Notre Dame Law Review

Volume 60 | Issue 3 Article 3

1-1-1985

Contort: Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance Commercial Contracts--Its Existence and Desirability

Matthew J. Barrett

NOTES

"Contort": Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance, Commercial Contracts—Its Existence and Desirability

Every contract contains an implied covenant of good faith and fair dealing which prohibits any contracting party from injuring another party's right to receive the benefits of the agreement.[1] Breach of this implied covenant creates a cause of action in contract. Beginning twenty-five years ago, some courts also recognized a cause of action in tort for breach of this implied convenant in insurance contracts.[2]

In recent years, the California courts, the leaders in the development of "contort,"[3] have repeatedly faced the issue whether courts should expand its application beyond the insurance context.[4] Resolution of the issue is important because tort treatment enables a plaintiff to recover damages ordinarily not recoverable in a con-

1 *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); *see also* notes 12-17 *infra* and accompanying text.

2 *See, e.g.*, Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 620 P.2d 141, 169 Cal. Rptr. 691 (1979), *appeal dismissed and cert. denied*, 445 U.S. 912 (1980); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958). Although California courts developed this tort cause of action, courts of other states also have allowed tort recovery for breach of the implied covenant in insurance cases. *See* Kornblum, *Recent Cases Interpreting the Implied Covenant of Good Faith and Fair Dealing*, 30 DEF. L.J. 411, 431 n.50 (1981) (listing cases from 17 other states). This note makes no attempt to address the desirability of the tort of breach of the implied covenant of good faith and fair dealing in the insurance context.

3 This note will use the term "contort" to refer to the tortious breach of the implied covenant of good faith and fair dealing because the cause of action sounds in both tort and contract. *Cf.* Brüggemeier, *Perspectives on the Law of "Contorts": A Discussion of the Dominant Trends in West German Tort Law*, 6 HASTINGS INT'L & COMP. L. REV. 355 (1983).

Legal commentators, however, have used various names such as the tort of the "Insurer's Mistaken Judgment," the "New Tort of Outrage," "*Gruenberg*-ian Tort," "Tort of Bad Faith," "Tortious Breach of Contract," "Tortious Interference with a Protected Property Interest," and "Bad Faith Breach" to refer to the tort cause of action for breach of the implied covenant of good faith and fair dealing in the insurance context. *See* Comment, *The New Tort of Bad Faith Breach of Contract:* Christian v. American Home Assurance Corp., 13 TULSA L.J. 605, 625 (1978).

4 *See* notes 23-26 *infra* and accompanying text. Several commentators also have addressed the question. *See* Diamond, *The Tort of Bad Faith Breach of Contract: When, If At All, Should It Be Extended Beyond Insurance Transactions?*, 64 MARQ. L. REV. 425 (1981); Kornblum, *Recent Cases Interpreting the Implied Covenant of Good Faith and Fair Dealing*, 30 DEF. L.J. 411 (1981); Louderback & Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F.L. REV. 187 (1981); Speidel, *The Borderland of Contract*, 10 N. KY. L. REV. 163 (1983).

tract action, such as damages for mental suffering,[5] losses not foreseeable at the time of contracting,[6] and punitive damages.[7] In *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*,[8] the Supreme Court of California recently faced the question: "May a plaintiff recover in tort for breach of an implied covenant of good faith and fair dealing in a noninsurance, commercial contract?"[9] Although the court did not directly answer this question, the court's language indicates that breach of the covenant in a commercial context may create a tort cause of action.[10]

Part I of this note discusses the covenant of good faith and fair dealing inherent in every contract. Part II traces the development of the tort cause of action for breach of the covenant in noninsurance cases in California, discusses the *Seaman's* case, and analyzes other recent cases interpreting the tort cause of action for breach of the implied covenant. Part III discusses the desirability of allowing tort recovery for breach of the implied covenant of good faith and fair dealing in ordinary commercial contracts.[11] Part IV suggests that an award of attorneys' fees under the "bad faith" exception to the American rule better solves the problems that the California cases raise. Part V concludes that the "contort" cause of action threatens to literally "contort" the interrelationship between contract and tort law.

I. Implied Covenant of Good Faith and Fair Dealing and Its Breach

A. *Implied Covenant of Good Faith and Fair Dealing*

Restatement (Second) of Contracts section 205 provides: "Every contract imposes upon each party a duty of good faith and

5 "Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result." RESTATEMENT (SECOND) OF CONTRACTS § 353 (1981).

Corbin explains that breaches of contract, in general, do not cause as much resentment or other mental anguish and physical discomfort as do the wrongs labeled "torts." Even Corbin, however, warns that there is no exact line between the two causes of action. *See* 5 A. CORBIN, CORBIN ON CONTRACTS § 1076 (1964).

6 *See, e.g.*, Hadley v. Baxendale, 9 Ex. 341, 354, 156 Eng. Rep. 145, 151 (1854).

7 "Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable." RESTATEMENT (SECOND) OF CONTRACTS § 355 (1981); *see* note 94 *infra*; *see also* 5 A. CORBIN, CORBIN ON CONTRACTS § 1077 (1964).

8 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

9 *Id.* at 758, 686 P.2d at 1160, 206 Cal. Rptr. at 356.

10 The court explicitly declined to decide whether the breach of the implied covenant always gives rise to a tort cause of action. 36 Cal. 3d at 768, 769, 686 P.2d at 1166, 1167, 206 Cal. Rptr. at 362, 363; *see* notes 42-57 *infra* and accompanying text.

11 This note uses the term "ordinary commercial contract" to refer to the situation in which the contracting parties occupy relatively equal bargaining positions.

fair dealing in its performance and enforcement."[12] Good faith performance or enforcement of a contract requires faithfulness to the agreed common purpose and protects the justified expectations of the parties. The duty prohibits "bad faith" conduct which violates community standards of decency, fairness, or reasonableness.[13] Both the common law and the Uniform Commercial Code ("U.C.C.") impose the implied covenant of good faith and fair dealing. Under the common law, the implied duty of good faith and fair dealing prohibits the contracting parties from injuring another party's right to receive the benefits of the agreement.[14]

Under U.C.C. section 1-203, every contract or duty under the U.C.C. imposes an obligation of good faith in its performance or enforcement.[15] U.C.C. section 1-201(19) defines good faith as "honesty in fact in the conduct or transaction concerned."[16] Although U.C.C. section 1-102(3) allows the parties, by agreement, to determine the standards by which they will measure the obligation of good faith, the parties cannot disclaim the obligation.[17]

B. *Remedies for Breach of the Implied Covenant*

While courts uniformly recognize the implied covenant of good faith and fair dealing, they disagree as to the proper remedy for its breach. Restatement (Second) of Contracts section 205 comment (a) supports alternative remedies for breach of the covenant, stating that the appropriate remedy varies with the circumstances.[18] Courts, however, initially treated a breach of the covenant as creat-

12 RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); *see* 3 A. CORBIN, CORBIN ON CONTRACTS § 654A (Kaufman ed. Supp. 1984); 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 670 (3d ed. 1961); *see also* Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980); Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810 (1982); Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968).

13 RESTATEMENT (SECOND) OF CONTRACTS § 205 comment a (1981).

14 *See, e.g.*, Kirke La Shelle Co. v. Paul Armstrong Co., 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933) ("[I]n every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing."); *see also* Burton, *supra* note 12, at 404 (listing cases recognizing a general obligation of good faith performance in every contract at common law).

