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## A Complete View of the Cathedral: Claims of Tortious Interference and the Specific Performance Remedy in Mergers and Acquisitions Litigation

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# A COMPLETE VIEW OF THE CATHEDRAL: CLAIMS OF TORTIOUS INTERFERENCE AND THE SPECIFIC PERFORMANCE REMEDY IN MERGERS AND ACQUISITIONS LITIGATION

*Luke Nikas\* and Paul B. Maslo†*

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“Merely invoking tortious interference will send shivers down an M&A lawyer’s spine.”<sup>1</sup>

## I. INTRODUCTION

A bank promises to lend several billion dollars to fund a buyer’s purchase of a target company. The buyer enters into a merger agreement with the target. Thereafter, the economy plummets, and the bank decides that breaching its contract with the buyer will cost less than performing. The buyer seeks specific performance. The target also sues the bank, alleging tortious interference with the merger agreement. Billions of dollars are on the line.

This is the reality lived by many investment banks that committed to fund leveraged buyouts during the recent economic downturn. Most of these matters were resolved in private settlements to avoid the possibility of crippling tort liability and publicly airing the messy details of the targets’ poor financial circumstances. The judicial decisions that do exist

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1. Steven M. Davidoff, *Wachovia and the Uncertainty Principle*, N.Y. TIMES DEALBOOK (Oct. 3, 2008, 12:05 PM), <http://dealbook.nytimes.com/2008/10/03/wachovia-and-the-uncertainty-principle/>.

reveal a myopic view of the relationship between the buyer's specific performance claim against the bank, on the one hand, and the target's tort claim against the bank, on the other. By treating these claims as substantively distinct, courts threaten to impose an inefficient liability rule for the bank's allegedly tortious conduct (including the possibility of punitive damages) and an equally inefficient property rule for the bank's alleged breach of contract (specific performance). Courts must take a singular view of the combined costs and efficiencies created by the buyer's and target's individual claims to properly determine the appropriate remedy for the bank's conduct.

Part II addresses the current state of tortious-interference law and the viability of the target's tortious-interference claim. This section analyzes and identifies relevant precedents that have gone largely unnoticed both in litigation and commentary related to a bank's potential liability for tortious interference.

Part III explains that allowing both the buyer's and target's claims to succeed against the bank is inefficient because it increases *ex ante* and *ex post* costs of negotiations and overcompensates the target for its alleged harm.

Part IV argues that the target's tort claim should fail, unless the bank causes a wrongful breach or its conduct is independently unlawful. Further, expectation damages (a liability rule)—i.e., damages that put the buyer in the position in which it would have been had the bank fulfilled its obligation—should apply to the buyer's contract claim (assuming there *is* a breach), unless the bank's breach is opportunistic. In addition, the rules of evidence should be amended and the common law further developed to prevent a target from introducing evidence of most settlement negotiations between the buyer and bank to prove the bank's intent to interfere with the merger agreement.

Part V concludes by demonstrating that this debate matters. Mergers are an integral part of the economic landscape, resulting in billions of dollars changing hands every year. And yet, the litigation that impacts these deals when they become troubled reflects a deep misunderstanding of the financial industry, tort law, and the law of remedies. These failures have massive economic consequences, as well as far-reaching implications for analogous disputes to which the caselaw and incentives at issue apply. The debate ensnares billion-dollar transactions as readily as everyday transactions involving a set of interlocking contracts. These inefficiencies waste billions of dollars; they throw sand in the wheels of innumerable business transactions. Enough is enough.

## II. THE CURRENT STATE OF TORTIOUS-INTERFERENCE LAW

In simple terms, a merger is a process whereby two or more autonomous companies combine to form a single entity. Motives for engaging in mergers vary (e.g., the achievement of economies of scale and scope, the unlocking of synergies, and product and geographic diversification). Meth-

ods of purchase differ as well: a buyer can acquire a target company using its stock or cash, either from its war chest or borrowed. This article focuses on potential liability arising when a buyer seeks to borrow money to purchase a target, otherwise known as a leveraged buyout, and the deal subsequently goes awry.

The corporate law community has immersed itself in a roiling debate over the viability of a target's tortious-interference claim in these circumstances. At least one commentator has stated that tortious interference with contract is a viable claim in a leveraged-buyout case,<sup>2</sup> and one court has found that a bank cannot even litigate its obligations under its commitment letter without the possibility of being held liable for tortiously interfering with the target's merger agreement.<sup>3</sup> Hyped-up references to the multi-billion dollar verdict in *Pennzoil*<sup>4</sup> and viral speculations about whether the troubled mergers would close have clouded the rational assessment of tortious-interference law. This section fills that gap.

### A. Elements and Nature of the Tort

Attorneys that paper corporate transactions forecast risk: what disputes may arise and how the merger agreement or the commitment letter should address them. They also use forum-selection and choice-of-law clauses to decide where those disputes should be litigated, if they need to be, and which state's law would apply if they are. While banks may, therefore, gauge how a court of their choosing would interpret their commitment letter, a contractual choice-of-law provision would likely not bind a target in a tort action against the lending bank.<sup>5</sup> That dispute would in-

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2. *Clear Channel: Lessons Learned*, N.Y. TIMES DEALBOOK (May 14, 2008, 11:02 AM), <http://dealbook.blogs.nytimes.com/2008/05/14/clear-channel-lessons-learned/>.

3. See *Credit Suisse Sec. (USA) LLC v. Huntsman Corp.*, 269 S.W.3d 722, 725, 730 (Tex. App. 2008).

4. In *Texaco, Inc. v. Pennzoil Co.*, 729 S.W.2d 768 (Tex. App. 1987), a Texas appellate court upheld substantially all of a state court jury verdict in excess of ten billion dollars in a tortious-interference action. Plaintiff Pennzoil in essence alleged that Texaco tortiously interfered with Pennzoil's efforts to acquire Getty Oil via a tender offer by making a subsequent, larger tender offer that was ultimately accepted by Getty. An action to challenge the constitutionality of the verdict was brought in federal court and was the subject of important litigation on the question of federal jurisdiction in *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1 (1987). The Supreme Court held that Younger abstention required the federal district court to abstain from hearing the claims brought by Texaco challenging the constitutionality of the Texas jury verdict. *Id.* See also Timothy S. Feltham, Note, *Tortious Interference With Contractual Relations: The Texaco Inc. v. Pennzoil Co. Litigation*, 33 N.Y.L. SCH. L. REV. 111 (1988); Harvey L. Temkin, *When Does the 'Fat Lady' Sing?: An Analysis of 'Agreements in Principle' in Corporate Acquisitions*, 55 FORDHAM L. REV. 125 (1986); Roger M. Baron & Ronald J. Baron, *The Pennzoil-Texaco Dispute: An Independent Analysis*, 38 BAYLOR L. REV. 253 (1986). See generally Robert H. Mnookin & Robert B. Wilson, *Rational Bargaining and Efficiency: Understanding Pennzoil v. Texaco*, 75 VA. L. REV. 295 (1989) (providing a thorough background of the Pennzoil litigation).

5. See, e.g., *Fin. One Pub. Co. v. Lehman Bros. Special Fin., Inc.*, 414 F.3d 325, 335 (2d Cir. 2005) ("Under New York law, then, tort claims are outside the scope of contractual choice-of-law provisions that specify what law governs construction of the terms of the con-

stead be governed by whichever state's law prevails in a choice-of-law analysis, potentially exposing banks to tort claims in far-flung jurisdictions they would prefer to avoid. Thus, the applicable law of tortious interference may extend as widely as the geographical region in which banks choose to fund deals (although many states have adopted similar doctrines of tortious interference).

New York, for example, adopts a common formulation of the tortious-interference doctrine, under which a target would be required to prove the following four elements:

1. the existence of a valid contract between the target and the buyer, such as a merger agreement;
2. the bank's knowledge of that contract;
3. the bank's intentional and improper procuring of the buyer's breach of that contract; and
4. actual breach of that contract and damages resulting therefrom.<sup>6</sup>

This article assumes that the target will be able to prove elements one, two, and four. Thus, if the bank has intentionally and improperly caused the buyer to breach its merger agreement with the target, the target has stated a cause of action for tortious interference. Restatement (Second) of Torts § 767 identifies several factors to guide the analysis of element three:

- the nature of the actor's conduct;
- the actor's motive;
- the interests of the other with which the actor's conduct interferes;
- the interests sought to be advanced by the actor;
- the social interests in protecting the actor's freedom of action and the other's contractual interests;
- the proximity or remoteness of the actor's conduct to the interference; and
- the relations between the parties.<sup>7</sup>

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tract, even when the contract also includes a broader forum-selection clause.”); *Walker v. Bankers Life & Cas. Co.*, No. 06 C 6906, 2007 WL 967888, at \*3 (N.D. Ill. Mar. 28, 2007) (holding that contractual choice-of-law clauses “do not govern tort claims unless it is clear this was the parties’ intent” and finding that a choice-of-law provision, which did not by its terms apply to “any action,” did not apply to extracontractual tort claims). *But see, e.g.*, *Fla. State Bd. of Admin. v. Law Eng'g & Envtl. Servs., Inc.*, 262 F. Supp. 2d 1004, 1012 (D. Minn. 2003) (applying Minnesota choice of law principles and holding contractual choice-of-law clause applicable to tort claims related to the contract).

6. *White Plains Coat & Apron Co. v. Cintas Corp.*, 867 N.E.2d 381, 383 (N.Y. 2007). The law in other states is similar. *See, e.g.*, *Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 992 (Del. Ch. 1987) (“There must be (1) a contract, (2) about which defendant knew and (3) an intentional act that is a significant factor in causing the breach of such contract (4) without justification (5) which causes injury.”); *Nelson v. Fleet Nat'l Bank*, 949 F. Supp. 254, 260 (D. Del. 1996) (under Delaware law, defendant's conduct must be improper).

7. RESTATEMENT (SECOND) OF TORTS § 767 (1979). New York, Delaware, and several other states have adopted these factors. *See, e.g.*, *MLI Indus. Inc. v. N.Y. State Urban Dev. Corp.*, 613 N.Y.S.2d 977 (N.Y. App. Div. 1994) (New York); *Lloyd v. Jefferson*, 53 F. Supp. 2d 643 (D. Del. 1999) (Delaware); *Neonatology Assoc'ns v. Phx. Perinatal Assoc's.*, 164 P.3d 691 (Ariz. Ct. App. 2007) (Arizona); *Johnson & Johnson v. Guidant Corp.*, 525 F. Supp. 2d 336 (S.D.N.Y. 2007) (Indiana); *Gen. Electric Capital Corp. v. Commercial Servs. Grp.*, 485 F. Supp. 2d 1015 (N.D. Iowa 2007) (Iowa).

Flexible standards often lead to unpredictable outcomes. We must therefore ask what such a standard means in practice; that is, how courts have *applied* the standard in cases like the one being discussed here.

At this point, the terrain divides. Two categories of cases suggest, for different reasons, that when the breach of one contract causes the failure of another, the breaching party should not be liable for tortious interference. A third category suggests that banks may properly raise a defense of economic justification. But outliers exist. And, adding to the very real possibility of tort liability, courts that have dismissed tortious-interference claims have either insufficiently articulated the underlying reasons for doing so or not applied those reasons to facts that would easily compare to our hypothetical. What they *have* said does move the ball forward; it is a step toward developing a comprehensive rationale for when tort liability should exist. Ultimately, however, the facts in those cases were different, and the stakes lower. Billions of dollars were not on the line.

As the cases start to fall into place, so do the lines we need to draw. When should a bank be liable for tortious interference and when should it not be? It is critical to assess and answer this question carefully, because a target's attempt to leverage a tortious-interference claim into a favorable settlement represents precisely the sort of perceived blackmail that some might say has driven Material Adverse Change ("MAC") clause litigation.<sup>8</sup>

Tough financial times make MAC clauses more appealing, but MAC clauses are difficult to invoke successfully. It is important that they be that way. MAC clauses seek to cure the "lemon problem"—a problem of information asymmetry between buyer and seller, not a problem of aversion to the risk inherent in the transaction itself.<sup>9</sup> With this view in hand, courts have set the bar high.<sup>10</sup> No buyer has successfully invoked a MAC clause to avoid its obligations. And only one court has found a MAC, a finding made largely irrelevant by the unique language in the merger

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8. A MAC clause is a provision that permits the buyer (or any other specified party) to refuse to complete the transaction if such a change, as defined by the agreement, occurs. Substantial litigation has resulted over the interpretation of these clauses and whether the facts at issue constitute a material adverse change that permits the party invoking the clause to terminate the deal.

9. See David Cheng, *Interpretation of Material Adverse Change Clauses in an Adverse Economy*, 2009 COLUM. BUS. L. REV. 564, 569-71 (2009).

10. See, e.g., *Frontier Oil Corp. v. Holly Corp.*, No. Civ.A. 20502, 2005 WL 1039027 (Del. Ch. April 29, 2005) (adopting the Tyson standard under Delaware law and stating that the event must be "catastrophic"); *IBP, Inc. v. Tyson Foods, Inc.*, 789 A.2d 14, 68 (Del. Ch. 2001) (applying New York law and stating that the event must be durationally significant).

agreement and the court's ultimate holding that an exception to the MAC clause applied.<sup>11</sup> Authors have urged courts to continue this trend.<sup>12</sup>

Nevertheless, "'[m]aterial adverse change' are 'magic words that usually permit a buyer to walk away without a financial penalty.'" Just like other types of litigation, MAC cases are often settled before reaching a courtroom."<sup>13</sup> Ironically, some perceived victims of those practices have been the ones destroying efficiencies that might have been possible through renegotiated commitment letters. Hexion's Delaware and Texas litigations with Huntsman provide a prime example, although Hexion's MAC assertion backfired.

