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Tortious Interference With Contractual Relations: The Texaco Inc. v. Pennzoil Co. Litigation

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TORTIOUS INTERFERENCE WITH CONTRACTUAL RELATIONS: THE *TEXACO INC. V. PENNZOIL CO.* LITIGATION

I. INTRODUCTION

Simply stated, a cause of action for tortious interference with contractual relations will lie against a third party, C, if, after A contracts with B, A can show that C induced B to breach that contract.[1] On December 10, 1985, following a heated battle for control of Getty Oil Co. ("Getty"), judgment was entered, based on a claim of this sort, against Texaco Inc. ("Texaco") in an amount "unprecedented in the annals of legal history."[2]

The applicable law proved to be the source of continuing dispute. Pennzoil claimed, and a Texas jury agreed,[3] that Pennzoil had a contractual interest in 43% of Getty, and that Texaco tortiously interfered with that interest by inducing Getty to breach the contract in favor of a more profitable offer from Texaco.[4] Texaco, on the other hand, contended that Pennzoil had, at most, a prospective contractual interest in Getty at the time Texaco made its offer.[5]

The main questions presented on appeal were: 1) whether, under New York law,[6] the merger agreement between Getty and Pennzoil was

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1. For a general discussion of the tort of interference with contractual relations see, *e.g.*, Dobbs, *Tortious Interference with Contractual Relations*, 34 ARK. L. REV. 335 (1980); Perlman, *Interference with Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 U. CHI. L. REV. 61 (1982); Note, *Tortious Interference with Contract: A Reassertion of Society's Interest in Commercial Stability and Contractual Integrity*, 81 COLUM. L. REV. 1491 (1981). This cause of action is alternatively known as tortious inducement to breach. *See* Israel v. Wood Dolson Co., 1 N.Y.2d 116, 134 N.E.2d 97, 151 N.Y.S.2d 1 (1956).

2. Texaco, Inc. v. Pennzoil Co., 784 F.2d 1133, 1157 (2d Cir. 1986), *rev'd*, 107 S. Ct. 1519 (1987). On November 17, 1985, a Texas jury awarded Pennzoil $10.53 billion in compensatory and punitive damages. Judgment was entered in the amount of $11.12 billion, which included costs and pre-judgment interest. *Id.* at 1136. For a discussion of the computation of damages in this case, see *infra* note 69. The punitive portions of the damages were lowered, on appeal, from $3 billion to $1 billion, see *infra* note 69.

3. *Texaco, Inc.*, 784 F.2d at 1136.

4. *Id.*

5. Texaco, Inc. v. Pennzoil, Co., 729 S.W.2d 768, 803 (Tex. Ct. App. 1987); Brief for Appellant at 20-30, 43-54, 65-73, Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 (Tex. Ct. App. 1987) (No. 01-86-00216-CV) [hereinafter Texaco Brief]. For a discussion of the elements of the tort of interference with prospective contractual relations, see *infra* text accompanying notes 162-74.

6. Since the transaction in question took place in New York, the parties conceded the applicability of New York law. Texaco Brief, *supra* note 5, at 15; Brief for Appellee at

a valid and enforceable contract;[7] 2) if so, whether Texaco had, by its actions, tortiously interfered with that contract; and 3) if so, what damages Pennzoil suffered as a result of Texaco's actions.[8]

This case has engendered tremendous publicity because of the magnitude of the judgment,[9] the court's application of the tort in the tender offer context,[10] and its effect on other areas of the law.[11] After a summary account of the factual background, this Comment addresses the substance of Pennzoil's claim of tortious interference with contract, critiquing the Texas court's findings of law respecting when an agreement to agree becomes a valid contract and what actions constitute interference with that contract. Additionally, it distinguishes between the tort of interference with contract and the related tort of interference with prospective contractual relations, focusing on the propriety of sustaining a claim of the former in the tender offer context.

A. *Factual Background*

Getty had approximately eighty million shares outstanding.[12] Of these, 40.2% were owned by the Sarah C. Getty Trust[13] ["Trust" or, when referring to Gordon P. Getty, the "Trustee"]; 11.8% were owned by the J. Paul Getty Museum[14] ["Museum"]; and the remaining 48%

66, Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 (Tex. Ct. App. 1987) (No. 01-86-00216-CV) [hereinafter Pennzoil Brief].

7. For a discussion of the "Memorandom of Agreement," see *infra* text accompanying notes 23-34.

8. *Texaco, Inc.*, 729 S.W.2d at 784-85; *Texaco, Inc.*, 784 F.2d at 1137. While a full discussion of the damage issue is beyond the scope of this comment, see *infra* note 69 for an outline of the basic requirements, under New York law, needed to prove damages and the method of computation utilized by the Texas court.

9. *See, e.g.*, Lauter, *The Best Argument Money Can Buy?*, Nat'l L. J., Jan. 26, 1987, at 1, col. 1. "[T]he massive award, swelling at the rate of roughly 3 million a day in interest, threw many creditors, stockholders and suppliers into panic . . . ." *Id.* at 9, col. 1.

10. *See, e.g.*, Reich, *The Litigator: David Boies, the Wall Street Lawyer Everybody Wants*, N.Y. Times, June 1, 1986, § 6 (Magazine), at 18. The jury decision finding a contract "sent shivers through the high flying world of big time corporate mergers— a world in which deals are customarily shopped around right up to the moment when the last signature is affixed to the last official document." *Id.* at 20.

11. *See, e.g.*, Note, *Texaco, Inc. v. Pennzoil Co.: Some Thoughts on the Limits of Federal Court Power Over State Court Proceedings*, 54 FORDHAM L. REV. 767 (1986) (discussing the Second Circuit's jurisdiction over the state court proceeding).

12. Texaco Brief, *supra* note 5, at 11.

13. Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768, 785 (Tex. Ct. App. 1987). The beneficiaries of the Trust are descendants of J. Paul Getty. The trustee of the Trust is Gordon P. Getty, son of J. Paul Getty and a director of Getty Oil. Pennzoil Brief, *supra* note 6, at 10; Texaco Brief, *supra* note 5, at 10.

14. *Texaco, Inc.*, 729 S.W.2d at 785. The Museum is a charitable trust established by J. Paul Getty for the purpose of collecting and exhibiting art. Pennzoil Brief, *supra* note

of the outstanding shares were held by individual public investors.[15]

The sequence of events which gave rise to Pennzoil's suit for tortious interference occurred between December 23, 1983 and January 9, 1984. On December 23, Pennzoil initiated a tender offer for up to 20% of Getty's outstanding shares[16] at a price of $100 cash per share.[17] Following the announcement of Pennzoil's tender offer, the Trustee met with Pennzoil.[18] Getty's management then scheduled a special meeting of Getty's board of directors for January 2, 1984.[19]

On January 1-2, 1984, Pennzoil and the Trustee agreed to combine forces in an attempt to acquire 100% of Getty.[20] This venture called for Pennzoil and the Trustee to buy the Museum's 11.8% interest for $110 per share and, later, through a cash merger, purchase the remaining outstanding shares also for $110 per share.[21] As a result of this venture, control of Getty would be in the hands of the Trust (57% of the outstanding shares) and the remaining interest would be held by Pennzoil (43% of the outstanding shares).[22]

The venture was memorialized in a five-page document entitled "Memorandum of Agreement," ("Agreement") dated January 2, 1984.[23] The Agreement also provided that if after one year the Trustee and Pennzoil had not been able to work together effectively on a proposed restructuring of Getty, Getty's assets would be liquidated with 57% of the proceeds going to the Trust and 43% going to Pennzoil.[24] The conditional language in which the Agreement was couched was extremely important to the present cause of action.[25] Specifically, the Agreement concluded with an expiration clause providing that the plan was *subject to* the approval of Getty's board, and if the board did not approve it at its meeting on January 2, it would expire.[26] Attached to the Memorandum of Agreement was a document entitled "Joinder by the Com-

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6, at 10-11; Texaco Brief, *supra* note 5, at 10-11.

15. *Texaco, Inc.*, 729 S.W.2d at 785.

16. Pennzoil Brief, *supra* note 6, at 16.

17. *Texaco, Inc.*, 729 S.W.2d at 785.

18. *Id.*

19. *Id.* Texaco claimed that the purpose of this meeting was to discuss Getty's fear that after Pennzoil had purchased 20% of Getty's shares (through the tender offer) it would "join forces with one or more other shareholders and squeeze out the remaining shareholders at a significantly lower price." Texaco Brief, *supra* note 5, at 11.

20. *Texaco, Inc.*, 729 S.W.2d at 785.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.* As the cause of action requires evidence of a binding contract, this language is, under New York law, objective evidence of intent. *See infra* text accompanying notes 139-44.

26. *Texaco, Inc.*, 729 S.W.2d at 785.

pany" which contained a blank signature line for Getty in the event that the Plan set forth in the Agreement was approved.[27]

Prior to its submission to the Getty Board of Directors (the "Board"), the Agreement was signed by Pennzoil.[28] Apparently, neither the Trust nor any other representative of Getty ever signed the actual Agreement. The Trustee did, however, sign a separate letter of agreement wherein he agreed to support the Agreement at the Getty board meeting and to oppose any alternative plan of acquisition that did not provide for Pennzoil to become at least a 43% holder.[29] The Museum orally agreed to the provisions of the Agreement subject to its acceptance by the Board.[30]

The Board put the Agreement to a vote on January 2, and, because the offered price was deemed inadequate, it *was rejected* by a margin of nine to six.[31] The Board, realizing that Pennzoil still had an outstanding tender offer which, when coupled with the Trustee's 40% holding, would give Pennzoil and the Trust 52% of Getty, voted to *reject* recommending Pennzoil's tender offer to the Getty shareholders.[32] The Board further undertook discussions of how to protect Getty's public shareholders from the inadequate tender offer price.[33] The Board considered its main options to be a self-tender, a modified agreement with Pennzoil, or an agreement with some third party.[34]

Having rejected all outstanding offers, the Board then decided to make a counter-proposal to Pennzoil, while, at the same time, initiating a campaign to solicit higher bids for Getty.[35] The Board sent word to Pennzoil that it would consider an offer of $110 per share, in cash, plus a $10 debenture.[36] Pennzoil responded by offering $110 plus a "$3 stub."[37] The "stub," a type of debenture, was to be payable in five years from the excess proceeds of the sale of Employees Reinsurance Corporation ("ERC"), a Getty subsidiary.[38] Getty rejected this offer and made a counterproposal for $110 per share plus a guaranteed $5

27. Texaco Brief, *supra* note 5, at 11.
28. *Texaco, Inc.*, 729 S.W.2d at 785.
29. *Id.* at 798.
30. *Id.* at 785.
31. *Id.*
32. *Id.*
33. *Id.* at 785-86.
34. *Id.*
35. *Id.* at 786. Goldman Sachs, Getty's investment banker, contacted several major companies, including Texaco, to inform them that the Getty board was interested in considering offers. *Id.* Pennzoil claimed that a representative of Goldman Sachs had, during a break in the meeting, told directors that he had "taken matters into his own hands by 'shopping' the company that morning." Pennzoil Brief, *supra* note 6, at 28.
36. *Texaco, Inc.*, 729 S.W.2d at 785.
37. *Id.* at 785-86.
38. *Id.*

stub.[39] Pennzoil signaled it would consider a $5 stub if the Board approved the transaction.[40] On January 3, the Board adopted a resolution "approving something."[41]

Texaco claimed that the only thing the Board approved was a price formula to be presented to Pennzoil, with the understanding that "there would have to be 'extensive negotiation [on] the rest of the terms' of a merger agreement, and that 'if negotiations proceeded successfully . . . an agreement would be brought back to the Board for [its] review.' "[42] Pennzoil claimed that when it accepted the Board's counterproposal, a binding contract immediately came into being between Pennzoil and the Getty entities[43] encompassing the Agreement with a modified price formula.[44]

On January 3, representatives of Getty and Pennzoil drafted a press release which was issued on January 5 on behalf of Getty, the Museum, and the Trustee.[45] The release announced that the parties had "*agreed in principle* with Pennzoil Company to a merger of Getty Oil and a newly formed entity owned by Pennzoil and the Trustee."[46] The joint press release also announced other elements on which there

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39. *Id.* at 786.

