree to it."[205]

But because transactions and rules have effects on third parties as well, there is a more complicated conception of efficiency, Kaldor-Hicks efficiency.[206] A rule or transaction is Kaldor-Hicks efficient if its overall benefits outweigh its costs—"if the gains made by those who benefit from the rule are greater than the losses incurred by anyone who might be harmed by the rule."[207] Smith opines that "Pareto-efficiency is favoured as a standard by many economists since it does not require the complex (some would say impossible) interpersonal comparisons of welfare required to assess Kaldor-Hicks efficiency."[208]

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201. SMITH, *supra* note 7, at 107.

202. POSNER, *supra* note 10, at 16.

203. SMITH, *supra* note 7, at 110.

204. *Id.*

205. *Id.* at 111.

206. POSNER, *supra* note 10, at 17.

207. SMITH, *supra* note 7, at 110.

208. *Id.* at 110–11 (alteration in original). For an additional explanation of Pareto-efficiency and Kaldor-Hicks efficiency, see Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 512–20 (1980).

The most well-known insight of efficiency theory is the concept of the efficient breach of contract.[209] Sometimes it is more economical for a party to breach a contract than to complete performance, even if we take into account the compensatory damages the breaching party must pay to the non-breaching party.[210] Posner provides a clear example of this situation:

> Suppose I sign a contract to deliver 100,000 custom-ground widgets at 10¢ apiece to A for use in his boiler factory. After I have delivered 10,000, B comes to me, explains that he desperately needs 25,000 custom-ground widgets at once since otherwise he will be forced to close his pianola factory at great cost, and offers me 15¢ apiece for them. I sell him the widgets and as a result do not complete timely delivery to A, causing him to lose $1,000 in profits. Having obtained an additional profit of $1,250 on the sale to B, I am better off even after reimbursing A for his loss, and B is also better off. The breach is therefore Pareto superior.[211]

The reason why the breach is Pareto superior is that the breaching party has gained $250 more than it would have gained by performing the original contract and A, the non-breaching party, is no worse off because it has been paid its expectation of $1,000 in profits. Indeed, the breach may be Kaldor-Hicks efficient because in addition to the $250 of additional profit earned by the breaching party, B has obtained 25,000 widgets that it places a higher value on than A did, the pianola factory remains open, providing jobs to all of its employees and economic activity to society, and the widgets go to the place of their highest utility and value. If we assume that the parties to contracts act rationally to maximize wealth or avoid loss, then most breaches of contract are likely efficient—done either because performance will result in a loss or less of a gain than an alternative contract or no contract at all.[212]

The necessary consequence of recognizing that many or most breaches of contract are efficient is a conclusion that contract law should not impose remedies that punish or deter a breach of contract. In the words of Robert L. Birmingham, "protection of the expectation interest is . . . dictated by considerations of economic efficiency, since it encourages optimal reallocation of factors of production and goods without causing material instability of

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209. *See generally* POSNER, *supra* note 10; SMITH, *supra* note 7; Birmingham, *supra* note 9.

210. POSNER, *supra* note 10, at 151; *see* SMITH, *supra* note 7, at 117.

211. POSNER, *supra* note 10, at 151.

212. *Id.* at 149 ("Most breaches of contract, however, are not opportunistic. Many are involuntary; performance is impossible at a reasonable cost—maybe at any cost . . . . Other breaches are voluntary but, as we are about to see, efficient—which from an economic standpoint is the same case as that of an involuntary breach.").

expectations."[213] On the other hand, if parties were punished for a breach of contract with supra-compensatory, punitive damages, parties would be forced to perform contracts even where performance results in a loss or less profit for the breaching party, delivery of the goods or services to a party that values them less than another party, and less wealth-maximization and economic activity in society as a whole. To return to the hypothetical described above, if the breaching party were forced to perform the original contract with A, A would be in the same position as it would had the contract been breached, but the breaching party would be $250 poorer, B would lose 25,000 desperately needed widgets, and the pianola factory would be shuttered, and all of its employees would lose their jobs. Moreover, the law would bend the widgets to a use valued at 10¢ apiece rather than a use valued at 15¢ apiece resulting in a sub-optimal utility for those widgets. According to efficiency theory, it is to avoid deterring efficient breaches of contract that the standard remedy is expectation damages, and not punitive damages.[214]

Now to return to the situation of a parent company directing its subsidiary to breach a contract: should the law punish the parent for inducing these breaches of contract? At first blush, the answer would appear to be no, never. Just as efficiency theory assumes that a simple breach of contract is committed for rational reasons to maximize wealth,[215] so too must a parent company's inducement of breach be presumed to be motivated by a desire to maximize wealth. If a parent company induces a breach of contract, it will be because performance by the subsidiary of the contract will result in less gain or more loss than breaching the contract would, even after taking into account the need to compensate the non-breaching party for its expectation damages. Accordingly, Category 1, complete immunity from tort liability for the parent company, would appear to be the approach favored by efficiency theory.