In 2007, Hexion and Huntsman entered into a merger agreement under which Hexion agreed to acquire Huntsman at \$28 per share.<sup>14</sup> Huntsman soon ran into financial trouble. Its quarterly results missed the projections conveyed to Hexion when they signed the deal. Without the banks' knowledge, Hexion obtained an opinion asserting that the combined Hexion-Huntsman entity would be insolvent.<sup>15</sup> Hexion then filed suit, seeking a declaration that it was not required to close for two reasons: (1) the combined entity would be insolvent, and (2) Huntsman had suffered a MAC.<sup>16</sup>

The question of insolvency was not yet ripe because the banks had not refused to fund the deal.<sup>17</sup> But the court methodically dismantled Hexion's MAC claim.<sup>18</sup> In a strong rebuke of Hexion's strategy, the court

11. See *Genesco, Inc. v. Finish Line, Inc.*, No. 07-2137-II(III) 1, 33 (Tenn. Ch. Ct. 20th Dist. Dec. 27, 2007), available at [http://online.wsj.com/public/resources/documents/wsj071227-lb-finishline\\_headwind.pdf](http://online.wsj.com/public/resources/documents/wsj071227-lb-finishline_headwind.pdf); see also Steven M. Davidoff, *Genesco v. Finish Line: The Opinion*, M&A LAW PROF BLOG (Dec. 27, 2007), <http://lawprofessors.typepad.com/mergers/2007/12/genesco-the-opi.html>.

12. See Cheng, *supra* note 9, at 599-603; Steven M. Davidoff, *The State of the MAC*, N.Y. TIMES DEALBOOK (Nov. 7, 2008), <http://dealbook.blogs.nytimes.com/2008/11/07/the-state-of-the-mac>.

13. Cheng, *supra* note 9, at 602 (quoting Andrew R. Sorkin, *If Buyout Firms Are So Smart, Why Are They So Wrong?*, N.Y. TIMES (Nov. 18, 2007), <http://www.nytimes.com/2007/11/18/business/18deal.html>); see also *id.* at 675 (noting that "[j]ust like in other recent deals, the buyers [in the Sallie Mae litigation] were able to renegotiate without any serious financial penalty merely by asserting a MAE").

14. *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715, 723 (Del. Ch. 2008). In July 2007, Hexion—owned by private equity firm Apollo Management—agreed to acquire rival chemical company Huntsman. This horizontal merger was expected to create the largest specialty chemical company in the world, achieving for its participants great synergies, economies of scale and scope, and geographic diversification. Once the financial crisis took hold in 2008 and the demand for chemicals nosedived, however, Hexion and the banks that were to finance the deal allegedly wanted out. Litigation ensued, first between Hexion and Huntsman (Hexion was ordered by Vice Chancellor Lamb of the Delaware Chancery Court to perform the conditions precedent to closing) and then between Hexion and the banks (the banks allegedly refused to provide the necessary financing).

15. *Id.* at 721.

16. *Id.* at 723.

17. *Id.* at 758.

18. *Id.* at 736.

concluded that Hexion knowingly and intentionally breached the merger agreement—a conclusion that removed the \$325 million termination fee as the upper limit of Hexion’s liability.<sup>19</sup>

The specific details of Huntsman’s Texas lawsuit against Hexion and the resulting \$1.73 billion settlement are not relevant for the purposes of this discussion. It is enough to say here that Huntsman’s case turned significantly on the appeal to Texas jurors of throwing mud at two Wall Street investment banks that had allegedly duped a Texas company.<sup>20</sup> As one commentator put it, “[t]he legal case for Credit Suisse and Deutsche Bank was a good one—in truth, Huntsman had only snippets of e-mail messages and other statements, a very good narrative story and a Texas jury.”<sup>21</sup> The core theory of the case—that the banks never intended to honor their commitment letter—defied common sense. The banks earned their fee only if the deal closed. They were stuck with the potential of billions of dollars of liabilities if it did not. Huntsman had no good explanation for this gaping hole, but the case settled anyway.<sup>22</sup>

In a world of high-stakes litigation, settlements of this magnitude should be no surprise. Even a minuscule risk of losing at trial—at which Huntsman, for example, demanded \$4 billion in damages<sup>23</sup>—translates

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19. *Id.* at 746.

20. See David Bario, *In Opening Arguments at \$4.65 Billion Trial, Gibbs & Bruns Tells Texas Jury that Banks Betrayed Huntsman*, AM. LAWYER (July 15, 2009), [http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202431483064&In\\_Opening\\_Arguments\\_at\\_465\\_Billion\\_Trial\\_Gibbs\\_\\_Bruns\\_Tells\\_Texas\\_Jury\\_that\\_Banks\\_Betrayed\\_Huntsman](http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202431483064&In_Opening_Arguments_at_465_Billion_Trial_Gibbs__Bruns_Tells_Texas_Jury_that_Banks_Betrayed_Huntsman) (quoting Huntsman’s attorney as stating that “[t]hese banks gave Huntsman a commitment that they never intended to honor. If they had just told Huntsman the truth, none of us would be here”; and the jurors would see documents that would show how “‘these enormous investment banks wield enormous power,’ and how their private discussions about Huntsman (filled with ‘harsh words’ and ‘expletives’) revealed their true intentions.”); see also Steven M. Davidoff, *Live-Blogging the Huntsman Trial*, N.Y. TIMES DEALBOOK (June 15, 2009, 3:00 PM), <http://dealbook.nytimes.com/2009/06/15/live-blogging-the-huntsman-trial/> (“The banks appear to have a better legal case, but Huntsman also appears to have some advantage here in that the company has a tangible narrative, and there are some damaging e-mail messages it can throw in.”).

21. Steven M. Davidoff, *A Huntsman Victory in More Ways Than One*, N.Y. TIMES, DEALBOOK (June 23, 2009, 3:48 PM), <http://dealbook.nytimes.com/2009/06/23/a-huntsman-victory-in-more-ways-than-one/>.

22. Press Release, Huntsman Corporation, Huntsman Reaches Settlement with Banks for \$1.73 Billion of Cash and Financing (June 23, 2009), available at [http://www.huntsman.com/corporate/Applications/itemrenderer?p\\_renderitemtitle=no&p\\_renderdate=no&p\\_renderitem\\_id=241465612&p\\_item\\_caid=1123](http://www.huntsman.com/corporate/Applications/itemrenderer?p_renderitemtitle=no&p_renderdate=no&p_renderitem_id=241465612&p_item_caid=1123); see also Bario, *supra* note 20 (noting before the settlement that, “for the banks . . . the challenge will be to convince the jury that the voluminous e-mail exchanges and discussions that their clients had with Apollo about crafting the merger and then mitigating their losses were nothing unusual for lenders and their private equity clients. [The banks] made a strong start Monday, but we predict [that the banks] are going to have a long few weeks in Conroe if Huntsman and the banks can’t settle this one.”).

23. *Huntsman Gets Personal in Apollo Lawsuit*, N.Y. TIMES DEALBOOK (June 23, 2008, 10:17 AM), <http://dealbook.blogs.nytimes.com/2008/06/23/huntsman-sues-apollo-and-its-top-executives-over-hexion-deal/>.



into a sky-high settlement value. Targets know this risk exists, and they can and have exploited it. Yet, these settlements should not always be acceptable outcomes. In some instances, the law ought to be more responsive to the facts at hand and the policies that generated the relevant legal doctrines in the first place.

### B. *Caselaw*

#### 1. The Breach of One Contract that Incidentally Causes Failure of Another Cannot Give Rise to a Tortious-Interference Claim

Motive is key. A defendant that *wanted* its breach to cause the breach of a second contract has likely committed tortious interference; a defendant that wanted only to breach, not to cause the *incidental* breach of another contract, is more likely to escape liability.

In *Alvord & Swift v. Stewart M. Muller Construction Co., Inc.*,<sup>24</sup> Muller (a general contractor) promised New York Telephone Company (“NYTC”) that it would renovate NYTC’s property.<sup>25</sup> Alvord & Swift (a subcontractor) then signed a contract with Muller agreeing to perform some of this work.<sup>26</sup> The construction took longer than expected, however, and the delay allegedly caused Alvord to incur additional expenses.<sup>27</sup> Alvord filed a tortious-interference claim against NYTC, arguing that NYTC breached its contract with Muller by failing to supervise Muller and the construction project, thereby interfering with Alvord’s contract with Muller.<sup>28</sup>

The New York Court of Appeals granted NYTC’s summary judgment motion.<sup>29</sup> As the Restatement (Second) of Torts defines it, “intent” means the desire to cause a certain result or knowledge of substantial certainty that conduct will bring about that result.<sup>30</sup> The court in *Alvord & Swift* saw things differently, however, drawing a line between a defendant’s actual intent and its constructive intent: “the interference must be intentional, not merely negligent or *incidental* to some other, lawful, purpose.”<sup>31</sup> Because Alvord had alleged only that NYTC breached its contract with Muller, which incidentally interfered with Alvord’s contract,

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24. *Alvord & Swift v. Stewart M. Muller Constr. Co., Inc.*, 385 N.E.2d 1238 (N.Y. 1978).

25. *Id.* at 1239.

26. *Id.*

27. *Id.*

28. *See id.* at 1240-41. The court did not explain whether Muller sued Alvord for breach; it explained only that Muller was insolvent (and therefore unable to pay Alvord’s additional expenses) and that Alvord alleged that NYTC interfered with Alvord’s contract with Muller by disrupting Alvord’s construction work.

29. *Id.* at 1241.

30. *See* RESTATEMENT (SECOND) OF TORTS § 8A (“intent” requires “that the actor desires to cause consequences of his act, or that he believes that the consequences are substantially certain to result from it”).

31. *Alvord & Swift*, 385 N.E.2d at 1241 (emphasis added) (citations omitted).

Alvord's claim failed.<sup>32</sup> As the court explained, because "there exists . . . no tort liability to incidental beneficiaries not in privity," in the absence of proof that NYTC intended to harm Alvord without justification, Alvord's claim must be dismissed.<sup>33</sup>

Though *Alvord & Swift* planted the seed, it is, of course, distinguishable from the circumstances being discussed. Alvord alleged that NYTC interfered with Alvord's performance, not Muller's—as if the bank interfered with the target's performance, not the buyer's. Further, in contrast to service contracts, both merger agreements and commitment letters usually bar any third-party beneficiaries.<sup>34</sup>

One of New York's intermediate courts, however, applied *Alvord & Swift's* principles in a case much like our hypothetical. In *Artwear, Inc. v. Hughes*,<sup>35</sup> Andy Warhol's estate signed a contract with Schlaifer Nance & Company, granting Schlaifer exclusive rights to use and license to others Warhol's artwork and trademarks.<sup>36</sup> Schlaifer then entered into an agreement with Artwear, granting Artwear a sublicense to manufacture a product using Warhol copyrights and trademarks, subject to Schlaifer's final approval.<sup>37</sup> Schlaifer never approved Artwear's product, allegedly because the Estate breached its contract with Schlaifer.<sup>38</sup> Artwear brought a tortious-interference claim against the Estate. The court dismissed the claim, stating that Artwear's claim was "nothing more than a claim for damages incidentally flowing from the [Estate's] breach of the license agreement, to which Artwear was not a party and of which it is not . . . a third-party beneficiary."<sup>39</sup> In other words, the court explained, *Alvord & Swift* was legally indistinguishable.<sup>40</sup>

In a similar case, the Georgia Court of Appeals in *Wometco Theatres, Inc. v. United Artists Corp.*,<sup>41</sup> reached the same result as the court in *Artwear*. In *Wometco*, United Artists agreed to allow Sparks to exhibit certain United Artist films, and Sparks granted Wometco the right to show six of those films.<sup>42</sup> United Artists then refused to deliver one of the films

32. *Id.*

33. *Id.*

34. See, e.g., Agreement and Plan of Merger Among Hexion Specialty Chem. Inc., Nimbus Merger Sub Inc. and Huntsman Corp. § 8.6 (July 12, 2007) ("nothing in this Agreement, express or implied, is intended to or shall confer upon any Person other than the parties hereto any right, benefit or remedy of any nature whatsoever").

35. *Artwear, Inc. v. Hughes*, 615 N.Y.S.2d 689 (N.Y. App. Div. 1994).

36. *Id.* at 690-91.

37. *Id.* at 691.

38. *Id.*

39. *Id.* at 695.

40. *Id.* See also *Highland Capital Mgmt LP v. Schneider*, 198 Fed. Appx. 41, 46 (2d Cir. 2006) (stating that defendant did not "procure" the alleged breach of plaintiff's contract because defendant did not "prevail upon" an entity to breach its contract with plaintiff; the result was incidental to defendant's conduct).

41. *Wometco Theatres, Inc. v. United Artists Corp.*, 186 S.E. 572 (Ga. App. 1935).

42. *Id.* at 572-73.

to Sparks and instead entered a contract with another exhibitor to show the film.<sup>43</sup> Sparks was therefore unable to deliver the film to Wometco, in breach of their agreement.<sup>44</sup> Wometco sued United Artists for tortious interference.