40. *Id.*

41. Pennzoil Co. v. Getty Oil Co., No. 7425 (Del. Ch. Feb. 6, 1984) (Brown, Chancellor) (LEXIS, States library, Del. file). For a discussion of the Delaware action, see *infra* text accompanying notes 57-65. The substance of what was approved by the Board on January 3 was at the root of this litigation. If it was, as Texaco claims, an agreement to agree, then no contract was formed, no contract breached, and the tort of interference with prospective contractual relations would apply. *See infra* text accompanying notes 162-74. If, as Pennzoil claimed, an enforceable contract was approved by the Board, the tort of interference with contract was correctly applied.

42. Texaco Brief, *supra* note 5, at 13; *see Texaco, Inc.*, 729 S.W.2d at 794.

43. *Texaco, Inc.*, 729 S.W.2d at 792. However, on January 4, Pennzoil filed an amended 14D-1 with the Securities and Exchange Commission informing the federal government and the investing public "that it was *not* withdrawing its pending tender offer (which it would have been required to do if it in fact had a binding contract to purchase Getty Oil shares), and that it would do so only '*if* a definitive merger agreement [were] executed.' " Texaco Brief, *supra* note 5, at 13-14 (emphasis in original). For further discussion of Pennzoil's actions as they relate to the Securities Exchange Act of 1934, see *infra* text accompanying notes 218-19.

44. *Texaco, Inc.*, 729 S.W.2d at 794.

45. *Id.*

46. *Id.* at 789 (emphasis added). Texaco argued that a draft of the press release stated that the parties "had reached an agreement." Texaco Brief, *supra* note 5, at 13 (citations omitted). The representatives of both the Museum and Getty objected that this characterization was "totally misleading and inaccurate . . . ." *Id.* The release, according to Texaco, was then redrafted to state that the companies had reached an "agreement in principle . . . subject to the execution of a definitive merger agreement." *Id.* Texaco further claimed that both the Getty and Pennzoil attorneys used the phrase " 'agreement in principle' precisely because they understood and intended it to mean that there was no binding contract with Pennzoil." *Id.*

was agreement which corresponded with the basic terms of the Agreement.[47] Finally, the release stated that "[t]he transaction is *subject to* execution of a definitive merger agreement, approval by the stockholders of Getty Oil and completion of various governmental filing and waiting period requirements."[48]

On January 4, counsel for the parties met to begin drafting the definitive merger agreement.[49] By January 6, the agreement was substantially completed[50] except for certain technical matters which, according to Pennzoil, could easily have been resolved by the parties' good faith efforts.[51] All drafts of the merger agreement provided that "obligations would come into effect promptly *after* execution and delivery of the agreement."[52]

While Pennzoil and Getty were drafting, representatives of the Trustee and the Museum were involved in discussions with Texaco about the possible acquisition of their shares by Texaco.[53] Pennzoil was unaware that these discussions were taking place. On January 6, Texaco agreed to purchase shares belonging to the Museum and the Trust at $125 cash per share, and a press release was issued announcing this agreement.[54] Soon after the Texaco press release appeared, Pennzoil informed the Getty Board that it expected Getty to honor the agreement made with Pennzoil.[55] Nevertheless, on January 6, Texaco and

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47. *Texaco, Inc.*, 729 S.W.2d at 789.

48. *Id.* (emphasis added). Texaco argued that there was an additional stumbling block in Pennzoil's path before a binding agreement could have been reached. Texaco Brief, *supra* note 5, at 14. On January 4, a California court issued a temporary restraining order enjoining the Trustee from "entering into any legally binding agreements in any way concerning the stock or assets of Getty Oil Company." *Id.* Approval by the court was required before any definitive agreement could have been reached. *Id.* Inexplicably, the only mention of this restraining order in the appellate court opinion is in relation to the Texaco offer to the Trustee. *Texaco, Inc.*, 729 S.W.2d at 787. Specifically, it was mentioned in regard to the Trustee's signing of a letter of intent to sell his stock to Texaco after the temporary restraining order was lifted. *Id.*

49. *Texaco, Inc.*, 729 S.W.2d at 786.

50. *Id.*

51. Pennzoil Brief, *supra* note 6, at 19.

52. Pennzoil Brief, *supra* note 6, at 35.

53. *Texaco, Inc.*, 729 S.W.2d at 786. In negotiating the purchase, Texaco agreed to indemnify both the Museum and the Trust from any liability that may have arisen from any previous contractual relationships to which the Museum or the Trust may have been a party. This referred to Pennzoil or any other party. Pennzoil claims that this was clear evidence of Texaco's knowledge that the Pennzoil/Getty agreement was valid. Pennzoil Brief, *supra* note 6, at 67. Texaco argues that prior to indemnification, the Museum had assured Texaco that there was no binding contract between Getty and Pennzoil, and that it was only after this assurance that Texaco was willing to give the indemnity. Texaco Brief, *supra* note 5, at 57 n.126.

54. *Texaco, Inc.*, 729 S.W.2d at 787.

55. *Id.*

Getty signed a merger agreement.[56]

B. *Procedural History*

When Getty received word from Pennzoil stating that Pennzoil expected Getty to honor their original agreement, Getty filed suit in the Chancery Court of Delaware seeking a declaratory judgment that it was not bound by any agreement with Pennzoil.[57] Pennzoil responded by bringing suit, also in Delaware, against Getty, the Trustee, the Museum, and Texaco seeking: (1) a preliminary injunction to prohibit the Texaco deal from proceeding;[58] and (2) specific performance of its alleged contractual right to purchase a 43% interest in Getty (that interest having allegedly been acquired prior to the consummation of Texaco's offer), or, in the alternative, $7 billion in compensatory damages.[59] In addition to its contract claim, Pennzoil sought tort damages from Texaco, on the theory that Texaco induced Getty and the Trustee to breach their contractual obligations to Pennzoil.[60] The motion for preliminary injunction was denied, because the court found that Pennzoil's ownership interest was contingent upon the Trustee's going through with the plan, but, because the Trustee had opted for a more beneficial contract with Texaco, Pennzoil's contractual interest never came to fruition.[61] As to the tort claim, the Delaware court held that Pennzoil would be unable to prove at trial that: "(a) Texaco knew of the existence of a contract between Pennzoil and the other defendants, and (b) that armed with such knowledge Texaco intentionally set out to cause the other defendants to breach that contract in favor of a new agreement with Texaco."[62]

Texaco, however, had not filed an answer to Pennzoil's complaint prior to the court's denial of the motion for a preliminary injunction.[63] As a result, Pennzoil was permitted to file a notice of voluntary dismissal[64] and was able to file the tort action in Harris County, Texas. This

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56. *Id.*

57. *Id.*

58. Pennzoil Co. v. Getty Oil Co., No. 7425 (Del. Ch. Feb. 6, 1984) (Brown, Chancellor) (LEXIS, States library, Del. file).

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. Pennzoil Co. v. Getty Oil Co., No. 7425, slip op. at 2 (Del. Ch. Dec., 18, 1984) (Walsh, Chancellor).

64. *Id.* Voluntary dismissal is permitted pursuant to Chancery Rule 41(a)(1)(i). In retrospect, Texaco's failure to answer Pennzoil's complaint is probably one of the most expensive tactical errors ever committed in a lawsuit. It resulted, after trial, in the imposition of a multi-billion dollar judgment against Texaco. If Texaco had filed an answer, Pennzoil would have been forced to litigate in Delaware where the chancery court had

was strategically desirable because Texas was a more hospitable forum and allowed Pennzoil to obtain a trial by jury.[65]

The Texas action commenced on February 8, 1985 with Pennzoil asserting the same tortious interference claim that had been rejected in the Delaware proceeding.[66] The trial took place from July though mid-November and was punctuated by frequent motions for mistrial made by Texaco.[67] On November 14, 1985, the jury was charged.[68] Five days later it returned with a $10.53 billion award against Texaco, representing $7.53 billion in compensatory damages and $3 billion in punitive damages.[69]

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already determined that Pennzoil's contractual interest had not yet come to fruition.

65. *Id.*

66. *Id.*

67. Texaco Brief, *supra* note 5, at 9-10. Texaco first moved for a mistrial when Judge Farris made his opening remarks to the jury characterizing the case as "the largest ever." *Id.* at 17 n.11. Texaco then moved for a mistrial when it was discovered that Pennzoil's lead counsel had made a $10,000 campaign contribution to Judge Farris. *Id.* at 9. Texaco once again moved for a mistrial when Judge Farris later removed himself because of illness and Judge Cassab, Jr. (who was appointed as a "retired judge") stated that he had not read the whole record, but that he would not remove himself from the case despite his unfamiliarity with it. *Id.* at 103-04.

68. *Id.* at 10.

69. Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768, 784 (Tex. Ct. App. 1987); Texaco, Inc. v. Pennzoil Co., 784 F.2d 1133, 1136 (2d Cir. 1986). Generally, in an action for breach of contract, the plaintiff is limited in the amount of recoverable damages. Guard-Life v. S. Parker Hardware Mfg. Corp., 50 N.Y.2d 183, 197 n.6, 406 N.E.2d 445, 452 n.6, 428 N.Y.S.2d 628, 636 n.6 (1980). In an action for tortious interference with contract (or interference with prospective relations), on the other hand, the plaintiff, if he should prevail, is entitled to the more liberal rules applicable to damages in tort actions. *Id.* In *Guard-Life*, the court of appeals suggested that it would look to the RESTATEMENT (SECOND) OF TORTS at least in part, in determining the relative measure of damages. *Id.* The Restatement provides, as to compensatory damages, that liability for interference with a contract or a prospective contractual relation extends to "the pecuniary loss of the benefits of the contract or the prospective relation; [the] consequential losses for which the interference is a legal cause; and emotional distress or actual harm to reputation, if they are reasonably to be expected to result from the interference." RESTATEMENT (SECOND) OF TORTS § 774A(1) (1977). Where the action is one for inducing the breach of a contract, as opposed to the breach of prospective relations, "the fact that the third person is liable for the breach does not affect the amount of damages awardable against the actor; but any damages in fact paid by the person will reduce the damages actually recoverable on the judgment." *Id.* §77A(2).

