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Losing Faith: Extracting the Implied Covenant of Good Faith from (Some) Contracts

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TERI J. DOBBINS*

Losing Faith: Extracting the Implied Covenant of Good Faith from (Some) Contracts

Human beings are imperfect. It is not surprising, then, that parties often enter into contracts that are incomplete or that imperfectly express their agreement. Under classic contract principles, many of these contracts would be unenforceable. In other cases, enforcement would lead to unjust and unintended results. Dissatisfied with the results in these cases, courts and scholars have developed doctrines to fill gaps left by the parties or otherwise make unenforceable promises enforceable.[1] But even when the parties' intentions and agreements are clearly and unambiguously stated, enforcement may be undesirable or inequitable because one party has taken unfair advantage of the other by acting dishonestly during contract formation, performance, or enforcement; by including onerous or unduly burdensome terms; or by abusing discretion granted to that party under the contract. In response, courts have relied upon equitable principles to develop doctrines that promote fairness in contractual relationships. The implied covenant of good faith is one such doctrine.[2]

Although the duty of good faith has been around for centu-

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[1] For example, the doctrines of promissory estoppel, implied covenants, and restitution have all received widespread acceptance in the law of contracts. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 90, 205, 370-77 (1981).

[2] The implied covenant is also commonly referred to as the implied covenant of good faith and fair dealing. Both courts and scholars seem to treat these as synonymous terms. For the sake of simplicity, this Article will do so as well. The term "duty of good faith" will be used to refer to the duty imposed by the implied covenant of good faith. *See, e.g.*, Tufankjian v. Rockland Trust Co., 782 N.E.2d 1, 5

ries,[3] it did not receive widespread acceptance in the United States until the mid-twentieth century. It is now recognized in some form in most jurisdictions.[4] However, although there is presently general agreement in these jurisdictions that every contract includes an implied covenant of good faith in the performance of the contract, there is little agreement about how the common law duty of "good faith" should be defined or what the duty of good faith requires.[5] Indeed, there is debate regarding whether the term can or should be defined at all.

(Mass. App. Ct. 2003) (stating that the duty of good faith in every contract translates into an implied term of the contract).

[3] E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 669 (1963) ("The inclusion of an obligation of good faith performance in the Code revives an ancient, although largely forgotten, principle."). The duty of good faith is recognized in the performance of contracts, but there is no generally recognized duty of good faith in contract formation or enforcement.

[4] The doctrine's widespread acceptance is due in large part to the inclusion of the duty of good faith in the Uniform Commercial Code. *See id.; see also* Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, app. (1980) (citing cases from jurisdictions recognizing the good faith obligation in every contract at common law); Thomas A. Diamond & Howard Foss, *Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery*, 47 HASTINGS L.J. 585, 585 n.1 (1996) (citing RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979), U.C.C. § 1-203 (1994), and cases from various jurisdictions recognizing the duty of good faith in common law contracts). The States of Texas and Indiana, however, do not recognize a duty of good faith in most arms-length commercial transactions. *See* Allen v. Great Am. Reserve Ins. Co., 766 N.E.2d 1157, 1162 (Ind. 2002); English v. Fischer, 660 S.W.2d 521, 522 (Tex. 1983).

[5] *See, e.g.*, Seth William Goren, *Looking for Law in All the Wrong Places: Problems in Applying the Implied Covenant of Good Faith Performance*, 37 U.S.F. L. REV. 257, 258 (2003) ("Unfortunately, discussions of good faith in general and the implied covenant of good faith performance in particular are often laced with inconsistencies and failures to use sufficiently specific terms. . . . The consequence[s] of these lapses and lack of attention to detail is considerable confusion as to the nature of the covenant of good faith, when the covenant is implicated, and how claims arising from a breach of the covenant are enforced."); Mkt. St. Assocs. v. Frey, 941 F.2d 588, 593 (7th Cir. 1991) ("The Wisconsin cases are cryptic as to [good faith's] meaning though emphatic about its existence . . . ."). *Compare* Burnette Techno-Metrics, Inc. v. TSI Inc., 44 F.3d 641, 643 (8th Cir. 1994) ("Under Minnesota law, the implied covenant requires only 'that one party not make it impossible for the other party to perform the contract.'"), *and* De La Concha, Inc. v. Aetna Life Ins. Co., 849 A.2d 382, 388 (Conn. 2004) (describing that the implied covenant of good faith requires that "'neither party do anything that will injure the right of the other to receive the benefits of the agreement'") (quoting Gaudio v. Griffin Health Services Corp., 733 A.2d 197, 221 (Conn. 1999)), *with* Beraha v. Baxter Health Care Corp., 956 F.2d 1436, 1445 (7th Cir. 1992) (stating that the implied covenant of good faith in Illinois requires parties to exercise discretion "in a manner consistent with the reasonable expectations of the parties").

In his seminal 1968 article on good faith, Professor Robert S. Summers argued that good faith cannot be defined and can only be understood by reference to "bad faith."[6] Others have argued that good faith should be defined in terms of the parties' reasonable expectations[7] or as a duty to refrain from seeking to recapture opportunities forgone at the time of contracting.[8] Still others have concluded that good faith can only be defined in the context of the particular contract at issue, so that the determination of whether a party has violated the implied covenant of good faith must be made on a case-by-case basis.[9] Finally, jurisdictions vary with respect to whether the implied covenant exists in every contract or only in certain contracts, such as those in which the parties have a "special relationship."[10]

Despite decades of attempts to clarify the good-faith duty and its application in various contracts, almost all acknowledge that the cases in which courts have applied the duty of good faith are rife with inconsistencies and confusion, even within single jurisdictions.[11] Yet, most commentators who have examined and

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[6] Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provision of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968) [hereinafter Summers, *Good Faith*]. "In contract law, taken as a whole, good faith is an 'excluder.' It is a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith." *Id.* at 201 (citation omitted). This approach was adopted by the Second Restatement. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. d (1981).

[7] *E.g.*, Diamond & Foss, *supra* note 4, at 594.

[8] *E.g.*, Burton, *supra* note 4, at 378 (proposing a conceptualization of good faith in which "a party fails to perform in good faith when it uses . . . discretion to recapture forgone opportunities.").

[9] *See, e.g.*, Chateau Chamberay Homeowners Ass'n v. Associated Int'l Ins. Co., 108 Cal. Rptr. 2d 776, 783 (Cal. Ct. App. 2001) (noting that whether conduct meets standard of good faith must be determined on a case-by-case basis); Amoco Oil Co. v. Ervin, 908 P.2d 493, 499 (Colo. 1995) ("Whether a party acted in good faith is a question of fact which must be determined on a case by case basis.").

[10] For example, Texas does not recognize a general duty of good faith in ordinary arms-length transactions, but does recognize a duty in contracts between parties with a "special relationship," such as insurer-insured, joint venturers, or partners in a partnership. Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc., 960 S.W.2d 41 (Tex. 1998); *see also* English v. Fischer, 660 S.W.2d 521 (Tex. 1983).

[11] *See, e.g.*, Diamond & Foss, *supra* note 4, at 585-86 (stating that "the implied covenant of good faith and fair dealing is shrouded in mystery" and declaring that "[e]fforts to devise workable standards or relevant criteria for determining when the covenant has been violated have been unavailing."); Honorable Howard L. Fink, *The Splintering of the Implied Covenant of Good Faith and Fair Dealing in Illinois Courts*, 30 LOY. U. CHI. L.J. 247, 247 (1999) (calling Illinois courts "splintered about not only the correct remedy, but also about whether there should be a remedy at all when a contracting party fails to carry out its promises in good faith"); Goren, *supra*

even critiqued the good faith doctrine have defended its usefulness or even its necessity, arguing that the implied covenant of good faith is an essential tool that enables courts to protect the expectations of the parties and to promote fairness in the performance of contracts.[12] Thus, most articles and commentary discussing good faith have focused on finding ways to create a workable definition or conceptualization[13] of good faith and on debating its proper scope and application.[14]

This Article argues that in many contracts, the implied covenant of good faith is not capable or worthy of being saved from the chaos that currently surrounds it. The inability to define good faith leaves contracting parties with no clear understanding of their obligations. For this reason alone, courts should be wary of including the implied covenant of good faith in every contract. But what makes the good-faith duty unworthy of salvation is the fact that other contract doctrines exist that more effectively serve

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note 5, at 258 (noting the confusion in Pennsylvania and other jurisdictions "as to the nature of the covenant of good faith, when the covenant is implicated, and how claims arising from a breach of the covenant are enforced"); Emily M.S. Houh, *Critical Interventions: Toward an Expansive Equality Approach to the Doctrine of Good Faith in Contract Law*, 88 CORNELL L. REV. 1025, 1033 (2003) (noting that the standard by which good faith is discerned "can be frustratingly elusive"); Michael K. Martin & Daniel L. Cummings, *The Implied Covenant of Good Faith: Now You See It, Now You Don't*, 9 ME. B. J. 306 (1994) (discussing inconsistent opinions from Maine courts regarding the duty of good faith).

[12] *See, e.g.*, Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 812 (1982) [hereinafter Summers, *Recognition and Conceptualization*] ("It is a kind of 'safety valve' to which judges may turn to fill gaps and qualify or limit rights and duties otherwise arising under rules of law and specific contract language.").

[13] The term "conceptualization" is used to mean "an intellectual construct that represents or embodies an idea formulated in words for some general or special purpose or purposes." *Id.* at 816.