The court rejected Wometco's claim for the same reasons that prevailed in *Artwear*:

The mere failure of a party to a contract to carry out its terms will not give rise to a cause of action *ex delicto* against it, to a third party who has contracted with the opposite party to such contract, although in breaching the contract such person may be charged with notice that the opposite party will not be able to perform its contract with such third party.<sup>45</sup>

Because United Artists "merely . . . failed to comply with its contract with Sparks" and did not "induce[ ] Sparks to break his contract with the plaintiff," Wometco's tortious-interference claim failed.<sup>46</sup>

Relying on *Wometco*, the United States Court of Appeals for the Seventh Circuit has concluded that a claim analogous to Wometco's would not survive under Illinois law. In *R.E. Davis Chemical Corp. v. Disonics, Inc.*,<sup>47</sup> Disonics contracted to sell medical diagnostic equipment to Davis, which contracted with two physicians to establish a facility where the physicians would use the equipment.<sup>48</sup> The physicians breached their contract with Davis to establish this facility, knowing "that their conduct was reasonably certain to cause a breach by Davis of its contract with Disonics[.]"<sup>49</sup> Davis, having no need for the equipment, did precisely that.<sup>50</sup> Disonics then sued Davis for breach of contract and the physicians for tortious interference, alleging that, "the doctors knew of the contract between Davis and Disonics and also knew that, if they breached their contract with Davis, Davis would have no use for the equipment it had agreed to buy from Disonics."<sup>51</sup>

The court dismissed the claim, adopting the reasoning of *Wometco*.<sup>52</sup> Importantly, the court also considered a key factor from Restatement § 767: "The fact that . . . interference with the other's contract was not desired and was purely incidental in character . . ." <sup>53</sup> Several other courts have recognized the importance of this factor as well.<sup>54</sup>

43. *Id.* at 573.

44. *Id.*

45. *Id.* at 574-75.

46. *Id.* at 575.

47. *R.E. Davis Chem. Corp. v. Disonics, Inc.*, 826 F.2d 678 (7th Cir. 1987).

48. *Id.* at 679.

49. *Id.* at 685.

50. *Id.*

51. *Id.* at 680.

52. *Id.* at 686-67.

53. *R.E. Davis*, 826 F.2d at 687.

54. *See, e.g.*, *NCC Sunday Inserts, Inc. v. World Color Press, Inc.*, 759 F. Supp. 1004, 1015 (S.D.N.Y. 1991) (Connecticut law: "Tortious interference requires more than mere

Delaware courts have not yet addressed an analogous case, but one decision is instructive. In *Nelson v. Fleet National Bank*,<sup>55</sup> Plaza Home Mortgage Bank (which became Fleet National Bank) employed plaintiffs Humphries and Nelson and defendant Naworol.<sup>56</sup> Naworol allegedly sexually harassed both plaintiffs, solicited negative comments about their work performances, and ultimately forced Nelson to resign and Humphries to accept an unfavorable employment contract.<sup>57</sup> Both Nelson and Humphries sued Naworol, alleging that he tortiously interfered with their contracts with Plaza.<sup>58</sup>

The court explained that Naworol could be held liable for tortious interference only if his conduct was improper.<sup>59</sup> It turned to Restatement § 767 for guidance and noted that, “[t]hese factors can be summarized by simply asking ‘whether pursuit of self-interest justified one in inducing another to breach a contract in the particular circumstances.’”<sup>60</sup> Addressing Humphries’ complaint, the court concluded that her allegations supported the claim that Naworol “acted for reasons other than business concerns[,]” therefore implying that a defendant’s conduct *may* be proper if it acts solely to further its business interests.<sup>61</sup> The court denied Naworol’s motion to dismiss.<sup>62</sup>

These decisions rest upon at least one of two principles: (1) a defendant does not improperly interfere with another’s contract if the interference is incidental to the defendant’s purpose; and (2) a defendant procures a breach of another’s contract only if it takes affirmative steps to cause

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knowledge that one’s actions may cause the breach of an existing contract.”); *Johnson & Johnson v. Guidant Corp.*, 525 F. Supp. 2d 336, 360, 362-63 (S.D.N.Y. 2007) (New Jersey law: “If the [alleged interference] does not rest upon some legitimate interest or if there is sharp dealing or overreaching or other conduct below the behavior of fair men similarly situated, the ensuing loss should be redressed. Competition and financial self-interest are . . . legitimate interests.”); *Gen. Elec. Corp. v. Commercial Servs. Grp., Inc.*, 485 F. Supp. 2d 1015, 1027 (N.D. Iowa 2007) (Iowa law: “In the case of interference with either an existing or prospective contract or business relationship, the conduct was not ‘improper’ if it was merely a consequence of action undertaken for a purpose other than to interfere with a contract.”); *Mann v. GTCR Golder Runner, L.L.C.*, 483 F. Supp. 2d 864, 871-72 (D. Ariz. 2007) (Arizona law: same); *Pinewood Homes, Inc. v. Harris*, 646 S.E.2d 826, 832 (N.C. Ct. App. 2007) (North Carolina law: “In general, a wrong purpose exists where the act is done other than as a reasonable and bona fide attempt to protect the interest of the defendant which is involved . . . . The interference is without justification if the defendants’ motives . . . were not reasonably related to the protection of a legitimate business interest of the defendant.”) (citations omitted) (internal quotations omitted).

55. *Nelson v. Fleet N. Bank*, 949 F. Supp. 254 (D. Del. 1996).

56. *Id.* at 256.

57. *Id.* at 257-58.

58. *Id.* at 259-60.

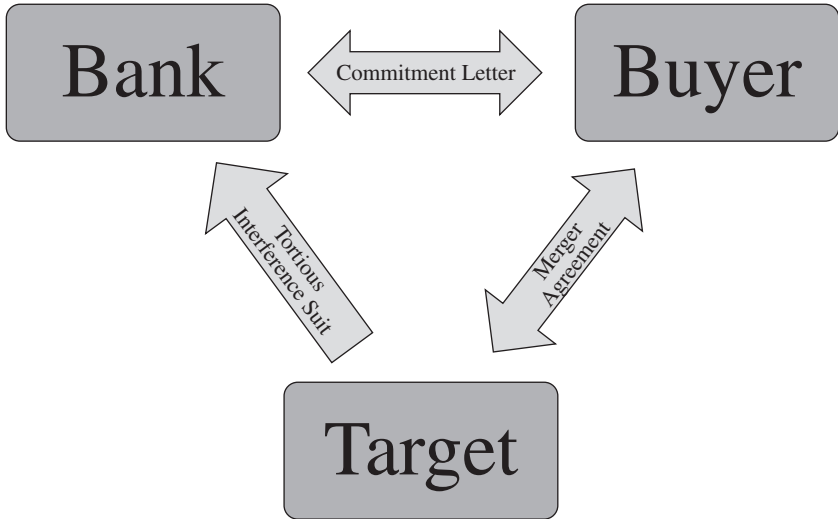
59. *Id.* at 260.

60. *Id.* at 260 (quoting *Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 992 (Del. Ch. 1987)).

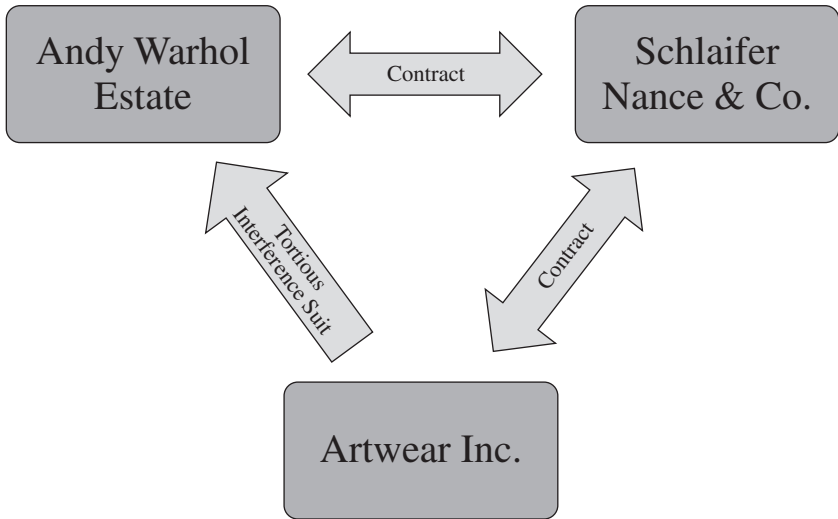
61. *Nelson*, 949 F. Supp. at 260-61.

62. *Id.* at 264.

that breach, beyond breaching its own contract. These cases are most similar to our hypothetical and therefore begin to draw the lines we need. They outline certain facts that may give rise to liability and those that may not. Consider the following visual comparison.



**Our Hypothetical**



***Artwear, Inc. v. Hughes*, 202 A.D.2d 76 (1st Dep't 1994)**

Part III explains the reasons that these factually analogous cases deserve legally indistinguishable treatment. First, however, two other categories of precedents must be addressed.

## 2. Only a Stranger can Tortiously Interfere With a Contract

Courts have limited the tortious-inference doctrine in other ways. Delaware, New York, and Georgia, for example, have limited tortious-interference claims to circumstances where the parties involved are “strangers”:

Imposition of liability for tortious interference with contractual relationship requires that the defendant “be a stranger to both the contract and the business relationship giving rise to and underpinning the contract.” . . . [O]ne need not be a party to a contract to be deemed not to be a stranger to the contract . . . .<sup>63</sup>

For example, under Georgia law, a person is not a stranger to a contract if, among other things, the contract is part and parcel of an interwoven set of relationships or contracts:

[A] defendant is not a “stranger” to a contract or business relationship when [ ] (1) the defendant is an essential entity to the purported injured relations; (2) the allegedly injured relations are inextricably a part of or dependent upon the defendant’s contractual or business relations; (3) the defendant would benefit economically from the alleged injured relations; or (4) both the defendant and the plaintiff are parties to a comprehensive interwoven set of contracts or relations.<sup>64</sup>

The Georgia Court of Appeals applied this test in *Jefferson-Pilot Communications Co. v. Phoenix City Broadcasting Ltd.*<sup>65</sup> There, Phoenix City Broadcasting (“PCB”) entered a purchase agreement to sell a radio station to Jefferson-Pilot.<sup>66</sup> PCB obtained financing from H.J. Russell so it could begin building the station (PCB held an FCC permit to build and operate the station).<sup>67</sup> Soon after, H.J. Russell brought in a participating lender, which signed an agreement with Jefferson-Pilot, PCB, and H.J. Russell, requiring these entities to notify the lender of any default under the purchase agreement.<sup>68</sup> While the station was being built, Jefferson-Pilot and PCB disputed who was responsible for certain construction costs, and Jefferson-Pilot sent a letter to both lenders describing the disagree-

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63. *Tenneco Auto. Inc. v. El Paso Corp.*, No. Civ.A. 18810, 2007 WL 92621, at \*5-\*6 & n.33 (Del. Ch. Jan. 8, 2007) (quoting *Atlanta Mkt. Ctr. Mgmt. Co. v. McLane*, 503 S.E.2d 278, 283 (Ga. 1998)); *see also* *Atlanta Mkt.*, 503 S.E.2d at 283-84 (“[A]ll partys [sic] to an interwoven contractual arrangement are not liable for tortious interference with any of the contracts or business relationships.”) (citing *Jefferson-Pilot Commc’ns Co. v. Phoenix City Broad., Ltd. of Atlanta*, 421 S.E.2d 295 (Ga. Ct. App. 1992)); *Koret, Inc. v. Christian Dior, S.A.*, 554 N.Y.S.2d 867, 869 (N.Y. App. Div. 1990) (citing *Greyhound Corp. v. Commercial Cas. Ins. Co.*, 19 N.Y.S.2d 239, 242 (N.Y. App. Div. 1940)).

64. *Waddell & Reed, Inc. v. United Investors Life Ins. Co.*, 875 So.2d 1143, 1156 (Ala. 2003) (citations omitted) (quoting *Britt/Paulk Ins. Agency, Inc. v. Vandroff Ins. Agency, Inc.*, 952 F. Supp. 1575, 1584 (N.D. Ga. 1996)) (internal quotation marks omitted).

65. *Jefferson-Pilot*, 421 S.E.2d at 298-99.

66. *Id.* at 297.

67. *Id.*

68. *Id.*

ment.<sup>69</sup> Ultimately, Jefferson-Pilot terminated the purchase agreement.<sup>70</sup> PCB then sued Jefferson-Pilot for tortiously interfering with PCB and the lenders' financing agreement.<sup>71</sup>

Jefferson-Pilot moved for a directed verdict at trial. The trial court denied that motion, but the appellate court reversed.<sup>72</sup> It explained that a non-stranger to an agreement cannot tortiously interfere with it: "[T]he buyer, seller, and lenders were all parties to a comprehensive interwoven set of contracts which provided for the financing, construction, and transfer of ownership of the radio station. Therefore, [Jefferson-Pilot] could not have tortiously interfered with that contractual relationship between [PCB] and its lenders."<sup>73</sup> The court observed that Jefferson-Pilot was an essential party to PCB and the lenders' financing agreement, even though it was not bound by it.<sup>74</sup>

The entities are different, but the analogy leads to the same result. A bank, target, and buyer interact frequently through their negotiations of the merger deal, and their agreements and relationships are plainly interwoven. But it is unclear how firmly this rule would apply: could a bank escape tort liability under *all* circumstances, so long as it is deemed a non-stranger? The decisions that have adopted the doctrine have not gone this far, perhaps because they have not been presented with the circumstances to do so. Nor have they explained the underlying *reasons* for the non-stranger doctrine, though it may be that the same intuition that gave rise to decisions like *Artwear* also drove the analyses in cases like *Jefferson-Pilot*.