15 U.C.C. § 1-203 (1977); *see* Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code*, 67 IOWA L. REV. 1 (1981).

16 U.C.C. § 1-201(19) (1977). In the case of a merchant, good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." *Id.* § 2-103(1)(b).

17 *Id.* § 1-102(3). The parties, however, may not establish manifestly unreasonable standards. *Id.*

18 RESTATEMENT (SECOND) OF CONTRACTS § 205 comment a (1981).

ing a cause of action in contract.[19]

But in the seminal case of *Comunale v. Traders & General Insurance Co.*,[20] the California Supreme Court recognized that breach of the implied covenant of good faith and fair dealing in insurance contracts could constitute a tort.[21] Thereafter, courts in many other states allowed tort recovery for breach of the implied covenant in insurance contracts.[22]

A tort remedy for the breach of the implied covenant of good faith and fair dealing is separate and distinct from a cause of action for breach of contract. Consequently, the implied duty of good faith and fair dealing has a significant impact on both contract and tort law. Today, courts face the question whether they should extend "contort" into noninsurance, commercial cases.

II. The Development of "Contort" as a Remedy for the Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance Cases

A. *Early California Cases*

After *Comunale*, California courts initially rejected expanding the doctrine into noninsurance contracts.[23] Twenty-two years later,

---

19 *See* note 14 *supra* and note 43 *infra*.

20 50 Cal. 2d 654, 328 P.2d 198 (1958). In *Comunale*, the court held:

> [A]n insurer, who wrongfully declines to defend and who refuses to accept a reasonable settlement within the policy limits in violation of its duty to consider in good faith the interest of the insured in the settlement, is liable for the entire judgment against the insured even if it exceeds the policy limits.

Id. at 661, 328 P.2d at 202.

21 Other courts have cited Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967), as originally stating the proposition that breach of the implied covenant of good faith and fair dealing in an insurance contract created a cause of action in tort. *See, e.g.*, Wallis v. Superior Court, 160 Cal. App. 3d 1109, 1116, 207 Cal. Rptr. 123, 127 (1984). In a footnote, the *Crisci* court stated: "In any event *Comunale* expressly recognizes that 'wrongful refusal to settle has generally been treated as a tort.' " 66 Cal. 2d at 432 n.3, 426 P.2d at 178 n.3, 58 Cal. Rptr. at 18 n.3.

In *Crisci*, the California Supreme Court affirmed an award of $25,000 for mental suffering against the insurer, not for a bad faith breach of contract, but for failure to meet the duty to accept reasonable settlements—a duty within the implied covenant of good faith and fair dealing.

22 *See* Kornblum, *supra* note 4, at 431 n.50 (listing 17 states that have adopted the tort cause of action in the insurance context).

23 In Glendale Fed. Sav. & Loan Ass'n v. Marina View Heights Dev., Inc., 66 Cal. App. 3d 101, 133, 135 Cal. Rptr. 802, 820 (1977), the California Court of Appeal, Fourth District, upheld an award of punitive damages on the theory of promissory fraud. While stating that courts may not ordinarily award punitive damages for breach of contract, the court declared that courts may award punitive damages when a defendant fraudulently induces a plaintiff to enter into a contract. In a footnote, the court observed:

> While a breach of the implied covenant of good faith and fair dealing may give rise to a cause of action sounding in tort in the insurance field, we are not aware of any appellate court case, and none has been cited, extending that principle to other contractual relationships.

however, in *Tameny v. Atlantic Richfield Co.*,[24] the California Supreme Court suggested that breach of the implied covenant of good faith and fair dealing in employment contracts could sound in tort as well as in contract.[25] Since *Tameny*, three other courts have recog-

Id. at 135 n.8, 135 Cal. Rptr. at 822 n.8 (citations omitted).

In Sawyer v. Bank of Am., 83 Cal. App. 3d 135, 145 Cal. Rptr. 623 (1978), the defendant bank refused to reimburse plaintiff for fire damage to his truck. Insurance coverage had allegedly lapsed because of the bank's failure to renew the insurance policy covering the truck. The California Court of Appeal, First District, held that the defendant bank had not violated the implied covenant of good faith and fair dealing in denying its liability. The court reasoned:

> [I]t is not a tort for a contractual obligor to dispute his liability under the contract. Rather, the tort of breaching an implied covenant of good faith and fair dealing consists in bad faith action, extraneous to the contract, with the motive intentionally to frustrate the obligee's enjoyment of contract rights.

Id. at 139, 145 Cal. Rptr. at 625. One judge, however, dissented on the ground that the court should have awarded tort damages for mental suffering for the bank's breach of the implied covenant of good faith and fair dealing. *Id.* at 141, 145 Cal. Rptr. at 627 (Rattigan, J., concurring in part and dissenting in part).

In Wagner v. Benson, 101 Cal. App. 3d 27, 161 Cal. Rptr. 516 (1980), the California Court of Appeal, Fourth District, again refused to recognize the tort cause of action in a loan transaction. The court indicated, however, that the doctrine was not necessarily limited to insurance transactions. The court held that the plaintiffs had not stated a cause of action against the defendant bank for breach of the implied covenant of good faith and fair dealing in a loan transaction. The plaintiffs had alleged that the bank acted in bad faith by withholding information about the plaintiff's investment in a cattle-raising program. Based on the following discussion, the court of appeal assumed, but did not decide, that a bad faith cause of action may arise from a borrower-lender relationship:

> In every contract there is an implied covenant of good faith and fair dealing . . . . A breach of this duty may be a tort as well as a breach of the underlying contract. However, not every breach of the covenant of good faith and fair dealing creates liability in tort. A bad faith cause of action sounding in tort has never been extended to contractual relationships other than in the insurance field. This does not mean such claims are limited only to insurance transactions. Modern tort law is not confined to causes of action recognized by legal precedent.

Id. at 33, 161 Cal. Rptr. at 520 (citations omitted). The court also observed:

> While [the duty of good faith and fair dealing] exists in addition to any contractual obligation, the nature and extent of the requirements of fair dealing are determined by the agreement itself (*Austero v. National Cas. Co.*, 84 Cal. App. 3d 1, 27, 148 Cal. Rptr. 653).

Id. at 34, 161 Cal. Rptr. at 521.

24 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980).

25 Plaintiff alleged defendant had breached the implied covenant of good faith and fair dealing by wrongfully discharging him after 15 years of service for refusing to participate in an illegal scheme to fix gasoline prices. The California Supreme Court concluded that plaintiff's complaint stated a cause of action under California's common law wrongful discharge doctrine. Therefore, the court did not reach the question whether plaintiff could recover in tort for breach of the implied covenant. In dicta, however, the court suggested that breach of the implied covenant in employment contracts sounds in tort as well as in contract:

> [W]e believe it is unnecessary to determine whether a tort recovery would additionally be available . . . on the theory that Arco's discharge constituted a breach of the implied-at-law covenant of good faith and fair dealing inherent in every contract. We do note in this regard, however, that authorities in other jurisdictions have on occasion found an employer's discharge of an at-will employee violative of the employer's "good faith and fair dealing" obligations and past California

nized that breach of the implied covenant in an employment contract may create a cause of action in tort.[26]

Accordingly, prior to the *Seaman's* case, courts holding that a breach of the implied covenant could constitute a tort confined tort application to insurance and, under certain circumstances, employment contracts.[27] Nevertheless, plaintiffs continued to urge the courts to expand tort damages for breach of the implied covenant to ordinary commercial contracts.