However, if we are to apply a truly concordant approach, then we must take into account the valid critiques of efficiency theory before selecting a rule. One principle critique of efficiency theory is that it is based on the false assumption that the breaching party always acts out of rational, self-interest.[216] Robert C. Ellickson critiques efficiency theory by pointing out "that the assumption of rationality exaggerates actual human cognitive capacities, and that, because a person's received utility is unobservable, the assumption of rational utility-

213. Birmingham, *supra* note 9, at 292.

214. SMITH, *supra* note 7, at 418.

215. *Id.* at 116–17.

216. Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23, 23 (1989).

maximization is strictly nonfalsifiable."[217] Rather than acting out of rational self-interest, people often act out of lack of information or the inability to process information,[218] irrational risk-aversion or risk-attraction,[219] malice,[220] revenge,[221] or a host of other human frailties.[222] Posner himself writes that "[p]eople are not always rational . . . [a]nd there are situations in which rational choice is precluded by uncertainty, defined as noncalculable risk."[223]

In response to this criticism of efficiency theory that it falsely assumes rational behavior, Posner writes, "[i]t is important to bear in mind that an assumption is not a finding."[224] Elsewhere, Posner explains that theory necessarily proceeds with simplifications and abstractions: "[A]n economic theory of law is certain not to capture the full complexity, richness, and confusion of the phenomena—criminal activity or whatever—that it seeks to illuminate. That lack of realism does not invalidate the theory; it is, indeed, the essential precondition of a theory."[225]

Nonetheless, in selecting from among several legal rules, why not select the rule that takes account of the possibility of a false assumption, rather than the rule that is premised on the artificial simplifications and abstractions of pure theory. This reasoning would advocate for Category 3, which allows for the possibility that the parent acts against good business judgment, as opposed to Category 1, which assumes that the parent company always acts rationally to induce only efficient breaches of contract. Posner goes on to argue that "a theory cannot be overturned by pointing out its defects or limitations but only by proposing a more inclusive, more powerful, and above all more useful theory."[226] This is the very goal of the concordant theory of applied pluralism,

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217. *Id.*

218. *Id.* ("The model assumes that a person can perfectly process available information about alternative courses of action, and can rank possible outcomes in order of expected utility.").

219. *Cf.* Ernst, *supra* note 66, at 469–70 ("[T]he settlement of litigation is not characterized by rationality.") (citing Jeffrey J. Rachlinski, *Gains, Losses, and the Psychology of Litigation*, 70 S. CAL. L. REV. 113, 114–19, 124–25, 145 (1996) (discussing the role of risk-aversion and risk-attraction in settling litigation)).

220. Holmes, *supra* note 51, at 471.

221. Kate Zernike, *Jurors Convict 2 Christie Allies in Lane Closings*, N.Y. TIMES, Nov. 5, 2016, at A1 (reporting conviction of former aides, to New Jersey Governor Chris Christie, of all charges resulting from the closing of the George Washington Bridge as punishment against a "mayor who declined to endorse the governor's re-election").

222. *See* Jon Elster, *Some Unresolved Problems in the Theory of Rational Behavior*, 36 ACTA SOCIOLOGICA 179, 179 (1993).

223. POSNER, *supra* note 10, at 4.

224. *Id.*

225. Richard A. Posner, *The Economic Approach to Law*, 53 TEX. L. REV. 757, 774 (1975).

226. *Id.*

which attempts to select the rule that takes into account multiple theories and the critiques of those theories.