[14] *See, e.g.*, Diamond & Foss, *supra* note 4, at 586 ("This article seeks to provide a structured framework that would substantially diminish ad hoc decision making. It also seeks to resolve confusion about when the covenant can be waived and what remedies the covenant provides."); Jason Randal Erb, *The Implied Covenant of Good Faith and Fair Dealing in Alaska: One Court's License to Override Contractual Expectations*, 11 ALASKA L. REV. 35 (1994) (making recommendations to counteract the uncertainty for contracting parties created by decisions based increasingly on public policy instead of the reasonable expectations of the parties); Houh, *supra* note 11, at 1025 (arguing that "courts should use the doctrine of good faith in contract law to prohibit improper considerations of race in contract formation and performance"); Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 WM. & MARY L. REV. 1223, 1230, 1278-80 (1999) (arguing against textualist approach to the duty of good faith, but stating that good faith "reflects important institutional values in the law of contracts").

the purposes for which the duty of good faith is often employed, while more carefully adhering to the parties' actual bargain.

This Article does not argue that the duty of good faith should be removed from all contracts. The implied covenant of good faith may be appropriate in certain categories of contracts where the duty can be defined with a reasonable degree of clarity, thus putting parties on notice of their obligations at the time of contracting. For instance, the covenant may be implied to address situations unforeseen at the time of contracting or to interpret ambiguous or incomplete contracts. Moreover, the duty of good faith in the Uniform Commercial Code (UCC) should be preserved.[15]

Instead, this Article argues that courts should abandon the rule that *every* contract contains an implied covenant of good faith. If the contract is sufficiently fair that it is not unconscionable or in violation of public policy and it is sufficiently clear that no implied obligation is required to make the contract enforceable or unambiguous, then no implied covenant of good faith is necessary or desirable.[16] The good-faith duty should no longer be used to impose obligations inconsistent with the parties' bargain, to deny rights that are expressly conferred in a contract, or to make unambiguous and otherwise enforceable contracts more "just" or "fair" in the eyes of the factfinder.

The desire to limit the application of the duty of good faith in unambiguous, otherwise enforceable contracts is not driven by a desire to elevate text over substance, or by a yearning to return to formalist rules of contract interpretation. Instead, it is based on a conviction that the parties' agreement should take precedence over the parties' expectations, to the extent that the two do not coincide. Moreover, it recognizes that expectations or the anticipated "fruits" of the contract are often difficult or impossible to discern and courts' attempts to impose liability based on these elusive notions result in inconsistent and imprudent outcomes. Consequently, parties are left with no clear understanding of their obligations, even when the contract terms are

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[15] This Article does not address extensively the duty of good faith in other statutes or the duty of good faith as an express contractual term. It focuses only on the implied covenant of good faith and, to a lesser extent, the duty of good faith in the Uniform Commercial Code.

[16] However, duties such as the duty of cooperation or the duty of disclosure that are often associated with or subsumed within the duty of good faith may continue to be recognized. *See* discussion *infra* Part V.

unambiguous.[17]

Equally important, parties may not share the same expectations and one party may be ignorant of the expectations of the other. Requiring a party to act in accordance with the other party's unknown expectations is itself inequitable. Instead, courts should begin with the presumption that the parties are justified in expecting performance and results (or "fruits") consistent with the express terms of their agreement. Likewise, absent evidence of fraud, misrepresentation, or facts giving rise to a claim of estoppel, waiver, unconscionability, or other grounds for denying enforcement, parties should be able to exercise rights consistent with the express terms of their agreement without fear of liability for breach of the implied covenant of good faith. This should be so even if the exercise of those rights leads to results inconsistent with the other party's expectations.

Finally, although courts deny that parties are required to behave altruistically,[18] many have relied on the vague concept of good faith to impose liability when a party has done nothing more than fail to go beyond the obligations imposed in the contract for the benefit of the other party.[19] While courts should be able to use equitable defenses and remedies to protect parties from various forms of overreaching and from onerous or unduly burdensome terms that violate public policy, using the implied covenant of good faith to enforce general notions of fairness can be more harmful than helpful.

Part I of this Article examines the role of equity in contract law and the use of the implied covenant of good faith as a tool of equity. Part II discusses the contracts and contexts in which the implied covenant of good faith is a necessary and appropriate term of the contract. The reasons for its usefulness in those contracts and contexts are discussed, including its role as an interpre-

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[17] Indeed, it is remarkable that courts do not hesitate to impose liability for breach of the duty of good faith when the courts themselves cannot agree on the scope of the obligation. This, however, is not unheard-of in the law of contracts (or other areas of the law). Many concepts, such as reasonableness, are similarly imprecise yet prevalent. The prevalence of these concepts, however, does not make them desirable. To the extent that more precise concepts are available, they should be used; if vague concepts can be avoided, they should be avoided.

[18] *See* Wilson v. Amerada Hess Corp., 773 A.2d 1121, 1130 (N.J. 2001) (stating that parties are not required to behave altruistically toward the other party); *see also* Mkt. St. Assocs. v. Frey, 941 F.2d 588, 594 (7th Cir. 1991).

[19] *See, e.g.*, Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575 (N.J. 1997) (discussed *infra* Part III.C).

tive aid and gap-filler, and in contracts granting sole discretion to one party.

Part III argues that jurisdictions should abandon the rule that the covenant should be included in *every* contract. Dominant conceptualizations of good faith and cases employing those conceptualizations are analyzed to illustrate the detrimental effects of implying the covenant in every contract, including the inclination of courts to use the implied covenant of good faith to add to or modify the terms of the parties' agreement. It is further argued that the good-faith covenant should not be used to punish parties for exercising rights expressly granted under the unambiguous terms of the contract or to impose obligations inconsistent with the parties' bargain.

Part IV discusses the availability of other remedies to achieve the equitable results desired by courts. Part V refutes the argument that without the implied covenant of good faith courts will necessarily return to formalist presumptions and refuse to look beyond the plain meaning of the contract to determine the parties' intent. Instead, the Article advocates a more expansive view of contract interpretation that looks beyond the four corners of the agreement to determine if ambiguities exist and to resolve those ambiguities. The resulting agreement, instead of the parties' expectations, should be the basis for determining whether a party is in breach.

Finally, Part VI addresses concerns that, without the duty of good faith, some discrete duties that are often viewed as a part of the duty of good faith will no longer apply. Instead of implying the expansive but amorphous duty of good faith, it is suggested that courts may, when necessary, imply the narrower, well-defined duties that are relevant to the specific context and type of contract at issue.

I

Good Faith as a Tool of Equity

Equity certainly has a rightful place in the law of contracts, but the degree to which equity can or should supplement or supersede agreements is at the heart of the debate regarding when and how the implied covenant of good faith should be applied. Equitable doctrines have traditionally provided relief when there is no adequate remedy at law. Equitable defenses and remedies are intended to "do justice," although the manner in which they

have generally been applied is not as vague as that term might suggest. The doctrines cannot be invoked simply because a contract favors one party's interests or because the contract is objectively unfair.[20]

Equitable doctrines have been developed to protect expectations that are the result of the actions or statements of another. Doctrines such as fraud and misrepresentation ensure that one party is not coerced or tricked into believing that certain rights or obligations exist when they do not. Defenses such as duress, undue influence, and incapacity excuse one party from a bargain entered into against its will or at a time when it was unable to comprehend the nature of the transaction.[21] The remedy of reformation allows the court to rewrite a contract to reflect the parties' actual intentions.[22] Promissory and equitable estoppel provide remedies when one party's otherwise unenforceable promise or action induces foreseeable reliance by another.[23] Each of these doctrines remedies defects in the process of contract formation, but none provides relief based on dissatisfaction with the *substance* of the parties' agreement if the agreement was freely and knowingly entered into by competent parties.

Even the doctrine of unconscionability requires more than a contract that is more favorable to one party than the other. In-

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[20] Friendly Ice Cream Corp. v. Beckner, 597 S.E.2d 34, 38 (Va. 2004) ("A court of equity will not set aside a contract because it is 'rash, improvident or [a] hard bargain' but equity will act if the circumstances raise the inference that the contract was the result of imposition, deception, or undue influence.") (quoting Payne v. Simmons, 350 S.E.2d 637, 640 (Va. 1986)); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 79 (1981) (stating that courts will not inquire into the adequacy of consideration). However, courts may refuse to grant equitable *remedies* if the contract is unfair. *See* RESTATEMENT (SECOND) OF CONTRACTS § 364 (1981) ("Specific performance or an injunction will be refused if such relief would be unfair because . . . the exchange is grossly inadequate or the terms of the contract are otherwise unfair.").

[21] *See, e.g.*, *Friendly Ice Cream*, 597 S.E.2d at 31 ("To set aside a deed or contract on the basis of undue influence requires a showing that the free agency of the contracting party has been destroyed. Because undue influence is a species of fraud, the person seeking to set aside the contract must prove undue influence by clear and convincing evidence.") (citations omitted); Wilkes v. Estate of Wilkes, 27 P.3d 433, 436 (Mont. 2001) (stating that a person lacks capacity to enter into a contract if the party is incapable of understanding the force and effect of the alleged agreement).

[22] "Where a writing that evidences or embodies an agreement in whole or in part fails to express the agreement because of a mistake of both parties as to the contents of or effect of the writing, the court may at the request of a party reform the writing to express the agreement . . . ." RESTATEMENT (SECOND) OF CONTRACTS § 155 (1981).