B. Seaman's Direct Buying Service, Inc. v. Standard Oil Co.

Seaman's Direct Buying Service, Inc. v. Standard Oil Co.[28] arose from a complex factual setting in which the defendant, Standard Oil Company of California, Inc. ("Standard"), allegedly entered into an agreement to supply petroleum products to the plaintiff, Seaman's Direct Buying Service, Inc. ("Seaman's"). To qualify for a lease, Seaman's had to submit evidence of a written agreement with an oil supplier.[29] After lengthy negotiations and upon Seaman's repeated

---

cases have held that a breach of this implied-at-law covenant sounds in tort as well as in contract.

Id. at 179 n.12, 610 P.2d at 1337 n.12, 164 Cal. Rptr. at 846 n.12 (citations omitted).

26 In Cleary v. American Airlines, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980), the California Court of Appeal, Second District, held that plaintiff's complaint stated a cause of action for wrongful discharge. The court of appeal found that defendant's termination of an oral employment contract after 18 years of satisfactory performance without legal cause offended the implied-in-law covenant of good faith and fair dealing contained in all contracts. Furthermore, defendant's expressed policy requiring a "fair, impartial and objective hearing" for adjudicating employee disputes indicated the defendant-employer had recognized its responsibility to engage in good faith and fair dealing rather than in arbitrary conduct towards all of its employees.

In Pugh v. See's Candies, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981), the California Court of Appeal, First District, held that an employee discharged after 32 years had demonstrated a prima facie case of wrongful termination in violation of employer's implied promise that the corporation would not act arbitrarily in dealing with the employee. Although the court mentioned Cleary v. American Airlines, the court did not base its holding on the implied covenant of good faith and fair dealing.

In Cancellier v. Federated Dept. Stores, 672 F.2d 1312, 1318 (9th Cir.), *cert. denied*, 459 U.S. 859 (1982), defendant terminated the plaintiffs' employment after 25, 17, and 18 years of service, respectively. Plaintiffs alleged only lengthy service to defendant and the existence of personnel policies or oral representations showing an implied promise by the defendant not to act arbitrarily in dealing with its employees. The Ninth Circuit rejected the defendant's contention that the jury could not award emotional distress and punitive damages for breach of the implied covenant of good faith and fair dealing under California law under the circumstances.

For a discussion of the arguments against application of the implied covenant to employment contracts, see Note, *Defining Public Policy Torts in At-Will Dismissals*, 34 STAN. L. REV. 153 (1981).

27 *See* Seaman's Direct Buying Serv. v. Standard Oil Co., 181 Cal. Rptr. 126, 134 (Cal. App. 1982) (not officially published, *see* 129 Cal. App. 3d 416), *vacated*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984); Wallis v. Superior Court, 160 Cal. App. 3d 1109, 1116, 207 Cal. Rptr. 123, 127 (1984).

28 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

29 *Id.* at 759, 686 P.2d at 1160, 206 Cal. Rptr. at 356. Seaman's, a dealer in ship sup-

requests for an instrument evidencing a binding commitment, Standard wrote a letter to Seaman's, stating the terms of the "agreement."[30] The letter satisfied the lease requirement, and Seaman's signed the lease.[31] After intervening events, however, Standard adopted a "no new business" policy. Consequently, Seaman's and Standard never signed the contemplated agreement,[32] and subsequently, Standard refused to supply oil to Seaman's.[33] As a result, Seaman's defaulted on the lease and discontinued operations.[34] Seaman's then sued Standard, claiming breach of contract, fraud, breach of the implied covenant of good faith and fair dealing, and interference with a contractual relationship. Upon appeal from a judgment for Seaman's on all but the fraud claim,[35] the California Court of Appeal reversed the judgment as to the breach of the implied covenant and the interference claims.[36] Seaman's appealed to

---

plies and equipment, sought to lease a large portion of a redeveloped marina from the City of Eureka. The City's bonding consultants required evidence of a binding agreement with an oil supplier before they would approve the lease to Seaman's.

30 *Id.* at 760, 686 P.2d at 1160, 206 Cal. Rptr. at 356. The letter contained significant ambiguity as to whether the letter represented an "offer" or a "mutual agreement . . . of the final agreements." 181 Cal. Rptr. at 129. An agent of Seaman's signed the letter under the legend, "we accept and agree to the terms and conditions stated herein," and returned two copies to Standard. 36 Cal. 3d at 760, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

31 36 Cal. 3d at 760, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

32 *Id.* at 761, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

33 Standard indicated that new federal regulations, requiring suppliers to supply previous customers, posed the *only* barrier to contract. *Id.* With Standard's help and advice, Seaman's sought relief from the allocation program to enable Standard to legally supply Seaman's. 181 Cal. Rptr. at 129. Standard even supplied Seaman's with the forms necessary to seek a supply authorization from the federal agency and helped Seaman's fill them out. 36 Cal. 3d at 761, 686 P.2d at 1161, 206 Cal. Rptr. at 357.

The Federal Energy Office ("FEO") eventually issued a supply order. 181 Cal. Rptr. at 129. Standard, however, responded by changing its position, contending that it had never reached a binding agreement with Seaman's. 36 Cal. 3d at 761, 686 P.2d at 1161-62, 206 Cal. Rptr. at 357-58. Standard appealed the federal supply order, and the FEO rescinded its earlier order authorizing Standard to supply Seaman's. 181 Cal. Rptr. at 129. Seaman's then appealed, and the FEO granted an exception from the normal allocation rules stating that the FEO would issue an order directing Standard to fulfill supply obligations to Seaman's when Seaman's filed a copy of a court decree finding that under state law a valid contract existed between the parties. Standard refused to stipulate to the existence of a contract, taking a "see you in court" attitude. 36 Cal. 3d at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

34 36 Cal. 3d at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

35 The jury's verdict for Seaman's awarded $397,050 compensatory damages for breach of contract, $397,050 compensatory damages and $11,058,810 punitive damages for tortious breach of the implied covenant of good faith and fair dealing, and $1,588,200 compensatory damages and $11,058,810 punitive damages for intentional interference with an advantageous business relationship. The trial court conditionally granted Standard's motion for a new trial unless Seaman's consented to a reduction of punitive damages to $6,000,000 on the interference claim and $1,000,000 on the good faith claim. Seaman's consented to the reduction and the trial court entered judgment accordingly. *Id.*

36 Standard appealed from the judgment and the trial court's denial of its motion for judgment notwithstanding the verdict. Seaman's cross-appealed from the trial court's remittitur of punitive damages. The California Court of Appeal, Fourth District, reversed the

the California Supreme Court.