A more convincing answer to the argument that efficiency theory is premised on a false assumption of rationality is that, whereas individuals may act out of irrational disregard for self-interest, business firms are far more likely to act rationally. Alan Schwartz and Robert E. Scott write that "[t]hese objections [to efficiency theory] would be troublesome for an efficiency approach that covered all contract types."[227] However, Schwartz and Scott argue "that they have little force when [firm to firm] contracts *alone* are considered."[228] Schwartz and Scott reason as follows:

> A firm is directed by its owners, who often are shareholders. Shareholders prefer their firms to maximize profits, which the shareholders then can consume or save. . . . No one doubts that managers sometimes successfully sabotage owners. For two reasons, however, we will assume that managers obey shareholder instructions. First, managers sabotage shareholders either by diverting corporate wealth to themselves or by failing to take appropriate risks on behalf of the firm. Managers, however, have no incentive to degrade the quality of the contracts that they write; after all, these contracts create the wealth that the managers later can divert. Second, the legal rules that attempt to deter bad manager behavior fall in the domains of the criminal, corporate, and securities laws. Contract law should exploit this specialization by assuming that the agreements it regulates reflect the parties' maximizing choices.[229]

Hence, Schwartz and Scott reason that presuming economic rationality by business firms keeps contract law within its boundaries.[230] To the extent there is "bad manager behavior," that will fall within the realm of other areas of law to police.[231] This reasoning would tend to support the aspect of the Category 3 rule that there should be no tort liability for a parent inducing a breach of contract unless the conduct constitutes an independent tort. If the conduct is independently tortious, then the behavior is beyond the realm of contract law and should be punished as a tort, according to Schwartz and Scott's boundary theory.[232]

227. Schwartz & Scott, *supra* note 7, at 545.

228. *Id.*

229. *Id.* at 550–51.

230. *Id.* at 545, 551.

231. *Id.*

232. *Id*. at 545.

Schwartz and Scott go on to justify efficiency theory's assumption of rationality in the context of firm-to-firm contracts as follows:

> [T]he pressure to survive promotes competence. This pressure takes two forms. First, firms that systematically make bad economic decisions lose out in competition with profit-maximizing firms. Hence, surviving firms are generally the ones that can do what they set out to do. Second, employees who systematically make bad economic decisions are unlikely to be promoted to positions of responsibility. Hence, senior managers can generally do what they set out to do. This is not to say that all firms all the time pursue profit-maximizing strategies. But it is to say that owners and the market put systematic pressure on firms to behave optimally; hence, it is a plausible working assumption that firms rationally pursue the objective of maximizing profits.[233]

Hence, according to efficiency theory, we can generally presume that in the context of firm-to-firm contracts (like those that are the subject of this Article), parent companies will act rationally and efficiently in their business interest in determining whether to induce a breach of contract. Accordingly, as a general rule such breaches should not be punished unless they are independently tortious. Otherwise, the law will deter and punish efficient breaches of contract.

However, even Schwartz and Scott acknowledge that rational firm behavior is not always the case. They write, "[t]his is not to say that all firms all the time pursue profit-maximizing strategies."[234] Other defenders of the rationality assumption also acknowledge that companies do not *always* act out of rational self-interest.[235] Stephen A. Smith agrees with Schwartz and Scott that companies are more likely to act out of rational economic interest because they "are required by corporate statute to act for profit. And even if they were not so required, they would likely go out of business if they failed to act in a self-interested rational manner."[236] But Smith goes on to acknowledge that

> [t]he second, more important reason that the unrealistic assumptions objection is not fatal to efficiency theories of contract law is that efficiency theories do not require that everyone, or even the majority of people, act in a rational, self-interested fashion. It is enough that a significant number of people act in this way.[237]

233. *Id.* at 551.

234. *Id.*

235. *See* SMITH, *supra* note 7, at 126–27; Coleman, *supra* note 208, at 523; Elster, *supra* note 222, at 179; Feinman, *supra* note 65, at 52.

236. SMITH, *supra* note 7, at 126–27.

237. *Id.* at 127.

Hence, efficiency theory applied in this context would be based on the premise that when a parent company induces the breach of a subsidiary company's contract, it will *usually* do so for rational business reasons. But sometimes it will not. And when the parent's behavior constitutes an independent tort, then it exceeds the boundaries of contract law and should be governed by the punitive policies of tort. And in those rare situations when a parent company acts not to maximize corporate assets but out of malice, oppression or some other irrational motive, then it is not inducing an efficient breach of contract and such behavior should also be punished and deterred.