### 3. Economic-Justification Defense

One last doctrine remains, the defense of economic justification. The New York State Court of Appeals has recognized the existence of this defense in response to a claim for tortious interference with contract. In *White Plains Coat & Apron Co., Inc. v. Cintas Corp.*,<sup>75</sup> White Plains had five-year exclusive-service contracts with its customers.<sup>76</sup> Cintas knew of these contracts, and it allegedly induced several of the customers to breach their contracts with White Plains and sign contracts with Cintas.<sup>77</sup> White Plains sued Cintas for tortious interference, and Cintas raised the defense

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69. *Id.*

70. *Id.*

71. *Jefferson-Pilot*, 421 S.E.2d at 297.

72. *Id.* at 299-300.

73. *Id.* at 299.

74. *Id.* at 298. The court also concluded that Jefferson-Pilot's letter to the lenders was not the proximate cause of the harm to PCB's financing agreement; it was a secondary reason why PCB's claim failed. *Id.* at 299. *See also* Atlanta Mkt. Ctr. Mgmt. Co. v. McLane, 503 S.E.2d 278, 283-84 (Ga. 1998) (citing *Jefferson-Pilot*, 421 S.E.2d at 299 with approval).

75. *White Plains Coat & Apron Co., Inc. v. Cintas Corp.*, 867 N.E.2d 381 (N.Y. 2007).

76. *Id.* at 382.

77. *Id.*

of economic justification: “that it acted to protect its own legal or financial stake in the breaching party’s business.”<sup>78</sup>

The court recognized that Cintas could properly raise such a defense.<sup>79</sup> The defense failed, however, because Cintas’ alleged justification constituted only a general economic interest in soliciting business for profit—an insufficient factual basis for the defense.<sup>80</sup>

*White Plains* made clear what would *not* be a basis for an economic-justification defense, but it did not explain what would be. Nearly every case where the defense has been asserted successfully involved a parent company asserting the defense after it directed its subsidiary to breach one of the subsidiary’s contracts.<sup>81</sup> The United States Court of Appeals for the Second Circuit, however, has suggested that a defendant’s *own* economic interests can justify the interference. In *Don King Productions, Inc. v. Smith*,<sup>82</sup> a boxer (Page) entered a four-year exclusive agreement with Don King Productions (“DKP”), a corporation that promoted boxing events.<sup>83</sup> Page simultaneously entered a managerial contract with Carl King.<sup>84</sup> Shortly thereafter, another boxing manager named Prince allegedly induced Page to breach his promotional and bout agreements.<sup>85</sup> Thus, DKP asserted that Prince tortiously interfered with DKP’s contracts with Page. In response, Prince raised the economic-interest defense.<sup>86</sup>

DKP argued that Prince’s defense should fail because Prince was not acting to protect Page’s economic interests.<sup>87</sup> The court found this to be irrelevant: “[s]uch economic interest . . . is not limited to that of the breaching party, but can include that of the alleged interferers as well.”<sup>88</sup> That is, a defendant need not own the breaching party to raise an economic-interest defense. Rather, the defendant can assert that defense on its own behalf, when acting in its own interest.<sup>89</sup>

78. *Id.* at 383.

79. *Id.* at 426.

80. *Id.* at 425.

81. See *White Plains*, 867 N.E.2d at 426 (citing *Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A.*, 579 N.Y.S.2d 353, 354 (N.Y. App. Div. 1992) (stating that defendant’s attempt to protect its security interest “cannot be construed as malicious or carried out with the intent to harm the plaintiff”)).

82. *Don King Prods., Inc. v. Smith*, 47 F. App’x 12 (2d Cir. 2002).

83. *Id.* at 13.

84. *Id.*

85. *Id.*

86. *Id.* at 14.

87. *Id.* at 15.

88. *Don King*, 47 F. App’x at 15.

89. *Id.* at 15, 16 n.4.



Economic justification is a defense, so the defendant bears the burden to prove it.<sup>90</sup> Once it does, the plaintiff must establish that the defendant's interference was either malicious or involved criminal or fraudulent conduct.<sup>91</sup> For example, in *E.F. Hutton International Associates Ltd. v. Shearson Lehman Brothers Holdings, Inc.*, Shearson signed a merger agreement promising to purchase E.F. Hutton & Co., which had contractual obligations to provide services to plaintiff E.F. Hutton International.<sup>92</sup> Before the merger occurred, however, Shearson announced that it would reject plaintiff's services agreements.<sup>93</sup> E.F. Hutton therefore terminated services to plaintiff, allegedly negatively affecting plaintiff's ability to do business.<sup>94</sup> In plaintiff's tortious-interference suit against Shearson, the court held that Shearson did not act maliciously, even if it *knew* that terminating plaintiff's contracts would negatively affect its ability to do business.<sup>95</sup>

The economic-justification defense thus provides the weakest protection for a bank. Although defendants have successfully raised the defense, courts have generally concluded that existing contracts deserve substantial protection<sup>96</sup> and that one's own economic interests will rarely justify interference with another's executed contract.<sup>97</sup>

### III. ON PROPERTY RULES AND LIABILITY RULES: AN ECONOMICALLY EFFICIENT APPROACH

Tortious-interference claims can be defeated. The above cases begin to define when they should be. One may reasonably conclude that these cases provide sufficient guidance to address the scenario assessed in this article: the principles seem applicable and the facts appear to be analogous. Even so, these principles have not stopped commentators from claiming that a tortious-interference claim against a bank would be viable.<sup>98</sup> Nor have they stopped courts from holding that a bank's effort to seek a declaration of its rights under a commitment letter would constitute tortious interference with the target's merger agreement.<sup>99</sup> In the end,

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90. *See, e.g.*, *Foster v. Churchill*, 665 N.E.2d 153, 157 (N.Y. 1996) ("To defeat a claim of tortious interference . . . respondents need to establish that their actions were taken to protect an economic interest.").

91. *E.F. Hutton Int'l Assocs. Ltd. v. Shearson Lehman Brothers Holdings, Inc.*, 723 N.Y.S.2d 161, 162 (N.Y. App. Div. 2001) (citing *Foster*, 665 N.E.2d 153, 157 (1996)).

92. *Id.*

93. *Id. at* 363.

94. *Id.*

95. *Id.*

96. *See, e.g.*, *Guard-Life Corp. v. S. Parker Hardware Mfg. Corp.*, 406 N.E.2d 445, 448-49 (N.Y. 1980).

97. *See, e.g.*, *MLI Indus. Inc. v. N.Y. State Urban Dev. Corp.*, 613 N.Y.S.2d 977, 979 (N.Y. App. Div. 1994).

98. *Clear Channel: Lessons Learned*, N.Y. TIMES DEALBOOK (May 14, 2008, 11:02 AM), <http://dealbook.nytimes.com/2008/05/14/clear-channel-lessons-learned/>.

99. *See Credit Suisse Sec. (USA) LLC v. Huntsman Corp.*, 269 S.W.3d 722, 725, 730 (Tex. App. 2008).

then, the heat of the moment prevails: a court can bend these principles, because it is easy to distinguish, on the surface, most contracts from a multi-billion-dollar commitment to lend money.

But these precedents alone do not tell the entire story. The principles explained in these precedents stem from at least two sources: (1) the economic theory underpinning tort law, and (2) the economic theory underpinning the law of remedies.

#### A. Analyzing the Tort: Has the Bank Acted Intentionally?

In a tortious-interference case, the plaintiff must show that the defendant *intentionally* caused the breach of the plaintiff's contract with a third party.<sup>100</sup> Generally, an entity has acted intentionally if its conduct was designed to bring about a particular result or if it has knowledge of substantial certainty that acting in a particular way will cause a particular kind of harm.<sup>101</sup> Without question, the bank knows that breaching its contract with the buyer will require the buyer to breach its contract with the target, even if the bank does not *want* this harm to occur. But the concept of intent is more complex than this: economic theories of tort law and remedies do not support saddling the bank with tort liability.

Judge Learned Hand famously wrote that one has acted negligently only if the cost of taking a precaution to avoid the accident (B) was lower than the probability of injury (P) multiplied by the magnitude of the loss (L) (i.e., if  $B < PL$ ).<sup>102</sup> For example, assume that a farmer knows that erecting a wooden fence to confine his cows creates a 10% chance that the cows will escape and trample a passerby, causing a \$100,000 loss. The expected accident cost is therefore \$10,000 ( $0.1 \times \$100,000$ ). If it would cost the farmer less than \$10,000 to install an electric fence and reduce P to 0, for example, he should do it. If he does not, and an accident occurs, the farmer has acted negligently.

This theory also allows us to distinguish between intentional torts and unintentional torts. When the ratio of B to PL is unaffected by the scale of the potential injurer's operation, the potential injurer is not an intentional tortfeasor.<sup>103</sup> For example, a railroad that runs several trains per day has knowledge of substantial certainty that it will kill a certain number of people every year in railroad-automobile collisions.<sup>104</sup> But we do not hold the railroad liable as an intentional tortfeasor, because "the same thing that makes PL high—the scale of the railroad's operations—also makes B high."<sup>105</sup> As Judge Richard Posner explains,

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100. See *Lama Holding Co. v. Smith Barney Inc.*, 668 N.E.2d 1370, 1375 (N.Y. 1996).

101. See RESTATEMENT (SECOND) OF TORTS § 8A.

102. *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947).

103. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 206 (6th ed. 2003).

104. *Id.*

105. *Id.*

I want a car, and I decide to save time by stealing your car. B is not only lower than in an accident case; it is actually a negative number, because rather than saving resources by injuring the victim (implying a positive B) I would save resources by not injuring the victim (implying a negative B), since it must cost me something to steal the car. (Of course, there is an offsetting gain, or I would not steal it, but that gain does not represent a net social benefit, because it is offset by the loss of the car to the victim.) P, furthermore, is very high—much higher than in an accident case—because wanting to do someone an injury makes it much more likely that an injury will occur than if the injury . . . will simply be an undesired by-product of another activity . . .<sup>106</sup>

The bank's conduct does not meet this test. The bank has no desire to harm the target; it makes its decision to lend based on its own economic interests. The target incurs harm only when the bank concludes that its mark-to-market loss on the deal would exceed the cost of breaching its contract with the buyer. Thus, P will be low. Further, because the bank will breach its contract when performing would be inefficient, the bank would *not* save resources by not injuring the target (a negative B), but by refusing to perform and injuring the target (a positive B).

Nor would awarding tort damages (the value of the thing taken by the tortfeasor) improve social welfare. A threat of such liability induces the bank to spend as much on prevention as it would have spent on performance, and likely more, given the costs of litigation. This results in a net social loss. In contrast, if the bank faces only expectation damages (in the buyer's lawsuit), then the bank will breach only when the benefit of doing so exceeds the expected loss. This results in a net social gain, because damages paid to the buyer will be funneled to the target, and the bank can both avoid the cost of performance and put the money saved by not performing to a socially beneficial use.

Even if the bank *were* held liable in tort, punitive damages should be unavailable. The gap between PL and B is large in a typical intentional tort case.<sup>107</sup> B will be a negative number (or at least a very low number) in such a case because the tortfeasor would save resources by not injuring the victim, and P will be very high because the tortfeasor's desire to injure its victim will increase the likelihood of such an injury. In a case where the difference between PL and B is small, however, such as a negligence case or a target's case against the bank, artificially increasing L within legal limits via punitive damages—which could exceed \$50 or \$100 billion in some leveraged buyouts—would force the bank to spend multiples of B to avoid injuring the target.

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106. *Id.*

107. *Id.*

*B. Property Rules and Liability Rules: The Target's Tort Claim  
Makes Efficiency an Unattainable Goal*

We must, therefore, ask how to remedy the target's harm. We can do so by imposing a liability rule or a property rule.<sup>108</sup> As suggested above in Section III.A. (and considered in detail below in Section IV.A.), awarding expectation damages (a liability rule) in the buyer's claim against the bank is the preferred remedy.

A liability rule protects a property right by compensating the holder with damages measured under an objective standard of value.<sup>109</sup> A property rule prohibits a person from taking another's entitlement to private property unless the holder sells it willingly for the price at which the other subjectively values the property.<sup>110</sup> In the law of contract remedies, an order of specific performance creates such a regime.

One reason for choosing a liability rule to protect an entitlement is that the market cannot efficiently value that entitlement.<sup>111</sup> For example, a liability rule is appropriate in the following scenario. A factory spews pollutants while manufacturing widgets. The pollution disturbs hundreds of nearby landowners; wind patterns carry the pollution across the State. Thousands are affected. Any negotiations would be protracted and infinitely complex. And some individuals would become holdouts, backing up their unreasonably high settlement demands with a threat to torpedo the negotiations. A property rule would require the factory to shut down completely, or at least for a random period, when the value created by the factory may exceed the damage done to the landowners. Protecting the landowners with a liability rule preserves the factory's right to operate, but requires the factory to decide whether the benefits of operating exceed the costs of damages. The factory is in the best position to make this calculation. Impossible negotiations are avoided.