[23] *See id.* § 90.

stead, the disputed term or contract must be one "that no promisor with any sense, and not under a delusion, would make, and that no honest and fair promisee would accept."[24] Although this definition is almost as vague as the definition of "good faith," courts generally have been cautious about finding contracts or provisions unconscionable and have consistently required something more than a simple imbalance in the benefits received under the contract.[25] Indeed, even in Texas, where courts cannot use the duty of good faith to regulate performance, courts are not eager to void contracts on grounds of unconscionability.[26]

Perhaps because they are dissatisfied with these doctrines, many courts have begun to use the implied covenant of good faith to protect party expectations. Unfortunately, it has been applied to protect those expectations when the other party has acted within the express terms of the agreement, even when the terms of the contract are neither ambiguous nor unconscionable.[27] It has also been applied to protect expectations that are unilaterally held and perhaps even unknown by the party who violated those expectations.[28]

The implied covenant of good faith has been described as a means to do "justice, and justice according to law."[29] It is a tool

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[24] BLACK'S LAW DICTIONARY 75 (8th ed. 2004). A term is only unconscionable if it is "'such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other.'" RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. b (1981) (quoting Hume v. United States, 132 U.S. 406, 411 (1889)).

[25] "On the whole, judges have been cautious in applying the doctrine of unconscionability, recognizing that the parties often must make their contract quickly, that their bargaining power will rarely be equal, and that courts are ill-equipped to deal with problems of unequal wealth in society. Most cases of unconscionability involve a combination of procedural and substantive unconscionability, and it is generally agreed that if more of one is present, then less of the other is required." E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 4.28 at 559 (2d. ed. 1998); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. c (1981) ("Inadequacy of consideration does not of itself invalidate a bargain, but gross disparity in the values exchanged may be an important factor in a determination that the contract is unconscionable . . . .").

[26] *See, e.g.*, *In re* Marriage of Smith, 115 S.W.3d 126, 135 (Tex. App. 2003) (noting that a contract will not be void on grounds of unconscionability if its terms are merely lawful but improvident).

[27] *See, e.g.*, Emerson Radio Corp. v. Orion Sales, Inc., 253 F.3d 159 (3d Cir. 2001) (discussed *infra* Part III.A).

[28] *See id.*

[29] Summers, *Good Faith*, *supra* note 6, at 198. Professor Summers also described good faith as "a kind of 'safety valve' to which judges may turn to fill gaps and qualify or limit rights and duties otherwise arising under rules of law and specific

enabling courts to enforce notions of fairness and justice between the parties.[30] In this sense, it is an equitable tool.[31] Yet, the duty of good faith is distinctive in that the implied covenant becomes a substantive term of the contract, not a defense or remedial measure. In some jurisdictions where the covenant is included in every contract, the duty is imposed even if there is no finding that there was unequal bargaining power, grossly unfair terms,[32] or that the agreement fails to accurately reflect the parties' bargain or intent. Even unambiguous, complete, fully integrated contracts include an obligation of good faith and fair dealing.[33] In such cases, it only serves to impose a general obligation of fairness and reasonableness that is at odds with traditional contract law.[34]

Although the covenant of good faith does not on its face require fair terms, interpretation in a manner that requires performance that is "fair" and "reasonable" leads to the same result. Parties cannot merely perform in accordance with the terms of a valid, enforceable contract; the performance must lead to a result that the court believes to be fair. In other words, the terms of the

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contract language." Summers, *Recognition and Conceptualization*, *supra* note 12, at 812.

30 RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981) (describing that good faith "excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness").

31 *See* Summers, *Recognition and Conceptualization*, *supra* note 12, at 811 (opining that good faith "is of a piece with explicit requirements of 'contractual morality' such as the unconscionability doctrine and various general equitable principles") (citation omitted); Emily L. Sherwin, *Law and Equity in Contract Enforcement*, 50 MD. L. REV. 253, 273 (1991) ("The values that drive equitable defenses are values of fairness and justice between parties.").

32 *See, e.g.*, Seidenberg v. Summit Bank, 791 A.2d 1068, 1075 (N.J. Super. Ct. App. Div. 2002) (stating that disparate bargaining strength "is not the *sine qua non*" of an action for breach of the duty of good faith).

33 *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). Thus, the covenant is implied even if no aspect of the performance is discretionary, no terms have been left open, and no circumstances have arisen that were not contemplated at the time of contract formation.

34 *See id.* § 79 ("If the requirement of consideration is met, there is no additional requirement of . . . equivalence in the values exchanged . . . or 'mutuality of obligation.'").

> Ordinarily . . . courts do not inquire into the adequacy of consideration. . . . Gross inadequacy of consideration may be relevant to issues of capacity, fraud and the like, but the requirement of consideration is not a safeguard against imprudent and improvident contracts except in cases where it appears that there is no bargain in fact.

Id. § 79 cmt. c.

contract are not controlling if they lead to an unfair result. Consistent with this view of good faith, the implied covenant has been used to protect parties who willingly and knowingly enter into facially fair contracts but are disappointed by *results* that fail to live up to the party's expectations or yield the expected "fruits."[35] In this way, the implied covenant of good faith makes every party a guarantor of the other party's satisfaction with the outcome of the bargain. It does not look to whether the agreement was deemed fair by all parties at the time it was entered into, but instead looks to whether, in retrospect and in light of the other party's performance *in accordance with the terms of the contract*, the party is satisfied with the agreement.

Use of the covenant of good faith in this manner is ill advised. Just as there is no requirement that the terms of the contract be fair or just, there should be no separate requirement that the parties' performance be fair or just, so long as the performance is consistent with the parties' agreement and the agreement itself is not unenforceable on other grounds, such as unconscionability. In short, courts should not be allowed to rely on the implied covenant of good faith as a way to reform or overrule contracts that are too reasonable to be unconscionable but too one-sided to be objectively fair.

II

Contracts in Which the Covenant of Good Faith is Worth Keeping

In certain contexts, such as those discussed below, the implied covenant of good faith can be employed in a manner that furthers both the intent of the parties and important public policy goals. For example, in cases involving parties in "special relationships," the implied covenant of good faith can be well-defined and tailored to the nature of the relationship involved, thereby avoiding many of the pitfalls associated with the amorphous concept of good faith as applied to all contracts. In addition, the duty of good faith in the UCC is discussed and approved of as a part of a comprehensive statutory scheme that includes definitions of the term.[36] Finally, the implied covenant can be useful as a gap-filler to rescue otherwise unenforceable contracts,

[35] *See* discussion *infra* Part III.

[36] *See* discussion *infra* Part II.B.

or as an interpretive aid to discern the parties' actual intent or bargain in ambiguous contracts or provisions. In particular, it is an appropriate tool to limit a party's exercise of contractually granted exclusive discretion, so long as it is applied in a way that is consistent with the express terms of the agreement.

A. Special Relationships

Although a disparity in bargaining power does not always result in a contract that is unfair or that violates public policy, certain categories of contracts warrant inclusion of an implied covenant of good faith and fair dealing on public policy grounds. These categories include insurance contracts, which impact large numbers of citizens (consequently impacting the economy of the community) in fundamentally important ways.[37] They also include joint venture and partnership contracts, because the parties are engaged in an enterprise in which they have a common interest.[38] The duty of good faith in these contracts addresses some of the most egregious situations and most vulnerable parties, as well as cases in which the parties have expressly agreed to work cooperatively or in which one party has expressly placed their trust in the judgment of the other. It does not, however, usurp party autonomy in all cases, nor does it impose obligations of fidelity when the parties themselves have not intended to create or take on those obligations.

The most obvious advantage to restricting the good-faith covenant to "special relationship" contracts is that instead of relying on vague notions of fairness or reasonableness, the duty of good faith can be more precisely defined in terms relevant to the type of contract involved. In the insurance context, the duty of good faith may require the insurer to "give at least as much consideration to the welfare of its insured as it gives to its own interests. The governing standard is whether a prudent insurer would have accepted the settlement offer if it alone were liable for the entire

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[37] *See* Cent. Sav. & Loan Ass'n. v. Stemmons N.W. Bank, N.A., 848 S.W.2d 232, 239 (Tex. App. 1992) ("the [Texas Supreme Court] has found such a 'special relationship' arises only in the context of an insured and its insurer under an insurance policy because of the parties' unequal bargaining power and the nature of insurance contracts that would allow unscrupulous insurers to take advantage of their insureds' misfortunes in bargaining for settlement or resolution of claims."); Freeman & Mills, Inc. v. Belcher Oil Co., 900 P.2d 669, 672 (Cal. 1995) (emphasizing "the 'special relationship' between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility").

[38] Bank One, Texas, N.A. v. Stewart, 967 S.W.2d 419, 442 (Tex. App. 1998).

judgment."[39] This standard reflects the insured's dependence upon the insurer to defend the insured against third-party claims.[40]

Parties to a joint venture or members of a partnership have a "special relationship" that is fiduciary in nature.[41] In those contexts, the duty of good faith means more than simple reasonableness or fairness. Instead, parties "bear the obligation of the utmost good faith and integrity in their dealings with one another."[42]

> Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.[43]

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[39] Egan v. Mut. of Omaha Ins. Co., 169 Cal. Rptr. 691, 695 (Cal. 1979); *see also* Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987) ("A cause of action for breach of the duty of good faith and fair dealing is stated when it is alleged that there is no reasonable basis for denial of a claim or delay in payment or a failure on the part of the insurer to determine whether there is any reasonable basis for the denial or delay.").