After holding that the letter satisfied the statute of frauds[37] and that an erroneous instruction about Standard's intent on the interference claim constituted reversible error,[38] the California Supreme Court turned to the issue of "whether, and under what circumstances, a breach of the implied covenant of good faith and fair dealing in a commercial contract may give rise to an action in tort."[39] Interestingly, the parties argued extreme positions before the California Supreme Court. Seaman's contended that breach of the covenant always gives rise to a tort cause of action.[40] Standard, on the other hand, argued that courts have always limited tort actions for breach of the implied covenant to the insurance context.[41]

The court began its analysis by emphasizing that California law implies a covenant of good faith and fair dealing in *every* contract.[42] The court cited several California cases where the court provided contract remedies for breach of the covenant in diverse contractual contexts.[43] Next, the court reviewed the establishment of the tort

---

judgment for Seaman's on the action for intentional interference with contractual relations and economic advantage. The court of appeal also reversed the judgment for Seaman's on the action for breach of implied covenant of good faith and fair dealing and instructed the court to dismiss the count, but affirmed the judgment in all other respects. 181 Cal. Rptr. 126 (Cal. App. 1982). The court's opinion stated:

> We detect an unwillingness on the part of the Supreme Court to expand the law allowing recovery in tort, including punitive damages, for the breach of every commercial contract. Where the dominant purpose of such a contract is merely the obtaining of a commercial advantage and there attends to it no particular aspect of protection against mental distress, no special relationship giving rise to public policy or public interest considerations and no lack of balance in the contractual relationship as is characteristic in contracts of adhesion, tort recovery including punitive damages is not available.
>
> . . .
>
> [T]he state of the law shows insurance cases do not necessarily represent the limit of possibility of tort recovery. We can properly conclude, however, it is not available in ordinary commercial contracts.

Id. at 135-36.

37 36 Cal. 3d at 765, 686 P.2d at 1164, 206 Cal. Rptr. at 360.

38 *Id.* at 767, 686 P.2d at 1165-66, 206 Cal. Rptr. at 361-62.

39 *Id.*, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

40 *Id.* at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

41 *Id.* at 767-68, 686 P.2d at 1166, 206 Cal. Rptr. at 362. Standard argued that the court should continue this limitation. *Id.*

42 *Id.* at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362; *see* Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 818, 620 P.2d 141, 145, 169 Cal. Rptr. 691, 695 (1979), *appeal dismissed and cert. denied*, 445 U.S. 912 (1980); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 573, 510 P.2d 1032, 1036, 108 Cal. Rptr. 480, 484 (1973); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967) ("in every contract, including policies of insurance, there is an implied covenant of good faith and fair dealing"); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958).

43 36 Cal. 3d at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362; *see, e.g.*, Brown v. Superior Court, 34 Cal. 2d 559, 212 P.2d 878 (1949) (agreement to make mutual wills [specific performance]); Cordonier v. Central Shopping Plaza Assocs., 82 Cal. App. 3d 991, 147 Cal. Rptr. 558 (1978) (lease [damages]); Osborne v. Cal-Am Fin. Corp., 80 Cal. App. 3d 259,

remedy in insurance cases. Noting that breach of the implied covenant in an insurance contract justifies imposition of tort liability, the court observed that California decisions had emphasized the "special relationship" between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility.[44] The court noted that in *Tameny v. Atlantic Richfield Co.*,[45] it had suggested that breach of the covenant of good faith and fair dealing in the employment relationship might also give rise to a tort cause of action.[46] Therefore, the court recognized that other relationships involving similar characteristics deserved similar legal treatment:

> In holding that a tort action is available for breach of the covenant in an insurance contract, we have emphasized the "special relationship" between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility. No doubt there are other relationships with similar characteristics and deserving of similar legal treatment.
>
> When we move from such special relationships to consideration of the tort remedy in the context of the ordinary commercial contract, we move into largely uncharted and potentially dangerous waters. . . . This is not to say that tort remedies have no place in such a commercial context, but that it is wise to proceed with caution in determining their scope and application.[47]

In the context of ordinary commercial contracts, the court advised caution in determining the scope and application of tort remedies because (1) courts could have difficulty distinguishing between breach of the covenant and breach of the underlying contract, and (2) tort remedies might frustrate the contracting parties' expectations.[48] In commercial contracts, roughly equal bargaining power enables the parties to shape the contours of the agreement and include provisions for attorneys' fees and liquidated damages in the event of breach.[49] Furthermore, while U.C.C. section 1-102(3) prohibits the parties from disclaiming the covenant of good faith, the parties may, within reasonable limits, agree upon the standard by which the courts will measure application of the implied

145 Cal. Rptr. 584 (1978) (agreement to sell real property [rescission]); Masonite Corp. v. Pacific Gas & Elec. Co., 65 Cal. App. 3d 1, 135 Cal. Rptr. 170 (1976) (contract to provide utility services [damages]); Foley v. U.S. Paving Co., 262 Cal. App. 2d 499, 68 Cal. Rptr. 780 (1968) (employee incentive contract [damages]).

44 36 Cal. 3d at 768, 686 P.2d at 1166, 206 Cal. Rptr. at 362; *see* Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d at 820, 620 P.2d at 146, 169 Cal. Rptr. at 696.

45 27 Cal. 3d 167, 610 P.2d 1330, 164 Cal. Rptr. 839 (1980); *see* note 25 *supra*.

46 36 Cal. 3d at 769 n.6, 686 P.2d at 1166 n.6, 206 Cal. Rptr. at 362 n.6.

47 *Id.* at 768-69, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63 (citation and footnote omitted).

48 *Id.* at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

49 *Id.*

covenant.[50]

Consequently, the court chose not to decide whether breach of the implied covenant of good faith and fair dealing always gives rise to an action in tort.[51] The court recognized, however, that a party to a contract may incur tort liability if, after breaching the contract, the party seeks to shield itself from liability by denying, in bad faith, that the contract exists.[52] According to the court, such an attempt to avoid all liability under a contract by adopting a "stonewall" or "see you in court" position without reasonable belief in the existence of a defense goes beyond the mere breach of a contract and offends accepted notions of business ethics.[53] Therefore, the court concluded that an award of tort remedies in this scenario does not intrude upon the bargaining relationship or frustrate the contracting parties' reasonable expectations.[54]

The trial court's instructions allowed the jury to find Standard liable if the jury found that Standard had denied the existence of a valid contract regardless of whether Standard made the denial in good or bad faith.[55] A contracting party may, however, dispute liability under a contract in good faith.[56] Concluding that the jury reasonably could have and probably would have reached a result more favorable to Standard in the absence of the erroneous instruction, the court reversed the judgment for Seaman's on the breach of the implied covenant claim.[57]

---

50 *Id.*

51 *Id.*

52 *Id.*

53 *Id.* at 769-70, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

54 *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

55 The trial judge instructed the jury: "[W]here a binding contract [has] been agreed upon, the law implies a covenant that neither party will deny the existence of a contract, since doing so violates the legal prohibition against doing anything to prevent realization of the promises of the performance of the contract." *Id.*

56 *Id.*; *see* Sawyer v. Bank of Am., 83 Cal. App. 3d 135, 139, 145 Cal. Rptr. 623, 625 (1978). In Photovest Corp. v. Fotomat Corp., 606 F.2d 704 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980), the court held that refusal to settle a case, thus forcing plaintiff to bring an action to establish its rights did not constitute a tort: "Nothing in the case law suggests that liability may stem from the *defense* of a lawsuit or from the decision to defend rather than settle. Such a rule would infringe basic rights in our system of jurisprudence." *Id.* at 729 (emphasis in original).

57 36 Cal. 3d at 774, 686 P.2d at 1170, 206 Cal. Rptr. at 366. In an opinion concurring in part and dissenting in part, Chief Justice Bird urged that the majority opinion refused to acknowledge that the court's past decisions, analyzing the scope of the implied covenant of good faith and fair dealing, compelled the court's holding that a contracting party's denial of the existence of a valid contract in an attempt to shield itself from liability for breach of that contract gives rise to an action in tort. *Id.* (Bird, C.J., concurring in part and dissenting in part). Chief Justice Bird would have affirmed the judgment for Seaman's for breach of the duty of good faith and fair dealing while expressly recognizing that a breach of the contract may support a tort cause of action for breach of the implied covenant under certain circumstances. *Id.* at 775, 784, 686 P.2d at 1171, 1177, 206 Cal. Rptr. at 367, 373.