The Texas jury, in computing the amount of compensatory damages, was instructed that the measure of damages was "the amount necessary to put Pennzoil in as good a position as it would have been in if its agreement . . . had been performed." Special Issue No. 3, Texaco Brief, *supra* note 5, at app. 2. In determining this amount, the jury used the "replacement theory" of damages proposed by Pennzoil. *Texaco, Inc.*, 729 S.W.2d at 860. Under this theory, while the figures are estimated, the computation is very straightforward. Pennzoil claims it was deprived of its right to acquire "3/7th's of Getty's proven reserves, amounting to 1,008 billion barrels of oil . . ., at a cost of $3.40 a barrel [total cost being approximately $3.45 billion]. Pennzoil's evidence further showed that its cost

to find equivalent reserves . . . was $10.87 per barrel [total cost of approximately $10.95 billion]." *Id.* Pennzoil then claimed that the correct amount of damages would be the difference between these two figures ($10.95 - $3.45 = $7.50 billion). *Id.* The jury agreed with this computation and awarded the full amount suggested by Pennzoil. *Id.*

Texaco argued on appeal that this figure was too speculative to withstand appellate review, and attempted to argue, for the first time, that a correct measure of damages would be the difference between the market value of the Getty shares and its contract price at the time of breach. This appeal was dismissed because Texaco did not raise it at trial (nor did Texaco offer any other alternative method of computing damages at trial). The appellate court further stated that, while a "plaintiff may not be able to prove its damages to a certainty . . . . [t]his uncertainty is tolerated when the difficulty in calculating damages is attributable to the defendant's conduct." *Id.* at 861; *see also* Whitney v. Citibank, 782 F.2d 1106 (2d Cir. 1986). Because the jury found that Texaco had tortiously interfered, it was permitted to rely on a computation of damages that was less than certain. *Texaco, Inc.*, 729 S.W.2d at 861.

As to punitive (exemplary) damages, the Restatement provides that they will only be awarded when the conduct of the third party is found to be "outrageous, because of defendant's evil motive or his reckless indifference to the rights of others." RESTATEMENT (SECOND) OF TORTS § 908 (1977). In computing the amount of punitive damages, it is proper for the "trier of fact to consider the character of the defendant's act, the nature and extent of the harm to the plaintiff that the defendant caused or intended to cause and the wealth of the defendant." *Id.*

The New York Court of Appeals has added a certain amount of gloss to the Restatement rendition of punitive damages, and in so doing, it has limited its availability. The court in Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 358, 353 N.E.2d 793, 795, 386 N.Y.S.2d 831, 833 (1976), stated that:

> [P]unitive damages are available only in a limited number of instances. . . . [For example,] "in cases where the wrong complained of is morally culpable, or is actuated by evil and reprehensible motives, not only to punish the defendant but to deter him, as well as others who might otherwise be so prompted, from indulging in similar conduct in the future." It is a social exemplary "remedy", not a private compensatory remedy.

Id. (quoting Walker v. Sheldon, 10 N.Y.2d 401, 404, 179 N.E.2d 497, 498, 223 N.Y.S.2d 488, 490 (1961)). Further, the conduct must be shown to be "wanton, willful or malicious." Russian Church of Our Lady of Kazan v. Dunkel, 67 Misc. 2d 1032, 1057, 326 N.Y.S.2d 727, 758 (N.Y. Sup. Ct. 1971), *aff'd in part modified in part*, 41 A.D.2d 746, 341 N.Y.S.2d 148 (1973), *aff'd*, 33 N.Y.2d 456, 310 N.E.2d 307, 354 N.Y.S.2d 631 (1974). In Newburger, Loeb & Co. v. Gross, 563 F.2d 1057 (2d Cir. 1977), the court, applying New York law, cogently stated a refinement to the situations wherein punitive damages would be available. The court stated that "punitive damages would not be proper where the wrong complained of was not 'aimed at the public generally,' and where the possibility of punitive damages was not necessary to induce suit that would have otherwise gone unpunished." *Id.* at 1080; *see* Walker v. Sheldon, 10 N.Y.2d 401, 405, 179 N.E.2d 497, 499, 223 N.Y.S.2d 488, 491 (1961) (exemplary damages permitted where the conduct is "aimed at the public generally, is gross and involves high moral culpability"); Gravitt v. Newman, 114 A.D.2d 1000, 1002, 495 N.Y.S.2d 439, 441 (1985) ("punitive damages are available . . . only where the actions of the alleged tort-feasor constitute gross recklessness or intentional, wanton, or malicious conduct aimed at the public generally").

The Texas jury had originally awarded $3 billion in punitive damages. Texaco argued that the award was "grossly excessive" and should either be remanded on that basis or that the appellate court should grant a remittitur. *Texaco, Inc.*, 729 S.W.2d at 864. In response to Texaco's request, the court stated that, "though the award was indeed large,

Based on the court's instructions[70] and "special issues,"[71] the jury found that at the end of the January 3, 1984 Getty board meeting, Pennzoil, Getty, the Trust, and the Museum "intended to bind themselves to an agreement."[72] The jury found that this agreement included the terms: (a) that the Getty shareholders, except Pennzoil and the Trust, were to receive $110 per share, and the right to deferred cash consideration from the sale of ERC of at least $5 per share within 5 years;[73] (b) Pennzoil was to own a three-sevenths interest in Getty and the Trust was to own the remaining four-sevenths interest;[74] and (c) Pennzoil and the Trust were to endeavor in good faith to agree upon a plan for restructuring Getty on or before December 31, 1984, and if they were unable to reach such agreement, they would divide the assets of Getty between them on a three-sevenths/four-sevenths basis.[75] The jury also found that the agreement contained the following additional terms: (i) Getty would immediately purchase the Museum's shares,[76] and (ii) Pennzoil would have an option to purchase an additional 8 million shares of Getty.[77] Finally, the jury found that the price to be paid Getty shareholders under the Pennzoil agreement was fair.[78]

The jury further found that Texaco had "knowingly interfered with the agreement between Pennzoil and [Getty]."[79] As a result of this interference, the jury determined that Pennzoil's actual damages "suffered as a direct and natural result of Texaco's knowingly interfering"[80] were $7.53 billion.[81] In considering whether punitive damages were warranted, the jury found that Texaco's actions were "inten-

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so were the stakes." *Id.* The jury had found Texaco's actions to be "intentional, willful, and in wanton disregard to the rights of Pennzoil." *Id.* at 865. Yet, in granting remittitur, the court stated that there was "a point where punitive damages . . . overstate their purpose and serve to confiscate rather than to deter or punish. In this case, punitive damages of one billion dollars are sufficient to satisfy any reason for their being awarded, whether it be punishment, deterrence, or encouragement to the victim to bring legal action." *Id.* at 866.

70. The relevant instructions to the jury are reprinted *infra* notes 195 and 206.

71. In addition to presenting the jury with instructions, the judge presented them with "Special Issues" which were specific questions of fact requiring the jury to answer either in the affirmative or the negative as to the truth of those facts. The relevant Special Issues are reprinted *infra* notes 194 and 202.

72. Special Issue No. 1, Texaco Brief, *supra* note 5, at app.2.

73. *Id.* For a discussion of ERC, see *supra* text accompanying note 38.

74. *Id.*

75. *Id.*

76. Special Issue No. 6, Texaco Brief, *supra* note 5, at app.2.

77. Special Issue No. 7, Texaco Brief, *supra* note 5, at app.2.

78. Special Issue No. 8, Texaco Brief, *supra* note 5, at app.2.

79. Special Issue No. 2, Texaco Brief, *supra* note 5, at app.2.

80. Special Issue No. 3, Texaco Brief, *supra* note 5, at app.2.

81. *Id.*

tional, willful and in wanton disregard of the rights of Pennzoil."[82] The jury then determined that the appropriate amount of punitive damages to be awarded against Texaco for its conduct was $3 billion.[83]

On December 4, Texaco moved for a judgment notwithstanding the verdict. This motion was denied,[84] and on December 10, 1985, judgment was entered against Texaco.[85]

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82. Special Issue No. 4, Texaco Brief, *supra* note 5, at app.2.

83. Special Issue No. 5, Texaco Brief, *supra* note 5, at app.2.

84. Texaco Brief, *supra* note 5, at 11.

85. *Id.* Following announcement of the judgment, Texaco commenced a federal suit in the Southern District of New York seeking a preliminary injunction to stay enforcement of the Texas court's judgment pending final appellate review by the Texas courts. Texaco, Inc. v. Pennzoil Co., 626 F. Supp. 250 (S.D.N.Y. 1986), *aff'd in part, rev'd in part*, 784 F.2d 1133 (2d Cir.), *rev'd*, 107 S. Ct. 1519 (1987). Texaco claimed that enforcement of the Texas judgment would infringe rights secured to Texaco by the United States Constitution, the Civil Rights Act of 1871, 42 U.S.C. § 1983 (1982), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a (1982). 626 F. Supp. at 251-52. Specifically, the complaint alleged:

> 1. That the Judgment and the legal principles underlying it impermissibly burden interstate commerce by deterring competitive tender offers and therefore violate the Commerce Clause and frustrate the purposes of the Williams Act. (Claims One and Two).
>
> 2. That the Judgment conflicts with, and therefore is preempted by, the Securities Exchange Act of 1934, 15 U.S.C. §§ 78n(d), 78n(e) and 78bb, which promotes and provides a framework for competing tender offers. (Claim Four).
>
> 3. That the Judgment fundamentally changes the New York law of tortious inducement of breach of contract, in derogation of fundamental New York policies and in violation of the Full Faith and Credit Clause. (Claim Five).
>
> 4. That application of the supersedeas bond and lien provisions of Texas law effectively precludes Texaco from exercising its right to appeal in the Texas courts and, if necessary, to petition for *certiorari* to the United States Supreme Court, all in violation of the Due Process and Equal Protection Clauses of the Fourteenth Amendment. (Claims Three and Six).
>
> 5. That the Judgment, as the result of a fundamentally unfair proceeding, violates the Due Process Clause of the Fourteenth Amendment. (Claim Seven).

Id. at 251. The District Court, in analyzing the request for preliminary injunction, stated that

> [t]he sudden death or dismemberment of a corporation, while it is not analogous to the sudden death of an individual, hurts the public interest.
>
> . . . .
>
> The imminent disruption to the national economy and to the interests of the public, supports a finding of irreparable harm, at least while the Texas judgment remains subject to appellate review. [The court included] in the public Texaco's customers, suppliers, employees and others who would suffer from the sudden disruption in Texaco's day to day activities.

Id. at 252-53. Accordingly, noting the irreparable harm that would befall both Texaco and the public, the court granted Texaco's motion for a preliminary injunction. *Id.*

The Second Circuit, in reversing in part and affirming in part, summarized the appellate issues as:

> (1) whether federal jurisdiction exists that would permit a federal court to rule on Texaco's constitutional and federal law claims, and, if so, (2) whether the

Texaco appealed, claiming that the trial court had both misapplied New York law and skewed the jury instructions in favor of Pennzoil.[86] On February 12, 1987, the apellate court affirmed in part the jury's findings of fact and the trial court's application of New York law.[87] The only modificiation to the jury's findings of fact and the trial court's application of New York law was in regard to the amount of punitive damages awarded: the jury award of $3 billion was reduced to $1 billion.[88]

On April 6, 1987, the United States Supreme Court ruled that the district court should not have ordered the supersedeas bond required by Texas procedure.[89]

On April 12, 1987, Texaco filed for reorganization under Chapter 11 of the Bankruptcy Code[90] to forestall enforcement of the judgment.[91] In December 1987, Texaco and Pennzoil agreed to settle the litigation for $3 billion and submit the settlement as part of a reorganization plan for Texaco's emergence from bankruptcy-law proceedings.[92]

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district court should, in the interests of comity and federalism, have abstained from exercising that jurisdiction in order to permit Texas courts to rule on those claims.