All of this argues for the Rule of Category 3, which shields a parent company from tort liability for inducing a subsidiary to breach a contract, except when its conduct constitutes an independent tort or is not justified by rational, business reasons.[238] Such a rule protects the large number of presumably efficient breaches of contract while acknowledging the possibility that sometimes even private companies fail to act for rational, business reasons. The Rule of Category 1 fails to take this possibility into account by granting the parent complete immunity from tort liability.[239] The Rule of Category 2 deters and punishes all breaches of contract, efficient or otherwise.[240] The Rule of Category 4 punishes many breaches of contracts that the parent induces for legitimate business reasons, simply because the conduct is adjudged wrongful in a way that can be less than tortious.[241]

Another critique of efficiency theory is that it is not grounded in morality because it fails to take into account individual rights.[242] Efficiency theory sacrifices the interests of the individual parties to the contract in the name of the overall maximization of wealth and utility in society.[243] As Posner writes, "by aggregating utility across persons, utilitarianism treats people as cells in the overall social organism rather than as individuals."[244] In the context of the particular issue at hand, imposing no punishment on parents to deter them from inducing subsidiaries to breach contracts disregards the right of the non-breaching party to the contract to make an enforceable contract and see it performed. One answer to this is that the non-breaching party is sufficiently compensated by receiving its full expectation damages under the contract.[245]

238. *See supra* Section II.C.
239. *See supra* Section II.A.
240. *See supra* Section II.B.
241. *See supra* Section II.D.
242. SMITH, *supra* note 7, at 129.
243. *Id.*
244. POSNER, *supra* note 10, at 16.
245. SMITH, *supra* note 7, at 118.

Another answer to address this is to argue that the overall benefit to society of increased wealth and utility outweighs the individual interest of the non-breaching party to see the contract performed.[246] But neither of these answers suffice when the parent company acts, not out of efficient, economic business interest, but out of malice to harm the non-breaching party or commits an independent tort. Hence, once again Category 3, which imposes punishment under such circumstances, is the best rule. Moreover, the advantage of the concordant approach to selecting contract rules is that we can now apply individual rights-based theory to the problem at hand, to see if the rule we have selected adequately safeguards individual rights.

IV. Applying Rights-Based Theory, Tort Liability Should be Incurred if the Parent Corporation Fails to Act in the Best Interests of the Parent and Subsidiary or Commits an Independent Tort

One cannot and should not rest solely on utilitarian theories (such as efficiency theory) to select the best contract rule to govern a particular situation. Courts, which are charged with meting out justice to the individual parties before them, presumably do not focus solely or even primarily on the interests of society at large. Rather, as Fuller and Perdue observe, "it is impossible to assume that when a court enforces a promise it necessarily pursues only one purpose and protects one 'interest.'"[247] When one is confronted with a palette of potential rules, the best rule is the rule that serves both societal interests and protects the rights of the parties. Hence, having determined that efficiency theory favors a rule holding a parent company immune from tort liability for inducing a subsidiary to breach a contract, except when the parent acts without regard to rational business interest or commits an independent tort, we now consider whether rights-based theories of contract support the same rule.

Rights-based theories explain and advocate for contract rules that uphold the individual rights of the parties to a contract.[248] A foundational component of individual liberty is the freedom to order one's own affairs on one's own terms through the making of private contracts.[249] In order to protect this freedom of contract, the promises enshrined in contracts must be enforceable.[250]

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246. *Id.* at 126.

247. Fuller & Perdue, *supra* note 5, at 66.

248. SMITH, *supra* note 7, at 107.

249. HILLMAN, *supra* note 8, at 9 (citing Samuel Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 366 (1921); Roscoe Pound, *Liberty of Contract*, 18 YALE L.J. 454, 457 (1909)).

250. *See* U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . .").

