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Chief Justice Tani Cantil-Sakauye
California Supreme Court
350 McAllister Street
San Francisco, CA 94107

Re: *Asahi Kasei Pharma Corporation v. Actelion Ltd., et al.* Ct. of Appeal No. A133927

Dear Chief Justice Tani Cantil-Sakauye:

Pursuant to Rule 8.500(g) of the California Rules of Court, I write to urge the Court to grant Defendants and Appellants'[1] Petition for Review in the case of *Asahi Kasei Pharma Corporation v. Actelion Ltd., et al.* I am a law professor at the Fowler School of Law at Chapman University. I teach classes in the areas of contract law, intellectual property, and commercial litigation and conduct scholarship in these fields. Prior to entering academia, I practiced intellectual property and commercial litigation for ten years at two major American law firms. Accordingly, I have an interest in the orderly and coherent development of the law and in the public policy implications of the commercial law on the people and economy of California.

The Petition raises three legal issues of significant importance to the people and economy of California. The Court of Appeal's decision on these issues is contrary to California law and policy, as reflected in the decisions of this Court, other panels of the Court of Appeal, and academic scholarship.

1. The Court Should Grant Review to Resolve Whether a Company Can Be Held Liable for Tortious Interference with Contract for its Business Decision to Terminate the Contract of a Wholly Owned Subsidiary.

The Court of Appeal held that after Actelion acquired 100% ownership of CoTherix[2], it was not immune from tort liability for its business decision to terminate a contract CoTherix had made with

[1] Defendants and Appellants are Actelion Ltd., Actelion Pharmaceuticals Ltd., Actelion Pharmaceuticals US, Inc., Actelion U.S. Holding Co. ("Actelion") and the individual Defendants and Appellants, Jean-Paul Clozel, Martine Clozel, and Simon Buckingham ("the Individual Defendants and Appellants"). Plaintiff and Appellee is Asahi Kasei Pharma Corporation ("Asahi").

[2] "CoTherix" refers to Actelion's subsidiary CoTherix, Inc.

Asahi—a license agreement to develop, seek FDA approval for, and market a pharmaceutical at great risk and expense. Pet. at 4. The court affirmed Actelion's liability for tortious interference with contract for its business decision, and affirmed $377 million in damages against Actelion and $30 million in punitive damages against the individual executives at Actelion who made the decision. These damages were awarded despite the fact that Asahi had already been compensated for Actelion's alleged breach of contract by obtaining an award of $91 million at an arbitration conducted pursuant to the contract. Pet. at 9-11.

The Court of Appeal's decision conflicts with core principles of California contract law that serve to promote economic activity. California adheres to the fundamental principle that under ordinary circumstances, a simple breach of contract does not give rise to tort liability. As this Court said in *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.*, "[c]onduct amounting to a breach of contract becomes tortious only when it also violates an independent duty arising from principles of tort law."[3] This venerable rule is supported by important public policies. The law should encourage the economic activity fostered by the formation of private contracts. But if businesses and people are punished for their breaches of contract beyond ordinary contract remedies, they will be discouraged from concluding contracts and engaging in economic activity. Accordingly, contract law should "promote the use of contract by encouraging promisees to rely on the promises of others, rather than by compelling promisors to perform their promises out of fear that the law will punish their breaches."[4] The law further encourages contract formation by limiting what may be recovered for breach to contract remedies because these are remedies that the parties would be able to anticipate and estimate at the time of contract formation. "This limitation on available damages serves to encourage contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprise."[5] Denying tort liability for breach of contract allows businesses the freedom to terminate contracts that become too risky or bad for business, while allowing full compensation for the non-breaching party in the form of contract damages. This results in the efficient allocation of resources across society.[6]

In accordance with these principles, this Court decided in *Applied Equipment* that a party cannot be held liable for tortiously interfering with its own contract.[7] Such conduct amounts to nothing more than a breach of contract, for which contract damages provide full compensation. Rather, tortious interference with contract can be committed only "by outsiders who have no legitimate social or economic interest in the contractual relationship."[8] The Court of Appeal's holding that Actelion could be liable in tort for terminating the contract of its wholly owned subsidiary narrows *Applied Equipment* beyond recognition, thereby eviscerating the policy concerns that animated the Court's decision.