784 F.2d at 1141. The Second Circuit reversed, and directed the district court to dismiss its exercise of jurisdiction over Texaco's claims one, two, four, five and seven because of lack of subject-matter jurisdiction. *Id.* at 1144. The court based its reversal on the *Rooker-Feldman* doctrine. *Id.* at 1142-43. This doctrine stands for the principle that a dual judicial system cannot function if state and federal courts are free to fight each other for control of cases.

> Allowing lower federal courts to review the judgments of state lower courts is as intrusive and as likely to breed antagonism between state and federal systems as allowing federal court review of the judgments of the states' highest courts. Indeed, if *Rooker-Feldman* only barred federal review of judgments which had been fully appealed through the state system, it would foster federal/state rivalry by creating incentives for disappointed state court appellants to forum-shop, jumping over to federal courts instead of appealing their cases to the states' highest tribunals.

Id. For a further discussion of the federal jurisdictional question, see Comment, *Texaco Inc. v. Pennzoil Co.: Some Thoughts on the Limits of Federal Court Power Over State Court Proceedings*, 54 FORDHAM L. REV. 767 (1986). The Second Circuit affirmed the district court's jurisdiction over allegations that the mandatory supesedeas bond had denied Texaco protection provided it pursuant to the due process and equal protection clauses of the United States Constitution. 784 F.2d at 1144. Pennzoil appealed the affirmance, but the Supreme Court declined to express an opinion. Pennzoil Co. v. Texaco, Inc., 107 S. Ct. 1519, 1529 (1987).

86. *Texaco, Inc.*, 729 S.W.2d at 768.
87. *Id.*
88. *Id.* at 784, 866.
89. *Texaco, Inc.*, 107 S. Ct. at 1529.
90. 11 U.S.C. §§ 1101-74 (1982 & Supp. IV 1986).
91. The Wall Street Journal, Jan. 29, 1988, at 4, col. 5.
92. *Id.*

II. Tortious Interference with Contractual Relations and with Prospective Business Relation: New York Law

The common law tort of interference with contractual relations[93] has been characterized as "an area of the law that has not fully congealed but is still in its formative stages."[94] The questions which have continued to plague New York courts concern the precise elements of the tort of interference with contract (as compared with the elements of the related tort of interference with *prospective* contractual relations), and the types of contractual relationships covered by the tort of interference with contract.

To prevail in a claim for tortious interference with contract under New York law, the plaintiff bears the burden of proving: (1) the existence of a valid and enforceable contract (as opposed to the mere prospect of business relations); (2) the defendant's awareness of the existence of that contract; (3) the defendant's intentional inducement of the breach of that contract; and (4) the actual damages accruing to the plaintiff as a result of that breach.[95]

In the situation where a binding contract has not yet come into existence, or where the contract is one terminable-at-will or otherwise voidable, the tort of interference with contract is not applicable.[96] There may, however, be a cause of action for interference with prospective contractual relations.[97] To prevail in such a case, the plaintiff must show that a legally enforceable contract *would* have come into existence *but for* the wrongful conduct of a third party whose tortious con-

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93. For an account of the early history of the tort of interference with contract, see Note, *Tortious Interference with Contractual Relations in the 19th Century: The Transformation of Property, Contract and Tort*, 93 Harv. L. Rev. 1510, 1511-21 (1980).

94. Guard-Life Corp. v. S. Parker Hardware, 50 N.Y.2d 183, 189, 406 N.E.2d 445, 448, 428 N.Y.S.2d 628, 631 (1980). "Jurisdictions, and even courts within a single jurisdiction, have taken different views with respect to liability for interference with contract." *Id.*

95. *See, e.g., id.*; Israel v. Wood Dolson Co., 1 N.Y.2d 116, 120, 134 N.E.2d 97, 99, 151 N.Y.S.2d 1, 5 (1956); Beacon Syracuse Assoc. v. Syracuse, 560 F. Supp. 188, 201 (N.D.N.Y. 1983).

96. *Guard-Life Corp.*, 50 N.Y.2d at 192, 406 N.E.2d at 452, 428 N.Y.S.2d at 633. The court stated:

> "[i]f the third person is free to terminate his contractual relation with the plaintiff when he chooses, there is still a subsisting contract relation; but any interference with it that induces its termination is primarily an interference with the future relation between the parties, and the plaintiff has no legal assurance of them. As for the future hopes he has no legal right but only an expectancy; and when the contract is terminated by the choice of the third person there is no breach of it. The competitor is therefore free [to cause termination of these future rights, for competitive reasons,] all without liability."

Id. at 192 n.4, 406 N.E.2d at 452 n.4, 428 N.Y.S.2d at 633 n.4 (quoting Restatement (Second) of Torts § 768 comment i (1977)).

97. *Id.* at 194, 406 N.E.2d at 448, 428 N.Y.S.2d at 634.

duct has made it the defendant to the action.[98]

A. *Interference with Contractual Relations*

In New York, the tort of interference with contract was not recognized by the court of appeals until 1918 in *Posner Co. v. Jackson.*[99] Posner Co., a dress design and manufacturing establishment, had signed Sarah Posner to an exclusive service contract to serve as a designer for a term of five years.[100] Two years after the signing of the contract, a competitor of Posner Co., Jackson Inc., induced Sarah Posner to sever her ties with Posner Co. by offering her a more lucrative contract.[101] The court of appeals found that Jackson Inc.'s actions were "*intended 'to injure* the plaintiff in its business,' and entice [an] employee from the plaintiff and persuade her to break her contract with the plaintiff for the purpose of 'depriving it of her services and of securing such services for a competitor and of thereby injuring this

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98. For a discussion of interference with prospective contractual relations, see *infra* text accompanying notes 162-74.

99. 223 N.Y. 325, 119 N.E. 573 (1918). Prior to this time, the New York Court of Appeals had consistently refused to allow a party to a contract to recover from a third party, not in privity, for inducing the breach of its contract, unless fraudulent means were used to induce the breach. In Ashley v. Dixon, 48 N.Y. 430 (1872), the court stated:

> If A. has agreed to sell property to B., *C. may at any time before the title has passed induce A. not to let B. have the property,* and to sell it to himself, provided he be guilty of no fraud or misrepresentation, without incurring any liability to B.; A. alone, in such a case, must respond to B. for the breach of his contract, and B. has no claim upon or relations with C. While, by the moral law, C. is under obligation to abstain from any interference with the contract between A. and B., yet it is one of those imperfect obligations which the law, as administered in our courts, does not take to enforce.

Id. at 432 (emphasis added). In Rice v. Manley, 66 N.Y. 82 (1876), the court of appeals affirmed the trial court, finding an action to exist where A had contracted to sell and deliver to plaintiff a quantity of cheese.

> The defendant knowing of the agreement, for the fraudulent purpose of defeating its performance by [A], of depriving the plaintiffs of the benefit thereof, and of himself obtaining the cheese, caused a telegraphic dispatch to be sent to [A], signed by the name of [plaintiff] . . ., to the effect that [A] could sell the cheese and plaintiffs did not care for it . . . . [B]y this fraud [defendant] induced [A] to sell and deliver the cheese to him . . . . [The court held that] defendant was liable to the plaintiffs for the damages sustained by them in consequence of this fraud.

Id. at 84. The court further stated that the action was maintainable, even though the contract was not binding under the statute of frauds, as it was " 'established beyond all question that they would have fulfilled [the contract] but for the false and fraudulent representations of the defendant.' " *Id.* at 86 (quoting Benton v. Pratt, 2 Wend. 385 (N.Y. Sup. Ct. 1829)).

100. *Posner*, 223 N.Y. at 327, 119 N.E. at 573.

101. *Id.* at 328-29, 119 N.E. at 573-74.

(plaintiff) corporation.' "[102] The court based its finding of liability on its characterization of the contract as a "property interest."[103] The court held that "interference with such a property right by which it is lost to an employer is a wrong in morals and when without justification or excuse may be an actionable tort for which damages can be recovered against the wrongdoer."[104] The rule of law of the case, which was expressly limited to its facts, was stated succintly: "[i]f a person knowingly and intentionally interfere with the express contract rights of an employer with his employee and *the purpose and intent of such interference is to injure such employer* and it does result in his injury, an action will be sustained to recover damages therefor."[105]

The rule in *Posner* had the effect of confusing rather than enlightening the lower courts as to the elements of the newly accepted tort. The rule appeared to impose a requirement of actual malice[106] before recovery could be had against a party not privy to the contract. Shortly after *Posner,* however, the court of appeals had the opportunity to correct this misconception. The court of appeals, in *Lamb v. S. Cheney & Son,*[107] found for the plaintiff in a suit involving the defendant's allegedly malicious inducement of the plaintiff's employee to break his contract and enter into employment with the defendant:

> The act is malicious when the thing done is with the knowledge of plaintiff's [contractual] rights and with the intent to interfere therewith. In a legal sense [malice] means a wrongful act, done intentionally, without just cause or excuse. *It does not mean actual malice or ill-will,* but consists in the intentional doing of a wrongful act . . . *The gist of the action is not the intent to injure* [the plaintiff], but to interfere without justification with plaintiff's contractual rights with knowledge thereof.[108]

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102. *Id.* at 331-32, 119 N.E. at 574 (quoting from plaintiff's complaint) (emphasis added).

103. *Id.* By basing its holding on a finding that the contract rights were property rights, the court created a system of analysis which has, to the present, caused problems. This characterization has led to different findings by the courts looking at various types of contracts. For a consideration of whether the rights of a person to a voidable contract are of sufficient magnitude to amount to a property right, see *infra* text accompanying notes 117-21.

104. *Posner,* 223 N.Y. at 332, 119 N.E. at 574.

105. *Id.* at 332, 119 N.E. at 575 (emphasis added).

106. Actual malice involves a deliberate intent to injure. *See* Lamb v. S. Cheney & Son, 227 N.Y. 418, 422, 125 N.E. 817, 818 (1920) (defining actual malice as "a wrongful act, done intentionally, without just cause or excuse").

107. 227 N.Y. 418, 125 N.E. 817 (1920).

