Protecting business relationships

JOSEPH HENNESSEY

Someone who interferes with a contract between businesses may be liable for the harm that results. If your client alleges such an injury, you need to know when a tortious interference claim is a viable cause of action.

Contracts are indispensable in our society. People in business recognize the importance of performing contract obligations and know that they can sue—or be sued—for breach of contract. But the idea of suing someone for interfering with contracts and business opportunities is not as apparent.

Several tort actions exist to punish those who interfere with contract performance. Yet because society tends to associate tort causes of action with personal injury rather than business law, those harmed by malicious interference with their contracts often neglect to bring their cause of action through the courtroom door. "Business tort" causes of action are underused, often misapplied, and surprisingly little understood.

What constitutes tortious interference with contract and business relations? Consider three hypothetical parties: Aceco, Inc., Bluechip Co., and Claypot, Ltd. Bluechip and Claypot are rivals; they both compete for Aceco's business. Aceco decides to enter into a contract with Bluechip, much to Claypot's discontent.

Claypot issues a press release that makes a knowing misrepresentation about Bluechip: that the IRS is investigating Bluechip for tax fraud. Due to this press release, a significant financial backer of Bluechip withdraws his investment from the company. With this loss of capital, Bluechip cannot meet its obligations to Aceco and is forced to breach the contract.

Under contract law, neither Aceco nor

Questions? JHennessey@nmlaw.com

Bluechip has a cause of action against Claypot because neither of them is in privity of contract with Claypot. But there are ways Aceco and (in some jurisdictions) Bluechip can obtain compensation from Claypot for its improper interference with Bluechip's ability to perform on the contract.

Under traditional common law theories (as summarized in the *Restatement (Second) of Torts* §766), Aceco has a cause of action against Claypot for interfering with the contract through the tort of defamation. Under an increasingly accepted expansion of traditional tort liability (under §766A), Bluechip also has a cause of action against Claypot for damages caused to its contractual relationship with Aceco.

Interference with contracts

We have the Romans to thank for the tortious interference cause of action.[1] Rome permitted these claims for heads of households to compensate them when people injured members of their household, and for masters who were injured by damages inflicted on their servants.

The English adopted this theory of recovery in 1853 in *Lumley v. Gye*.[2] In that case, a theater manager suffered damages when a rival theater induced a singer to break her contract with him.

Under traditional common law, a party such as the hypothetical Aceco may recover damages when a stranger to its contract—Claypot—causes Aceco's counterparty, Bluechip, to breach its contract by maliciously damaging Bluechip.

The cause of action must contain several elements:

- A contract must exist between A and B.
- C must have known that the contract between A and B existed.
- C's actions in interfering with the contract between A and B must be purposefully wrongful or illegal.
- Party A must have suffered damages caused by C's interference with B's contract obligations.

A good real-life example of this cause of action is *Owner-Operator Independent Drivers Association, Inc. v. Swift Transportation Co.*, a case pending in federal court in Arizona.[3] Owner-operator truck drivers brought suit against Swift Transportation, the largest publicly owned trucking company in the world. In the late 1990s, Swift purchased another large trucking company called MS Carriers, Inc. The complaint alleges that before the purchase, Swift sent its personnel into key management positions at MS Carriers to raise the company's profitability.

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The truck-driver plaintiffs claim that Swift—a stranger to their contracts with MS Carriers—interfered with the contracts by, among other things, unilaterally changing the terms and conditions by which the drivers bought fuel and other supplies from MS Carriers. The drivers argued that Swift effected these unilateral changes to increase the profit margin MS Carriers would realize through selling them fuel.

The plaintiffs argued that under the Truth in Leasing regulations, it is illegal for a trucking company to profit from the sale of its goods and services to independent truck drivers (a regulation put in place to protect drivers from being forced to purchase "at the company store").[4] Thus, the truck drivers, strangers to the illegal changes that Swift forced on MS Carriers, sued Swift for tortiously interfering with their contracts.