[40] Jonathan Neil & Assocs., Inc. v. Jones, 94 P.3d 1055, 1068 (Cal. 2004). Without the obligation of good faith, the insurer would be able to arbitrarily reject settlement offers and take its chances at trial, secure in the knowledge that even if the insured is hit with a large judgment, the insurer's liability will not exceed its coverage amount.

[41] *See, e.g.*, TSA Int'l. Ltd. v. Shimizu Corp., 990 P.2d 713 (Haw. 1999) (noting the fiduciary relationship between partners); Bohatch v. Butler & Binion, 977 S.W.2d 543 (Tex. 1998) (same); *see also* Pear v. Grand Forks Motel Assocs., 553 N.W.2d 774 (N.D. 1996) (stating that relationship between partners is fiduciary and confidential). Because these relationships are fiduciary in nature, the standard of care required is higher than for arms-length commercial transactions. *Bank One*, 967 S.W.2d at 442 ("While both fiduciary and extracontractual special relationships establish a duty of good faith and fair dealing from which tort damages result, the two duties have a different standard of care. A fiduciary duty requires the fiduciary to place the interest of the other party before his own, if necessary, whereas the common law duty of good faith and fair dealing merely requires the parties to deal fairly with one another.") (citation omitted).

[42] *In re* Estate of Thomas, 532 N.W.2d 676, 683 (N.D. 1995); s*ee, e.g.*, Starr v. Fordham, 648 N.E.2d 1261, 1265 (Mass. 1995) ("Partners owe each other a fiduciary duty of the highest degree of good faith and fair dealing.").

[43] Heller v. Hartz Mountain Indus., Inc., 636 A.2d 599, 603 (N.J. Super. Ct. Law Div. 1993) (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. App. 1928)). When a fiduciary relationship exists, a partner's silence as to a material matter can constitute fraud. Ong Int'l (U.S.A.) Inc. v. 11th Ave. Corp., 850 P.2d 447, 454 (Utah 1993); Redwend Ltd. P'ship v. Edwards, 581 S.E.2d 496, 505 (S.C. Ct. App. 2003) ("In all matters connected with the partnership every partner is bound to act in a

Not surprisingly, courts disagree about which contracts should include a good-faith covenant, and whether breach of the covenant in these "special relationship" contracts should give rise to a claim based solely in contract or in tort. For instance, in Texas, only contracts between parties with a special relationship include a covenant of good faith, but the breach of the covenant is an independent tort.[44] In California, there is an implied covenant of good faith and fair dealing in every contract, but the breach of the covenant only gives rise to a breach of contract claim *unless* the contract is between parties in a "special relationship."[45] A breach of the good-faith covenant in a special relationship contract is an independent tort.[46]

Courts or legislatures can identify additional categories of contracts or relationships in which there is a significant disparity of bargaining power, or which have a sufficient impact on the community as a whole, that the duty of good faith is necessary to protect the weaker party or protect the public interest.[47] The duty of good faith may vary according to the context, but when the precise type of contract is identified, the scope of the duty is more easily defined. This is so because it is easier for the courts or legislatures to define the duty of good faith between parties in a particular context than to try to define it in a manner that encompasses every contract.

Although limiting the good-faith duty to parties in a special relationship excludes many categories of contracting parties who may be susceptible to unfair or onerous (but not unconscionable)

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manner not to obtain any advantage over his copartner in the partnership affairs by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind. A partner cannot act too quickly to protect his own financial position at the expense of his partners, even in the absence of malice.") (quoting 59A Am. Jur. 2d *Partnership* § 420 (1987) (citations omitted)).

[44] *See Bank One*, 967 S.W.2d at 441.

[45] Freeman & Mills, Inc. v. Belcher Oil Co., 900 P.2d 669, 672 (Cal. 1995).

[46] *Id.*

[47] *See, e.g.*, Automobile Dealers Day in Court Act (ADDCA), 15 U.S.C. § 1221(e) (2000) (defining duty of good faith as "the duty of each party to any franchise . . . to act in a fair and equitable manner toward each other so as to guarantee the one party freedom from coercion, intimidation, or threats of coercion or intimidation from the other party . . . ."). The duty of good faith in this statute has been interpreted to require actual or threatened coercion or intimidation as an element of an ADDCA claim. Likewise, courts or legislatures could decide to include a duty of good faith in employment contracts, although this idea has already been rejected by some courts and has been the subject of much scholarly debate. *See, e.g.*, Houh, *supra* note 11, at 1029 (arguing that good faith in employment context should preclude termination on a discriminatory basis).

contracts—particularly consumers—state and federal consumer protection statutes often protect those parties in a much more comprehensive and predictable manner than an implied covenant of good faith.[48] Many of the statutes include a duty of good faith, but, as discussed above, that duty can be defined in the statute or in reference to the particular context.[49] Moreover, terms in a contract of adhesion will not be enforced if the term is beyond the reasonable expectation of the adhering party.[50] This serves essentially the same purpose as the implied covenant of good faith, but limits its application to cases in which there is a disparity in bargaining power.[51]

B. Uniform Commercial Code

There are several reasons for maintaining the good-faith duty in the UCC. Keeping good faith is pragmatic because the UCC is a statute requiring legislative approval for revision or amendment. Considering the recent amendment of Article 1, including the expanded definition of good faith, and the many references to good faith throughout the Code, it is unlikely that legislatures will agree to extract the duty of good faith from the UCC any time soon. Additionally, there is less need to do so than in the common law, because fewer courts have applied the duty of good faith in cases governed by the UCC in as expansive a manner as they have when applying the common law duty of good faith. In fact, relatively few cases have imposed liability solely for breach of the duty of good faith.[52]

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[48] *See, e.g.*, ADDCA, 15 U.S.C. §§ 1221-25; Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. §§ 2301-12 (2000); Delaware Automobile Lemon Law, DEL. CODE ANN. tit. 6 § 5002 (1999); Illinois Franchise Disclosure Act, 815 ILL. COMP. STAT. 705/9 (2004); Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. § 17.46 (2001); Wisconsin Lemon Law, WIS. STAT. ANN. § 218.0171 (2000).

[49] *See, e.g.*, ADDCA § 1221(e).

[50] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981); Graham v. Scissor-Tail, Inc. 623 P.2d 165, 172 (Cal. 1981); Broemmer v. Abortion Servs., Ltd., 840 P.2d 1013, 1016 (Ariz. 1992).

[51] It is true that this focuses on the contract terms instead of the party's performance, but the two are inextricably intertwined. If the contract terms allow for performance that is inconsistent with the party's expectation, the term is beyond the party's reasonable expectation.

[52] *See, e.g.*, El Paso Natural Gas Co. v. Minco Oil & Gas, Inc., 8 S.W.3d 309 (Tex. 1999) (deciding that the UCC's statutory duty of good faith and fair dealing in the performance, enforcement, and modification of a commercial contract does not apply to a final release of liability executed by the parties).

Courts' restraint in enforcing the duty of good faith may be attributed to the fact that good faith is defined in the Code.[53] While imprecise, the definition at least attempts to articulate a standard.[54] Indeed, it is that fact that has led to criticism of the UCC standard by those who argue that the duty is too narrow.[55] Yet the definition in revised Article 1,[56] which includes the objective standard requiring observance of reasonable commercial standards of fair dealing, at least provides notice of the standard by which performance will be judged. Whether that standard provides much guidance is debatable, but it provides more guidance than is available for non-UCC transactions. The UCC also more clearly and comprehensively defines the parties' rights and obligations with respect to other aspects of transactions, leaving less to the discretion of the parties and the courts.[57] Obligations of good faith included in other statutory schemes may be worth preserving for similar reasons. Set in a particular context as a defined term, the duty takes on a more concrete and predictable meaning that is absent in the common law.

C. Gap-filler or Interpretive Aid

In many cases, whether intentionally or inadvertently, parties

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[53] U.C.C. § 1-201(20) (2004) ("'Good faith,' except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.").

[54] The definition, of course, varies based upon the Article in question and the version enacted by a particular state. *See* U.C.C. § 1-201(19) (pre-2001 revision) ("'Good faith' means honesty in fact in the conduct or transaction concerned."); 2-103(1)(b) (pre-2001 amendment to conform to Article 1 revision) ("'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.").

[55] *See, e.g.*, Summers, *Good Faith, supra* note 6, at 215 ("[T]he Code's definitions restrictively distort the doctrine of good faith."). The narrow definition in the pre-2001 version might also explain the relatively small number of cases imposing liability based solely upon a breach of the duty of good faith.

[56] Uniform Commercial Code Article 1 was revised in 2001. The revised version has been adopted in eight states (Alabama, Arkansas, Delaware, Hawaii, Idaho, Minnesota, Texas, and Virginia) as of the time of this writing. Bills proposing the adoption of Revised Article 1 are pending in Arizona, Connecticut, Illinois, Kansas, Montana, Nebraska, Nevada, New Hampshire, New Mexico, Oklahoma, and West Virginia.