In her opinion, when courts decide what conduct constitutes a tortious breach of the

Thus, in *Seaman's*, the California Supreme Court recognized the new tort of wrongful denial of the existence of a contract, but avoided the question whether a breach of the implied covenant of good faith and fair dealing in a commercial contract always gives rise to an action in tort. While apparently acknowledging the tort of bad faith breach of contract, however, the court did not specify when courts should extend "contort" to noninsurance cases. The court suggested that courts should only extend tort liability to cases involving relationships with "similar characteristics" to those found in insurance contracts. Thus, the *Seaman's* court did not explicitly recognize tortious breach of the implied convenant in commercial cases. On the other hand, the court did very little to reject its application.

C. *Cases After* Seaman's

Since *Seaman's*, other courts have taken different positions regarding the impact of the California Supreme Court's decision. In *Wallis v. Superior Court*,[58] the California Court of Appeal, Fourth Dis-

---

covenant, the courts consider the parties' reasonable expectations regarding the nature and purpose of the agreement and the underlying rights and responsibilities. *Id.* at 776, 779, 686 P.2d at 1171, 1174, 206 Cal. Rptr. at 367, 370; *see, e.g.*, Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 818, 620 P.2d 141, 145, 169 Cal. Rptr 691, 695 (1979), *appeal dismissed and cert. denied*, 445 U.S. 912 (1980); Neal v. Farmers Ins. Exch., 21 Cal. 3d 910, 921 n.5, 582 P.2d 980, 986 n.5, 148 Cal. Rptr. 389, 395 n.5 (1978); Austero v. National Cas. Co., 84 Cal. App. 3d 1, 27-32, 148 Cal. Rptr. 653, 670-73 (1978); Jarchow v. Transamerica Title Ins. Co., 48 Cal. App. 3d 917, 941, 122 Cal. Rptr. 470, 487 (1975). Contracting parties expect that a breaching party will compensate the nonbreaching party for damages caused by the breaching party's failure to perform. 36 Cal. 3d at 777, 686 P.2d at 1173, 206 Cal. Rptr. at 369. When the breaching party acts in bad faith by denying the existence of the contract in an attempt to shield itself from liability for breach of the contract, this denial violates the duty of good faith and fair dealing because the nonbreaching party justifiably expects that the breaching party will pay compensation for the damages incurred as a result of the breach. Accordingly, Standard's conduct, in Chief Justice Bird's opinion, constituted a tortious breach of the implied covenant of good faith and fair dealing. *Id.* at 779-80, 686 P.2d at 1174, 206 Cal. Rptr. at 370.

Chief Justice Bird would also recognize tortious breach of the implied covenant when the parties do not accept or reasonably expect the possibility that one party will breach the contract. For example, at the time of contracting, the parties may expressly indicate an understanding that they will not permit breach of the contract. In insurance and employment contracts, the parties may realize from the inception of the contract that contract damages would provide inadequate compensation for breach. *Id.* at 780, 686 P.2d at 1174, 206 Cal. Rptr. at 370. Chief Justice Bird also concluded that if a plaintiff can show, under certain circumstances or characteristics of the contract, a justifiable expectation that the other party would not breach, a voluntary breach of the *acknowledged* contract could constitute a violation of the duty to deal fairly and in good faith without an independent showing of bad faith. *Id.* at 781, 686 P.2d at 1175, 206 Cal. Rptr. at 371. Since Standard did not voluntarily breach an *acknowledged* contract, but denied the existence of the contract, Chief Justice Bird would require Seaman's to prove Standard made the denial in bad faith.

58 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984). In *Wallis*, plaintiff sued defendant for terminating a contract that the parties signed when defendant laid off plaintiff after 32 years of employment. The contract provided that, in exchange for the plaintiff-employee's

trict, addressed the issue whether the plaintiff had successfully pleaded a cause of action for tortious breach of an employment contract.[59] The court concluded the complaint stated a cause of action and interpreted the *Seaman's* decision as acknowledging, however tentatively, the validity of extending the tort of bad faith breach of the implied convenant to contracts outside the insurance context.[60] The court of appeal admitted that the California Supreme Court had not specified the circumstances justifying such an extension.[61] The court, however, wrote that in its view the *Seaman's* decision indicated that courts should only extend the tort to cases involving relationships with "similar characteristics" to those found in insurance contracts.[62]

The *Wallis* court then attempted to enumerate the "similar characteristics" necessary for tort liability: (1) the parties must occupy inherently unequal bargaining positions; (2) a non-profit motivation such as peace of mind, security, or future protection must provide the incentive for entering into the contract; (3) ordinary contract damages must fail to provide adequate compensation to the injured party because (a) they do not require the party in the superior bargaining position to account for its actions, and (b) they do not make the injured party "whole"; (4) the type of harm that one party may suffer and the necessary trust that this party places in the other party to perform must leave the first party especially vulnerable to breach; and (5) the other party must know of this vulnerability.[63] *Wallis* marks the first attempt by the California courts to articulate specific guidelines for the expansion of the tort to noninsurance contracts.

In contrast, the California Court of Appeal, Fifth District, in *Quigley v. Pet, Inc.*,[64] interpreted the *Seaman's* decision as avoiding a broad rule which would impose tort liability regardless of special relationships, justifiable expectations, and public policy.[65] In *Quigley*, a case involving commerical enterprises occupying equal bargaining positions, the court reversed a judgment awarding $3.8 million in punitive damages for breach of the implied covenant of

---

promise not to compete with the defendant's business, the company would pay him a certain amount monthly until he turned 65. Defendant made the payments for three years until new management terminated the payments.

59 *Id.* at 1113, 207 Cal. Rptr. at 125.

60 *Id.* at 1116, 207 Cal. Rptr. at 127.

61 *Id.*

62 *Id.*

63 *Id.* at 1118, 207 Cal. Rptr. at 129.

64 162 Cal. App. 3d 223, 208 Cal. Rptr. 394 (1984). In *Quigley*, plaintiffs sued defendants for allegedly wrongful conduct arising out of a written contract for hauling raw walnuts for the defendant corporation.

65 *Id.* at 237, 208 Cal. Rptr. at 402.

good faith and fair dealing. The court stated that "[t]here was no admitted special relationship which would provide an exception to the rule restricting relief to contract damages."[66] According to the court: "In *Seaman's*, the plaintiff unsuccessfully sought a judicially declared rule that *whatever the contractual relationship*, a bad faith position taken by a contracting party exposes that person to tort liability, including punitive damages."[67] Consequently, the court concluded: "[A]t least for the present, courts must enforce the rule of 'contract damages only,' unless an exception is found which is not foreign to those already approved."[68]

Finally, in *Eaton Corp. v. Detrick*,[69] the United States Court of Appeals for the Ninth Circuit, in an unpublished opinion, held that, under California law, courts may award tort remedies, including punitive damages, for breach of the implied covenant of good faith and fair dealing in an employment contract.[70] The court of appeals did not reach the question whether courts may award tort damages for breach of the implied covenant in an acquisition agreement.[71] The court noted that in *Seaman's* the California Supreme Court left open the question of when there can be recovery in tort for breach of the implied covenant of good faith and fair dealing outside the insurance and employment contexts.[72]

Departing from early cases rejecting "contort" in ordinary commercial cases, *Seaman's* appears to recognize its viability outside the insurance context. Later cases, though cautious, have interpreted "contort" in such a way that the doctrine seems likely to expand into ordinary commercial contracts. Consequently, the legal community should question the appropriateness of this potential expansion before it occurs.