108. *Id.* at 422, 125 N.E. at 818 (citations omitted) (emphasis added); *see also* Campbell v. Gates, 236 N.Y. 457, 460, 141 N.E. 914, 915 (1923) (tortious interference "is a wrongful act, done intentionally, without just cause or excuse, and from this a *malicious*

In *Hornstein v. Podowitz*,[109] the court of appeals further elucidated the tort of interference with contract. The question presented to the court was whether the existence of a cause of action against the party breaching the contract precluded an action against a third party for inducing that breach.[110] The plaintiff was a real estate broker who had been employed by the owner of certain real property to secure a purchaser for the property.[111] The broker fulfilled his contractual obligations by procuring a ready, willing, and able purchaser and was thus owed a commission on the sale.[112] The owner of the property, however, had entered into an agreement with the purchaser, who had actual knowledge of the contract with the broker, to deprive the broker of his commission.[113] By failing to inform the broker that the sale had been consummated, and intending to divide the commission among themselves, the defendants caused injury—economic loss—to the broker.[114] The defendants argued that no damages had been suffered because plaintiff "now has all that he ever had, viz., a cause of action against his principal for the agreed commissions."[115] The court of appeals rejected this argument, declaring that: "all of the parties who induced the breach of the contract are jointly and severally liable for the [injury] to the plaintiff."[116]

In *Guard-Life Corp. v. S. Parker Hardware Mfg. Corp.*,[117] the New York Court of Appeals determined that a plaintiff will be precluded from asserting the claim of tortious interference with contract when the "legal interest under a contract . . . may be avoided by the other contracting party at his election."[118] Where the contract is void, voidable, or terminable-at-will, the party asserting the claim of tortious interference with contract possesses "no legally enforceable right to performance."[119] The interest this party does possess is a future interest or, rather, an expectation of future contractual relations. Such an expectation or future interest is not of sufficient magnitude to support a claim of interference with contractual relations.[120] The court of appeals reasoned that the expectation of future contractual relations and

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motive is to be inferred") (emphasis added).

109. 254 N.Y. 443, 173 N.E. 674 (1930).

110. *Id.* at 447, 173 N.E. at 674.

111. *Id.* at 446, 173 N.E. at 675.

112. *Id.*

113. *Id.*

114. *Id.* at 448, 173 N.E. at 675.

115. *Id.* at 449, 173 N.E. at 675.

116. *Id.* at 449, 173 N.E. at 675-76; *see also* S & S Hotel Ventures Ltd. Partnership v. 777 S.H. Corp., 108 A.D.2d 351, 355, 489 N.Y.S. 2d 478, 481 (1985).

117. 50 N.Y.2d 183, 406 N.E.2d 445, 428 N.Y.S.2d 628 (1980).

118. *Id.* at 193, 406 N.E.2d at 450, 428 N.Y.S.2d at 634.

119. *Id.*

120. *Id.*

the interests of a party to a contract terminable-at-will were substantially identical. In each circumstance, the party's interest is "less substantive" than that existing in a valid contract: this less substantive interest is a speculative one, wherein liability will be imposed only if evidence of wrongful conduct is shown.[121]

The court of appeals took pains in *Guard-Life* to distinguish the elements and application of the tort of interference with contract from the tort of interference with prospective contractual relations. Plaintiff, Guard-Life, alleged that the defendant, S. Parker Hardware, had tortiously interfered with a contract between Guard-Life and Kokusan, a Japanese manufacturer of locks, providing Guard-Life exclusive distribution of Kokusan's products for a period of five years.[122] After less than one year into the contract, S. Parker Hardware, a competitor of Guard-Life, undertook negotiations with, and received a similar contract from Kokusan,[123] granting it the exclusive distributorship that had previously been granted to Guard-Life.[124] The court of appeals denied Guard-Life relief on its claim of tortious interference with contract stating that, under the principles of collateral estoppel, Guard-Life was bound by a Japanese arbitrator's finding that its contract with Kokusan was unenforceable due to a lack of mutuality.[125] Since the alleged interference was with an unenforceable contract, the tort of interference with contract did not apply.[126]

The court of appeals, in dismissing Guard-Life's claim of tortious interference, did not alter the elements of the tort. It did, however, attempt to define the tort in relation to the similar tort of interference with prospective contractual relations.[127] In so doing, the court of appeals essentially adopted the Restatement position which imposes liability where "[o]ne . . . intentionally and *improperly* interferes with the performance of a contract . . . between another and a third person by inducing or otherwise causing the third person not to perform the contract."[128] The court stated that the term "improperly" was the keystone of the principle of the torts, the definition of which is "inconstant and mutable, drawing its substance from the circumstances of the particular situation at hand."[129] "[A]mong the factors to be consid-

121. *Id.* at 192, 406 N.E.2d at 449, 428 N.Y.S.2d at 633. For a discussion of imposing liability for interference with a speculative interest, see *infra* text accompanying notes 162-74.

122. *Guard-Life*, 50 N.Y.2d at 189, 406 N.E.2d at 447, 428 N.Y.S.2d at 630-31.

123. *Id.*

124. *Id.*

125. *Id.* at 195-96, 406 N.E.2d at 452, 428 N.Y.S.2d at 631.

126. *Id.* at 196, 406 N.E.2d at 452, 428 N.Y.S.2d at 636.

127. *Id.* at 196 n.5, 406 N.E.2d at 452 n.5, 428 N.Y.S.2d at 636 n.5.

128. RESTATEMENT (SECOND) OF TORTS § 766 (1977) (emphasis added).

129. *Guard-Life*, 50 N.Y.2d at 189-90, 406 N.E.2d at 448, 428 N.Y.S.2d at 631.

ered are the nature of the conduct of the person who interferes . . ., the interest of the party being interefered with . . ., and the relationship between the parties."[130]

In a situation where a valid contract exists, impropriety will be found if it is proven that the defendant had knowledge of that contract, that the defendant intentionally procured the breach of that contract, and that damages accrued to the plaintiff as a result of that breach.[131] If, on the other hand, no valid contract is found, the tort of prospective contract will apply, and impropriety will exist only if "wrongful means" are utilized.[132]

In determining whether the tort of interference with contractual relations is applicable, the first inquiry is often the most troublesome; *i.e.*, determining the existence of a valid and enforceable contract between the parties. When proof of such a contract is shown, very broad protection will be afforded the plaintiff once interference has been established.[133] The protection is broad in that liability will be imposed even where the defendant has merely offered better terms than were available in the original contract if, by so doing, he knowingly and intentionally interfered with the contracting party, thereby causing injury.[134]

In assessing whether a contract exists, examination of the objective intent of the parties is necessary.[135] Objective intent can be found in the parties' "expressed words and deeds [looking to the] totality of the circumstances . . . to the end that there is a realization of [their] reasonable expectations."[136] Parties are free to enter into a binding contract without memorializing their agreement into a fully executed document.[137] Further, binding contracts may be found if an agreement can be "pieced together out of separate writings, not all of which need be signed, provided they clearly refer to the same transaction."[138]

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130. *Id.* at 190, 406 N.E.2d at 448, 428 N.Y.S.2d at 632.

131. RESTATEMENT (SECOND) OF TORTS § 766 (1977); *see also Guard-Life*, 50 N.Y.2d at 189, 406 N.E.2d at 448-49, 428 N.Y.S.2d at 631; Israel v. Wood Dolson Co., 1 N.Y.2d 116, 134 N.E.2d 97, 151 N.Y.S.2d 1 (1956); Beacon Syracuse Assoc. v. Syracuse, 560 F. Supp. 188 (N.D.N.Y. 1983).

132. *Guard-Life*, 50 N.Y.2d at 191, 406 N.E.2d at 448-49, 428 N.Y.S.2d at 633; Union Car Advertising v. Collier, 263 N.Y. 386, 189 N.E. 463 (1934); Susskind v. IPCO Hospital Corp., 49 A.D.2d 915, 373 N.Y.S.2d 627 (1975).

133. *Guard-Life*, 50 N.Y.2d at 191, 406 N.E.2d at 450, 428 N.Y.S.2d at 632-33.

134. *Id.* at 194, 406 N.E.2d at 450-51, 428 N.Y.S.2d at 634.

135. *See, e.g.*, Brown Bros. Elec. Constr., Inc. v. Beam Constr. Corp., 41 N.Y.2d 397, 361 N.E.2d 999, 393 N.Y.S.2d 350 (1977).

136. *Id.* at 401, 361 N.E.2d at 1002, 393 N.Y.S.2d at 352-53.

137. *Id.*

138. APS Food Sys., Inc. v. Ward Foods, Inc., 70 A.D.2d 483, 486, 421 N.Y.S.2d 223, 225 (1979); *see also* Kleinschmit Div. of SCM Corp. v. Futuronics Corp., 41 N.Y.2d 972, 973, 363 N.E.2d 701, 702, 395 N.Y.S.2d 151, 152 (1977). "When there is a basic agree-

If, on the other hand, the parties do not intend to be bound by an agreement until it is in writing and signed, then no contract exists until that event occurs so long as neither party detrimentally relied upon the agreement.[139] This may be true even where oral agreement has been reached with respect to all of the terms of the contract. In *ABC Trading Co. v. Westinghouse Elec. Supply Co.*,[140] a single reference in a letter from the defendant to the plaintiff was found sufficient to prevent the defendant from being obligated until a formal agreement had been signed.[141] The court stated that it was "everywhere agreed that if the parties contemplate a reduction to writing of their agreement before it is to be considered complete, there is no contract until the writing is signed."[142]

In *Winston v. Mediafare Entertainment Corp.*,[143] the Second Circuit, concluding that the parties had never reached the point of creating a binding contract, listed several factors to be considered in determining whether the parties intended to be bound prior to the execution of a formal written agreement: (1) whether there had been an express reservation of the right not to be bound in the absence of a writing; (2) whether all of the alleged contract terms had been agreed

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ment, however manifested and whether or not the precise moment of agreement may be determined, failure to articulate that agreement in the precise language of a lawyer . . . will not prevent formation of a contract." *Id.*

139. *APS Food Sys.*, 70 A.D.2d at 487, 421 N.Y.S.2d at 225 (with an unsigned writing, intent to be bound is manifested by such criteria as authority of contracting parties to negotiate terms, sufficiency of the writing's contents, and whether other writings exist).

140. 382 F. Supp. 600 (E.D.N.Y. 1974) (applying New York law).

141. *Id.* at 602.

142. *Id.* at 601 (quoting WILLISTON ON CONTRACTS § 28 (1970)).

143. 777 F.2d 78 (2d Cir. 1986). Winston, plaintiff, brought suit claiming entitlement to a finders fee for arranging for the sale of 50% interest in "a series of characters known as 'The Gallavants'" between Mediafare (buyer) from Marcus & O'Leary, Inc. (seller). *Id.* at 78. Prior to a finding by the court the parties met to discuss a settlement. *Id.* at 79. During negotiations, the parties "orally reached an agreement in principle." *Id.* As a result of the agreement in principle, the parties requested a thirty day notice from the court which, in effect, closed the case until the parties requested that it be reopened. *Id.* During the period when the case was "closed," the parties wrote and revised a total of four drafts of the proposed agreement (each draft representing changes by one, the other, or both parties). *Id.* Following receipt of the fourth draft, Mediafare claimed they were dissatisfied with the terms of settlement and refused to proceed with negotiations. *Id.* In response, the plaintiff wrote Mediafare "that [it] was releasing Mediafare's check from escrow." *Id.* Defendant had previously transmitted to plaintiff three copies of the executed third draft of the proposed agreement and, at the same time, enclosed a check for $15,000 to be held in an escrow account pending return to defendant of the executed agreement. *Id.* Furthermore, the plaintiff wrote that it was "enclosing what [he] characterized as 'two fully executed copies of the agreement.' . . . [t]he enclosed agreement was . . . the 'fourth draft' [to] which he [attached] the signature page from the 'third draft,'" which had been signed and approved by all but Winston. *Id.* at 79-80.

upon; and (3) whether the agreement at issue was of the type usually committed to writing.[144] In determining whether the parties had expressly reserved their right not to be bound, the court in *Winston* found that the words "subject to consummation of the proposed settlement"—in a letter between the parties—was sufficient evidence that the parties did not intend to be contractually bound by the agreement prior to signing.[145]