[57] *E.g.*, U.C.C. § 2-202 (2004) (stating specifically that written agreements may be supplemented by course of performance, course of dealing, and usage of trade); §§ 2-308, 2-309 (providing default terms if the parties neglect to include those terms in their agreement); §§ 2-314, 2-315 (giving notice of implied warranties); § 2-706 (spelling out sellers' rights and obligations regarding resale after wrongful rejection or revocation).

will enter into contracts that are enforceable yet incomplete. Although parties may decide to leave certain terms open (such as price, quantity, or time for performance), contracts often fail to address issues because parties could not have contemplated the circumstances requiring a particular term or because the right or obligation was so obvious to the parties that inclusion of the term was deemed unnecessary.[58] While the use of implied covenants generally is not favored, courts use them to fill in the gaps in such circumstances.[59] Implied covenants are also useful as aids to interpret ambiguous contracts or terms.[60]

When applied appropriately, use of the duty of good faith to fill in gaps or to interpret contracts appropriately recognizes the primacy of the bargain while acknowledging that parties are often unable to anticipate and account for every occurrence in their agreements. It further recognizes that the parties' intent may be imperfectly expressed in the written agreement.[61] How-

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[58] *See* Continental Potash, Inc. v. Freeport-McMoran, Inc., 858 P.2d 66, 80 (N.M. 1993) ("When it is clear . . . from the relevant parts of the contract taken together and considered with the facts and circumstances surrounding the execution of the agreement, that the obligation in question was within the contemplation of the parties or was necessary to effect their intention, then such obligation may be implied and enforced.").

[59] *See, e.g.*, Plaza Assocs. v. Unified Dev., Inc., 524 N.W.2d 725, 728 (Minn. Ct. App. 1995) ("The courts will imply a covenant if necessary to effectuate the intent of the parties. But 'the implication must result from the language employed in the instrument or be indispensable to carrying the intention of the parties into effect.'") (quoting Closuit v. Mitby, 56 N.W.2d 428, 432-33 (Minn. 1953)); Bank One, Texas, N.A. v. Stewart, 967 S.W.2d 419, 434 (Tex. App. 1998) ("[T]he court looks beyond the written agreement to imply a covenant only if necessary to effectuate the intention of the parties as disclosed by the contract as a whole . . . ."). For example, in a lease that requires the lessee to send rental payments to the lessor annually, but which is silent regarding notification of a change of land ownership, the court may imply a covenant requiring the lessor to notify the lessee of any change of ownership or to accept late payments when the delay is due to the lessee's ignorance of the change in ownership and the lessee has made a reasonable effort to comply with the lease terms. *See* Burlington Res. Oil & Gas Co. v. Cox, 729 N.E.2d 398, 402 (Ohio Ct. App. 1999).

[60] *See, e.g.*, N. Trust Co. v. VIII S. Michigan Assocs., 657 N.E.2d 1095, 1104 (Ill. App. Ct. 1995) ("The obligation of good faith and fair dealing is essentially used to determine the intent of the parties where a contract is susceptible to two conflicting constructions."); Gerdlund v. Elec. Dispensers Int'l, 235 Cal. Rptr. 279, 286 (Cal. Ct. App. 1987) ("The covenant of good faith and fair dealing implied in every contract has been held in certain special cases to supply a requirement of good cause for termination where the contract itself is silent or ambiguous on that subject.").

[61] *See In re* Vylene Enters., Inc., 90 F.3d 1472 (9th Cir. 1999). In *Vylene*, a franchise agreement included an option to extend the agreement beyond the initial ten-year term "on terms and conditions to be negotiated." *Id.* at 1473. The court held that while the term was too vague to be enforceable as a right to renew, the

ever, it is not a license to overrule or modify express contract terms,[62] nor should the covenant be implied simply to make the contract more reasonable or fair.[63] Instead, the implied covenant of good faith should, to the extent possible, give effect to the parties' actual intent and agreement, not the agreement that should have been made or that would lead to a just result.

A common example of the implied covenant of good faith as a gap-filler or interpretive aid is its use in contracts granting discretion to one party with respect to some aspect of the contract. Such discretion might be given in setting price or date of performance, or in assessing the quality or acceptability of performance under the contract ("satisfaction clauses"). Many courts, even those that are reluctant to recognize implied covenants, have embraced the duty of good faith in this context.[64] This uniform acceptance of the implied covenant of good faith in this context reflects its value.

Yet despite the multitude of cases applying good faith in discretionary contracts, courts have been somewhat inconsistent in applying the duty of good faith when assessing a party's exercise of discretion. This inconsistency may stem in part from a digression from the original reason for including the implied covenant of good faith to discretionary contracts. Under classic contract principles, total discretion on the part of one party made the con-

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franchisor had an implied obligation to negotiate in good faith regarding the extension. *Id.* at 1476.

[62] *N. Trust*, 657 N.E.2d at 1104 ("[A]n implied covenant of good faith cannot overrule or modify the express terms of a contract."); *see also, e.g.*, Kassebaum v. Kassebaum, 42 S.W.3d 685, 696 (Mo. Ct. App. 2001) ("[T]here can be no implication where the subject is completely covered by the contract.").

[63] *See, e.g.*, *Kassebaum*, 42 S.W.3d at 696 ("It is not enough to say that the implied term is necessary to make the contract fair, or that without such implied term the contract would be improvident or unwise, or that the contract would operate unjustly."); *Bank One*, 967 S.W.2d at 434 (describing covenant implied to effectuate the intention of the parties, "but not to make the contract fair, wise, or just").

[64] *See, e.g.*, Dayan v. McDonald's Corp., 466 N.E.2d 958, 972 (Ill. App. Ct. 1984) ("[T]he courts of this state have held that a party vested with contractual discretion must exercise that discretion reasonably and with proper motive, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties."); Zep Mfg. Co. v. Harthcock, 824 S.W.2d 654 (Tex. App. 1992) (holding that Texas law implies duty of good faith in contract giving one party "sole discretion" to determine the quality of the other party's performance); Wilson v. Amerada Hess Corp., 773 A.2d 1121, 1130 (N.J. 2001) ("[A] party exercising its right to use discretion in setting price under a contract breaches the duty of good faith and fair dealing if that party exercises its discretionary authority arbitrarily, unreasonably, or capriciously, with the objective of preventing the other party from receiving its reasonably expected fruits under the contract.").

tract unenforceable because the discretion-exercising party's promise was illusory.[65] To rescue such contracts, courts either implied an obligation to exercise the discretion in a reasonable manner or implied a duty of good faith in the exercise of the discretion.[66] In theory, these are two separate standards, although not all courts treat them as distinct. If the contract does not expressly convey complete discretion to one party, or if "it is practicable to determine whether a reasonable person in the position of the obligor would be satisfied, an interpretation is preferred under which the condition occurs if such a reasonable person in the position of the obligor would be satisfied."[67]

If the express terms of the contract make it clear that one party is to have complete discretion, or if the discretion is based on subjective factors or individual judgment, then most courts have stated that the contract terms should be enforced and that party should not be required to act reasonably in exercising that discretion. Instead, the party must act in good faith.[68] Thus, the duty of good faith is limited to contracts in which a party has sole discretion or in which the parties intend for the discretion to be exercised based upon subjective factors. Although courts assert

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[65] *See* Mattei v. Hopper, 330 P.2d 625, 626 (Cal. 1958) ("[I]f one of the promises leaves a party free to perform or to withdraw from the agreement at his own unrestricted pleasure, the promise is deemed illusory and it provides no consideration."). This assumes that there is no other consideration sufficient to support the contract. Storek & Storek, Inc. v. Citicorp Real Estate, Inc., 122 Cal. Rptr. 2d 267, 278 (Cal. Ct. App. 2002) ("[W]hen the contract is adequately supported by adequate consideration regardless of the discretionary power, there is no need to impose a covenant of good faith in order to create mutuality."). For example, a clause that allows one party to terminate a contract "at any time and for any reason" on thirty-day notice is enforceable without implying a covenant of good faith because the thirty-day notice requirement is sufficient consideration for the other party's promise.

[66] *See Storek*, 122 Cal. Rptr. 2d at 278 ("[T]he courts will imply a covenant of good faith and fair dealing to limit that discretion in order to create a binding contract and avoid a finding that the promise is illusory.").

[67] RESTATEMENT (SECOND) OF CONTRACTS § 228 (1981); *see also Storek*, 122 Cal. Rptr. 2d at 280 ("In the absence of a specific expression in the contract or one implied from the subject matter, the preference of the law is for the less arbitrary reasonable person standard."); *Mattei*, 330 P.2d at 626-27 ("[I]n those contracts where the condition calls for satisfaction as to commercial value or quality, operative fitness, or mechanical utility, dissatisfaction cannot be claimed arbitrarily, unreasonably, or capriciously . . . .").

[68] RESTATEMENT (SECOND) OF CONTRACTS § 228 cmt. a (1981); *Mattei*, 330 P.2d at 627 ("Where the question is one of judgment, the promisor's determination that he is not satisfied, when made in good faith, has been held to be a defense to an action on the contract.").

that the reasonableness and good faith concepts are distinct,[69] it is often unclear from the language in the courts' opinions how or if good faith differs from reasonableness.[70]

Whether the standard is objective or subjective, the implied covenant of good faith in these cases is consistent with the parties' intent because the parties presumably intended to enter into an enforceable bargain, and without the covenant the promises would be illusory. Additionally, it is unlikely that a party would ever intend to give the other party absolute and unbounded discretion without any corresponding obligations. In this context, it may be fair to say that the implied covenant merely reflects a term that was so obvious to the parties that its inclusion was unnecessary.[71]

However, some courts have expanded the good-faith doctrine to apply when a party has some, but not total, discretion with respect to any aspect of the contract and when the covenant is not necessary to provide consideration to support the contract. These contracts do not require an implied covenant of good faith in order to be enforceable, nor are they always consistent with the terms of the parties' bargain. Nonetheless, courts have in-

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[69] *Storek*, 122 Cal. Rptr. 2d at 279 (noting that when a contract includes a satisfaction clause two different tests are recognized — good faith and reasonableness: "In this context, reasonableness and good faith are distinct concepts.").