III. Should Courts Recognize "Contort" for Breach of the Implied Covenant of Good Faith and Fair Dealing in Ordinary Commercial Contracts?

Exposing the parties to ordinary commercial contracts to potentially large tort damages could serve both useful and harmful purposes. Arguably, courts should treat acts of bad faith and unfairness more severely than bona fide defaults on contractual spe-

66 *Id.* at 239, 208 Cal. Rptr. at 404.

67 *Id.* at 235, 208 Cal. Rptr. at 401 (emphasis in original).

68 *Id.* at 237, 208 Cal. Rptr. at 402.

69 Eaton Corp. v. Detrick, No. 83-1841, 83-1872 (9th Cir. Nov. 26, 1984). In *Eaton*, plaintiff was the president of a company which was acquired by another corporation, which in turn was acquired by defendant. Plaintiff was apparently promised long-term employment and a secure future after the acquisition.

70 *Id.*, slip op. at 10-11.

71 *Id.* at 12.

72 *Id.*

cifics. Moreover, as a matter of public policy and sound morality, courts should not condone unethical behavior regardless of the context in which it occurs. Finally, threat of "contort" liability may discourage unethical business practices.[73]

Nevertheless, for three reasons, courts should not extend the tort of bad faith breach of the implied covenant of good faith and fair dealing to ordinary commerical contracts. First, while a special relationship characterized by elements of public interest, adhesion, and fiduciary responsibility exists between an insurer and the insured, these factors do not arise in commercial contracts where the parties possess presumably equal bargaining power.[74] Absent these special circumstances, the remedy for breach of the implied covenant should lie only in contract.

Second, if courts apply tortious breach of contract uniformly to any and all breaches of contract, the new doctrine could entirely replace "ordinary" breach of contract.[75] Finally, strong public policy concerns counsel against introducing potentially large tort damages into the ordinary commercial context.[76]

A. *Insurance is a Quasi-Public Industry*

Courts recognizing a tort cause of action, in the insurance context, have focused on the existence of a "special relationship" between the insurer and the insured to justify imposing the duty as a matter of law, independent of the underlying promissory obligations in the contract itself.[77] This "special relationship" and the vulnerability of the insured are the public policy bases for allowing tort remedies for breach of the implied covenant of good faith and fair dealing in insurance cases. In *Egan v. Mutual of Omaha Insurance Co.*,[78] the California Supreme Court observed that "[i]nsurers hold themselves out as fiduciaries"[79] and that "the relationship of insurer and insured is inherently unbalanced"[80] as reflected in "the

73 *See* Quigley v. Pet, Inc., 162 Cal. App. 3d at 237, 208 Cal. Rptr. at 403. On the other hand, an unrestricted rule of tort liablity for unfair dealing could convert routine breach of contract cases into "contort" jury trials because parties may easily raise issues of fact regarding perceived tortious conduct. *Id.* at 238, 208 Cal. Rptr. at 403.

74 *See* notes 77-84 *infra* and accompanying text.

75 *See* Chilton, *Editor's Viewpoint*, 55 CAL. ST. B.J. 276, 278 (1980); *see also* notes 90-93 *infra* and accompanying text.

76 *See* notes 94-99 *infra* and accompanying text.

77 Seaman's Direct Buying Serv. v. Standard Oil, 36 Cal. 3d 752, 768, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984); *see, e.g.*, Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 620 P.2d 141, 146, 169 Cal. Rptr. 691, 696 (1979), *appeal dismissed and cert. denied*, 445 U.S. 912 (1980).

78 24 Cal. 3d 809, 620 P.2d 141, 169 Cal. Rptr. 691 (1979), *appeal dismissed and cert. denied*, 445 U.S. 912 (1980).

79 *Id.* at 820, 620 P.2d at 146, 169 Cal. Rptr. at 696.

80 *Id.*

adhesive nature of insurance contracts."[81] In addition, the insured does not seek a commercial advantage, but rather protection and peace of mind and security.[82] The insurance industry's "quasi-public"[83] nature justifies the exception for breach of insurance contracts. The obligation of good faith and fair dealing requires qualities of decency and humanity inherent in the responsibilities of a fiduciary.[84]

This special relationship does not exist in ordinary commercial contracts where the contracting parties do not occupy a fiduciary relationship. Furthermore, since parties of roughly equal bargaining power shape the contours of their agreement, adhesion contracts are the exception rather than the rule. While U.C.C. section 1-102(3) prohibits the parties from disclaiming the covenant of good faith, the parties, within reasonable limits, may define the standards under which they will measure application of the covenant.

Given the basis for the very existence of the tort remedy, courts should not expand the availability of tort remedies to ordinary commercial contracts where these "special relationships" do not exist. The common law has declined to permit tort recovery based upon allegations of failure to perform contractual obligations absent a fiduciary or other similar special relationship between the parties.[85] For this reason, courts in several jurisdictions have declined to recognize tort liability for alleged breaches of the implied covenant in commercial contracts.[86] Courts should protect the distinction be-

81 *Id.*

82 *Id.* at 819, 620 P.2d at 145, 169 Cal. Rptr. at 695; *see* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 434, 426 P.2d 173, 179, 58 Cal. Rptr. 13, 19 (1967).

83 *See* Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 668 n.5, 456 P.2d 674, 680 n.5, 79 Cal. Rptr. 106, 112 n.5 (1969).

84 24 Cal. 3d at 820, 620 P.2d at 146, 169 Cal. Rptr. at 696.

85 Prosser and Keeton note that cases imposing tort liability for failure to perform a contract include situations involving (1) a "common calling" such as common carriers, innkeepers, public warehousemen, and public utilities; (2) a special relationship between the parties such as bailments, employment agreements, or lease arrangements which creates a duty of affirmative care; or (3) fraud in the inducement. PROSSER AND KEETON ON THE LAW OF TORTS § 92, at 662-64 (W. Keeton 5th ed. 1984).

86 *See, e.g.*, Nifty Foods Corp. v. Great Atl. & Pac. Tea Co., 614 F.2d 832, 837-38 (2d Cir. 1980); Battista v. Lebanon Trotting Ass'n, 538 F.2d 111, 118 (6th Cir. 1976) ("The special considerations existent in a consumer-held insurance contract do not apply to an ordinary contract between businessmen."); Iron Mountain Sec. Storage v. American Speciality Foods, 457 F. Supp. 1158, 1168 (E.D. Pa. 1978) ("Defendants have cited no case from any jurisdiction that has extended the tort law theory beyond the insurance context to breach of other commercial contracts."); Wild v. Rarig, 302 Minn. 419, 442, 234 N.W.2d 775, 790 (1975), *appeal dismissed and cert. denied*, 424 U.S. 902, *reh'g denied*, 425 U.S. 945 (1976) ("A malicious or bad-faith motive in breaching a contract does not convert a contract action into a tort action."); Tibbs v. National Homes Constr. Corp., 52 Ohio App. 2d 281, 291, 369 N.E.2d 1218, 1225 (1977) ("characterizing an action as one 'willfully, wan-

tween contracts in a quasi-public industry and contracts in the ordinary commericial context.