The promissory theory of contract, most eloquently articulated by Charles Fried, urges that "respect for others as free and rational requires taking seriously their capacity to determine their own values."[251] Fried argues that we enforce contractual promises because "holding people to their obligations is a way of taking them seriously."[252] Moreover, having invoked the social and legal conventions of private contracts, which are designed to protect our individual liberties, the parties to a contract have a moral obligation either to keep their promises or pay compensation for breaking them.[253]

Does this moral obligation to honor promises apply to a parent company who inherits the contracts of a subsidiary it acquires? Freedom of contract requires that we only enforce promises that are voluntarily undertaken and accepted.[254] Charles Fried explains that "[t]he need for acceptance shows the moral relation of promising to be voluntary on both sides."[255] As Randy Barnett phrases it, "enforcement is not morally justified without a genuine commitment by the person who is to be subjected to a legal sanction."[256] One might argue that there is no moral justification for holding a parent company to a contractual promise it never made in the first place. But even in the case where a parent acquires a subsidiary after the subsidiary entered into the contract in question, the parent company presumably had a full opportunity to discover and examine the subsidiary's existing contractual obligations. In voluntarily acquiring the subsidiary, the parent company voluntarily inherited the subsidiary's contractual promises, and liberty does not suffer if we hold the parent to those promises.

Moreover, an alternative rights-based theory of contract, the reliance theory, also demands that the parent be held to the contractual promises of its subsidiary. The reliance theory posits that contract rules are explained and justified by the need to protect the party who has relied to its detriment on the promises enshrined in contracts.[257] There is a pressing moral case for protecting a party that has relied on the institution of a binding contract to incur expenses and forego alternative business opportunities. As Fuller and Perdue write, "[T]he promisee who has actually relied on the promise, even though he may not thereby have enriched the promisor, certainly presents a more pressing case

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251. FRIED, *supra* note 15, at 20.

252. *Id.*

253. *Id.* at 16 ("An individual is morally bound to keep his promises because he has intentionally invoked a convention whose function it is to give grounds—moral grounds—for another to expect the promised performance.")

254. *Id.* at 43.

255. *Id.*

256. Barnett, *supra* note 7, at 272.

257. *Id.* at 274.

for relief than the promisee who merely demands satisfaction for his disappointment in not getting what was promised him."[258] If we are to apply a truly concordant approach, we have to consider reliance theory in addition to promissory theory. Where a parent has acquired a subsidiary corporation, parties who have contracts with the subsidiary corporation face the danger that their reliance interests will be frustrated should the parent decide to terminate those contracts.[259] Those reliance interests must be protected, not only to protect the individual interests of the non-breaching party, but because we want to facilitate a system whereby businesses can rationally rely on private contracts to make investments, plan, and order their affairs.[260]

Accordingly, a parent company should be bound to the contracts of its subsidiary to the same extent as its subsidiary is bound to those contracts—but not to a greater extent. Particularly because the parent never made the contractual promises in the first place, and never induced the reliance that resulted from those promises, it would be a perverse set of rules that punished the parent more severely for inducing a breach of contract than it punished the subsidiary who actually entered into the contract. Under both promissory and reliance theories of contract, the proper measure of damages is compensatory damages, not punitive damages.

The "normal" measure of damages for breach of contract is expectation damages under both reliance theory and promissory theory. The need to protect against reliance injury results in an award of expectation damages because expectation encompasses reliance injury in two distinct ways.[261] First, if one expects to make a profit under a contract, that necessarily includes "(1) reimbursement for what has been done, and (2) a profit in addition."[262] Hence, expectation damages compensate for the reliance damages resulting from "what has been done." But there is another type of reliance harm which is not compensated by only reimbursing for "what has been done": in reliance on the contract, the promisee may forego other business opportunities. "Hence, the reliance interest must be interpreted as at least potentially covering 'gains prevented' as well as 'losses caused.'"[263] But opportunities lost and gains prevented are difficult to prove and quantify, and so, according to Fuller and Perdue, the law awards expectation damages as a "prophylaxis" against such

258. Fuller & Perdue, *supra* note 5, at 56.

259. *See supra* Section II.A.

260. Fuller & Perdue, *supra* note 5, at 62 (referring to "the need for facilitating reliance on business agreements").

261. *Id.* at 74.

