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VIA ELECTRONIC SUBMISSION AND
VIA FEDERAL EXPRESS (ORIGINAL AND EIGHT PAPER COPIES)

The Honorable Tani Gorre Cantil-Sakauye, Chief Justice
and Associate Justices
California Supreme Court
350 McAllister Street
San Francisco, CA 94102-4797

Re: *Asahi Kasei Pharma Corporation v. Actelion Ltd., et al.*, No. S216123
(Court of Appeal No. A133927)
(San Mateo Super. Ct. CIV478533)
Amicus Curiae Letter Supporting Petition for Review

Honorable Justices of the California Supreme Court:

Pursuant to the California Rules of Court, Rule 8.500(g), TechNet submits this letter in support of the petition for review in the above-referenced case.

The Interest of Amicus Curiae TechNet

TechNet is a national network of chief executive officers and senior executives in the technology industry that has as its objective the promotion of growth in the technology industry and the economy. TechNet's members represent more than one million employees in the fields of information technology, biotechnology, e-commerce, and finance. TechNet's members include more than 60 of America's leading technology, biotechnology, communications, and financial companies. More information about TechNet is available at http://www.technet.org.[1]

Review Should Be Granted

The opinion below, if allowed to stand, seriously erodes two bedrock principles of California law: the centuries-old contract law principle of efficient breach of contracts, and California's strong public policy against "tortification" of contract law. The opinion below runs contrary to both.

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[1] This letter was not authored in whole or in part by counsel for any party, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this letter. No person or entity other than *Amicus*, its members, or their counsel made a monetary contribution to the preparation or submission of this letter.

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The Opinion Below Discourages Efficient Breach of Contracts

Since Blackstone, Anglo-American contract law has embraced the concept of "efficient breach" of contracts: The idea that, if a contracting party can obtain a better deal from a new deal with a third party, while still paying the original contractor the profit it bargained for, society and consumers benefit. For example, Party A contracts to buy parts to be incorporated into its product from Party B for five cents each, and it costs Party B four cents each to produce them. Party C comes along and offers to sell the same parts for three cents each. If A breaches the contract with B in favor of C, and pays B the one cent profit it bargained for, B ismade whole, and A has saved one cent a piece, which saving redounds to the benefit of either A's consumers or A's shareholders.

As this Court explained in *Freeman & Mills*:

> The traditional goal of contract remedies is compensation of the promisee for the loss resulting from the breach, not compulsion of the promisor to perform his promises. Therefore, 'willful' breaches have not been distinguished from other breaches. The restrictions on contract remedies serve purposes not found in tort law. They protect the parties' freedom to bargain over special risks and they promote contract formation by limiting liability to the value of the promise. This encourages efficient breaches, resulting in increased production of goods and services at lower cost to society. Because of these overriding policy considerations, the California Supreme Court has proceeded with caution in carving out exceptions to the traditional contract remedy restrictions.

(*Freeman & Mills, Inc. v. Belcher Oil Co.* (1995) 11 Cal.4th 85, 98 [900 P.2d 669, 676–77, 44 Cal.Rptr.2d 420, 428–29] (citations omitted, quoting *Harris v. Atlantic Richfield Co.* (1993) 14 Cal.App.4th 70, 77 [17 Cal.Rptr.2d 649, 653–54]; *see also Rogoff v. Grabowski* (1988) 200 Cal.App.3d 624, 629 fn. 2 [246 Cal.Rptr. 185, 188 fn. 2] (emphasis added)):

> The social policy begins with recognition that if breaches are too harshly sanctioned, there will be deterrence not only of breach but of the execution of contracts. Therefore, damages must not be so oppressive as to discourage the formation of binding commercial agreements. *But far more important is an awareness that intentional breaches of contract often promote the economic efficiency of society. To the extent the promisor's pecuniary gains from breach exceed the promisee's pecuniary injuries, the costs of production have been reduced. Were legal liability to exceed the promisee's pecuniary injuries, an efficient reallocation of resources would be discouraged at societal expense.*

The opinion below is in direct tension with this basic principle of contract law. If—as in the case at bar—a corporation can only direct the breach of its wholly-owned subsidiary's contracts at the risk of

uncertain and potentially ruinous tort liability, the strategic acquisition of companies, and the attendant societal benefits of increased efficiency and synergy, will be impaired.