As to the second item for consideration—agreement with respect to all terms—the *Winston* court reasoned that, while the unresolved terms may have been minor and despite the fact that oral agreement was actually reached on all of the remaining terms, the parties were not, as a matter of law, bound by their oral agreements.[146] Nor did the oral contract indicate a relinquishment of the parties' intent not to be bound pending execution of a formal document.[147] In drafting a written instrument, parties sometimes uncover points of disagreement, ambiguity, or omission which need to be resolved prior to execution. These unnoticed points of potential disagreement, passed over in oral negotiation, will be uncovered and agreed upon when the understanding is reduced to writing. While the unnoticed and passed over terms may, in the long run, be "fairly characterized as minor or technical," this does not mean that a binding contract was reached prior to the time when they would have been worked out.[148]

The third item for consideration is whether the agreement is of the type ordinarily memorialized in a writing. Courts here look to the complexity of the transaction. The agreement in *Winston* involved the payment of $62,500 to be made payable over a period of several years on a percentage-of-earnings basis.[149] The court stated that the amount involved was not a "trifling amount" and that while the agreement consisted of only four pages, the terms and language were complex enough to require substantial redrafting.[150] On these facts, the court stated that "prudence strongly suggest[ed] that [the] agreement be written in order to make it readily enforceable, and to avoid . . . litigation."[151]

When, following this initial inquiry, the existence of a valid contract is shown, the plaintiff must further prove that the interfering party had knowledge of that contract.[152] The general rule is that "[o]ne

144. *Id.* at 80-81.
145. *Id.* at 79, 81.
146. *Id.* at 82.
147. *Id.*
148. *Id.*
149. *Id.* at 83.
150. *Id.*
151. *Id.*
152. *See, e.g.*, Guard-Life Corp. v. S. Parker Hardware Mfg. Corp., 50 N.Y.2d 183,

must know there is a contract before he can be found to have intended to do an unlawful act by inducing its breach."[153] The policy underlying this rule is the belief that "[c]ompetition in the market place [should] not be stifled unless there is an intentional wrong to a known contractual relation."[154] In furtherance of this policy, the New York courts require a showing of "actual knowledge."[155] Often, this requirement can be satisfied by such circumstantial evidence as participation in the negotiation process, public announcement of an executed agreement, or close contact with a party who would undoubtedly have actual knowledge of the existence of a valid contract.[156] The defendant does not, however, have an affirmative duty to investigate or to question involved parties as to whether a valid contract exists.[157]

In light of its subsequent exclusion of voidable contracts and contracts terminable-at-will from coverage under the tort of interference with contract, the New York Court of Appeals has refined this requirement.[158] The court stated that "as a practical matter [the interfering party] will usually be totally unaware of, and customarily indifferent to, the legal particulars of [the] contract. . . . [The interferor] will seldom if ever know whether the third party has a right to terminate or is

valid contract to the detriment, or injury of the plaintiff. This cause of action is maintainable notwithstanding the availability of a claim in contract for breach of contract. Any confusion which surrounds this tort arises either when there is no existing contract, or where there is a contract deemed not to amount to sufficient interest to be characterized as a "property right" worthy of the protection afforded by the tort.

B. *Interference with Prospective Contractual Relations*

New York law recognizes the existence of a related tort: tortious interference with prospective contractual relations.[162] Liability, in this instance, will exist only to the extent that "a contract would have been entered into had it not been for the malicious, fraudulent, or deceitful actions of a third party."[163] Where no valid contract exists and there is no impropriety, "interference" by a competitor is said to be justified, and no liability will attach.[164]

Prior to the existence of an enforceable contract, competitors vying for a competitive edge, in the hope of securing a contract, will engage "in a struggle and fight. . . . [During this struggle,] all kinds of methods are devised for creating a favorable impression or an advantage."[165] New York law will not, however, take judicial notice of these means unless they are in some way improper. For example, in *Union Car Advertising Co. v. Collier,*[166] the court of appeals expressed its distaste for many of the methods utilized when attempting to secure a

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162. *See, e.g., Guard-Life,* 50 N.Y.2d 181, 406 N.E.2d 445, 428 N.Y.S.2d 628. The rationale for these two separate torts—interference with contract and interference with prospective contractual relations—lies in the recognition of the differing protections that should be afforded the interest of one involved in a valid contract, as compared with the interests of one who merely has the expectation of future contractual relations. *Id.* at 191, 406 N.E.2d at 449, 428 N.Y.S.2d at 632-33. In the case of a valid contract, society's interest in protecting, individual contractual rights outweighs the public benefit to be derived from unfettered competition. *Id.* On the other hand, in the case of prospective contractual relations—which include contracts terminable-at-will and voidable contracts—the interfering party's right to freedom of action and society's interest in seeing that competition is not unduly hampered, outweigh the individual's rights to prospective contractual relations. *Id.*

163. Optivision, Inc. v. Syracuse Shopping Center Assocs., 472 F. Supp. 665, 685 (S.D.N.Y. 1979) (applying New York law); *see Guard-Life,* 50 N.Y.2d at 191, 406 N.E.2d at 449, 428 N.Y.S.2d at 632; Union Car Advertising Co. v. Collier, 263 N.Y. 386, 401, 189 N.E.2d 463, 468-70 (1934); Gertler v. Goodgold, 107 A.D.2d 481, 490, 487 N.Y.S.2d 565, 572 (following *Union Car Advertising*), *aff'd on other grounds,* 66 N.Y.2d 946, 489 N.E.2d 748, 498 N.Y.S.2d 779 (1985).

164. *See Guard-Life,* 50 N.Y.2d at 191, 406 N.E.2d at 449, 428 N.Y.S.2d at 632.

165. *Union Car Advertising,* 263 N.Y. at 395-96, 189 N.E. at 467.

166. 263 N.Y. 386, 189 N.E.2d 463 (1934).

competitive "edge."[167] The court stated that "[w]hatever [it] may personally think about these selfish, fierce and unfriendly contests for gain and for profit, the law is indifferent. *Not until false, fraudulent and malicious methods are used to kill off a competitor does the law take notice.*"[168]

Union Car Advertising involved the bidding and awarding of a contract for the right to gain control over all advertising space on a railway system.[169] Union Car alleged that its failure to receive the contract was due to the wrongful activities of a competitor, Collier, which had improperly influenced public officials and that but for this interference, Union Car would have received the contract.[170] The court of appeals determined there was insufficient certainty that Union Car would have received the contract and refused to hold Collier liable for Union Car's loss.[171] The court stated that, where competitors are vying for the same contract,

> [t]here must be . . . certainty that the plaintiff would have gotten the contract but for the fraud. This cannot be left to surmise or speculation. The courts rightfully extended the arm of the law to reach one who deliberately interfered with an executed contract, since which time they have gone a step further and mulcted in damages him who does the same thing to one who *would* have received such a contract *but for* the illegal interference. The courts will [not] permit[ ] juries to speculate upon what a competitor had reason to expect or might reasonably suppose would happen.[172]

In sum, a party will be held liable for tortiously interfering with prospective contractual relations when the interference is improper—improper being defined as fraudulent, deceitful, or illegal.[173] In addition, there must be assurances that the negotiations "*would* have culminated in a contract *but for* the interference of [plaintiff]."[174]

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167. *Id.*

168. *Id.* at 396, 189 N.E. at 465 (emphasis added).

169. *Id.* at 388, 189 N.E. at 464.

170. *Id.* at 392, 189 N.E. at 465.

171. *Id.* at 392-93, 189 N.E. at 465.

172. *Id.* at 401, 189 N.E. at 470 (emphasis added).

173. *Id.* at 401, 189 N.E. at 469; *Guard-Life,* 50 N.Y.2d at 190, 406 N.E.2d at 499, 428 N.Y.S.2d at 632; Susskind v. IPCO Hospital Corp., 49 A.D.2d 915, 915, 373 N.Y.S.2d 627, 629 (1975).

174. *Susskind,* 49 A.D.2d at 916, 373 N.Y.S.2d at 629.

C. *Application of the Tort of Interference with Contract in the Mergers and Acquisitions Context*

In contemplating the application of the tort of interference with contractual relations in the mergers and acquisitions context, it must be clearly understood that the process of contract formation in this area is not "the usual sequence of events."[175] The difficulty arises in the recognition of the "gap between the realities of the formation of complex business agreements and . . . traditional contract formulation."[176] It is because of this "gap" that this tort is not amenable to application in this context.

In a "traditional merger," the parties will generally begin negotiations with an emphasis on reaching a mutually satisfactory price.[177] When a meeting of the minds occurs, the parties are said to have reached an "agreement in principle" on the transaction.[178] One of the purposes of coming to this preliminary meeting of the minds, and memorializing it in the general terms of an agreement in principle, is to allow the corporations to avoid the expense of researching and preparing detailed appraisals of each other; if the parties cannot agree, even in general terms, there would be no need to commit to such an expenditure.[179] The agreement in principle is normally reduced to a writing which reiterates the parties' mutual intent to merge at "a stated (or formula) price, which is made expressly subject to the negotiation and execution of a definitive [merger] agreement, the approval of their respective boards and at least the target's stockholders, and the obtaining of needed consents from . . . regulatory authorities."[180] In other

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175. International Telemeter Corp. v. Teleprometer Corp., 592 F.2d 49, 49 n.1 (1979) (Friendly, J., concurring). In traditional contract formation, a contract is formed at a determinable moment through the process of offer and acceptance. 2 SCHLESINGER, FORMATION OF CONTRACTS: A CASE STUDY OF LEGAL SYSTEM 1584-86 (1968), *reprinted in* FARNSWORTH & YOUNG, CONTRACTS: CASES AND MATERIALS, 180-81 (3d ed. 1980) [hereinafter SCHLESINGER].

176. *International Telemeter*, 592 F.2d at 57. In the realm of large scale corporate dealings, "the traditional analysis [of offer and acceptance] is no longer in tune with present day practice." SCHLESINGER, *supra* note 175, at 1584-85. Because of the complexity of such transactions, businessmen will refrain from entering into a binding offer until the words of the deal have been reduced by lawyers to an "enforceable transaction." *Id.* "Thus the original negotiators will merely attempt to ascertain whether they [the parties] see eye to eye concerning those aspects of the deal which seem to be most important . . . . " *Id.*

177. *See* Fruend, *The Three-Piece Suitor: An Alternative Approach to Negotiated Transactions*, 34 BUS. LAW. 1679, 1687 (1979) [hereinafter *The Three-Piece Suitor*]; KRAMER, MERGERS AND ACQUISITIONS 22-23 (1969) [hereinafter KRAMER].

178. *The Three-Piece Suitor, supra* note 177, at 1685, KRAMER, *supra* note 177, at 22-23.