[70] Compliance with the reasonableness standard requires that the party not act arbitrarily or capriciously, or in a manner "lacking in evidentiary support." *Id.* "A lack of good faith, on the other hand, suggests a moral quality, such as dishonesty, deceit, or unfaithfulness to duty." *Id.* In many cases, courts appear to find that the discretion-exercising party has acted in good faith if the court determines that the party exercised its discretion in a reasonable manner. *See, e.g.*, Publix Super Mkts., Inc. v. Wilder Corp., 876 So. 2d 652, 655 (Fla. Dist. Ct. App. 2004) (holding that Publix's exercise of discretion was "commercially reasonable and not arbitrary and thus did not constitute a breach of good faith, as a matter of law"); Sepe v. City of Safety Harbor, 761 So. 2d 1182, 1185 (Fla. Dist. Ct. App. 2000) (noting that implied covenant of good faith applied to City's exercise of "sole discretion" and stating that "[u]nless no reasonable party in the position of the City would have made the same discretionary decision the City made, it seems unlikely that its decision would violate the covenant of good faith in this context."). One court declared that the covenant of good faith "is not a general reasonableness requirement," but acknowledged that "[r]easonableness does play a role in the good faith analysis—but only as evidence of subjective intent to undermine fulfillment of the contract." Schell v. Lifemark Hosps., 92 S.W.3d 222, 230-31 (Mo. Ct. App. 2002). According to the Missouri Court of Appeals, good faith requires "behavior on behalf of the parties that comports with the 'reasonable expectations of the parties' but *only* in light of [the parties'] *purposes* in contracting." *Id.* at 231.

[71] *See* Continental Potash, Inc. v. Freeport-McMoran, Inc., 858 P.2d 66, 80 (N.M. 1993).

creasingly held that the covenant should be applied.[72]

The decision in *Locke v. Warner Bros., Inc.*[73] illustrates the pitfalls of implying a duty of good faith in these cases. Locke entered into an agreement with Warner Bros. that was characterized as a three-year "non-exclusive first look deal."[74] Locke was obligated to submit any picture that she was interested in developing to Warner Bros. for approval or rejection at Warner Bros.' sole discretion before she submitted it to any other studio.[75] In exchange, Locke received $250,000 per year.[76] In addition, the contract included a "pay or play" directing provision that gave Warner Bros. the option of either using Locke to direct pictures or paying her a $750,000 fee.[77] Warner Bros. rejected all of Locke's submissions during the contract period and declined to use her to direct any pictures; however, it did pay the $1.5 million required under the contract.[78] Despite receiving the payments, Locke filed suit alleging breach of the implied covenant of good faith.[79] According to Locke, Warner Bros. never intended to develop any of her projects or hire her to direct any films.[80] Instead, the studio entered into the agreement to help Clint Eastwood—one of the studio's biggest stars—settle a lawsuit with Locke, and it intended to refuse to work with her out of deference to Eastwood.[81]

The court imposed the duty of good faith even though the promise to pay the $1.5 million was sufficient consideration to support the contract, and it held that Warner Bros. could have breached its duty of good faith by rejecting Locke's proposals without evaluating them.[82]

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[72] *See, e.g.*, Beraha v. Baxter Health Care Corp., 956 F.2d 1436, 1445 (7th Cir. 1992); Amoco Oil Co. v. Ervin, 908 P.2d 493, 498-99 (Colo. 1995).

[73] 66 Cal. Rptr. 2d 921 (Cal. Ct. App. 1997).

[74] *Id.* at 922.

[75] *Id.* If the project was rejected by Warner, Locke was free to "shop" or present the project to other studios or production companies. *See* Brief of Respondent Warner Bros., 1997 WL 33563078, at *2-3 (Cal. Ct. App.).

[76] *Locke*, 66 Cal. Rptr. 2d at 922.

[77] *Id.*

[78] *Id.*

[79] *Id.* at 922-23.

[80] *Id.* at 922.

[81] Locke and Eastwood had been involved in a relationship for several years. *Id.* When it ended, Locke sued Eastwood. *Id.* Locke claimed that Eastwood secured the agreement with Warner Bros. for Locke in exchange for her dropping her case against Eastwood. *Id.*

[82] *Id.* at 926.

> Unquestionably, Warner was entitled to reject Locke's work based on its subjective judgment . . . . However, bearing in mind the requirement that subjective dissatisfaction must be an honestly held dissatisfaction, the evidence raises a triable issue as to whether Warner breached its agreement with Locke by not considering her proposals on their merits.[83]

In other words, the studio could not simply decide for any reason to reject the proposals and pay the money. It could do so only if it was dissatisfied with the quality of the proposals. Essentially, the court read into the contract a "satisfaction" requirement that was not included in the language of the contract itself.[84] If the studio had agreed to develop all projects that it determined, in its sole discretion, were acceptable or marketable, then Locke would have been justified in expecting the studio to at least review each proposed project. However, the contract contained no such clause. The studio promised either to develop her projects *or* pay her $1.5 million, and it chose to pay the money.[85] By holding that the studio had an obligation to do more, the court imposed different and more burdensome obligations than were included in the contract itself based on the *court's* understanding of and belief regarding the parties' expectations and motivations in entering into the contract.[86]

The court distinguished *Locke* from *Third Story Music, Inc. v. Waits*[87] on the assertion that the Locke contract "gave Warner *discretion* with respect to developing Locke's projects," whereas in *Third Story Music*, "the agreement expressly provided that Warner Communications had the right to *refrain* from marketing

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[83] *Id.*

[84] *Id.* at 927.

[85] Examination of Locke's brief to the court of appeals reveals that Locke's expectation that the studio would use her for future projects was based on conversations with and representations from persons directly and indirectly affiliated with Warner Bros. *See* Appellant's Opening Brief, 1996 WL 33454719, at *5-6 (Cal. Ct. App.). If these statements could have been attributed to Warner Bros., then Locke may have had a claim for fraudulent inducement or misrepresentation, or the statements may have been evidence regarding the proper interpretation of the contract. To the extent that the statements were made after the contract was entered into, they are irrelevant and could not be the basis for any reasonable expectations regarding Warner Bros.' performance.

[86] *Locke*, 66 Cal. Rptr. 2d at 926 (accepting Locke's assertion that "the value in the subject development deal was not merely the guaranteed payments under the agreement, but also the opportunity to direct and produce films and earn additional sums, and most importantly, the opportunity to promote and enhance a career.").

[87] 48 Cal. Rptr. 2d 747 (Cal. Ct. App. 1995).

the Waits recordings."[88] The court's distinction is unpersuasive because the word "discretion" was not used in Locke's contract and the contract expressly gave the studio the right to approve or reject her submissions.[89] The bargain that the parties struck was that the studio would either develop Locke's projects or pay her the stipulated amount. This was a valid bargain supported by consideration.

Instead, the court enforced an agreement to consider and evaluate projects for development, and then either develop the projects or pay the stipulated amount. This gave Locke what she expected, although it was more than that for which she bargained. Therein lies the danger of implying a duty of good faith in otherwise enforceable, unambiguous contracts. Rather than enforce the bargain made and agreed to by the parties, courts interpret any grant of discretion as a license to inquire into the parties' expectations and intentions.

Undertaking such a task after the parties' relationship has deteriorated, when each is likely to assert, in retrospect, expectations consistent with their current legal position—regardless of whether those same expectations and motivations existed at the time of contract formation—is difficult at best. The more troubling possibility is that the parties may not have disclosed their expectations or motivations to each other and, indeed, their reasonable expectations may be in direct conflict with one another. In that situation, the court must choose and will necessarily enforce the contract in a way that is inconsistent with the reasonable expectations of at least one party.

In *Beraha v. Baxter Health Care Corp.*,[90] Beraha entered into an exclusive license agreement with Baxter under which Baxter would develop and sell biopsy needles designed and patented by Beraha.[91] Baxter paid Beraha $50,000 for advance royalties and was obligated to pay royalties of 3.5%.[92] After several years, Beraha became dissatisfied with Baxter's efforts and sued, alleging breach of the implied covenant of good faith and fair dealing.[93] Although Baxter had provided some assurances that it would "do its best" to develop and market the needle, the court

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[88] *Locke*, 66 Cal. Rptr. 2d at 927.
[89] *Id.* at 922.
[90] 956 F.2d 1436 (7th Cir. 1992).
[91] *Id.* at 1437.
[92] *Id.* at 1438.
[93] *Id.* at 1439.

held that those promises were too vague and indefinite to be enforced as an obligation to use its "best efforts."[94]

However, the court did hold that Baxter had discretion under the contract with respect to developing and marketing the needle, and it was obligated by the covenant of good faith to exercise that discretion reasonably.[95] While it is true that the contract did not specify a level of effort required by Baxter, Baxter's obligations were clear: it had to pay the $50,000 fee up front and a percentage of the net sales.[96] Beraha expressly declined to include a minimum annual royalty in the contract.[97] He wanted to include a provision requiring Baxter to use its best efforts to market and develop the needle, but signed the agreement even after noting that no such provision was included.[98] In fact, Baxter declined to give assurances of the level of effort to be used when Beraha specifically asked it to do so before he signed.[99]

On these facts, it is clear that Beraha wanted to include a minimum required level of effort in the contract, but that Baxter did not and Beraha was aware of this fact. Thus, the parties' agreement *deliberately* failed to include a requirement that Baxter use a specified level of effort in developing and marketing the needle. Instead, the parties agreed to a larger lump sum payment up front. The court's holding that Baxter's discretion gave rise to a duty to use reasonable effort was contrary to the written agreement and the evident intent of the parties. It was also unnecessary to imply a duty of good faith in that context because Baxter did not have total discretion to determine whether Beraha would receive any compensation under the contract.[100] Baxter was obligated to pay $50,000 regardless of whether it ever developed or sold a single needle. This gave Baxter incentive (but not a man-

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[94] *Id.* at 1440.