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[3] (1994) 7 Cal.4th 503, 515.

[4] E. Allen Farnsworth, "Legal Remedies for Breach of Contract," 70 COLUM. L. REV. 1145, 1147 (1970).

[5] *Applied Equipment*, 7 Cal. 4th at 515.

[6] *See* RICHARD POSNER, ECONOMIC ANALYSIS OF LAW § 4.10 (7th ed. 2007).

[7] 7 Cal.4th at 507-08.

[8] Id. at 514.

The Court of Appeal's decision rests on the formalistic notion that a parent company is an "outsider" having "no legitimate social or economic interest in the contractual relationship" of its subsidiary. In fact, Actelion had an economic interest in CoTherix amounting to 100% ownership and control of the company. Parent companies form or acquire wholly owned subsidiaries for a variety of reasons, including "to make a high-risk transaction more safe or simply as a means of branching into a new area of trade."9 Once a parent company obtains 100% control of a subsidiary, it must be free to operate the subsidiary, making good business decisions for the benefit of shareholders. A wholly owned and controlled subsidiary is an arm of the parent company. As such, regardless of the formalities of the particular corporate structure, in the business world, "parent corporations and their subsidiaries are viewed as one."10

The Court of Appeal disregarded these realities of the business world by holding that a party enjoys immunity from tortious interference with contract only if it is "a party to the contract or an agent of a party to the contract." (Typed Opn. 18). This holding conflicts with decisions of the other panels of the Court of Appeal and of federal courts, which have properly interpreted Applied Equipment to bar claims of tortious interference with contract against defendants that have significant connections to the contract, even if such defendants are not technically agents of the contracting party.11 Despite the fact that Actelion was not formally an agent of CoTherix, it acted as CoTherix's agent by controlling CoTherix's operations and making business decisions on behalf of CoTherix.12 This was Actelion's prerogative as the 100% owner of CoTherix. The Court of Appeal denied Actelion immunity from tort liability for its actions in directing its subsidiary merely because there was no formal agency agreement between Actelion and CoTherix. This restrictive, formalistic reading of Applied Equipment is wholly unmoored from the practical reality of how businesses operate and divorced from the policy concerns motivating this Court in *Applied Equipment*.

Upon assuming control of a wholly owned subsidiary, among the many decisions parent companies confront is how and whether to continue with existing business relationships and contracts. The parent company may decide that a contract needs to be terminated, and although this may be a breach of contract, breaches of contract, in the words of Judge Posner, are "not necessarily blameworthy... provided [the breaching party] makes good the promisee's actual losses."[13] Rather than being blameworthy, these are business decisions that a company must be free to make.[14]

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[9] Dax O. Faubus, Casenote, *A Parent Corporation's Right to Interfere with its Wholly-Owned Subsidiary's Contractual Relationships—The San Antonio Court of Appeal's Incorrect Application of Texas Law, Valores Corporativos v. McClane Co.*, 39 S. TEX. L. REV. 1071, 1087 (1998).

[10] *Id.*

[11] *See PM Group, Inc. v. Stewart* (2007) 154 Cal.App.4th 55, 65; *Kasparian v. County of Los Angeles* (1995) 38 Cal.App.4th 242, 266; *Exxon Corp. v. Superior Court* (1997) 51 Cal.App.4th 1672, 1688; *Marin Tug & Barge, Inc. v. Westport Petroleum, Inc.* (9th Cir. 2001) 271 F.3d 825, 832; *Fresno Motors, LLC v. Mercedes-Benz USA, LLC* (E.D. Cal. 2012) 852 F.Supp.2d 1280, 1293, 1295; *Nat'l Rural Telecomms. Coop. v. DirecTV, Inc.* (C.D. Cal. 2003) 319 F.Supp.2d 1059, 1070, 1073.

[12] For a detailed recitation of the evidence showing that Actelion was the de facto agent for CoTherix (and that Asahi treated it as such) as of the date of the acquisition, see Appellant's Pet. for Reh'g at 4-5.

[13] *Patton v. Mid-Continent Sys.* (7th Cir. 1988) 841 F.2d 742 750 (Posner, J).