179. KRAMER, *supra* note 177, at 23; SCHLESINGER, *supra* note 175, at 1585-86.

180. *The Three-Piece Suitor, supra* note 177, at 1687-88. Texaco argued Getty and

words, pending the signing and approval of the definitive merger agreement, the agreement in principle serves merely as an announcement of intention.[181] As such, it takes on the appearance of a contract terminable-at-will or a voidable contract, neither of which amounts to a sufficient enough interest to be viewed as a valid, enforceable contract.[182] Thus, the agreement in principle does not give rise to the tortious interference with contract situation.[183]

While the New York Court of Appeals has not had occasion to answer the question of the binding effect of agreements in principle in the merger context, decisions relating to these agreements generally indicate that the interest of a party to it will be insufficient. New York courts have consistently held that mere agreements to agree are unenforceable unless the parties have specifically intended, *through express language* in the agreement, to be bound by the terms of the agreement in principle.[184] The usual sort of provision a court will look to when finding that an agreement is non-binding, is a statement to the effect that "the transaction is subject to the execution of a definitive contract between the parties."[185] This language is precisely the language of the Pennzoil/Getty agreement in principle which the Texas court, purportedly applying New York law, found enforceable.[186]

While the agreement is generally not legally binding, it is, nevertheless, considered evidence of the parties' seriousness towards the transaction.[187] As a result, a press release is issued which puts the "world . . . on notice that the target is up for sale at a time when the parties are *not* contractually obligated to each other."[188] At this point

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Pennzoil had reached this point when Texaco offered $125 per share for Getty. *See supra* text accompanying notes 42-48.

181. *The Three-Piece Suitor, supra* note 177, at 1688 n.42.

182. The similarity between the agreement in principle and voidable contracts and contracts terminable-at-will is that in neither situation can a party's performance be legally compelled. *See supra* text accompanying notes 117-21.

183. *See supra* text accompanying notes 117-21.

184. *The Three-Piece Suitor, supra* note 177, at 1688; *see, e.g.*, Pinnacle Books, Inc. v. Harlequin Enters. Ltd., 519 F.Supp. 118, 122 (S.D.N.Y. 1981) (applying New York law) (no tortious interference claim where contract interfered with was an agreement to agree); Joseph Martin, Jr., Delicatessen v. Schumacher, 52 N.Y.2d 105, 109, 417 N.E.2d 541, 543, 436 N.Y.S.2d 247, 249 (1981) (a mere agreement to agree is unenforceable); Willmott v. Giarraputo, 5 N.Y.2d 250, 253, 157 N.E.2d 282, 184 N.Y.S.2d 97, 98 (1959) (no contract exists if material element of a contemplated contract is left for future negotiations).

185. J. FRUEND, ANATOMY OF A MERGER 62 (1975); Reprosystem v. SCM Corp., 727 F.2d 257, 261-62 (2d Cir. 1984); *see Joseph Martin*, 52 N.Y.2d 105, 417 N.E.2d 541, 436 N.Y.S.2d 247; *Willmott*, 5 N.Y.2d 250, 157 N.E.2d 282, 184 N.Y.S.2d 97.

186. For a discussion of the Pennzoil/Getty agreement in principle, see *supra* text accompanying notes 42-48.

187. *The Three-Piece Suitor, supra* note 177, at 1688.

188. *Id.* (emphasis in original).

there is "nothing to stop any other company interested in acquiring the target from entering [into] the fray."[189]

A third party entering the fray at this time, who is successful in wooing the target away from the party to whom it had agreed in principle, should not be found liable for tortious interference with contract. In such a situation the third party may, at most, have induced the target to breach an unenforceable agreement to agree. An essential element of the claim has not been satisfied—the existence of a contract: where there is no contract there can be no breach and no third-party liability.[190]

As a matter of practicality and policy, the element of actual knowledge required by the New York courts will rarely be present prior to the formation of an agreement in principle, because of the very nature of the merger process and the requirements of the federal securities laws. The preliminary negotiations which culminate in an agreement in principle are conducted in an atmosphere of almost paranoiac secrecy. One reason for this secrecy is the fact that the corporation believes it has found a good business opportunity and will not want to risk the chance that outside influences will hinder the negotiation process. Furthermore, although the corporation is under a duty to disclose material corporate developments,[191] there is no bright-line test for when materiality occurs.[192] A finding of materiality, in the first instance, is made by the corporation based upon the probability that the transaction will be consummated weighed against the significance of the transaction to the shareholders.[193] This being the case, it will often be true that there will be no material development, and no disclosure, until an agreement in principle is reached.

In sum, whether the corporation remains silent prior to any announcement because of its desire to keep a business opportunity to itself or to avoid SEC sanction, the result is the same: no one will have actual knowledge until the announcement is made. If the announcement is made when the agreement in principle is signed and the agreement is in fact binding, as the Texas court has held, all potential bidders will be effectively precluded from participating in any competitive bidding process. The merger will be a legally enforceable fact the first time it is made public. This result cuts against the shareholders as much as against potential bidders. The shareholders are notified of the

189. *Id.*

190. Pinnacle Books, Inc. v. Harlequin Enters. Ltd., 519 F. Supp. 118, 121 (S.D.N.Y. 1981); Guard-Life Corp. v. S. Parker Hardware Mfg. Corp., 50 N.Y.2d 183, 190, 406 N.E.2d 445, 448, 428 N.Y.S.2d 628, 632 (1980).

191. *See* Basic Inc. v. Levinson, 108 S. Ct. 978, 982 (1988); Securities Exchange Act of 1934 § 106, 15 U.S.C. § 78j (1982); rule 10b-5, 17 C.F.R. § 240.10b-5 (1987).

192. *Basic*, 108 S. Ct. at 987.

193. *Id.* at 993.

merger after it is too late to become involved in the corporate decision-making process. Their investment decisions are limited to the question of whether to buy or sell, rather than questioning whether the price being paid is a fair one or if the merger is in the best interests of the corporation. Along the same lines if the agreement is legally binding and tort liability is imposed, competitive bidding becomes too risky and uncertain, resulting in a substantial detriment to the shareholders who, arguably, receive maximum value for their shares through a competitive market.

D. *Analysis of the Charge to the Jury and Application of New York Law*

The Texas jury was presented with eight "special issues." Only two of these are pertinent for purposes of this Comment. Special Issue One[194] was accompanied by six instructions which were intended to aid the jury in answering the question posed in Issue One.[195] The errors of

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194. Texaco, Inc. v. Pennziol Co., 729 S.W.2d 768, 812 (Tex. Ct. App. 1987). Special Issue No. 1 presented to the jury the question:

> Do you find from a preponderance of the evidence that at the end of the Getty Oil board meeting of January 3, 1984, Pennzoil and each of the Getty entities, to wit, the Getty Oil Company, the Sarah C. Getty Trust and the J. Paul Getty Museum, intended to bind themselves to an agreement that included the following terms:
>
> a. all Getty Oil shareholders except Pennzoil and the Sarah C. Getty Trust were to receive $110 per share, plus the right to receive a deferred cash consideration from the sale of ERC Corporation of at least $5 per share within five years;
>
> b. Pennzoil was to own 3/7th of the stock of Getty Oil and the Sarah C. Getty Trust was to own the remaining 4/7ths of the stock of Getty Oil; and
>
> c. Pennzoil and the Sarah C. Getty Trust were to endeavor in good faith to agree upon a plan for restructuring Getty Oil on or before December 31, 1984, and if they were unable to reach such agreement they would divide the assets of Getty Oil between them also on a 3/7ths-4/7ths basis.

Id.

195. *Id.* The accompanying instructions to the Special Issues No. 1 were as follows:

> 1. An agreement may be oral, it may be written or it may be partly written and partly oral. Where an agreement is fully or partially in writing, the law provides that persons may bind themselves to that agreement even though they may not sign it, where their assent is otherwise indicated.
>
> 2. In answering Issue No. 1, you should look to the intent of Pennzoil and the Getty entities as outwardly or objectively demonstrated to each other by their words and deeds. The question is not determined by the parties' secret, inward, or subjective intentions.
>
> 3. Persons may intend to be bound to an agreement even though they plan to sign a more detailed and formal document at a later time. On the other hand, parties may intend not to be bound until such a document is signed.
>
> 4. There is no legal requirement that parties agree on all the matters incidental to their agreement before they can intend to be bound. Thus, even if certain

this instruction, as well as in those that follow, lay more in what was unwritten than what was written. These omissions led to both erroneous findings of fact by the jury and a misapplication of the law of New York by the Texas court.

As to factual findings, Issue One was misleading in its inclusion of three specific terms which, had the jury agreed upon them, would lead to a finding of a binding contract. Without offering the jury an opportunity to consider other terms (through additional instructions or by the exclusion of the three specific terms) which may have been essential to the contract and not agreed upon, or terms which may, at that point, have been considered minor or technical, the jury did not have enough knowledge of the law to make an informed factual determination as to whether there was intent to form a binding contract. Specifically, there was no mention of the factors to be considered in determining when and whether the parties intended to bind themselves prior to formal execution of a definitive agreement. For example, an instruction on how intent may be shown through usage and custom or the types of agreements typically committed to writing would have balanced and clarified this Special Issue.[196]

The terms included in Issue One were agreement as to price, ownership, and a future restructuring plan. These terms correspond to those items usually dealt with in preliminary negotiation and incorporated, generally, in an agreement in principle which is not, when "subject to the execution" of a definitive agreement, binding under New York law.[197] This "subject to" language is a clear indication of intent *not* to be bound to the agreement in principle.[198] Pennzoil's agreement with Getty contained this same language, as did the press release issued by Pennzoil; yet, there was no mention of it in the one issue dealing with the intent of the parties. As such, the Issue does not ade-

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legal matters were left for future negotiations, those matters may not have been regarded by Pennzoil and the Getty entities as essential to their agreement, if any, on January 3. On the other hand, you may find that the parties did not intend to be bound until each and every term of their transaction was resolved.

5. Every binding agreement carries with it the duty of good faith performance. If Pennzoil and the Getty entities intended to be bound at the end of the Getty Oil board meeting of January 3, they were obliged to negotiate in good faith the terms of the definitive merger agreement and to carry out the transaction.

6. Modification or discussions to modify an agreement may not defeat or nullify a prior intention to be bound. Parties may always, by mutual consent and understanding, add new provisions spelling out additional terms that were not included in their original agreement.

Id.

196. *See supra* text accompanying notes 143-50.

197. *See supra* text accompanying notes 184-86.

198. For a discussion of the non-binding effect of agreements in principle, see *supra* text accompanying notes 185-90.

quately reflect New York law and does not provide a sufficient basis for a factual finding of intent. Pennzoil's only cause of action was for interference with an existing contract; therefore, this omission was critical.

Further, Issue One is phrased in language that is ambiguous. The jury was requested to determine whether, at the end of the board meeting, the parties "*intended* to bind themselves to an agreement," rather than asking whether the jury found that the parties had in fact bound themselves to an agreement.[199] With this instruction the jury may have seen its role as determining either that at the end of the Getty board meeting the parties had bound themselves to an agreement, or that at the end of the board meeting the parties intended to bind themselves to an agreement subject to the execution of a definitive merger agreement. If the latter, the intent found would not be sufficient to amount to a legally enforceable contract under New York law: it would merely have been an agreement to agree.[200] If this is in fact what the jurors had found, their role would have been completed, since if no contract exists, there can be no breach and no third-party liability absent improper means.[201]

Special Issues One and Two,[202] and their corresponding instructions, by repeated use of the undefined word "agreement," allowed the jury to mix the elements of the two torts. The jury was able to give Pennzoil the broad protection associated with interference with contract without having to find a contract. The use of this term further compounded the problem in Issue One. By not forcing a distinction between an agreement, an agreement in principle, and a binding contract, the jury was able to find Pennzoil and Getty bound in Issue One to something less than a legally enforceable contract; and yet, in Issue Two was able to apply the elements of tortious interference with contract in invoking third-party liability.[203]

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199. For the text of Issue No. 1, see *supra* note 194.