B. *A Tort Cause of Action Could Entirely Replace Actions for Breach of Contract*

Although law, rather than consensual agreement, imposes the duty of good faith and fair dealing,[87] not every breach of a legal duty should create a cause of action in tort. Courts originally awarded contract damages for breach of the implied covenant.[88] Only later did courts in many states begin awarding tort damages for breach of the implied covenant in insurance cases.[89] Awarding tort remedies for every breach of the implied covenant could eliminate "ordinary breach of contract."

At least one article has suggested that the duty of good faith, imposed regardless of consent, provides the potential for greater integration of the two theories of civil liability within the bargain relationship.[90] While recent decisions have seriously undermined the traditional distinctions between contract and tort liability,[91] total merger of the concepts would be unfortunate.[92] Since every

---

tonly, and maliciously' done adds nothing new to a cause essentially directed to securing relief for a breach of contract").

87 Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 574, 510 P.2d 1032, 1037, 108 Cal. Rptr. 480, 485 (1973).

88 *See* Burton, *supra* note 12, at 404 (1980) (listing cases awarding contract damages for breach of the implied convenant of good faith and fair dealing); *see also* note 43 *supra*.

89 *See* notes 20-22 *supra* and accompanying text.

90 Speidel, *supra* note 4, at 195-96.

91 *Id.* at 188-93.

92 *See, e.g.*, PROSSER AND KEETON ON THE LAW OF TORTS § 92 (W. Keeton 5th ed. 1984); Diamond, *supra* note 4, at 433-39; Louderback & Jurika, *supra* note 4, at 202-06; Speidel, *supra* note 4, at 168-74.

Although tort law and contract law developed from a common origin, the common law has recognized distinct differences between civil actions for tort and breach of contract. Historically, causes of action in tort and contract have had different purposes and have protected different interests.

In contract law, the failure, without justification, to perform an enforceable promise creates a cause of action for breach of contract. Contract law does not require the injured party to prove the breaching party negligently or intentionally breached the contract. Consequently, commentators have described contract law as a theory of strict rather than fault-based liability. Contract law provides remedies for both misfeasance or defective promised performance and nonfeasance or failure to render promised performance.

In contract law, the parties' duties extend to third party beneficiaries. The parties' agreement defines the duties of the parties, but courts sometimes supplement the parties' agreement by filling in any gaps in the contract. Consequently, by their agreement, the contracting parties can limit the scope and content of their contractual duties. Accordingly, courts rarely use public policy considerations to interfere with the obligations and duties that the contracting parties negotiated.

The remedies in contract law protect the injured party's reasonable expectations by awarding the injured party the value of the breaching party's promised performance or "the benefit of the bargain." Courts generally award money damages over specific performance. Furthermore, courts have generally limited the recoverable damages to economic losses

breach of contract injures the right of another party to receive the benefits of the agreement, every breach of contract would also include a breach of the implied covenant of good faith and fair dealing. In commercial contracts, courts would have difficulty distinguishing the breach of the covenant of good faith and fair dealing and breach of the underlying contract.[93]

C. *Public Policy Reasons Support Limited Measure of Damages in Contract Cases*

Strong public policy concerns support the limited measure of damages in contract cases. Courts traditionally have awarded damages for breach of contract to compensate the aggrieved party rather than to punish the breaching party.[94] When courts interject

---

reasonably foreseeable at the time of the execution of the contract. As a general rule, courts have refused to award damages for mental suffering and punitive damages for breach of contract, even though the defendant wilfully breached the contract.

Tort law protects members of society from the unreasonable conduct of others by requiring certain minimal standards of conduct. In tort law, public policy helps to determine what particular acts will constitute a tort. Courts impose tort liability for losses resulting from intentional or negligent conduct or unreasonably dangerous activities. Absent special circumstances, nonfeasance does not create tort liability. In summary, fault and motive determine liability much more so in tort law than in contract law.

In tort law, the tortfeasor's duty extends to those persons within a legally defined "zone of risk" that the actor's tortious conduct has created. Courts define and impose duties by operation of law. Tort law protects an individual's person, property, and existing relationships from unauthorized harm or infringement.

Tort remedies attempt to restore the injured party to the position occupied before the tortious conduct. The remedial relief may include an award for mental anguish, punitive damages if the tortfeasor conduct was intentional, wilful or wanton, and all losses, whether foreseeable or not at the time of the tort, if an intentional tort caused the loss.

93 *See* Chilton, *supra* note 75, at 278. Proponents of "contort" would argue that allowing tort recovery for the breach of the covenant of good faith and fair dealing does not automatically convert every breach of contract action into a tort cause of action. Under "contort," arguably, the aggrieved party may only recover tort damages when the other party breaches the covenant—not the underlying contract from which the covenant arose. As one court put it:

> [I]f the cause of action arises from a breach of a promise set forth in the contract, the action is ex contractu, *but if it arises from a breach of duty growing out of the contract it is ex delicto*.

Tameny v. Atlantic Richfield Co., 27 Cal. 3d 167, 175, 610 P.2d 1330, 1334-35, 164 Cal. Rptr. 839, 843-44 (1980) (emphasis in original); *see* Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 577-78, 510 P.2d 1032, 1039-40, 108 Cal. Rptr. 480, 487-88 (1973); Jarchow v. Transamerica Title Ins. Co., 48 Cal. App. 3d 917, 940, 122 Cal. Rptr. 470, 486 (1975).

94 "The purpose[] of awarding contract damages is to compensate the injured party." RESTATEMENT (SECOND) OF CONTRACTS § 355 comment a (1981). The assumption that a contracting party may breach the contract at will while risking only contract damages is one of the cornerstones of contract law. As Richard Posner wrote: "[I]t is not the policy of the law to compel adherence to contracts, but only to require each party to choose between performing in accordance with the contract and compensating the other party for any injury resulting from a failure to perform." R. POSNER, ECONOMIC ANALYSIS OF LAW 55 (1972). In most commercial contracts, the parties accept the possibility of breach, particularly because their right to recover contract damages provides adequate protection. Seaman's Direct

tort remedies into commercial contracts, they frustrate the contracting parties' expectations because, in most cases, the parties anticipate contract damages as the only remedy for purposeful breaches of contract.[95] Moreover, "contort" could impede commercial transactions because commercial parties might fear potentially large punitive damage liability for breach of the implied covenant of good faith and fair dealing. Insurance generally does not cover punitive damage awards.[96] Furthermore, bankruptcy courts cannot discharge punitive damage awards in bankruptcy proceedings.[97] The risk of a "contort" action may cause a hesitancy to defend a contract action because a jury may later find such a defense to constitute bad faith.[98] Furthermore, from an economic standpoint, society should, under appropriate circumstances, encourage "efficient" breaches of contract.[99] Thus, policy concerns caution against expanding "contort" into ordinary commercial contracts.

IV. An Alternative—Awarding Attorneys' Fees

When facing a case involving potentially unethical conduct, policy considerations pressure a court to punish the wrongdoer. While the courts should not condone unethical conduct, courts should not ignore traditions deeply rooted in our legal heritage. If a court finds that a breaching party wrongfully denied the existence of a contract and forced the aggrieved party to incur significant inconvenience, time, and expense to vindicate the aggrieved party's contractual rights, the courts have an alternative other than expanding "contort" into noninsurance, commercial contracts. Courts can award attorneys' fees to successful parties harmed by unethical litigation tactics.