Improper action

Laurence G. Wolf Capital Management Trust Agreement v. City of Ferndale provides another example of how improper conduct can result in tort liability.[5] In 1999, the owners of a building that had roof space with unobstructed vistas of Ferndale, Michigan, entered into an agreement with AT&T to let the company erect cellular telephone antennae on the roof. The city of Ferndale, however, caused a breach of the contract with AT&T when it denied the building owners the construction permit required to build the antennae.

The building owners successfully sued the city for denying the variance on the theory that the city's action violated the Telecommunications Act of 1996. Plaintiffs were thwarted again when the city passed an ordinance that effectively barred construction of the towers.

Unable to carry out its contract with AT&T, the building owners were unpleasantly surprised when the company entered into a contract with the city to place its antennae on municipal buildings just blocks from their building. Suing under a tortious-interference-with-contract theory, the building owners were vindicated. The court found that the city's late-enacted ordinance was improper because it was passed only to usurp profits from the building owners to the city by making the municipal building the only suitable place for construction of the antennae.

The allegedly improper act does not *itself* have to be actionable to maintain a tortious interference cause of action. In its 2006 opinion in *Atkinson v. McLaughlin*, the U.S. District Court for North Dakota held that tortious interference, being a separate cause of action with its own prerequisites to recovery, is timely under its own statute of limitations even if a tort action constituting one of its critical elements is itself time-barred.[6]

In that case, disgruntled former volunteer workers made defamatory statements about the head of a nonprofit organization to its contributors. They coupled their statements with requests that donors stop contributing money to the organization. Establishing that cer-

Joseph Hennessey *is a partner in Newman McIntosh & Hennessey in Bethesda, Maryland.*

Questions? JHennessey@nmlaw.com

tain donors and benefactors had reneged on contribution obligations because of the scandalous allegations made, the nonprofit sued the former volunteer workers for interfering with these contractual contribution obligations.

Although the two-year statute of limitations had run on the nonprofit's claim of defamation, the six-year statute had not run on its claim that the former volunteers' defamatory statements had interfered with its donor pledges. The court held that the tort element of that cause of action was met not by a declaration of liability on the underlying tort action, but by proving at trial that the conduct was otherwise tortious.

The so-called manager's privilege establishes that a corporate officer or agent acting for the corporation **is** *the corporation for purposes of a tortious interference cause of action.*

The *Restatement (Second) of Torts* is helpful in understanding the nature of improper action as it relates to a claim of interference with contracts. Section 767 sets forth seven factors that should be considered:

- the nature of the actor's conduct
- the actor's motive
- the interests of the other party with which the actor's conduct interferes
- the interests that the actor sought to advance
- the social interests in protecting the actor's freedom to act and the other party's contractual interests
- the proximity or remoteness of the actor's conduct to the interference
- the relations among the parties

Comment A to §767 reinforces the requirement that the action "be both intentional and improper." Although §767 establishes broad principles for impropriety, §768 states specific acts that are not considered improper. Acts are not considered improper if the actor and the other are competing; the actor does not employ wrongful means; the action does not create or continue an unlawful restraint of trade; and the actor's purpose is at least in part to advance his or her interest in competing with the other.

Privileges

Privileges that exist for otherwise tortious conduct may affect the viability of a tortious interference cause of action. For example, since it is impossible to interfere with one's own contract, the parent of a wholly owned subsidiary corporation cannot tortiously interfere with that subsidiary's contracts. But this parent-subsidiary privilege is not absolute and may be lost if the parent company acts contrary to the subsidiary's economic interests or if the parent corporation employs wrongful means.[7]

The privilege to act for the welfare of a third party covers someone who is charged with responsibility for a third party's welfare and intentionally causes that party not to perform or enter into a contract. Under this privilege, articulated at §770,

> One who, charged with responsibility for the welfare of a third person, intentionally causes that person not to perform a contract or enter into a prospective contractual relation with another, does not interfere improperly with the other's relation if the actor (a) does not employ wrongful means and (b) acts to protect the welfare of the third person.