200. For a discussion of New York's law concerning agreements to agree see *supra* text accompanying notes 177-90.

201. For a discussion of the elements of the tort of interference with prospective contractual relations, see *supra* text accompanying notes 162-74.

202. Texaco, Inc. v. Pennziol Co., 729 S.W.2d 768, 826 (Tex. Ct. App. 1987). Special Issue No. 2 reads as follows: "Do you find from a preponderance of the evidence that Texaco knowingly interfered with the agreement between Pennzoil and the Getty entities . . . . " *Id.*

203. In response to this argument, the appellate court stated: "Since jurors are presumed to have average intelligence, the court is not required to convert the charge into a dictionary . . . . [T]he word 'agreement' was before the jury as an ordinary word, used in its ordinary meaning . . . . Consequently, no definition for the word 'agreement' was necessary." *Texaco, Inc.*, 729 S.W.2d at 814. This conclusion, however, does not acknowledge the various definitions applicable to the word both in the dictionary and business context, or the legal significance which attaches when one or the other definition is used.

Also, the phrase "knowingly interfered," in Issue Two, is a misstatement of the required elements of the cause of action. New York law requires actual knowledge of the contract before liability can attach.[204] There is no requirement that the third party know of its interference. The question should not have been whether Texaco "knowingly interfered," rather the court should have posed a two-step inquiry: (1) did Texaco have actual knowledge of the alleged contract between Pennzoil and Getty and (2) did Texaco intentionally interfere with that contract. Without actual knowledge of a contract, interference with it, and resulting damages, there can be no liability.[205]

Finally, Instruction Two to Issue Two created an implied duty to investigate—on the part of Texaco—the existence, or lack thereof, of a valid contract between Getty and Pennzoil.[206] The phrase "intentionally or willfully refused to ascertain the facts" implies a duty to ascertain the facts. The law of New York, contrary to this implication, imposes no affirmative duty to investigate.[207]

Upon analysis of New York law, it is clear that an entirely differ-

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For example, when an agreement is defined as an agreement to agree, application of the tort of interference with prospective relations is appropriate. However, when the agreement is defined as a binding contract, application of the tort of interference with contract applies. Substituting the word "contract" for the word "agreement" and defining the phrase "agreement in principle" could have solved the ambiguity in the instruction.

204. For a discussion of the element of actual knowledge, see *supra* text accompanying notes 152-57.

205. In looking to the language "knowingly interfered," the appellate court stated: "As used in this issue, 'knowingly' is an adverb modifying the verb 'interfered,' and answering the question 'how?' [did Pennzoil interfere with the agreement?]. A reasonable reading is that the issue asks about interference, with knowledge of the agreement." *Texaco, Inc.*, 729 S.W.2d at 832. This grammatical gymnastic is flawed. While the appellate court is correct in its characterization of the words "knowingly" and "interfered," its leap to what it calls a "reasonable reading" is without grammatical support. Read correctly, "interfered" is a verb modified by the adverb "knowingly." "Knowingly" cannot modify the prepositional phrase "with the agreement," because the verb "interfered" is inserted between the adverb and the prepositional phrase. As written, the Issue does not inquire if Texaco had knowledge of the agreement, but rather whether Texaco had knowledge of its interference.

206. Instruction No. 2 to Special Issue No. 2 provided that:

> In order to find that Texaco had knowledge of the agreement, if any, it is not necessary that Texaco had an accurate understanding of the legal significance of the facts which produced the agreement. If Texaco knew the facts that gave rise to the agreement, then it knew of the agreement, even if it did not believe those facts gave rise to an agreement, and even if it believed that any agreement that did exist violated the law. You may also find that Texaco knew of the agreement, if any, if you find that Texaco intentionally or willfully refused to ascertain the facts or if it exercized bad faith.

Texaco, Inc., 729 S.W.2d at 827.

207. For a discussion of the duty to inquire, see *supra* text accompanying notes 152-57.

ent cause of action should have been submitted to the jury — for instance, interference with prospective contract — a cause of action which likely would produce a different outcome. More important to a more balanced consideration by the jury would have been an instruction or special issue relating to the elements of interference with prospective relations enunciated in *Guard-Life,*[208] followed by the factors set forth in *Winston.*[209]

In Pennzoil's negotiations with Getty, the parties had expressly reserved the right not to be bound by a contract pending the execution of a formal instrument. This was most clearly done in the joint press release issued by the parties after the close of the board meeting on January 3. That release stated that the parties had reached an agreement in principle "*subject to* the execution of a definitive merger agreement."[210] By expressly reserving the right not to be bound, the parties could not have entered into an enforceable contract, even if they had agreed to the terms listed in Special Issue One. These facts should have alerted the court to the fact that the correct standard to be applied was not contractual interference but that of interference with prospective relations.

The jury should further have been instructed on whether the contract terms had been agreed upon. In *Winston,* the court found that where minor or technical issues remained unresolved and the parties were continuing to draft a final written agreement, there was strong evidence that the parties did not intend to be bound by the draft agreements, and, as such, no binding agreement existed.[211] By limiting the jury's consideration to the three terms enumerated in Issue One, the court effectively precluded the jury's consideration of any other terms.

Additionally, the jury should have been instructed to look to the complexity of the transaction to determine if it was of the type normally committed to a writing. In *Winston,* the agreement involved was, arguably, of less complexity; yet, the court found it to be of the type normally committed to writing.[212] In this case, the transaction involved billions of dollars and required the consent of Pennzoil, Getty, the Trust, the Museum, a California state court, and certain federal regulatory agencies, as well as considerations of both federal and state law. Such a transaction certainly would be committed to writing, that writ-

208. For a discussion of *Guard-Life,* see *supra* text accompanying notes 117-32. For a summary of the elements of tortious interference with prospective contractual relations, see *supra* text accompanying notes 173-74.

209. *See supra* text accompanying notes 143-45.

210. *See supra* text accompanying notes 46 & 48.

211. *See supra* text accompanying notes 146-48.

212. *See supra* text accompanying note 151.

ing being the definitive merger agreement. In *International Telemeter Corp. v. Teleprompter Corp.*,[213] the court recognized that in large corporate transactions:

> the usual sequence of events is not that of offer and acceptance; on the contrary, the [corporate executive] who originally conducts the negotiations . . . merely attempts to ascertain whether the parties see eye to eye concerning those aspects of the deal which seem most important from a business point of view.[214]

If the parties do see eye-to-eye, an agreement in principle is executed. However, because of the complexity of the transaction, there is no contract until a definitive merger agreement is signed. "[U]ntil then either party is free to bring up new points of form or substance, or to withdraw altogether."[215] This is certainly true in the merger context and obviously so when the merger involves billions of dollars. To rebut the presumption that a deal of this size would normally be committed to writing would require clear and convincing evidence of the parties intent to be bound to the agreement in principle.[216] Without an instruction dealing with the nature of "large deals" and common business practices, the jury was applying a standard of contract formation that had no application to the case before it.

Finally, if the alleged contract here at issue was legally binding, it would have been void as violating federal securities law, once again raising the question of the correct tort to apply. Once a tender offer has been initiated, the offeror may not, pursuant to rule 10b-13 of the Securities Exchange Act of 1934, purchase securities of the target except through the tender offer, as long as the tender offer remains open.[217] After Pennzoil initiated its tender offer, it negotiated and reached an agreement in principle with Getty. This agreement contained terms substantially different from those in the tender offer. When the agreement in principle was announced Pennzoil filed an amended schedule 14D-1 with the SEC informing them that it was *not* withdrawing its tender offer, and that it would not do so until the execution of a definitive merger agreement. As a result Pennzoil had, according to the Texas court, negotiated and concluded a binding contract for the purchase of Getty shares at the same time its tender offer remained outstanding. Pennzoil's actions violated Rule 10b-13, making

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213. 592 F.2d 49 (2d Cir. 1979) (Friendly, J., concurring).

214. *Id.* at 57.

215. SCHLESINGER, *supra* note 175, at 181-82; *see The Three-Piece Suiter, supra* note 177, at 1687-88.

216. *International Telemeter*, 592 F.2d at 57-58.

217. Rule 10b-13, 17 C.F.R. 240.10b-13 (1987).

the "contract" void pursuant to § 29(b) of the Securities Exchange Act of 1934.[218] If a contract is void, it is not a legally sufficient interest to impose liability upon a third party who interferes with it, unless that interference is improper. The appellate court, however, stated that the provision of rule 10b-13 which allows for an exemption to the rule (by the Commission, upon written request) "negates the suggestion that [an] infraction of the rule automatically makes the transaction void."[219] The court went on to state that "[i]f the transaction is . . . voidable, Texaco has no standing to assert [it] . . . . "[220] Nevertheless, the fact remains that Pennzoil made no written request to the Commission to exempt itself from the provisions of the rule and yet it executed a "contract" to purchase shares "outside" the tender offer. Whether this "contract" is characterized as void or voidable, and whether a party to it has or has not elected to assert it, it is not a contract for the purposes of tortious interference with contractual relations.

The instructions to the jury were written in a way which focused the jury's attention upon the evidence introduced by Pennzoil, rather than permitting the jury to decide between this evidence and Texaco's arguments. Texaco's defense was that Pennzoil and the Getty entities were still involved in negotiations when Texaco made their offer and that the parties had reached an agreement in principle—but no more. As such, the instructions should have included some mention of the rights and privileges parties enjoy when they are in the pre-contractual stage. At the very least, there should have been an instruction explaining that a competitive offer, involving no improper means, is a complete defense to interference with prospective contractual relations. Instead, instructions relating to Texaco's defense were either omitted completely or relegated to short sentences at the end of instructions.

III. Conclusion

On December 10, 1985, Texaco was found liable for tortiously interfering with an alleged contract between Getty and Pennzoil. To prevail on its claim, under New York law, Pennzoil had to prove that there was a legally enforceable contract in existence at the time of the breach; that Texaco had actual knowledge of that contract; that Texaco intentionally induced the breach of that contract; and that as a result of Texaco's actions, Pennzoil sustained damages. The Texas jury believed, and the appellate court agreed, that Pennzoil had met its

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218. Securities Exchange Act of 1934 § 29(b), 15 U.S.C. § 78cc(b) (1982). Section 29(b) provides that "[e]very contract made in violation of any provision of [the Exchange Act] or of any rule or regulation thereunder . . . shall be void." *Id.*

219. Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768, 806 (Tex. Ct. App. 1987).

220. *Id.*

burden.

In so finding, the Texas court has, in effect, held that an agreement in principle, which is subject to the execution of a definitive merger agreement, is a binding and legally enforecable contract. This is contrary to both the laws of New York and the requirements and policies of the Securities Exchange Act of 1934. A party to an agreement in principle has only an expectation of future performance; if a third party interferes with that expectation the applicable tort is interference with prospective relations—not with contract. Even assuming, for the sake of argument, that there was a binding contract in existence, the Texas court's instructions to the jury did not adequately portray the elements of New York's tort of interference with contract. Finally, if such an agreement was a binding contract, it would frustrate the purpose of the Williams Act by making competitive tender offers too risky a venture to be undertaken by any corporation.

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