[95] *Id.* at 1444.

[96] *Id.* at 1438-39.

[97] *Id.* at 1438. An earlier version of the proposed contract included a lower up front payment, but included a minimum annual royalty payment of $10,000 after the first anniversary of the agreement. *Id.*

[98] *Id.* at 1438-39.

[99] "At first Beraha refused to sign the . . . agreement because it contained no best efforts provision. He telephoned his contacts at Baxter . . . [but] received no representation concerning the specific level of effort that would be made." *Id.* Nevertheless, Beraha signed the agreement without the best-efforts clause. *Id.* at 1439. Beraha alleged that one of the Baxter executives promised to send him a letter, but it is unclear what the promised letter was supposed to say. *Id.* The letter that was eventually sent fell short of promising to use "best efforts." *Id.*

[100] Thus, Baxter's promise was not illusory.

date) to develop the needle and make it as profitable as possible. Beraha took this payment in hopes that Baxter would do so, but he knew before signing the contract that Baxter might not. He signed the agreement anyway and should have been held to the bargain that he made.

Implying a covenant of good faith in a contract granting sole discretion to one party is prudent to the extent that it is consistent with parties' intent to enter into a binding contract. However, when the duty is implied whenever a party has any discretion, and when the contract is otherwise unambiguous and enforceable, it can be used to modify the parties' agreement or to impose obligations inconsistent with the agreement. In those circumstances, the implied covenant does more harm than good.

III

No Implied Covenant in Every Contract

The implied covenant of good faith is unnecessary in many contracts. Its inclusion may be harmless in most cases because parties will generally behave in ways that are consistent with general notions of good faith of their own accord.[101] However, as long as it exists in every contract, and as long as there is no workable definition of good faith to guide (and restrain) parties or courts, it is a tool that can be used to alter the parties' bargain, rights, and obligations.

The same previously discussed problems posed by applying the duty of good faith in discretionary contracts exist and may be multiplied when the duty of good faith is incorporated into every contract. With respect to discretionary contracts, the duty of good faith can be limited to the parties' exercise of discretion. In jurisdictions where every contract has an implied covenant of good faith, the duty of good faith applies to every aspect of performance. Consequently, courts face the same difficulty of attempting to assess the parties' agreement and reasonable expectations, but must make that assessment in a variety of contexts, depending upon which aspect of performance is alleged to have been done in bad faith. This makes it difficult for courts to

[101] Aside from behaving honorably or reasonably for moral reasons, parties may be concerned with their business reputation, future business relationship with the same contracting party, or fear of extra-contractual sanctions (such as filing a complaint with the Better Business Bureau or generating negative publicity). In other cases, performance of the contract as written is beneficial to all parties.

develop a coherent yet comprehensive conceptualization of the duty of good faith. Predictably, it is even more difficult for parties to know what obligations and restrictions are imposed by the implied covenant of good faith.

The difficulty of defining good faith is by no means a new problem. In many jurisdictions, there is no single statement of what the duty of good faith requires. However, there are a few conceptualizations that have gained more or less general acceptance. In many jurisdictions, the implied covenant of good faith and fair dealing "embraces a pledge 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.'"[102] While most courts agree that the duty of good faith does not include obligations that conflict with the express terms of the contract, many hold that it does "encompass 'any promises which a reasonable person in the position of the promisee would be justified in understanding were included.'"[103] Some courts have interpreted this language to mean that the implied covenant of good faith imposes restrictions on parties not included in the agreement.[104] Consequently, parties must refrain from taking actions not prohibited by the contract, and perhaps not even mentioned, if those actions might prevent the other party from enjoying the anticipated "fruits of the contract" or interfere with the other party's "reasonable expectations."[105]

Still other jurisdictions adopt the approach advocated by Professor Robert S. Summers, in which good faith is defined as an "excluder."[106] According to Professor Summers, good faith is a

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[102] 511 West 232nd Owners Corp. v. Jennifer Realty Co., 773 N.E.2d 496, 500 (N.Y. 2002) (quoting Dalton v. Educ. Testing Serv., 663 N.E.2d 289, 291 (1995)); *see also, e.g.*, De La Concha, Inc. v. Aetna Life Ins. Co., 849 A.2d 382, 388 (Conn. 2004) (describing the implied covenant of good faith as a requirement that "neither party do anything that will injure the right of the other to receive the benefits of the agreement") (quoting Gaudio v. Griffin Health Servs. Corp., 733 A.2d 197, 221 (Conn. 1999)).

[103] *511 West 232nd Owners Corp.*, 773 N.E.2d at 500-01 (quoting Rowe v. Great Atl. & Pac. Tea Co., Inc., 385 N.E.2d 566, 569 (N.Y. 1978)).

[104] Use of the covenant of good faith in this manner goes far beyond the gap-filler function discussed with approval in Part II.C. because instead of implying terms that all parties *actually* believed were a part of the contract (but were so obvious that inclusion was not necessary), the court implies terms that a reasonable person might *expect* to be included.

[105] These two conceptualizations are closely related and are sometimes used interchangeably.

[106] Summers, *Good Faith, supra* note 6, at 201.

term "without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith."[107] Others have embraced the notion of good faith as prohibiting one party from seeking to recapture opportunities forgone during contract formation,[108] or judge performance based on motive.[109] Many jurisdictions employ some hybrid version incorporating elements of more than one of these approaches.[110]

An examination of the ways in which courts have applied the duty of good faith using these conceptualizations illustrates their inadequacy in providing guidance to parties seeking to understand their rights and obligations under their contracts. It also highlights the degree to which courts have used these vague definitions to impose obligations and curtail the rights of parties in ways that are inconsistent with the parties' actual bargain. Use of the covenant of good faith in this manner is inappropriate and should be abandoned.

A. Reasonable Expectations or "Fruits" of the Contract

Party expectations are an integral part of contract law. Damages are awarded to protect the parties' expectation interests.[111] But expectation damages are intended to give the non-breaching party the "benefit of the bargain" and put him or her "in as good a position as he would have been in had the contract been performed."[112] Thus, expectations and resulting damages are assessed based upon the terms of the contract, not the parties' subjective expectations. In other words, the bargain defines the expectations and associated damages.

However, courts in some jurisdictions have used the implied covenant of good faith to enforce parties' subjective expectations

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107 *Id.*

108 *See* Burton, *supra* note 4, at 377-78.

109 *See* Wilson v. Amerada Hess Corp., 773 A.2d 1121, 1129 (N.J. 2001).

110 *See, e.g.*, Tufankjian v. Rockland Trust Co., 782 N.E.2d 1, 4-6 (Mass. App. Ct. 2003) (defining good faith as "the understanding between the parties 'that neither party shall do anything that will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract'" (quoting Anthony's Pier Four, Inc. v. HBC Assocs., 583 N.E.2d 806, 820 (Mass. 1991), but finding a breach of the duty because the defendant sought to "recapture opportunities forgone on contracting as determined by [defendant's] reasonable expectations." (quoting *Anthony's Pier Four*, 583 N.E.2d at 821)).

111 RESTATEMENT (SECOND) OF CONTRACTS § 344 cmt. a (1981).

112 *Id.* § 344(a).

in ways that redefine or modify the parties' bargain. Instead of viewing the implied covenant as an interpretive aid or gap-filler, these courts have implied obligations that add to or even contradict the obligations spelled out in the parties' agreement in the name of fulfilling the parties' (or at least one party's) reasonable expectations. This conceptualization of the good-faith duty is most troubling when it is interpreted in a way that requires one party to refrain from exercising rights expressly granted in the contract because exercising those rights is determined to be contrary to the other party's reasonable expectations.

Requiring a party to take on obligations not included in the contract, or to refrain from activities not prohibited by the contract, solely for the benefit of the other party, is unreasonable and imposes duties more appropriate to parties in a fiduciary relationship than those in an arm's-length transaction.[113] However, a contract is not necessarily an agreement to enter into a relationship or even pursue a common purpose. In many cases, it is merely an assignment of rights and responsibilities between parties, each of whom have their own purpose and objectives in mind. The parties may agree upon terms because those terms meet their respective needs, not because they further some common goal. Treating parties' expectations as though they are terms of the contract ignores these facts. Moreover, expectations, as opposed to express obligations, are not always easy to discern with accuracy. Indeed, based on the parties' bargain, it may be impossible to distinguish between what a party reasonably expected and what that party *hoped* to achieve or accomplish.

In *Emerson Radio Corp. v. Orion Sales, Inc.*,[114] Emerson accused Orion of breaching the implied covenant of good faith in an agreement under which Orion was licensed to distribute goods manufactured by Emerson to Wal-Mart stores.[115] The Third Circuit noted that the obligation of good faith has been defined in New Jersey to mean 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."[116] The

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[113] *See* Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351, 1357 (7th Cir. 1990) ("Parties to a contract are not each others' fiduciaries; they are not bound to treat customers with the same consideration reserved for their families.").

[114] 253 F.3d 159 (3d Cir. 2001).

[115] *Id.* at 161.

