

Competition and Existing Contracts

In the normal course of events, two parties that enter into a contract are obligated to perform in accordance with that contract. Where a party fails to do so that party has breached the contract and will ordinarily be liable for any resulting damage to the other, non-breaching party. Although in most cases only the breaching party can be liable, there are limited scenarios where others may be liable as well. This article will discuss situations where a third-party that is not a party to the breached contract can also be liable to the non-breaching party. This third-party's liability is based on its improper interference with an existing contract, known as tortious interference with an existing contract.

Before discussing the details of this claim and liability, it is important to understand that courts will generally sanction and encourage legitimate business competition. Courts will not penalize a third-party's ordinary attempts to solicit business, even when doing so may result in the breach of a contract between two other parties. Therefore, the fact that a party to a contract breached that contract to respond to the solicitations of a third-party, does not automatically create liability for that third-party. As discussed below, the conduct of the third-party in soliciting the business often determines whether its conduct was proper.

For example, Tire Supply, Inc., has an exclusive contract to sell tires to Tire Depot, Inc., for \$10 a tire. The agreement provides that Tire Supply may sell to no one other than Tire Depot and Tire Depot may purchase tires only from Tire Supply. Tire Meddler Corp., approaches Tire Supply and offers to buy all of its tires for \$12 a tire, \$2 more than Tire Supply receives from Tire Depot. Selling to Tire Meddler will require that Tire Supply breach and terminate

its agreement with Tire Depot. Assuming that Tire Supply agrees to sell to Tire Meddler, and breaches its contract with Tire Depot, and is sued by Tire Depot for that breach, can Tire Depot sue Tire Meddler for causing Tire Supply to breach their agreement? Has Tire Meddler done anything legally wrong considering that from a strict business point of view, Tire Meddler did nothing more than offer Tire Supply a better deal?

Before we turn to Tire Meddler's liability, we should look to the considerations of the breach. Tire Supply made a conscious business decision to breach, reasoning that even if Tire Depot sued and recovered its damages, Tire Supply would still realize a profit on the tires it sold to Tire Meddler. It could even be said that although Tire Depot may have been damaged, Tire Supply's decision to breach was a smart business decision and part of the general capitalistic and competitive business scheme in which all businesses operate, and beneficial to the overall business environment. Although aware of the importance of enforcing agreements, courts recognize this concept, and would call Tire

Supply's breach of its agreement with Tire Depot an "efficient breach," in that it promotes the overall business landscape.

Now, we turn to Tire Meddler's liability. What if Tire Depot sued not only Tire Supplier but also Tire Meddler claiming that absent Tire Meddler's conduct, Tire Depot would continue to reap the benefit

of its contract with Tire Supply? Could Tire Meddler assert a defense that it did nothing more than engage in ordinary business competition and have no liability to Tire Depot? Would the outcome to this question change if Tire Meddler targeted Tire Supply and affirmatively induced Tire Supply to breach the

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contract with Tire Depot? Is Tire Meddler's knowledge of the relationship between the original parties or the intent in inducing Tire Supplier to breach at all relevant to its possible liability?

The facts in *White Plains Coat & Apron Co. v. Cintas Corp.*, provide a real-life example of the fine line parties traverse in a competitive setting. *White Plains Coat & Apron Co.* ("WP") rented napkins and tablecloths to restaurants and the food industry. WP's contracts were exclusive so that WP's customers agreed to rent these items only from WP. Cintas Corp., a competitor, allegedly induced WP's customers to terminate their contracts with WP and to patronize Cintas for those services. WP sued Cintas claiming that Cintas tortiously interfered with the contracts WP had with its customers. Although Cintas had some of the prior WP customers agree that Cintas had not induced them to terminate their WP contracts, and claimed that it did not even know of the WP contracts, an issue not entirely clear, the Court of Appeals, New York's highest court, found Cintas liable for tortious interference with WP's existing contracts.

After recognizing that the court's role was to strike a balance between public, robust competition and a stable marketplace with reliable relationships, the court decided against Cintas. The court stated that while businesses may solicit and compete with each other, that is so long as the businesses are on equal footing and competing that way. However, where a business has an existing contract with a customer gives that business a closer and more protected relationship with that customer. This means that a company with no prior relationship with a particular customer does not have the same level of interest in that customer as a company with an existing relationship, and simply being a competitor is an insufficient excuse to induce a customer to breach an existing contract. The court emphasized that its decision should not be read to rule out ordinary competition and solicitation, just the type that exceeded the minimum level of proper conduct, to be decided on a case-by-case basis.

Although the court did not provide firm details about specific approaches to competition, we can answer the questions posed earlier. Assuming that Tire Meddler did nothing more than solicit Tire Supplier in the ordinary course, and offered to buy tires as it would from any other supplier, even at a higher price, it is likely

that Tire Meddler could claim that it was just competing and avoid liability to Tire Depot. However, if Tire Meddler solicited Tire Supplier specifically knowing of its contract with Tire Depot, or provided some "sweetener" to Tire Supplier that was not available in the marketplace, Tire Meddler may have to answer for Tire Supplier's breach of its contract with Tire Depot. If Tire Meddler was acting with malice, it would be liable for Tire Depot's breach.

Despite the WP decision, and sometimes because of the decision, the line of permissible competition is not always clear. Some general guidelines in determining where the line of improper conduct is drawn include whether the solicitation (i) is made broadly to all potential customers or just to a competitor's existing customers; (ii) includes pricing that is standard or discounted; (iii) complies with the solicitation norms of that industry; and (iv) whether the solicitation makes unfair comparisons between the competing products. One factor that should not be deemed unfair is where the soliciting company offers expanded services that it knows the other company cannot match. Also, the consideration discussed would not apply where two companies are competing for the same customer, so long as neither of them have a prior relationship with the customer.

Query: What if one competitor had an existing relationship with a customer, but the term of that relationship ended and a renewal was being considered? Would the old relationship matter?

These issues are complex and require careful consideration. Feel free to call us at (212) 765-4567 or contact us at info@thesilberlawfirm.com to discuss possible liability and the details of permissible competition, or for counsel on any other commercial matter.

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