The Opinion Below is Contrary to California's Established Policy Against "Tortification" of Contract Law

In part because of the societal benefits of efficient breach of contracts, California has a corresponding public policy discouraging the "tortification" of contract law. The opinion below "obliterates vital and established distinctions between contract and tort theories of liability by effectively allowing the recovery of tort damages for an ordinary breach of contract." (*Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 510 [869 P.2d 454, 457, 28 Cal.Rptr.2d 475, 478].)

This fundamental distinction has long been recognized—and protected—by statute and this Court. Contract law's "limitation on available damages serves to encourage contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprise." (*Applied Equipment*, *supra*, at p. 515.) The measure of tort damages, in contrast, "is the amount which will compensate for all the detriment proximately caused thereby, *whether it could have been anticipated or not.*" (Civ. Code, § 3333 (emphasis added).)

Because of this essential distinction, damages beyond "expectation damages"—damages that were reasonably expected by the contracting party at the time of formation—are not available in contract actions. Consequential damages beyond the parties' expectation are not available. (*Mitchell v. Clarke* (1886) 71 Cal. 163, 169 [11 P. 882, 885]; *Brandon & Tibbs v. George Kevorkian Accountancy Corp.* (1990) 226 Cal.App.3d 442, 455–456 [277 Cal.Rptr. 40, 48]; *Mendoyoma, Inc. v. County of Mendocino* (1970) 8 Cal.App.3d 873, 879 [87 Cal.Rptr. 740, 744] (applying the rule of *Hadley v. Baxendale* (1884 Ex.) 156 Eng.Rep. 145).) Neither are damages for mental suffering or emotional distress available. (*Sawyer v. Bank of America* (1978) 83 Cal.App.3d 135, 139 [145 Cal.Rptr. 623, 625–26].) Nor are punitive or exemplary damages, "even where the defendant's conduct in breaching the contract was wilful, fraudulent, or malicious." (*Myers Building Industries, Ltd. v. Interface Technology, Inc.* (1993) 13 Cal.App.4th 949, 960 [17 Cal.Rptr.2d 242, 248]; *see also Crogan v. Metz* (1956) 47 Cal.2d 398, 405 [303 P.2d 1029, 1033].)

As the *Applied Equipment* court made clear, this long-standing policy against the "tortification" of contract law is grounded in the essential amorality of contract law: in order that "parties may estimate in advance the financial risks of their enterprise," it makes no difference the *reason* a party to a contract chooses to breach it. For that reason, only true strangers or interlopers can be subject to tort damages for "intermeddling" in contracts:

> The fundamental differences between contract and tort are obscured by the imposition of tort liability on a contracting party for conspiracy to interfere with contract. Whether or not a stranger to the contract induces its breach, the essential character of a contracting party's conduct remains the same—an unjustified failure or refusal to perform. In economic terms,

> the impact is identical—plaintiff has lost the benefit of a bargain and is entitled to recover compensation in the form of contract damages. In ethical terms, the mere entry of a stranger onto the scene does not render the contracting party's breach more socially or morally reprehensible. A party may breach a contract without any third party inducement because of personal, racial, or ethnic animus, or for other nefarious or unethical reasons. In contrast, a breach may be the product of naive or innocent misunderstanding or misperception created by the aggressive solicitation of an outsider. *In any case, motivation is irrelevant.* Regardless of the presence or absence of third party involvement, the contracting party has done nothing more socially opprobrious than to fall short in meeting a contractual commitment. *Only contract damages are due.*

(*Applied Equipment*, *supra*, 7 Cal.4th at pp. 516–17 (emphasis added).)

The same logic, and the same underlying public policy, should apply with equal force to parent corporations. Just as contract law is designed to assure that "parties may estimate in advance the financial risks of their enterprise," so too should it assure that a corporation, when deciding on whether (and at what price) to acquire another company, can estimate in advance the financial risks of that enterprise. For that reason, this Court should reaffirm the holding of *Applied Equipment*, confirm that tort damages for interference with contract are available *only* from true strangers to, and intermeddlers in, the contract at issue, and reject the opinion below's contrary view that anyone other than the actual party to a contract is a "stranger" to the transaction.