On the other hand, when the market can accurately and easily value the entitlement, a property rule will ensure that the parties allocate their resources efficiently. As Ronald Coase noted, however, the parties must be able to identify the person with whom they must negotiate and have few, if any, incentives to imperil their negotiations.<sup>112</sup>

Relying on these principles, commentators in favor of applying specific performance contend that, when parties can renegotiate their existing contract, they should bargain to an efficient outcome when they know that a court will award specific performance. Only if the parties are not in such a position, or if the transaction costs of negotiation would be prohibitively

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108. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972). This article derives its title from Calabresi and Melamed's seminal work.

109. *Id.* at 1105-06.

110. *Id.* at 1105.

111. *Id.* at 1110.

112. See Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 6-7 (1960).

high, should an economic analysis favor money damages.<sup>113</sup> Awarding expectation damages in these circumstances would provide parties with an incentive to perform when the value of performance exceeds the costs and to breach in the opposite circumstances. The threat of a court order of specific performance—which would be insensitive to the costs of performance—would not skew the breaching party’s calculations.<sup>114</sup>

Applying these principles here *should* be easy. The buyer and bank have already negotiated a commitment letter. They are repeat players in the market and have reputations to preserve. Indeed, the course of dealing between a buyer and the bank often includes restructuring the terms of the bank’s contract when significant changes in the market make it necessary to modify the deal. Renegotiation is a feasible and preferable option. Importantly, their economic interests are aligned, at least in part. A bank is no more interested in lending money to a buyer who will acquire a troubled target than the buyer is interested in purchasing a troubled target. Enforcing the parties’ bargain with a property rule should therefore facilitate a Pareto-optimal outcome.<sup>115</sup> The bank will buy the buyer’s right to an order of specific performance if doing so will be cheaper than the cost of performance.<sup>116</sup> In other words, the bank will breach its commitment letter if the mark-to-market losses on the loan are significantly greater than the cost of purchasing the buyer’s right to specific performance. The law encourages efficient breach.

But a target’s tort suit against the bank makes these renegotiations impossible because any evidence of such negotiations will be the centerpiece of the target’s claim for tortious interference with contract.

*C. The Target’s Tort Claim Increases the Costs of Negotiating a Commitment Letter and Eliminates the Bank’s Incentive to Renegotiate the Terms of Its Commitment in Economically Efficient Ways that Do Not Affect the Target*

Pre-dispute negotiations between a bank and a buyer occur in at least two stages. The parties first negotiate a commitment letter, which sets forth the terms on which the bank or syndicate of banks will finance the

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113. See Nathan Oman, *Specific Performance and the Thirteenth Amendment*, 93 MINN. L. REV. 2020, 2028 (2009).

114. See *id.* at 2029 (generally describing this analysis). See also ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 216, 233 (2d ed. 1997) (“In order for the promisor to internalize the benefits of precaution, he or she must pay full compensation to the promisee for breach.”).

115. See BLACK’S LAW DICTIONARY 963 (abr. 9th ed. 2010) (“Pareto optimality” is “[a]n economic situation in which no person can be made better off without making someone else worse off.”).

116. Of course, this analysis addresses only part of the issue. Courts have generally concluded that they will not specifically enforce a promise to lend money. See 25 WILLISTON ON CONTRACTS § 67:90 (4th ed. 2013) (“By the more traditional view, equity will not specifically enforce contracts to lend or borrow money, except under extraordinary circumstances.”).

buyer's deal. Although a commitment letter represents the bank's binding commitment, changes in the market may spur a new stage of negotiations. The typical course of dealing between a buyer and the bank often includes restructuring the terms of the bank's commitment. The bank and buyer understand that the buyer will be flexible when significant changes in the market make it necessary to modify the deal. A target's suit against the bank will make the first stage of negotiations costly; it will prevent the second stage of negotiations from happening altogether.

Certain terms of commitment letters will be subject to substantially more scrutiny. A prime example is the inclusion of additional closing conditions, such as pro-forma leverage conditions. Parties may invest significant time developing such conditions. For example, the agreement may require that the consolidated EBITDA of the buyer and its subsidiaries, as set forth in certain pro-forma financial statements, be greater than a certain stated amount. The bank may require that the qualified cash of certain loan parties not fall below a certain minimum threshold. It may provide that the arrangers of the debt be reasonably satisfied that, after giving pro-forma effect to the transactions, the amount of indebtedness outstanding on the closing date meets certain debt-to-consolidated EBITDA ratios for certain quarters. Alternatively, the bank may require that the consolidated EBITDA for a certain period be greater than a certain amount—a requirement that may cause the buyer to play hardball to exclude the consolidated EBITDA for certain windows within that period.

Crafting these provisions takes time, both in separately calculating the leverage ratios that meet each party's needs and in negotiating and finalizing the provisions, including any carve-outs, in a way that satisfies each party. Even after extensive negotiations, these calculations and provisions do not provide fail-safe protection against economically inefficient deals. While pro-forma leverage conditions may provide substantial protection, the conditions under which the bank would close a deal often change as the future unfolds. A general decline in economic activity may drain smaller banks of their cash and thereby freeze the secondary loan market. These smaller banks may demand substantially better terms than originally provided, making the loans difficult or impossible to syndicate. The loans then sit on the bank's books, tying up cash it did not anticipate operating without.

These are precisely the circumstances in which the bank and the buyer would want to renegotiate their deal. The terms of the bank's commitment to the buyer would not affect the target, having already accepted its merger consideration, but would provide the bank with the loan terms it needs to syndicate the debt. For example, a bank may promise to advance a bridge loan to a buyer in exchange for the buyer's promise to issue securities of the new entity a certain period after the loan is made, which securities the bank would resell to the market. That promise may include a condition that the securities' aggregate weighted average total effective yields may not exceed certain rates. In a difficult market, the underwriters

may need to offer the securities at a discount. If the underwriters absorb the cost of offering the securities at a discount, however, such a sale should not negatively impact the buyer's economic position. In other words, such a cap on effective yields would limit the buyer's payment obligations, but would not preclude the underwriters from selling to the market at a discount. On the other hand, precluding the underwriters from selling to the market at a discount would effectively require them to hold the loan at an even greater economic cost than the sale of discounted notes, without any corresponding benefit to the buyer.

Alternatively, the bank may instead forgo a piece of its compensation for underwriting the securities, or it may give up its right to make a securities demand on more than one occasion. Again, the buyer may agree to amend the parties' agreement to allow the bank to offer discounted notes to the market, so long as it accepts the cost of selling the discounted notes. Or, perhaps, the buyer may share in some of the bank's pain.

The bank and buyer might also agree to strip certain financial covenants from the commitment or include call protection, which would prohibit the buyer from calling back the securities for a certain period after their issuance.

In addition to provisions that may be (relatively) seamlessly renegotiated, several provisions exist in merger agreements that can give a bank significant trouble when it wishes to renegotiate its commitment. Commitment letters may directly address these provisions, or, if possible, may require the bank to negotiate with the buyer about those terms before the parties sign the merger agreement. For example, a merger agreement may require the buyer to take all actions necessary or advisable to consummate the financing on terms and conditions described in the commitment letter, including bringing suit against the bank if necessary. Huntsman and Hexion's agreement had such a provision.<sup>117</sup> It is often difficult to win a specific-performance claim seeking to force a contracting party to bring a lawsuit, even when the contract requires the party to exercise its reasonable best efforts to close the deal. A provision requiring a party to take all actions necessary to close the deal certainly takes some guesswork out of the equation. In doing so, however, it also destroys the common goal between a buyer and the bank of completing an economically sound transaction.

In any event, as explained in the next section, even without the threat of the target's tortious-interference claim, there is a significant chance that the parties would never bargain to an efficient outcome under a property rule because the buyer would only use specific performance as a means to exert bargaining leverage over and extort undue concessions from the

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117. Agreement and Plan of Merger Among Hexion Specialty Chem. Inc., Nimbus Merger Sub Inc. and Huntsman Corp. § 5.12(a) (July 12, 2007) (providing that Hexion "shall use its reasonable best efforts to take, or cause to be taken, all actions and to do, or cause to be done, all things necessary, proper or advisable to arrange and consummate the Financing on the terms and conditions described in the Commitment Letter").

bank. Thus, in addition to its increased costs and rigidity, specific performance is much more likely to lead to *inefficient* overperformance. For these reasons, awarding expectation damages in the buyer's claim against the bank, which will flow to the target, is generally the preferred remedy.

#### IV. SOLUTIONS

##### A. A Liability Rule Should Apply in the Buyer's Case Against the Bank, Unless the Bank's Breach Is Opportunistic

The choice of remedy for the bank's breach is not clear-cut. On the one hand, specific performance ensures that the buyer receives the full benefit of its bargain with the bank and that the bank does not attempt to breach opportunistically, hoping to pay damages below the cost of performance.<sup>118</sup> Where performance is efficient (i.e., the benefits of performing exceed the costs) and damages are lower than the cost of performance, under a liability rule a risk exists that performance will not occur.<sup>119</sup> Specific performance is beneficial because it deters this type of underperformance. On the other hand, specific performance encourages overperformance by preventing breaches where it would be more efficient for the bank not to perform.<sup>120</sup> "The relative importance of these two concerns—the tendency for underperformance arising from money damages versus . . . potential for overperformance with specific performance—determine[s] whether specific performance or damages should be the generally preferred remedy."<sup>121</sup> In the high-stakes world of LBOs, where billions of dollars are on the line and markets change on a dime,<sup>122</sup> the risk of overperformance is simply too great. Because imposing a liability regime minimizes this risk and incentivizes the bank—the party with the most information—to find the best use of its money (i.e., to breach only where it is efficient to do so), this article advocates applying expectation damages to the buyer's claim against the bank.

An "expectation-damages" rule encourages efficient breach:

A rule that awards expectation damages generally ensures that a breach will occur only when the breach is efficient. If the promisor breaches knowing

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118. Yair Listokin, *The Empirical Case for Specific Performance: Evidence from the IBP-Tyson Litigation*, 2 J. EMPIRICAL LEGAL STUD. 469, 470 (2005), available at [http://digitalcommons.law.yale.edu/fss\\_papers/568](http://digitalcommons.law.yale.edu/fss_papers/568).

119. *Id.*

120. *Id.* ("A specific performance remedy when breach is efficient, however, necessitates costly bargaining to arrive at efficient nonperformance. If bargaining fails, then specific performance causes overperformance.").

121. *Id.*

122. Expectation damages provide flexibility to deal with rapidly changing market conditions. See, e.g., Edward Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365, 1367 (1982) ("One significant asset of the current system of money damages is its ability to respond satisfactorily to the varied . . . economic considerations relevant to difficult contract cases. Much of this flexibility and responsiveness is likely to be lost if specific performance becomes the paradigmatic remedy for breach of contract.").



that he must compensate the promisee, breach is presumably efficient since the promisor would not breach unless his gain from not performing exceeds the compensation he must pay [the] promisee for the loss of his bargain. Thus, a rule that awards expectation damages generally ensures that breach will occur only if breach is, in economic terms, Pareto-superior to performance: the promisor is better off, and the promisee no worse off, as a result of breach.<sup>123</sup>

In addition, applying expectation damages prevents the buyer from using the specific performance remedy as a means to gain bargaining leverage over the bank. It also decreases negotiation costs, both *ex ante* and *ex post*. Accordingly, only if the buyer can show that the bank's breach is opportunistic should the court order specific performance. The case for specific performance when breach is opportunistic is strengthened when alternative financing is unavailable.

What is an "efficient" breach and how does a liability rule encourage that result? Imagine a seller who has contracted to deliver widgets in two weeks to a buyer who agreed to pay the seller \$10,000. After one week, another buyer comes along who is willing to pay \$20,000 for the widgets. If the original buyer covers for \$15,000 by purchasing substitute widgets elsewhere, the seller must pay expectation damages of \$5,000 (\$15,000 cover price - \$10,000 original purchase price). Because the seller's legal obligation is limited to paying expectation damages, it is better off by \$5,000: \$20,000 (new purchase price) - \$5,000 (damages) = \$15,000, which is \$5,000 greater than the original purchase price of \$10,000. At the same time, the seller has fully compensated the original buyer for its harm, and the widgets have been allocated to the party who values them the greatest. The most efficient result has been reached. This result is possible only where expectation damages are employed: had the seller been ordered to specifically perform, it would have been \$5,000 poorer and the goods would not have reached their optimal destination.

The efficient breach theory—advocating expectation damages to encourage breach where the profit to the promisor exceeds the loss to the promisee—is rooted in the teaching of Oliver Wendell Holmes, who, when dismissing the application of moral ideals to the law of contracts, stated the following: "The 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*."<sup>124</sup> As Judge Henry Friendly clarified in *Thyssen, Inc. v. S.S. Fortune Star*, Holmes' rule is grounded in the economic principle that an intentional breach may be efficient because it creates a net benefit to society:

Under Holmes' theory that a contract is simply a set of alternative promises either to perform or to pay damages for nonperformance . . . the rule would require no other explanation . . . [B]reaches of contract that are in fact efficient and wealth-enhancing should be encouraged[.] . . . [S]uch "efficient

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123. *Id.* at 1394.