[14] Nor does it matter what the parent company's motive may be for terminating the contract. As this Court stated in *Applied Equipment*:

But if the Court of Appeal's holding is allowed to stand, all of the sound policies articulated by this Court in *Applied Equipment* will be frustrated in the context of parents operating subsidiaries. No longer will the "limitation on available damages [for breach of contract] serve[] to encourage contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprise."[15] Parent companies will be paralyzed in their decision whether or not to acquire subsidiaries and whether to enter into contracts on their behalf. In light of the risk of tort liability and punitive damages for terminating any unwise contracts that are inherited through the acquisition, the prudent decision would be to forgo altogether the acquisition of another company. The state would thereby be deprived of the economic activity, growth, and efficiencies that are created when companies grow and expand into new industries.

Indeed, even where a parent corporation has owned a subsidiary for many years, the Court of Appeal's rule would expose that parent company to potential tort liability for directing its subsidiary to take the ordinary business decision to terminate a contract. Such a regime would paralyze the ability of businesses to operate subsidiaries for the benefit of shareholders.

Accordingly, the Court should grant Defendants and Appellants' Petition for Review and hold that the parent of a wholly owned subsidiary cannot be held liable for tortious interference with contract for terminating the contract of a wholly owned subsidiary.

2. *The Court Should Grant Review to Determine Whether a Corporation's Officers May be Held Personally Liable for Punitive Damages Based on Their Decision to Terminate a Subsidiary's Contract.*

Beyond the hundreds of millions of dollars in damages assessed against Actelion for terminating the Asahi contract, the Court of Appeal affirmed $30 million in punitive damages against the Actelion executives who made the decision to terminate the contract. This ruling merits the Court's review because it deepens a split in the Court of Appeal on the issue of whether corporate officers may be held personally liable for acts taken within the scope of their employment.[16] The Court should rule that corporate officers of a parent company may not be held liable for deciding that the contract of a wholly owned subsidiary should be terminated. Imposing personal liability will restrict executives' ability to

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> [T]he law generally does not distinguish between good and bad motives for breaching a contract. "[I]n traditional contract law, the *motive* of the breaching party generally has no bearing on the scope of damages that the injured party may recover for the breach of the implied covenant [of good faith and fair dealing]; the remedies are limited to contract damages."... "Varying personal or economic reasons motivate one to breach his contract, but the general rule is that... motives... are immaterial and cannot be inquired into on the question of compensatory damages."

7 Cal.4th at 516 (quoting *Foley v. Interactive Data Corp.*, (1988) 47 Cal.3d 654, 699 (emphasis in original); Note, *Civil Conspiracy and Interference with Contractual Relations*, 8 Loyola L.A. L. Rev. 302, 327 (1975)) (brackets in original).

[15] 7 Cal.4th at 515.

[16] *Compare Weiss v. Washington Mutual Bank* (2007) 147 Cal.App.4th 72, 78; *Self-Insurers' Security Fund v. ESIS, Inc.* (1988) 204 Cal.App.3d 1148, 1163 (rejecting personal liability for corporate officers acting within the scope of their employment); *with PMC, Inc. v. Kadisha* (2000) 78 Cal.App.4th 1368, 1380; *Klein v. Oakland Raiders, Ltd.* (1989) 211 Cal.App.3d 67, 79-81 (holding that individual liability may be imposed).

operate subsidiary companies in a profitable and effective manner. The Court of Appeal's rule would likely deter business leaders from conducting business in California, particularly men and women as prominent as the world renowned doctors and scientists who have been held personally liable here.[17]

Accordingly, the Court should grant Defendants and Appellants' Petition for Review and hold that a corporation's officers may not be held personally liable for tortious interference with contract for terminating the contract of the corporation's wholly owned subsidiary.