This privilege has been used to shield attorneys for advising clients.[8] Similarly, since an agent acts at the behest of a principal, an agent is conditionally privileged against a claim that it interfered in a third party's relationship with the principal. This privilege can be overcome by showing that the agent acted outside of his or her authority.[9]

Similarly, the so-called manager's privilege establishes that a corporate officer or agent acting for the corporation *is* the corporation for purposes of a tortious interference cause of action, because corporations can act only through their agents. A manager or agent may, with impersonal or disinterested motive, properly endeavor to protect the interests of his or her principal by counseling the breach of a contract with a third party that the manager reasonably believes to be harmful to his or her employer's best interests.

To use the manager's privilege, a director or shareholder of a corporation must show that he or she was involved in managing the company and was authorized to act on the corporation's behalf when he or she interfered with the contract at issue. Thus, a court must make a factual inquiry before extending the benefit of this privilege.[10]

A corporate officer or agent may be liable for tortious contract interference if he or she acts outside the scope of his or her duties. For example, a Minnesota court held that the privilege may be lost "if the defendant's actions are predominantly motivated by malice and bad faith, that is, by personal ill will, spite, hostility, or a deliberate intent to harm the plaintiff."[11]

Under the "superior interest" privilege, no liability arises for interfering with a contract or business expectancy if the action was something the defendant had a legal right to do, without any qualification. For example, someone who has a bona fide legal economic interest to protect is privileged in blocking a contract that threatens that interest. Also, intentionally causing a third party not to perform an existing contract by asserting in good faith one's own legally protected interest does not constitute improper interference. Under this rule, if two parties have separate contracts with a third party, each may use any legitimate means to secure performance of his or her own contract, even if it causes a breach of the other contract.[12]

Breach of one's own contract

Under §766A, courts increasingly are expanding the protection that traditional tortious interference actions provide. Even a party that has breached its own contract as a result of tortious interference may recover.

In our hypothetical scenario, Bluechip

could sue Claypot not merely for the damages the defamation caused, but also for the damages flowing from the breach of Bluechip's contract with Aceco. Under §766A, both Aceco and Bluechip have a cause of action for tortious interference against Claypot.

Even if the contract is fully performed (leaving Aceco without a cause of action), Bluechip still has a cause of action against Claypot if Bluechip's cost of performing its obligations to Aceco becomes more burdensome as a result of Claypot's conduct.

This cause of action under §766A was brought in *Shafir v. Steele.*[13] In that case, businessman Duane Steele lost a bidding war to Frances Shafir to purchase commercial property in Massachusetts. Disgruntled and unwilling to concede defeat, Steele sent Shafir an unsigned, yet-to-be-filed complaint that included allegations of criminal conduct—which Shafir said had no basis in fact.

Afraid of being named as a criminal defendant on trumped-up charges and eager to end Steele's harassment, Shafir sought to withdraw from a mortgage she had entered into with Shawmut Bank for the purchase of the commercial property. She requested the return of her $10,000 deposit, but the bank refused her request, indicating that it intended to close the sale.

Shafir then sued Steele, seeking the damages she suffered from her breach of contract with the bank. A jury found Steele liable for defamation and intentional interference with the contract.

Steele complained to the Massachusetts Supreme Judicial Court that the trial court should not have allowed Shafir to claim damages from him for her breach of her own contract with the bank. Upholding the trial court and forcefully endorsing the cause of action articulated in §766A, the court stated, "[T]he only difference between the torts described in §766 . . . and §766A is that, under §766, the tortious conduct causes the third [party] not to perform, whereas §766A involves interference preventing the plaintiff from performing his own part of the contract." The court declared that it saw "no compelling reason not to recognize such conduct [as Steele's] as being tortious."[14]

Before a contract is formed

What if a party interferes with a prospective business opportunity? Several states—backed by the guidance in §766B—have held that such wrongdoers should not escape liability.