Although the "American rule"[100] generally prohibits an award

---

Buying Serv. v. Standard Oil Co., 36 Cal. 3d at 778, 686 P.2d at 1173, 206 Cal. Rptr. at 369 (Bird, C.J., concurring in part and dissenting in part).

95 Quigley v. Pet, Inc., 162 Cal. App. 3d 223, 239, 208 Cal. Rptr. 394, 404 (1984) (citing Chief Justice Bird's concurring and dissenting opinion in Seaman's Direct Buying Serv. v. Standard Oil Co., 36 Cal. 3d at 778, 686 P.2d at 1173, 206 Cal. Rptr. at 369).

96 *See, e.g.*, Rosener v. Sears Roebuck & Co., 110 Cal. App. 3d 740, 762-63, 168 Cal. Rptr. 237, 250 (1980), *appeal dismissed*, 450 U.S. 1051 (1981).

97 *Id.* at 763, 168 Cal. Rptr. at 250; *see* 11 U.S.C. § 523(a)(6) (1982).

98 Quigley v. Pet, Inc., 162 App. 3d at 237, 208 Cal. Rptr. at 403.

99 The "efficient breach" theory downplays the "wrongfulness" of the breaching party's conduct, emphasizes the economic reasons permitting reinvestment of the "net gain" from the breach in other economic opportunities, and assumes that the injured party can recover full compensation from the breaching party in a relatively quick and costless litigation. *Contra* Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947 (1982).

100 Under the traditional "American rule," courts will not award attorneys' fees to the prevailing party unless a statute makes attorneys' fees a part of costs or an enforceable

of attorneys' fees to the prevailing party, a "bad faith" exception permits an award of attorneys' fees if the losing party acted "in bad faith, vexatiously, wantonly, or for oppressive reasons."[101] Moreover, at least one state has enacted a statute which expressly permits the award of attorneys' fees in contract actions.[102] The award of attorneys' fees based on a defendant's bad faith seeks to punish the defendant and to compensate the plaintiff for the added expense of having to vindicate clearly established rights in court. Such an award would be especially appropriate when a party in bad faith denies the existence of a contract. Furthermore, since the Supreme Court has repeatedly recognized the appropriateness of the bad faith exception,[103] awards of attorneys' fees will not frustrate the expectations of the parties. Finally, by requiring substantiation of attorneys' fees awarded, courts could "limit" such awards to actual expenditures, rather than allowing juries to award large tort damages for breach of the implied covenant.

Courts should allow tort damages only if the conduct of the breaching party amounts to a breach of the implied covenant and *independently* establishes the elements of a common law tort such as fraud.[104] In this situation, courts may and should award punitive damages if the plaintiff proves the required fraud, oppression, or malice. This requirement maintains the symmetry of the general rule of not allowing punitive damages for breach of contract, because the court awards the punitive damages for the tort, not for breach of contract. Furthermore, the independent tort requirement facilitates judicial review of the evidence by limiting the scope of review to a search for the elements of the tort.[105] Therefore, an award of attorneys' fees under the "bad faith" exception to the American rule provides a viable alternative to "contort."[106]

---

contract authorizes such an award. Consequently, each party, as a general rule, bears his own attorneys' fees. *See* Hall v. Cole, 412 U.S. 1, 4 (1973).

101 *Id.* at 5; *see also* 6 J. MOORE, W. TAGGART & J. WICKER, MOORE'S FEDERAL PRACTICE ¶ 54.77[2], at 1709 (2d ed. 1983).

102 *See, e.g.*, ARIZ. REV. STAT. ANN. § 12-341.01 (1982).

103 *See, e.g.*, Alyeska Pipeline Serv. v. Wilderness Soc'y, 421 U.S. 240 (1975); F. D. Rich Co. v. United States *ex rel.* Industrial Lumber Co., 417 U.S. 116 (1974); Hall v. Cole, 412 U.S. 1 (1973); Vaughan v. Atkinson, 369 U.S. 527 (1962).

104 As a last resort, courts could adopt the Indiana approach under which courts may award punitive damages in certain circumstances for breach of contract. In Vernon Fire & Cas. Ins. Co. v. Sharp, 264 Ind. 599, 349 N.E.2d 173 (1976), the Indiana Supreme Court approved awarding punitive damages in a breach of contract case if (1) the defendant has committed a serious wrong, even though the wrong does not fit into the confines of a previously recognized tort, *and* (2) the deterrent effect that punitive damages will have upon the future conduct of the wrongdoer and other similarly situated parties will serve the public interest. *Id.* at 608, 349 N.E.2d at 180; *see also* Jones v. Abriani, 169 Ind. App. 556, 350 N.E.2d 635 (1976).

105 264 Ind. at 608, 349 N.E.2d at 180.

106 Interestingly, the California Supreme Court has never explicitly adopted the "bad

V. Conclusion

Courts should award tort damages for breach of the implied covenant of good faith and fair dealing only when the defendant's conduct constitutes an independent intentional tort apart from the breach of the implied covenant. Decisions holding that breach of a contract—even an intentional breach of a contract—justifies tort remedies on the basis of the breach of the implied covenant of good faith and fair dealing could have an adverse long-term impact on business negotiations and contracting. "Contort" literally takes a "contorted" approach to the interrelationship between contract and tort law. Rather, when faced with situations involving unethical conduct, courts should award attorneys' fees under the bad faith exception to the "American rule." Such an award would preserve the distinction between contract and tort damages, protect the contracting parties' expectations, and deter unethical conduct.

Matthew J. Barrett

---

faith" exception to the American rule. *See, e.g.*, Twentieth Century-Fox Film Corp. v. Harbor Ins. Co., 85 Cal. App. 3d 105, 114, 149 Cal. Rptr. 313, 319 (1978) ("[T]he federal bad faith exception, has never been accepted in California . . . and as the lower appellate court in this state we do not deem it appropriate for us to adopt a judicial doctrine which our high court has not yet approved."); Douglas v. Los Angeles Herald-Examiner, 50 Cal. App. 3d 449, 469, 123 Cal. Rptr. 683, 695 (1975) ("Assuming, without deciding, that the California Supreme Court may, on a proper day in a proper case, incorporate the federal equitable rule into the law of California, it is clear that it has not yet done so.").

Dicta, however, suggests that the California Supreme Court may incorporate the exception into the law of California:

> [E]ven assuming that a California court . . . may in its discretion award attorneys fees to one party as a sanction for vexatious and oppressive conduct on the part of another party or its counsel (a matter which we are not required to, and do not, decide today), it appears that the trial court did exercise its discretion on that basis and did determine that a prior monetary sanction was sufficient in the circumstances.

D'Amico v. Board of Medical Examiners, 11 Cal. 3d 1, 27, 520 P.2d 10, 29, 112 Cal. Rptr. 786, 805 (1974); *see also* Serrano v. Priest, 20 Cal. 3d 25, 42, 569 P.2d 1303, 1312, 141 Cal. Rptr. 315, 324 (1977); Residents Ad Hoc Stadium Comm. v. Board of Trustees, 89 Cal. App. 3d 274, 293, 152 Cal. Rptr. 585, 597 (1979) ("The 'vexatious litigant' theory presupposes that the party seeking to recover fees has prevailed."); County of Inyo v. City of Los Angeles, 78 Cal. App. 3d 82, 91, 144 Cal. Rptr. 71, 77 (1978) ("We assume existence of power to make the award [of attorneys' fees] on [the 'vexatious litigant'] ground . . . , abstain from affirming the power[,] and reject the claim for lack of merit.").