262. *Id.*

263. *Id.* at 55.

harm.[264] The expectation damages award "is a cure for these losses in the sense that it offers the measure of recovery most likely to reimburse the plaintiff for the (often very numerous and very difficult to prove) individual acts and forbearances which make up his total reliance on the contract."[265] In addition to protecting this interest, the availability of expectation damages encourage businesses to rely on the enforceability of private contracts in making investments.[266] Hence, expectation damages are the preferred remedy even for a reliance theorist for two reasons: "(1) [T]he need for curing and preventing the harms occasioned by reliance, and (2) . . . the need for facilitating reliance on business agreements."[267]

Promissory theory also embraces compensatory damages (and in particular expectation damages) as a limit on damages for breach of contract. The moral obligation to keep a contractual promise means that the promisor should either perform the contract or "hand over the equivalent of the promised performance."[268] Fried writes that expectation damages are appropriate because "[t]he expectation standard gives the victim of a breach *no more or less* than he would have had had there been no breach—in other words, he gets the benefit of his bargain."[269]

But if there is a moral obligation to keep a contractual promise, why not punish a breach of contract with punitive damages, as we punish torts such as fraud and misrepresentation? According to promissory theory, the reason breaches are not punished is that a contract represents a dual promise. Contemporary promissory theorists Daniel Markovits and Alan Schwartz write that a contract is a promise "either to trade goods or services to buyers or to make a monetary transfer to buyers, equal to the value the buyers would realize from receiving the goods or services [i.e., an expectation value]."[270] This concept of the dual promise has long been enshrined in our law. Oliver Wendell Holmes wrote in the nineteenth century that "[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else."[271] If punitive damages beyond such compensation are awarded for breach of contract, it violates freedom of contract by imposing on parties something far beyond what they bargained for.[272] Markowitz and

264. *Id.* at 60–61.

265. *Id.* at 60.

266. *Id.* at 61–62.

267. *Id.* at 62.

268. FRIED, *supra* note 15, at 17.

269. *Id.* (emphasis added).

270. Markovits & Schwartz, *supra* note 19, at 808.

271. Holmes, *supra* note 51, at 462.

272. *See id.*

Schwartz add, "Because dual performance contracts leave the contracting parties in control of the substance of their obligations, and, in particular, because they do not impose any obligations that the parties did not agree to ex ante, they better respect freedom of contract."[273]

Hence, under a rights-based theory, a parent company who inherits the contracts of a newly acquired subsidiary should not be punished with tort liability for terminating those contracts. The parent company inherits the responsibility for respecting the non-breaching party's reliance interest in the existing contract, and so must pay compensation if it breaches the contract. The parent company, moreover, voluntarily inherits the moral obligation to keep the dual promise enshrined in its subsidiary's contract: either to see that the contract is performed or pay compensation. But it would violate the freedom of contract of the parent company if it were further punished for directing the termination of subsidiary contracts, particularly where the parent never made the promise or induced the reliance in the first place.

Accordingly, applying rights-based theory, the rule of Category 3 is again the best rule to govern when a parent company should be liable in tort for inducing the breach of a subsidiary contract. Parents should be immune from tort liability unless they act out of malice and bad faith or commit an independent tort. The imposition of tort liability for terminations undertaken not for good faith business reasons, finds its justification in rights-based contract theory's emphasis on good faith in the performance of a contract.[274] Respect for the institution of private contract as an institution that guards individual liberty requires that society "condemn chicanery and sharp practice in the carrying out of contractual obligations."[275] A parent company that voluntarily inherits a subsidiary contract also inherits the obligation to perform that contract in good faith. Under the dual-performance conception of a contract, this means that the parent has an obligation either to perform the contract or to terminate it for good faith reasons and pay compensation. A termination undertaken for malice and oppression violates this duty and society can rightfully punish it. And if the termination of the contract constitutes an independent tort such as fraud, then we have left the realm of contract law and entered the realm of torts, in which society has a legitimate interest in punishing and deterring such behavior.

273. Markovits & Schwartz, *supra* note 19, at 811.

274. FRIED, *supra* note 15, at 88.

275. *Id.* at 85.

V. CONCLUSION

The practical task of selecting among legal rules requires that we first acknowledge that no single normative theory can explain or justify a social and legal institution as old and complicated as contracts. A pluralist society demands a pluralist approach to selecting contract rules. Under this concordant approach, any rule we select should be justified by both utilitarian theories, because it recognizes the interests of society, and by rights-based theories, because it does justice to the individual parties to the contract. In this Article I have attempted to demonstrate that such a concordant approach to normative contract theory is possible by addressing the problem of whether and when a parent company should be held liable in tort for directing the breach of a subsidiary's contract. Under both the dominant utilitarian theory of our time (efficiency theory), and the dominant rights-based theories of our time (promissory and reliance theories), a parent should be held liable in tort for intentional interference with a subsidiary contract only where it fails to act for rational business reasons or where it commits an independent tort.