Section 766B states that someone who interferes is liable "whether the interference consists of (a) inducing or otherwise causing a third person not to enter into or continue the prospective relation or (b) preventing the other from acquiring or continuing the prospective relation."[15]

Some courts have been reluctant to recognize the tort of interference with noncontractual relationships. Tennessee's supreme court rejected it as too 'broad and undefined.'

Courts are more circumspect in allowing for recovery under this theory. But in jurisdictions that do recognize it, this cause of action is the vehicle through which damages can be extracted from those who intentionally and maliciously interfere with another's ability to do business.

In an example from the pharmaceutical industry, competition between Arriva Pharmaceuticals, Inc., and AlphaMed Pharmaceuticals Corp. ended up in court.[16] The dispute involved the development and production of the therapeutic protein Alpha 1-Antitrypsin (AAT), used to treat a wide range of human and veterinary conditions.

Arriva believed that AlphaMed was engaged in corporate espionage in an attempt to steal intellectual property associated with AAT. Arriva contacted the FBI and encouraged it to investigate. Not content to rely on the FBI to build a case against AlphaMed, Arriva hired a private investigator to pose as an FBI agent and inform AlphaMed's leading investor that the company was under investigation. After this, the investor declined further investment.

AlphaMed sued Arriva for tortiously interfering with its relationship with its leading investor. Though Arriva attempted to assert a privilege because of the actual (although brief) investigation by the FBI, the court found that AlphaMed had demonstrated that the actions of the private investigator were malicious and not tied to a bona fide FBI investigation. After trial, the jury found in AlphaMed's favor.

Courts in some states have been reluctant to recognize the tort of interference with noncontractual relationships, as the machinations of the Tennessee Supreme Court demonstrate. Ten years ago, in *Nelson v. Martin*, the court rejected the cause of action on the grounds that a tort protecting prospective relationships was too "broad and undefined" and that this was a tort "in which no specific conduct is proscribed and in which liability turns on the purpose for which the defendant acts, with the indistinct notion that the purposes must be considered improper in some undefined way."[17] The court expressed concern that protecting prospective economic advantage would weaken the significance and importance of contractual relationships and the legal principles underlying free competition.[18]

Five years later, the Tennessee Supreme Court reversed itself and adopted the cause of action in that state, relying heavily on the restatement's requirement that the conduct in question be improper and not merely zealous competition. The case, *Trau-Med of America, Inc. v. Allstate Insurance Co.*, involved prospective business advantage.[19]

Elaborating on the requirements for a tort cause of action that lacks an underlying contract, the court in *Trau-Med* established that a plaintiff must prove five separate elements:

- The plaintiff must have an existing

Questions? JHennessey@nmlaw.com

business relationship with specific third parties or a prospective relationship with an identifiable class of third parties.

■ The prospective defendant must have more than "mere awareness" of the plaintiff's general business dealings. He or she must know the specific nature of the business relationship the plaintiff seeks.

■ The defendant must intend to terminate the business relationship.

■ The termination of the business relationship must have been accomplished through improper means or with an improper motive.

■ A plaintiff filing an action under §766B must prove that he or she suffered actual damages as a result of the improper acts.[20]

On the other hand, two years ago, the Arkansas Supreme Court held that the prohibition on tortious interference with prospective business expectancy should yield to what it called the "privilege to compete." It stated:

> [I]t is no tort to beat a business rival to prospective customers. Thus, *in the absence of prohibition by statute, illegitimate means, or some other unlawful element*, a defendant seeking to increase his own business may cut rates or prices, allow discounts or rebates, enter into secret negotiations behind the plaintiff's back, refuse to deal with him or threaten to discharge employees who do, or even refuse to deal with third parties unless they cease dealing with the plaintiff, all without incurring liability.[21]

Clearly, states have applied §§766, 766A, and 766B differently. Most states recognize a cause of action against a stranger who wrongfully interferes with a party's ability to perform its contractual obligations. Many states recognize a claim against a party for making the performance of one's own contractual obligations impossible or more costly. And more and more states are allowing recovery when another interferes with a business relationship that has not yet germinated into a contract.