3. *The Court Should Grant Review to Clarify that An Award of Lost-Profits for the Abandonment of an Unproven Drug in Early Stages of FDA Review Is Impermissibly Speculative.*

The Court should also grant review of the Court of Appeal's affirmance of $359 million in lost-profits damages for Actelion's decision to terminate CoTherix's development of the drug Fasudil and return the development rights to Asahi. Because the drug had yet to complete Phase II and Phase III of FDA approval, completing development and marketing of the drug amounted to an unestablished business, and these lost profits were wholly speculative. The Court of Appeal's decision therefore violated another central tenet of California law that "damages for the loss of prospective profits are recoverable [only] where the evidence makes reasonably certain their occurrence."[18] And in particular, as this Court held recently in *Sargon Enterprises, Inc. v. University of Southern California*, "where the operation of an unestablished business is prevented or interrupted, damages for prospective profits that might otherwise have been made from its operation are not recoverable for the reason that their occurrence is uncertain, contingent and speculative."[19]

An award of $359 million in lost-profits damages for a drug that has not even entered Phase II of FDA approval is speculative by definition. Taking a drug through FDA approval is rigorous, expensive, uncertain and, above all, risky. A study conducted over the years 2006-2010 found that only 1 in 10 drugs in Phase I make it through to final approval.[20] In particular:

> The largest dropout rate along the clinical pathway came in advancing drugs from mid-stage Phase II studies to late-stage Phase III testing.
>
> Some 63 percent of drugs in Phase I testing advanced to Phase II, but only 33 percent of Phase II drugs made it to Phase III, which requires a commitment to larger and much more expensive clinical trials. Phase III is typically the final stage of human testing before a new drug is submitted to regulators for an approval decision.[21]

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[17] *See* http://www1.actelion.com/en/our-company/actelion-people/founders.page (last visited, Feb. 1, 2014).

[18] *Grupe v. Glick* (1945) 26 Cal.2d 680, 693 (quoted in *Sargon Enters., Inc. v. Univ. of Southern Cal.* (2012), 55 Cal.4th 747, 773).

[19] 55 Cal.4th 747, 774 (quoting *Grupe*, 26 Cal.2d at 692).

[20] Bill Berkrot, *Success rates for experimental drugs falls: study*, REUTERS, Feb. 14, 2011 (available at: http://www.reuters.com/article/2011/02/14/us-pharmaceuticals-success-idUSTRE71D2U920110214) (last visited, Feb. 1, 2014).

[21] Id. *See also* Michael Hay et al., *Clinical development success rates for investigational drugs*, 32 NATURE BIOTECHNOLOGY 40, 42 (Jan. 2014) (concluding that drugs in phase I have a likelihood of final FDA approval ranging from 10.4% to 15.3%).

The drug at issue here, Fasudil, had completed Phase I testing, but this was not predictive of its success, because 63 percent of drugs advance to Phase II. Because only one-third of drugs advance from Phase II to Phase III, and because only 10% of drugs are finally approved, it is wholly speculative to conclude that Fasudil would have cleared these hurdles and been able to earn any profits, much less profits that would have yielded royalties of $359 million.

Because of the risk, cost, and uncertainty of advancing a drug through final FDA approval, it is particularly important that the courts view this as a business decision within the discretion of corporate officers. Whereas this decision may result in breach-of-contract liability where, as here, the drug was being developed in partnership with another company, it must not result in exorbitant damages based on speculative lost profits. A rule to the contrary will chill California businesses from entering into partnerships with each other for the purpose of developing potentially life-saving medicines.

Accordingly, the Court should grant Defendants and Appellants' Petition for Review and hold that lost-Profits damages for the termination of development of a drug that is early in the FDA approval process are unavailable as speculative.

Respectfully submitted,

Sam Ernst

Samuel F. Ernst

SAE/ka

Enclosure: Proof of Service

PROOF OF SERVICE

I am employed at the Fowler School of Law at Chapman University in Orange, California. I am over the age of 18 and not a party to the within action; my business address is One University Drive, Orange, CA 92866.

On Friday, February 14, I served true copies of the attached amicus curiae letter in support of the petition for review on the interested parties in this action as follows:

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BY MAIL: I am readily familiar with the practices of the Fowler School of Law for collecting and processing correspondence for mailing with the U.S. Postal Service. Under that practice, it would be deposited with the U.S. Postal Service that same day in the ordinary course of business. I enclosed the foregoing in sealed envelopes as shown above, and such envelopes were placed for collection and mailing with postage thereon fully prepaid at Orange, California on that same day, following ordinary business practices.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on February 14, 2014 at Orange, California.

Karen Agrums

Karen Agrums