124. O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) (emphasis added).

breaches” occur when the breaching party will still profit after compensating the other party for its “expectation interest.”<sup>125</sup>

Judge Posner, perhaps the greatest champion of the efficient-breach theory, offered a similar characterization of Holmes’ rule:

[Holmes] thought of contracts as options—when you sign a contract in which you promise a specified performance (supplying a product, or providing a service) you buy an option to perform or pay damages . . . . As long as you pay the damages awarded by the court in the promisee’s suit for breach of contract . . . no blame can attach to your not performing even if it was deliberate—even if, for example, you did not perform simply because someone offered you more money for the product or service that you had undertaken to supply in the contract and you did not have enough capacity to supply both the promisee and the new, more necessitous customer. You have not *really* broken your promise, because what you promised (though that is not how the contract will have been worded) was either-or: not performance but *either* performance or compensation for the cost of nonperformance to the other party to the contract.<sup>126</sup>

Judge Posner regards expectation damages, not specific performance, to be the preferred remedy, because “a general entitlement to specific performance would thwart some efficient breaches.”<sup>127</sup> Judge Posner offers the following example to illustrate this point:

If *A* breaks his contract with *B* to sell to *C* because *C* will pay more than the harm (which equals damages) to *B* from the breach, the breach increases the social product: *B* is no worse off, and *A* and *C* are both better off. But if *B* is entitled to specific performance, *A* cannot sell to *C* without paying *B* to agree to terminate *A*’s contract with him, creating a bilateral-monopoly situation . . . .<sup>128</sup>

Judge Posner’s reasoning in a case with facts roughly analogous to those considered in this article (i.e., a change in market conditions rendering performance uneconomical and inefficient) illustrates why, under most circumstances, the bank should not be made to specifically perform its financing commitment in the face of changing economic circumstances, but should instead have to pay only expectation damages. In *North Indiana Public Service Co. v. Carbon County Coal Co.*, Judge Posner considered whether specific performance was necessary to enforce a 20-year agreement by NIPSCO, a public utility in Indiana, to purchase coal from Carbon County.<sup>129</sup> During the course of performance, the price of electricity dropped such that NIPSCO could purchase it for less than the cost of generating electricity from coal.<sup>130</sup> NIPSCO stopped accepting coal deliveries

125. *Thyssen, Inc. v. S.S. Fortune Star*, 777 F.2d 57, 63 (2d Cir. 1985) (citations omitted).

126. Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349, 1350 (2009) [hereinafter Posner, *Contract Breaker*] (emphasis in original).

127. *Id.* at 1350-51.

128. *Id.* at 1351.

129. *See generally* *N. Ind. Pub. Serv. Co. v. Carbon Cnty. Coal Co.*, 799 F.2d 265 (7th Cir. 1986) (Posner, J.).

130. *Id.* at 267.

and sought a declaration excusing it from purchasing coal.<sup>131</sup> Carbon County counter-claimed for specific performance.<sup>132</sup> Carbon County won damages at trial, and both parties appealed.<sup>133</sup> On appeal, Judge Posner found that the request for specific performance had no merit and upheld the damages award for two reasons: (1) breach was efficient, and (2) awarding specific performance would only serve to give Carbon County undue bargaining leverage.<sup>134</sup>

In finding that an order of specific performance would impose costs on society greater than the benefits, Judge Posner reasoned as follows:

Indeed, specific performance would be improper as well as unnecessary here, because it would force the continuation of production that has become uneconomical. No one wants coal from Carbon County's mine. With the collapse of oil prices, which has depressed the price of substitute fuels as well, this coal costs far more to get out of the ground than it is worth in the market. Continuing to produce it, under compulsion of an order for specific performance, would impose costs on society greater than the benefits. NIPSCO's breach, though it gave Carbon County a right to damages, was an efficient breach in the sense that it brought to a halt a production process that was no longer cost-justified. The reason why NIPSCO must pay Carbon County's loss is not that it should have continued buying coal it didn't need but that the contract assigned to NIPSCO the risk of market changes that made continued deliveries uneconomical. The judgment for damages is the method by which that risk is being fixed on NIPSCO in accordance with its undertakings.<sup>135</sup>

Moreover, Judge Posner found that an award of specific performance would likely never be implemented and refused to let Carbon County use specific performance to gain a bargaining advantage:

With continued production uneconomical, it is unlikely that an order of specific performance, if made, would ever actually be implemented. If, as a finding that the breach was efficient implies, the cost of a substitute supply (whether of coal, or of electricity) to NIPSCO is less than the cost of producing coal from Carbon County's mine, NIPSCO and Carbon County can both be made better off by negotiating a cancellation of the contract and with it a dissolution of the order of specific performance. Suppose, by way of example, that Carbon County's coal costs \$20 a ton to produce, that the contract price is \$40, and that NIPSCO can buy coal elsewhere for \$10. Then Carbon County would be making a profit of only \$20 on each ton it sold to NIPSCO (\$40-

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131. *Id.* at 267-68.

132. *Id.* at 268.

133. *Id.*

134. *Id.* at 279-80.

135. *N. Ind. Pub. Serv. Co.*, 799 F.2d at 279 (internal citations omitted). *See also* Walgreen Co. v. Sara Creek Prop. Co., B.V., 966 F.2d 273, 274 (7th Cir. 1992) ("Sara Creek reminds us that damages are the norm in breach of contract as in other cases. Many breaches, it points out, are 'efficient' in the sense that they allow resources to be moved into a more valuable use. Perhaps this is one—the value of Phar–Mor's occupancy of the anchor premises may exceed the cost to Walgreen of facing increased competition. If so, society will be better off if Walgreen is paid its damages, equal to that cost, and Phar–Mor is allowed to move in rather than being kept out by an injunction.") (internal citation omitted).

\$20), while NIPSCO would be losing \$30 on each ton it bought from Carbon County (\$40-\$10). Hence by offering Carbon County more than contract damages (i.e., more than Carbon County's lost profits), NIPSCO could induce Carbon County to discharge the contract and release NIPSCO to buy cheaper coal. For example, at \$25, both parties would be better off than under specific performance, where Carbon County gains only \$20 but NIPSCO loses \$30. Probably, therefore, Carbon County is seeking specific performance in order to have bargaining leverage with NIPSCO, and we can think of no reason why the law should give it such leverage. We add that if Carbon County obtained and enforced an order for specific performance this would mean that society was spending \$20 (in our hypothetical example) to produce coal that could be gotten elsewhere for \$10—a waste of scarce resources.<sup>136</sup>

Other commentators have similarly found that specific performance encourages inefficient stratagem:

An occasional promisee will request specific performance to satisfy a seemingly irrational motive, such as spite or vindictiveness, especially if the promisee has engaged in a long, rancorous, and ultimately fruitless attempt to convince the promisor to perform. More common, perhaps, than the spiteful promisee will be the promisee who requests specific performance primarily to warn other promisors who are tempted to breach that he will demand specific relief if they fail to perform. In such cases, the benefit that the promisee seeks from specific performance is not so much compensation for the loss of his bargain with the promisor as deterrence of subsequent promisors from breach. In short, . . . certain promisees may abuse [the right to specific performance] . . . to further impure, non-compensatory motives.<sup>137</sup>

Thus, not only would the application of expectation damages encourage efficient breach, it also would prevent the buyer from inefficiently seeking specific performance for the sole purpose of selling that right back to the bank.

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136. *N. Ind. Pub. Serv. Co.*, 799 F.2d at 279-80. See also *Walgreen Co.*, 966 F.2d at 276 (“The lack of alternatives in bilateral monopoly creates a bargaining range, and the costs of negotiating to a point within that range may be high. Suppose the cost to Walgreen of facing the competition of Phar–Mor at the Southgate Mall would be \$1 million, and the benefit to Sara Creek of leasing to Phar–Mor would be \$2 million. Then at any price between those figures for a waiver of Walgreen’s injunctive right both parties would be better off, and we expect parties to bargain around a judicial assignment of legal rights if the assignment is inefficient. But each of the parties would like to engross as much of the bargaining range as possible—Walgreen to press the price toward \$2 million, Sara Creek to depress it toward \$1 million. With so much at stake, both parties will have an incentive to devote substantial resources of time and money to the negotiation process. The process may even break down, if one or both parties want to create for future use a reputation as a hard bargainer; and if it does break down, the injunction will have brought about an inefficient result.”) (internal citation omitted); Posner, *Contract Breaker*, *supra* note 126, at 1353 (“Of course the three parties involved might bargain their way out of the situation. But that would be a costly bargaining because of the bilateral-monopoly setting. The promisor could get out of the contract only by negotiating with the promisee, and the promisee could extract concessions from the promisor only by negotiating with him. Each party would be pushing to maximize his share of the surplus value that the breach would enable, and such a negotiation is costly and may fail. If it fails, the surplus is lost, and that is a social and not merely a private cost.”).

137. Yorio, *supra* note 122, at 1373.

### 1. Specific Performance Increases Costs and Lowers Joint Contractual Value

In addition to incentivizing efficient breach and discouraging gamesmanship, applying expectation damages (a liability rule) minimizes negotiation and monitoring costs and maximizes joint contractual value. Specific performance (a property rule), on the other hand, results in a variety of inefficiencies. It “increase[es] the costs of contractual negotiations, by increasing postbreach transaction costs, and by generating additional administrative costs in fashioning specific performance decrees and in monitoring performance by promisors.”<sup>138</sup> Specific performance also involves disadvantages that lower joint contractual value (i.e., “the value gained by the parties less any expenses, costs of bargaining, and risk-associated disutility”) by requiring inefficient performance and leading parties to take unnecessary steps to avoid that risk.<sup>139</sup> Thus, “[w]hatever efficiency gains might be generated by specific performance would almost surely be outweighed by these losses, and could in any event be achieved within a money damages system.”<sup>140</sup>

First, by reflecting the relative *ex ante* preferences of the parties—i.e., the bank obviously prefers expectation damages because they allow maximum flexibility and permit the bank to breach when it is efficient to do so, while the buyer should be indifferent because money is not unique and an active market of substitute goods exists—a liability rule “mirror[s] the typical solution that the parties would arrange for themselves . . . and thereby reduces the costs of contractual negotiations.”<sup>141</sup> A right to specific performance provides the buyer with veto power to prevent the bank from breaching. In order for the bank to effect an efficient breach, it has to bribe the buyer for a contractual release, resulting in more complex and strategic negotiations than if specific performance were not permitted.<sup>142</sup>

Second, the availability of the specific performance remedy negatively affects bargaining conditions by interjecting moral considerations that detract from the buyer’s ability to make economically rational decisions:

First, instead of viewing contractual rights as a means to an end, a legal remedy itself may create intrinsic value in carrying out contractual promises. Second, by boosting the salience of performance, a specific performance default may cause [a buyer] to insist on performance even when it is in [its] material interest to accept the efficient breach. Third, when specific performance has an expressive effect on the moral intuitions of [the buyer], the resulting opposition to breach increases the burden on [the bank] when they negotiate to obtain release from inefficient contractual obligations . . . . In other words, by

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138. *Id.* at 1388.

139. Steven Shavell, *Specific Performance Versus Damages for Breach of Contract: An Economic Analysis*, 84 *TEX. L. REV.* 831, 832-33 (2006).

140. Yorio, *supra* note 122, at 1388.

141. *Id.* at 1379 (emphasis added); *see also id.* at 1380.

142. Ben Depoorter & Stephan Tontrup, *How Law Frames Moral Intuitions: The Expressive Effect of Specific Performance*, 54 *ARIZ. L. REV.* 673, 685 (2012).

fueling [the buyer's] moral aversion to breach, specific performance might lead parties into conflict rather [sic] than negotiation.<sup>143</sup>

The “trigger[ing] [of] such deontological moral viewpoints about contract performance” makes “efficient breach . . . more difficult” by “complicat[ing] private bargaining and the attainment of economically maximizing transactions.”<sup>144</sup>

Third, postbreach negotiations are more costly when a specific performance remedy is applied.<sup>145</sup> Under specific performance, any

postbreach negotiations between [the buyer] and [the bank] over [the bank's] profit from breach represent a “dead-weight” efficiency loss, which serves only to transfer wealth from [the bank] to [the buyer] without generating additional social wealth. These negotiations are likely to be protracted and costly both because [the buyer] may be unsure what [the bank's] profit from breach is and because [the bank] will try hard to keep as much of [its] profit as [it] can.<sup>146</sup>

While there are still postbreach negotiation costs associated with expectation damages, those costs are “likely to be lower than those generated by a specific performance rule, since damages are normally easy to determine and since [the bank] will be anxious to pay quickly to avoid the attorney's fees accompanying a lawsuit.”<sup>147</sup>

The following three examples illustrate that increased postbreach bargaining costs accompany the specific performance remedy under most circumstances:

In the first common scenario, a [bank] breaches because [it] believes—wrongly, it turns out—that the buyer has no contractual claim. Given the [bank's] convictions, [it] will reject any claim to recovery. Negotiations are likely to be strenuous and complicated, and will be especially difficult if the buyer seeks to share in the profits . . . above the alleged contract price or if the buyer insists upon specific performance of an obligation denied by the other party.

In the second case, the [bank] breaches because of factors peculiar to [its] own operations . . . . In this case, there is no opportunity gain for the parties to negotiate over . . . . Moreover, although the [bank] may be willing to admit some monetary liability to the buyer, [it] is likely to be particularly resistant to a demand by the buyer for specific performance in light of [its] personal difficulties in performing. Thus, the availability of specific performance is likely to complicate the negotiating process.