Finally, some states, notably Alabama, have taken the view that contracts are entitled to broad protection and have adopted tortious interference elements that are so broad that they encompass both tortious interference with contract and tortious interference with a prospective business relationship. As the Supreme Court of Alabama stated,

> Adoption of this broad scope of the cause of action has been recognized as the better approach in those jurisdictions, such as ours, in which an action for interference with business relations is allowed. We see no reason to continue the distinction between the two causes of action and are of the opinion that a single set of elements, broadly defined, so as to include both causes of action, would simplify and clarify the law in this area.[22]

These claims provide an effective alternative to contract law for obtaining just compensation for improper and intentional conduct that damages business relationships. ■

Notes

1. *See* Travis Newport, *Tortious Interference with International Contracts*, Intl. Trade L.J. 80, 80 (Summer 2000).
2. (1853) 118 Eng. Rep. 749 (Q.B.).
3. No. CV-02-1059-PHX-PGR (D. Ariz. filed June 6, 2002).
4. 49 C.F.R. §376.12 (2007).
5. 713 N.W.2d 274 (Mich. App. 2005), *appeal denied*, 723 N.W.2d 827 (Mich. 2006).
6. 462 F. Supp. 2d 1038, 1058-59 (D.N.D. 2006).
7. *See Waste Conversion Sys., Inc. v. Greenstone Indus.*, 33 S.W.3d 779, 783 (Tenn. 2000); *Valores Corporativos, S.A. de C.V. v. McLane Co.*, 945 S.W.2d 160, 168 (Tex. App. 1997).
8. *See e.g. Brown Mackie College v. Graham*, 768 F. Supp. 1457, 1461-62 (D. Kan. 1991), *aff'd*, 981 F.2d 1149 (10th Cir. 1992).
9. *See e.g. CGB Occupational Therapy, Inc. v. RHA Health Servs., Inc.*, 357 F.3d 375, 385 (3d Cir. 2004).
10. *See e.g. Huynh v. Vu*, 4 Cal. Rptr. 3d 595 (Cal. App. 2003).
11. *Fahrmann v. Fredd*, 2002 WL 1467451 at *6 (Minn. App. July 1, 2002).
12. *See e.g. Deutsche Fin. Servs. Corp. v. BCS Ins. Co.*, 299 F.3d 692, 696-97 (8th Cir. 2002).
13. 727 N.E.2d 1140 (Mass. 2000).
14. *Id.* at 1144.
15. *See also Blackstone v. Cashman*, 860 N.E.2d 7, 12-13 (Mass. 2007).
16. *AlphaMed Pharms. Corp. v. Arriva Pharms., Inc.*, 391 F. Supp. 2d 1148 (S.D. Fla. 2005).
17. 958 S.W.2d 643, 646 (Tenn. 1997); *overruled by Trau-Med of Am., Inc. v. Allstate Ins. Co.*, 71 S.W.3d 691 (Tenn. 2002).
18. See discussion in *Watson's Carpet & Floor Covering, Inc. v. McCormick*, 2007 WL 134132 at *3 (Tenn. App. Jan. 18, 2007).
19. 71 S.W.3d 691.
20. *Id.* at 701.
21. *Steward Title Guar. Co. v. Am. Abstract & Title Co.*, 215 S.W.3d 596, 601-02 (Ark. 2005).
22. *Gross v. Lowder Realty Better Homes & Gardens*, 494 So. 2d 590, 597 (Ala. 1986).

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