The Opinion Below Threatens the Predictability on which Technology Companies Depend

The opinion below is of particular concern to modern technology companies such as TechNet's members. In the software and technology industries in particular, modern corporations frequently grow by acquisition. Each of the largest and best-known companies in California has grown in significant part by a process of acquiring smaller, promising new technology companies. Moreover, much of the modern world of science and technology consists of an ever-more-complex web of patent, copyright, and technology licensing. As a result, the typical acquisition of another company involves acquiring that company's rights and obligations under a host of licensing agreements and contracts. Moreover, many such licenses are nontransferable: for obvious reasons, for example, a software company that licenses its code to a ten-person startup for $1,000 is hardly likely to allow that license to apply to the 50,000 employee acquirer.

For this and a host of other reasons, a typical modern technology company consists of a parent and a host of wholly-owned subsidiaries (and sub-subsidiaries, and so on), wherein the separate corporate identities of the subsidiaries are maintained for some period of time or indefinitely. In such circumstances, the acquired companies are run essentially as different operating divisions of a single entity, with their original boards of directors and officers replaced by officers and employees of the

parent company. Similarly, the acquiring company frequently assumes ownership of the subsidiary's intellectual property, or transfers it to a company-wide licensing subsidiary, and then licenses back whatever rights the acquired subsidiary needs to fulfill existing agreements and operate. In such circumstances, the proposition that the parent company is a "stranger" to the existing contracts of the wholly-owned subsidiary is untenable. To the contrary, the parent company has effectively become the real party in interest to those contracts, and has just as much interest in them as a corporation has in agreements executed by each of its operating divisions.

Indeed, that is precisely the situation presented in the case at bar. Actelion, having acquired CoTherix in its entirety, made the business decision to terminate a contract—to exercise the centuries-old right of efficient breach—and paid the established price for exercising that right, assessed as contract damages in the agreed-upon forum. At that point, Asahi had been made whole, and had received precisely the benefit of its bargain in the manner to which it had contracted. Meanwhile Actelion (assuming it was correct in assessing the financial impact of its decision) presumably came out ahead, to the benefit of its customers, its shareholders, or both.

The opinion below wreaks havoc with the established law reflected in *Applied Equipment*, and introduces an intolerable level of uncertainty for California corporations. If acquiring a wholly owned subsidiary can be done only at the price of extinguishing the established right of efficient breach of any contract to which that subsidiary is a party, and at the risk of ruinous tort liability for routine business decisions made by the acquiring company, California corporations will be deterred from making such acquisitions. That, in turn, will dampen the robust startup culture that has been the most successful economic engine in California over the past decades: After all, the paradigmatic incentive for entrepreneurial activity in the technology sector is the hope that one's effort and investment will pay off in the form of a profitable acquisition. Such an outcome is particularly problematic when compared with established law in other states (as collected in Petitioner's brief) which have correctly resisted adopting a similar rule.

The "tortification" of contract law in the opinion below is bad law and bad policy. Accordingly, TechNet joins in urging this Court to grant review of, and reverse, that opinion.

Respectfully submitted,

Michael H. Page

MHP:jp

cc: Parties listed on Proof of Service

PROOF OF SERVICE

I am a citizen of the United States and resident of the State of California. I am employed in San Francisco County, State of California, in the office of a member of the State Bar of California, at whose direction the service was made. I am over the age of eighteen years, and not a party to the within action. My business address is 217 Leidesdorff Street, San Francisco, CA 94111.

On February 25, 2014, I served the following document in the manner described below:

AMICUS CURIAE LETTER FROM MICHAEL PAGE TO CALIFORNIA SUPREME COURT JUSTICES SUPPORTING PETITION FOR REVIEW

☒ (BY U.S. MAIL) I am personally and readily familiar with the business practice of Durie Tangri LLP for collection and processing of correspondence for mailing with the United States Postal Service, and I caused such envelope(s) with postage thereon fully prepaid to be placed in the United States Postal Service at San Francisco, California.

☐ (BY MESSENGER SERVICE) by consigning the document(s) to an authorized courier and/or process server for hand delivery on this date.

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☐ (BY PERSONAL DELIVERY) I caused such envelope to be delivered by hand to the offices of each addressee below.

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I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on February 25, 2014, at San Francisco, California.

Jennifer Posada

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