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143. *Id.* at 680; *see also id.* at 689 (“If a specific performance as a default remedy provokes moral aversion against breach, promisors face a steeper challenge when negotiating to obtain release from inefficient contractual obligations. They must compensate the promisee not only for the material losses, but they must also obtain forgiveness for violating the statutory entitlement to performance. Contract breach might be perceived as an insult that cannot as easily be absolved by material compensation.”).

144. *Id.* at 716.

145. Yorio, *supra* note 122, at 1381.

146. *Id.*

147. *Id.*

In the third case, the existence of a contract is uncontested and the [bank] has no personal justification for not performing, but [it] may nevertheless breach because of a sudden [change in market conditions], which then remain[ ] stable until the date of performance. In this scenario, both specific performance and the current money damages rule enable the buyer to deprive the [bank] of whatever gain [it] may be able to realize from breach, should the buyer choose to press [its] legal claim. Under either remedial rule, the [bank] has a strong incentive to avoid a lawsuit by delivering substitute [financing]. Thus, the fact that the [bank] has not delivered suggests that high cover costs may make it difficult for [it] to cover in the market. If so, the availability of specific performance is likely to increase transaction costs by forcing the [bank] to [cover] in the market.<sup>148</sup>

Fourth, expanding the availability of specific performance would increase administrative costs because “granting specific performance itself consumes considerable resources in tailoring the terms of the decree and in supervising performance by the [bank].”<sup>149</sup> Once specific performance is granted, “the court must ensure that the stipulated performance is accomplished, meaning that the court must be able to ascertain the quality of performance to guard against its being inadequate.”<sup>150</sup> To enforce expectation damages, by contrast, “courts do not have to assess and oversee the quality of performance, for by hypothesis there is no performance.”<sup>151</sup> The costs associated with crafting and enforcing a specific performance remedy will therefore “usually exceed the costs of devising and enforcing a damages judgment.”<sup>152</sup>

Finally, specific performance involves several disadvantages that lower joint contractual value: the bank might have to perform even when doing so is inefficient; the increased costs associated with specific performance might lead the bank to take wasteful avoidance steps (such as entering into inefficient hedging transactions); and the possibility of having to pay a large sum for a release (or worse, of actually having to perform) if performance would be inefficient constitutes an undesirable risk for the bank.<sup>153</sup> These disadvantages will not arise when a liability rule is applied: “Under the expectation measure, if it were very expensive to perform, [the bank] could, and usually would, breach and pay damages rather than perform . . . Thus, [the bank] would not be forced to perform and ordinarily would avoid more than modest bargaining costs, would not be induced to spend wastefully on avoidance steps, and would not bear risk beyond that of expectation damages.”<sup>154</sup>

148. *Id.* at 1382-83.

149. *Id.* at 1386.

150. Shavell, *supra* note 139, at 845. *See also* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 39 (2011) (“Specific performance may appear impractical, or too difficult to enforce.”).

151. Shavell, *supra* note 139, at 846.

152. Yorio, *supra* note 122, at 1386.

153. Shavell, *supra* note 139, at 833.

154. *Id.*

## 2. Specific Performance Is Appropriate Where Breach Is Opportunistic and Alternative Financing Is Unavailable

Not all breaches are efficient, however. Some are opportunistic.<sup>155</sup> And to those breaches, specific performance should apply. This is so because, unlike efficient breach, which increases the size of the economic pot by allowing the promisor to reap a greater profit while fully compensating the promisee, opportunistic breach only redistributes wealth from the promisee to the promisor (i.e., it does not increase the size of the pot). Making an opportunistic breacher pay only expectation damages will not discourage this type of behavior: if the breacher is caught and held liable it will be in the exact same position as if its breach were efficient. In order to incentivize breach only where it is efficient and to adequately deter opportunism, the punishment for opportunistic breach must be more severe than for efficient breach. Specific performance should be the preferred remedy. As Judge Posner stated, “[i]t makes a difference in deciding which remedy to grant whether the breach was opportunistic. If a promisor breaks his promise merely to take advantage of the vulnerability of the promisee . . . we might as well *throw the book at the promisor*.”<sup>156</sup> Thus, under the circumstances considered in this article, the bank should have to specifically perform if it breaches opportunistically.

For example, in *IBP, Inc. v. Tyson Foods, Inc.*, the court’s decision to award specific performance turned, at least in part, on Tyson’s opportunistic breach of its merger agreement with IBP.<sup>157</sup> Tyson, the nation’s largest chicken distributor, entered into a merger agreement to acquire IBP, the nation’s number one beef and number two pork distributor. The goal of this horizontal merger was to achieve product diversification and synergies: “to create the world’s preeminent meat products company—a company that would dominate the meat cases of supermarkets in the United States and eventually throughout the globe.”<sup>158</sup> During the auction process, Tyson learned that there was accounting fraud at DFG, a small IBP subsidiary. But news of the fraud did not extinguish Tyson’s fire for IBP. To the contrary, Tyson increased its bid after learning of the fraud. Tyson’s perseverance paid off, and it won the auction.

After executing the merger agreement, however, both Tyson and IBP began to struggle financially, “due in large measure to a severe winter, which adversely affected livestock supplies and vitality. As these struggles deepened, Tyson’s desire to buy IBP weakened.”<sup>159</sup> Using the problems

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155. *E.g.*, *Patton v. Mid-Continent Sys., Inc.*, 841 F.2d 742, 751 (7th Cir. 1988) (“Not all breaches of contract are involuntary or otherwise efficient. Some are opportunistic; the promisor wants the benefit of the bargain without bearing the agreed-upon cost, and exploits the inadequacies of purely compensatory remedies . . .”).

156. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.8 (5th ed. 1998) (emphasis added).

157. *IBP, Inc. v. Tyson Foods, Inc.*, 789 A.2d 14 (Del. Ch. 2001).

158. *Id.* at 22.

159. *Id.*



at DFG (including the resolution of a SEC investigation) as an excuse, Tyson delayed the merger. Tyson's delay tactics did not fool the court, which characterized the true reason for slowing down the merger process as "buyer's regret."<sup>160</sup> "While Tyson still believed that the deal made strategic sense, it was keen on finding a way to consummate the deal at a lower price. The negotiations with the SEC [regarding DFG] were a pressure point that Tyson could use for that purpose and it did."<sup>161</sup> Put differently, "Tyson was . . . bent on *using its leverage to extract concessions from IBP*."<sup>162</sup> As conditions continued to deteriorate, Tyson got cold feet and ultimately decided to abandon the merger. Thereafter, IBP filed an action seeking specific performance.

In granting IBP's request for specific performance, the court concluded that the deal still made sense and that Tyson should not be allowed to take advantage of IBP's vulnerability to negotiate a lower purchase price: "[T]here is no doubt that a remedy of specific performance is practicable. Tyson itself admits that the combination still makes strategic sense. . . . Tyson Foods is still interested in purchasing IBP, *but wants to get its original purchase price back and then buy IBP off the day-old goods table*."<sup>163</sup>

The application of specific performance to instances of opportunistic breach by a bank in the LBO context is particularly appropriate where alternative means of financing are not available. For example, in *BT Triple Crown Merger Co., Inc. v. Citigroup Global Markets, Inc.*, defendants—a consortium of lenders including Citigroup, Morgan Stanley, Credit Suisse, The Royal Bank of Scotland, Wachovia, and Deutsche Bank entities—agreed to lend plaintiffs, which were controlled by Bain Capital Partners and Thomas H. Lee Partners, approximately \$22 billion to finance the leveraged buyout of the media company Clear Channel.<sup>164</sup> As the credit markets worsened in the summer of 2007, defendants allegedly developed a case of lenders' remorse and "plotted to shift about \$2.65 billion of losses to [plaintiffs] or to escape their commitment."<sup>165</sup> Specifically, plaintiffs alleged that defendants attempted to take advantage of the market conditions and plaintiffs' resulting vulnerability in order to "wrest concessions from [them] or prevent them from completing the Acquisition by (1) threatening to back out of another unrelated loan to [plaintiffs], (2) meeting with [plaintiffs] . . . to ask them, with hat in hand, to change the terms of the financing, (3) stalling to buy time to delay the transaction, and

160. *Id.*

161. *Id.* at 47.

162. *Id.* at 48 (emphasis added).

163. *IBP*, 789 A.2d at 83 (emphasis added). Note that Tyson was offering IBP shareholders a choice of cash or Tyson stock, which allowed the shareholders the chance to share in the upside of the new combined company. Thus, the court also relied on this fact to support the inadequacy of damages as a remedy. *Id.*

164. *BT Triple Crown Merger Co., Inc. v. Citigroup Global Mkts., Inc.*, No. 08-600899, 2008 WL 1970900, at \*1 (Sup. Ct. N.Y. Cnty. May 7, 2008).

165. *Id.* (alteration in original omitted) (internal quotation marks omitted).

(4) failing to negotiate the final transaction agreements in good faith and instead asking for unreasonable terms.”<sup>166</sup> Plaintiffs then filed an action seeking specific performance of defendants’ commitment to finance the deal, and defendants moved for summary judgment.

In support of their request for specific performance, plaintiffs argued that it was commercially impossible to borrow the \$22 billion from another group of lenders; the leveraged financing of the magnitude needed to complete the transaction was simply not available in the market because of the credit crisis (i.e., no other group of lenders was able to consummate the deal).<sup>167</sup> As such, if defendants were allowed to breach, plaintiffs would be unable to complete the Clear Channel acquisition.<sup>168</sup> The court accepted plaintiffs’ argument and denied defendants’ motion, because it was unable to determine “whether alternate financing c[ould] be procured for the Acquisition[.]”<sup>169</sup>

*B. The Bank Should Be Liable for Tortious Interference if it Intentionally Causes a Wrongful Breach of Contract or its Conduct Is Independently Unlawful*

As explained in this article, contract law does encourage efficient breach. We want to direct goods and services into the hands of those who will pay the most for them, presumably because those who pay more can

166. *Id.* (internal quotation marks omitted).

167. *Id.* at \*9 (Plaintiffs presented expert testimony that, “[g]iven the ongoing instability in leveraged loan markets, the uncertainty in the market about when the credit crisis will end and where the economy is headed, the size of the [defendants’ facility under the Commitment Letter], and the absence of any large new leveraged loans being brought to market, . . . it would be a practical impossibility under current market conditions for the Purchasers to replace [the defendants’ facility] with a new group of lenders on terms remotely similar to those in the Commitment Letter.”)

168. Plaintiffs argued that they fell within an exception to the general rule that “[o]rdinarily, the New York courts will not order specific performance of a contract to lend money to a plaintiff, on the ground that money is fungible, and an injured party can borrow funds elsewhere and recover damages based on the higher costs it was forced to pay to the replacement lender.” *Id.* at \*8 (emphasis added) (internal citation omitted). Note that plaintiffs’ argument is not novel, as other courts have granted specific performance of contracts to lend money where an alternative source of financing is unavailable. See *First Nat’l State Bank of N.J. v. Commonwealth Fed. Sav. & Loan Ass’n of Norristown*, 610 F.2d 164, 173 (3d Cir. 1979) (affirming order of specific performance where “there is no hope of obtaining similar financing”) (internal quotations omitted); *Bregman v. Meehan*, 479 N.Y.S.2d 422, 433 (N.Y. Sup. Ct. 1984) (“Therefore, it is highly unlikely these plaintiffs will find another lender willing to give them a \$60,000 second mortgage at 12% with a 15 year term, prepayment rights and a balloon payment. The principal amount, the term, and the prepayment right may all be different, making the substitute performance too costly or otherwise unacceptable.”); *Amaysing Techs. Corp. v. Cyberair Commc’ns, Inc.*, No. Civ.A. 19890, 2004 WL 1192602, at \*3 (Del. Ch. May 28, 2004) (plaintiff’s claim that it had “no alternative means of funding” supported claim for specific performance).

169. *BT Triple Crown*, 2008 WL 1970900, at \*9. Note that the parties ultimately settled. See *Stipulation and Order Staying All Proceedings, BT Triple Crown Merger Co., Inc. v. Citigroup Global Mkts. Inc.*, No. 08-600899, 2008 WL 5661838 (N.Y. Sup. Ct. May 14, 2008).

put the product to a more valuable use. But the existence of this principle has generated significant criticism of the tortious-interference doctrine. As one author noted, “[i]t is startling that doctrine of this sort is imposed on an economic order committed to competition.”<sup>170</sup> Yet, we can push the rationale for withholding tort liability only so far; a bank should not be immune from all tort liability.

It is difficult here to analogize contract law to tort law because contract law uses various means to encourage efficiency: a liability rule protects some contracting parties when their counterparty breaches, while a property rule protects others. When a property rule applies, we deny the breaching party the opportunity to simply breach and pay damages. We instead leave the outcome up to the aggrieved party itself and the negotiations over the value of the aggrieved party’s right to specific performance from the counterparty. Clark Remington has used this distinction between liability and property rules to develop his theory that liability for tortious interference should attach when the alleged interferer caused the breach of a contract for which damages would be an inadequate remedy.<sup>171</sup> For example, in *Lumley v. Wagner*, Johanna Wagner refused to sing exclusively at a theater in London, as she had promised, and instead accepted an offer to sing for higher pay at another location.<sup>172</sup> Constrained by the rule against ordering specific performance of a contract for personal services, the court enjoined Wagner from singing at the second location. She refused to comply, after which the theater filed a separate action for tortious interference against the owner of the second location.<sup>173</sup> The court held “that an action lies for maliciously procuring a breach of contract to give exclusive personal services for a time certain . . . and produces damage[s].”<sup>174</sup>

Remington identifies in *Lumley v. Gye* an important scenario when liability should exist for tortious interference: when the interferer caused a “wrongful” breach of contract. Remington calls a breach wrongful when contract law would prefer to award specific performance because damages would be inadequate, but some other principle prohibits an order of specific performance.<sup>175</sup> According to Remington, we should focus less, if at

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170. Harvey S. Perlman, *Interference with Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 U. CHI. L. REV. 61, 78 (1982); *see also id.* at 79 (“In a competitive society it should be assumed that competition is a good thing, and that a person need not be placed in the position of defending his status as a competitor when he engages in . . . normal competitive acts.”) (citations omitted) (internal quotation marks omitted).

171. Clark A. Remington, *Intentional Interference with Contract and the Doctrine of Efficient Breach: Fine Tuning the Notion of the Contract Breacher as Wrongdoer*, 47 BUFF. L. REV. 645, 681 (1999).

172. *Lumley v. Wagner*, [1852] 42 Eng. Rep. 687, 688.

173. *Lumley v. Gye*, [1853] 118 Eng. Rep. 749.

174. *Id.*

175. Remington, *supra* note 171, at 688-89, 697.

all, on the interferer's conduct.<sup>176</sup> Doing so, Remington argues, should silence critics of the tort because, on these facts, contract law would place the right to compel performance in the hands of the aggrieved party, if it were not prohibited by some principle, and would deny the breaching party the opportunity to breach and pay damages.<sup>177</sup> If the aggrieved party does forgo its right to compel performance, however, it will have no contract claim against the breaching party and no tort claim against the alleged interferer.<sup>178</sup> Remington argues that imposing tort liability for interference in these circumstances "sets up no added obstacles to the efficient result."<sup>179</sup> In our case, this is to say that tort liability may be appropriate when the target bargained for, or is otherwise entitled to, specific performance of the merger agreement.

Remington's theory is not a perfect fit to our facts, however, because it assumes two willing participants: the interferer convinces the breaching party to deal with him, and the breaching party chooses to make the better deal with the interfering party. Under Remington's theory, the important legal question is how we should force the breaching party and interferer to divide the surplus of their presumably more efficient deal with the aggrieved party. But our case does not involve a surplus. No one is making a better offer to the breaching party, nor is the breaching party refusing to perform the merger agreement of its own volition. It simply has insufficient funds to close the merger without receiving financing from the bank.

Nonetheless, Remington's theory raises important questions for our case. For example, is the buyer's breach "wrongful" if its own economic failure—i.e., its financial inability to close the deal—is the root cause of its failure to perform (as opposed to its refusal to perform)? Though merger agreements often have no-financing-out provisions that speak to this question, the issue is far more complicated when they do not, or when a buyer loses bank financing *and* suffers an economic decline. Furthermore, does a regime that imposes tort liability for wrongful breach, as Remington has defined it, prevent tort and contract principles from working at cross-purposes and actually give rise to liability in circumstances that demand it? Imposing tort liability no doubt impedes efficiency: consider the significant transaction costs associated with bargaining against a background of multi-billion-dollar potential tort liability, versus bargaining against a background of more limited contract damages. Moreover, by focusing on the breaching party, Remington's theory sidesteps what should be the lynchpin of the analysis—the intent of the party committing the tort. In addition to allowing what is likely the inefficient application of tortious interference, Remington's theory prevents the imposition of tort liability under circumstances where it is clearly called for to punish an interferer that is acting maliciously, but has not caused a "wrongful" breach.

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176. *Id.* at 697-98.

177. *Id.* at 698.

178. *Id.*

179. *Id.*

For those reasons, this article focuses on the conduct of the interferer and advocates the use of tortious interference only where the interferer either acts willfully to cause breach, or otherwise acts unlawfully—not where the interferer is only seeking to abdicate *its* contractual commitments because nonperformance is efficient. For example, in the LBO context, tortious interference would be appropriate where a bank, knowing that the buyer has no other financing option and will have to breach the merger agreement if the bank walks away, pulls its financing as an exclusively extortionate means or lever to compel the buyer to negotiate more favorable terms (i.e., to extract concessions from the buyer under the threat of compelled breach with respect to the target). The application of tortious interference also would be appropriate where a bank pulls its financing to cause the buyer to breach the merger agreement so that one of the bank's clients or affiliates can take the buyer's place or otherwise gain a strategic advantage. In both of these cases, the analysis turns (as it should) on the intent of the interferer.

Circling back to Remington's example of *Lumley v. Gye*, suppose that on the night Wagner was to sing at the theater, Gye kidnapped her, thereby preventing her performance.<sup>180</sup> Wagner could bring a false imprisonment claim against Gye, but the doctrine of impossibility would bar Lumley's breach of contract claim against Wagner. Gye would not have caused a wrongful breach of contract, as Remington defined such a breach, because Wagner did not breach at all. Thus, under the wrongful breach theory, it appears that Lumley's tortious interference claim against Gye should fail. Remington's theory does not adequately account for this *Lumley* hypothetical, however, and therefore cannot be reconciled with our case, because we should not bar Lumley from recovering from Gye. Gye *did* do something wrong to Lumley: he acted with the purpose of preventing Wagner from performing her contract with Lumley. We call *that* tortious interference with contract.

*C. Current Law Should Be Amended to Prevent A Target From  
Introducing Evidence of Settlement Negotiations Between the  
Buyer and Bank to Prove the Bank's Intent to  
Interfere With the Merger Agreement*

Consider the situation in which the bank and the buyer are prepared to renegotiate the bank's commitment. The bank will not be able to syndicate the loan without relaxed financial covenants and other deal-sweetening terms. If this negotiation fails, it intends to breach its commitment—a fact the buyer has inferred. Evidence of these negotiations should be inadmissible in court if offered to prove the bank's intent to interfere with the merger agreement.

The negotiations show the bank, facing devastating losses on a loan that it cannot syndicate, looking for mercy from a buyer. They also reflect

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180. Perlman, *supra* note 170, at 76.

the bank's desire to work with the buyer before breaching their contract. In this way, the negotiations are not only consistent with the public policy favoring settlement, but they also increase the likelihood of closing the deal.<sup>181</sup> That is, a buyer that renegotiates the bank's contract will be more likely to receive financing than a buyer who refuses to negotiate. Thus, allowing a target to introduce evidence of these negotiations as proof that the bank acted tortiously undermines the target's own desire to close the deal, assuming such a desire exists.

State and Federal Rules of Evidence currently encourage the bank to lend, while still preserving the possibility of tort claims if the bank *does* intentionally interfere with a merger agreement. The rules should say the following:

Evidence of the following is not admissible when offered to prove liability for, invalidity of, or amount of a tortious interference with contract claim, or to impeach through a prior inconsistent statement or contradiction:

Furnishing, offering, or promising to furnish to a third party, or accepting, offering, or promising to accept from a third party any consideration in exchange for amending or terminating the contract with that third party; *provided that* the court shall balance the probative value of any direct evidence of fraud or intent against its prejudicial effect.

Most will recognize that the provenance of such a rule is Federal Rule of Evidence 408.<sup>182</sup> Rule 408 implicitly provides certain relevant exceptions, and so should the proposal here: "This rule does not require exclusion if the evidence is offered [for example, to prove] a witness's bias or prejudice [or negate] contention of undue delay."

But we cannot rely on Rule 408 to serve our purposes here. Rule 408 would not apply in the target's suit against the bank because Rule 408 excludes evidence of an attempted compromise of the claim *being litigated*, not the buyer's potential breach claim against the bank.<sup>183</sup> But the *reasons* for adopting Rule 408 parallel the reasons a related rule should be extended to our facts. Rule 408 has at least two purposes: first, the rule excludes irrelevant evidence—irrelevant because a desire for peace may motivate the settlement offer, rather than a concession of weakness of position; and second, the rule advances the strong public policy in favor of settling disputes.<sup>184</sup>

181. See *supra* note 14 and accompanying text.

182. Given the various considerations often reflected in a decision to amend the rules of evidence, aside from the results of the specific change itself, this change could also be made through common law development.

183. See, e.g., *Dahlgren v. First Nat'l Bank of Holdrege*, 533 F.3d 681, 699-700 (8th Cir. 2008) ("Rule 408 does not require the exclusion of evidence regarding the settlement of a claim different from the one litigated, though admission of such evidence may nonetheless implicate the same concerns of prejudice and deterrence of settlements which underlie Rule 408[.]") (quoting *Towerridge, Inc. v. T.A.O., Inc.*, 111 F.3d 758, 770 (10th Cir. 1997)) (internal quotation marks omitted).

184. FED. R. EVID. 408 (Advisory Committee's Note).

These policies apply with particular force here. The negotiations of the bank and buyer do not necessarily reflect the bank's intent to interfere with the merger agreement; the bank has no such actual intent and, in any event, lacks sufficient intent to incur tort liability.<sup>185</sup> Nor do the negotiations reveal that the bank never intended to finance the deal. That is an implausible argument that assumes that the bank intended to subject itself to the downside of tort and contract liability without any corresponding benefit. The negotiations are precisely what they appear to be—a bank that faces crippling mark-to-market losses on a deal that it cannot syndicate seeking more reasonable terms from its borrower. These negotiations have little, if any, relevance to whether the bank intended to interfere with the merger agreement, but would substantially prejudice a jury that has little knowledge about complex leveraged buyouts.<sup>186</sup>

The negotiations also reflect the bank's desire to settle any dispute with the buyer before breaching its commitment. In this way, the negotiations are not only consistent with the public policy favoring settlement, but they also increase the likelihood that the deal will close. That is, a buyer who bends on certain terms of the bank's commitment will be more likely to get the promised financing than a buyer who refuses to negotiate. Allowing a target to introduce evidence of these negotiations as proof that the bank acted tortiously undermines the target's own alleged purpose—forcing the bank to close on that merger financing.

We must remember context: the scenario being analyzed is not just a tort case. The case rests at the crossroads of tort and contract law. Generally, contract law encourages parties to perform only when doing so is efficient—i.e., when the benefit of doing so will exceed the costs of performance. Contract law does not exist to punish those who breach contracts. Rather, its design is intended to ensure that the victim of such a breach is made whole, no more. Introducing evidence of the bank and buyer's negotiations encourages the bank to avoid potentially promising negotiations, furthers the punishment of a bank that does engage in such negotiations, and leaves the only legal theory that should conceivably apply to the bank's conduct—a contract theory—in shambles.

## V. CONCLUSION

These issues affect multi-billion-dollar deals, the creation of shareholder value, and the broader economy. For example, when Hexion and its financiers decided to walk away from the Huntsman transaction, Hexion and Apollo ended up settling for \$1 billion, while Deutsche Bank and Credit Suisse each paid over \$300 million in cash and each agreed to provide another \$550 million in senior debt financing to Huntsman. This money could have been put to more efficient, value-creating use elsewhere.

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185. *See supra* Part III.A.

186. *See supra* notes 20-22 (discussing Huntsman trial tactics).

Though not readily apparent, these issues are not limited to high-stakes LBOs. They affect everyday transactions as well. Assume that a movie theater owner wants to show a certain movie in her theater. She contacts an intermediary who owns a nonexclusive license to show the film. That intermediary properly grants the theater owner permission, but in the face of plummeting revenues, the movie owner grants an exclusive license to show the movie to another party for the consideration that is necessary to keep the company afloat. The theater owner then sues the movie owner for tortious interference, and the intermediary sues the movie owner for specific performance. While billions of dollars may not be on the line, the overriding issues are the same.

By failing to take a broader view of the cathedral, the current judicial landscape creates unnecessary risk and inefficiencies by increasing *ex ante* and *ex post* costs of negotiations. Negotiating in the shadow of tort liability all but ensures that the most efficient result will *not* be reached. The same can be said of specific performance, which destroys the possibility of efficient breach, resulting in value-destroying overperformance, and encourages deleterious strategic behavior.

But that does not have to be the case. As shown in this article, patches of caselaw and scholarship can be woven together into an economically sound framework to address these issues. This framework allows the entire cathedral to come into focus. Only then do the rules articulated in this article make sense. Specifically, under most circumstances, expectation damages are the appropriate remedy—nothing else. That is because imposing a liability regime incentivizes wealth-creating efficient breach and minimizes negotiation costs. Only under very limited circumstances—i.e., where breach is opportunistic or the interferer acts with intent to cause a breach—should specific performance or tortious interference come into play.

This agile framework is a perfect match for today's fast-paced economic environment, where markets change rapidly and decision-makers are forced to constantly reevaluate the economic soundness of their decisions. Applying a liability rule maximizes joint contractual value, discourages gamesmanship, and minimizes negotiation and monitoring costs. At the same time, we must still retain flexibility to "throw the book"<sup>187</sup> at and severely punish opportunistic breachers. The framework proposed in this article allows just that by imposing the remedy of specific performance. For the same reason, it also does not completely immunize an interferer from tort liability. Instead, the framework allows claims of tortious interference to proceed where appropriate: when an interferer intentionally causes a breach of contract.

The solutions proposed in this article strike a careful balance between efficiency and punitive concerns. By doing so, they create a system that does justice to those involved and improves social welfare.

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187. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.8 (5th ed. 1998).