[116] *Id.* at 170 (quoting Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 587 (N.J. 1997)).

court interpreted this to require an inquiry into the parties' reasonable expectations (their "expectation interests").[117]

Under the license agreement, Orion was required to make minimum annual royalty payments of $4 million, regardless of how many products it distributed.[118] Sales of Emerson-brand goods declined during the three-year term of the agreement, allegedly due to a deliberate effort by Orion to convince Wal-Mart to purchase goods manufactured by Orion instead of Emerson goods.[119] Emerson claimed that Orion deliberately failed to market Emerson goods to Wal-Mart and that this constituted a breach of its good-faith duty, even though Orion complied with its obligation to make the annual $4 million royalty payments.[120] Emerson claimed that it expected more than the $4 million payments.

> Emerson's Chairman and CEO . . . stated in his deposition that "[w]e thought we might get six or $8 million a year. We actually did at one point figure we might get six and three-quarters to seven and a quarter million dollars a year. That was our vision at the time for this license."[121]

According to Emerson, Orion's actions destroyed Emerson's expectation interest and breached the implied covenant of good faith and fair dealing.[122]

The Third Circuit held that Emerson raised a genuine issue of material fact precluding summary judgment on the good-faith claim.[123] The court, in effect, held that Orion could be liable for

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117 *Id.* at 170-71.

118 *Id.* at 166.

119 *Id.* at 163.

120 *Id.* at 171.

121 *Id.*

122 *Id.* at 172. Earlier in the opinion, the Third Circuit affirmed the district court's holding that no obligation to use "reasonable efforts" should be implied because "'a required annual payment of this magnitude constitutes sufficient non-contingent consideration such that the equitable purposes served by inferring a best efforts clause are not implicated in the situation.'" *Id.* at 166 (quoting Emerson Radio Corp. v. Orion Sales, Inc., 41 F. Supp. 2d 547, 551 (D.N.J. 1999)). It is unclear why equity would not require a best efforts clause but would require a good-faith obligation.

123 *Id.* at 172. The court also reversed the summary judgment in favor of Orion on the issue of whether Orion breached an express provision of the contract. *Id.* at 175. The License Agreement provided that Emerson granted Orion an exclusive "non-transferable license *to utilize and exploit the Licensed Marks*." *Id.* at 163. Emerson argued that this language imposed an obligation on Orion to use "reasonable efforts" or "due diligence" in marketing Emerson's products. *Id.* The Third Circuit held that the phrase was ambiguous and that the issue must go to the jury in order to

performance that failed to live up to Emerson's expectations, even though those "expectations" were in direct conflict with the contract terms.[124] In reality, Emerson's expectations were no more than hopes or optimistic predictions. There was no indication that Orion in any way fostered those hopes or led Emerson to believe that it would guarantee royalty payments in excess of $4 million. Nonetheless, it faced possible liability for failure to perform in accordance with Orion's expectations. Orion arguably acted despicably, but it did not breach its non-exclusive contract.[125] Emerson knew Orion manufactured competing goods, and it seems reasonable to expect Orion to try to develop the market for its own products.

This case illustrates the danger of including a duty of good faith based on party expectations. In this way, courts such as the Third Circuit use the implied covenant of good faith to elevate the parties' expectations above their agreement. Parties have the opportunity to make certain that the other party's performance meets their expectations by drafting contracts consistent with those expectations. Emerson could have included an exclusivity provision in the contract restricting or prohibiting Orion from selling its own brand to Wal-Mart during the length of the contract, but it failed to do so. After the agreement has been formed, parties should only reasonably expect performance that is consistent with the agreement. Otherwise, the implied covenant of good faith becomes a tool to rewrite the agreement after performance is complete to reflect what one party *should have said*, but did not.

Moreover, there may be disagreement about what expectations are reasonable in a given set of circumstances. Most notably, some courts have found a breach of the implied duty of good faith even when the party is merely exercising rights expressly granted under the contract.[126] Under this conceptualization of

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determine the proper interpretation. *Id.* at 165. Relying on contract interpretation to establish Orion's obligations is preferable to relying on the duty of good faith because it looks to the intent of the parties as expressed in their agreement rather than creating obligations outside of or inconsistent with their bargain.

[124] *See id.* at 171-72.

[125] There was some indication that the defendants had a "secret intent to decimate Emerson's relationship with Wal-Mart" and actively sought to conceal this intent from Emerson while pretending to help Emerson. *Id.* at 172. If Orion actively misled Emerson regarding its intent, then Emerson might have been able to sue for fraud or misrepresentation.

[126] *See, e.g.*, Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 588 (N.J. 1997)

good faith, it apparently is unreasonable to expect compliance with and enforcement of the contract terms if, in the opinion of the factfinder, the motivation for or the result of exercising contractual rights is determined to be inequitable or otherwise unfair.

Relying on expectations, even when those expectations are contrary to the contract terms, is inconsistent with the purpose of contracting. If parties are to be bound by expectations, then there is no need for binding agreements. The point of agreeing on terms is to ensure that all have a common understanding of their rights and obligations. Expectations may never be discussed or disclosed. If liability is based on expectations, then parties should be on notice of that fact at the time of contract formation so that those expectations may be enunciated and clarified.

In *Amoco Oil Co. v. Ervin*,[127] the Colorado Supreme Court affirmed a judgment based on a jury finding that Amoco breached the implied covenant of good faith and fair dealing by setting rental prices for the service stations of its independent retail dealers that were inconsistent with the dealers' "reasonable expectations."[128] While the lease agreement set a specific rental rate for the first year, Amoco had the right to modify the formula for determining the rental amount each year thereafter, provided that it gave the dealer ninety-day notice of the change.[129] If dissatisfied with the rental amount, the dealer had the right to terminate the lease upon fifteen-day written notice.[130]

During the course of the parties' relationship, Amoco changed the method it used to calculate rent.[131] Although the dealers agreed to pay the new amounts, they were evidently unaware of

("[A] party to a contract may breach the implied covenant of good faith and fair dealing in performing its obligations even when it exercises an express and unconditional right to terminate.").

127 908 P.2d 493 (Colo. 1995).

128 *Id.* at 499.

129 *Id.* at 497 n.4.

130 *Id.* at 497.

131 Amoco moved from a rate that was based on the sale of gasoline at a particular station to a method of calculation that was based on the asset value of the station. *Id.* at 495. The new Investment Value Report (IVR) formula was calculated by adding eight percent of the capital improvements on the property, a maintenance charge, actual real estate and property taxes for the previous year, rent increment for the next fiscal year, and a uniform charge for each service bay at the station. *Id.* at 496.

the precise formula used to determine the new rental amount.[132] Specifically, they did not realize that the formula included a charge for capital improvements (including the service bays) and a uniform charge for each service bay.[133] The dealers alleged that the lease gave Amoco discretion to set the rate, and that this gave rise to an obligation that Amoco exercise this discretion in good faith.[134] They claimed that Amoco breached the duty of good faith by double-charging them for the service bays.[135]

The Colorado Supreme Court agreed that Amoco retained discretion to modify the rental amount and that the implied covenant of good faith and fair dealing required Amoco to exercise the discretion in good faith.[136] Specifically, the court approved the trial court's instruction to the jury to "enforce the agreements according to the reasonable expectations of the parties."[137] The jury found that by including two charges for the service bays in its calculation of rent, Amoco "did not perform the contracts in accordance with the dealers' reasonable expectations."[138] The supreme court affirmed this finding, noting that "the dealers never agreed to be charged twice for any goods or services under the lease agreement. The dealers were justified in expecting that, in determining the appropriate rent, Amoco would not charge double for any one element of the calculation."[139]

The opinion in this case is noteworthy in several respects. First, there was no finding that the rental amounts charged by Amoco were unconscionable, or even unfair. The dealers agreed

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132 *See id.* at 499.

133 *Id.*

134 *Id.*

135 *Id.* at 497.

136 "Under the agreements, Amoco retained discretion to modify the monthly rental amount." *Id.* at 499. As an initial matter, the propriety of the finding that the lease gave Amoco discretion to set the rental price is questionable. Unlike cases in which one party has sole discretion to set the price (or, as in this case, rent) after contract formation and the other party has no right to object, in this case the dealers were not obligated to pay the modified rent. *See id.* at 497 n.4. If they believed the amount to be too high, they had the right to terminate the contract. They were only obligated to pay the rent specified in the contract for the first year. *Id.* Thus, it is more accurate to say that Amoco had discretion to *propose* a new rental rate, which could be accepted or rejected by the dealers. *See id.*

137 *Id.* at 497. The jury was informed that "Colorado law provides that each contract has an implied covenant that parties shall act in good faith and deal fairly" and "that the law requires each party to a contract to act in such a manner that each party will attain their reasonable expectations under the contract." *Id.* at 499.

138 *Id.*

139 *Id.*

to pay the modified rental amounts for three years before they knew the formula behind the amounts.[140] Obviously, the dealers' complaint was that they were ignorant of the formula, not the actual rental price. Moreover, there was no evidence that Amoco lied to the dealers about the formula or that the dealers ever asked how the rental amount was calculated.

But the formula used by Amoco should have been inconsequential. Absent an obligation imposed by the contract, Amoco had no obligation to explain the formula used to calculate the rental amounts. The dealers' true complaint was that the rental amount was too high, but that complaint does not implicate the duty of good faith as defined by the court. The jury was instructed to enforce the agreement according to the parties' reasonable expectations,[141] but there can be no doubt that the rental *amount* was clearly within the dealers' reasonable expectations since it was disclosed to them and they accepted it. If they believed it to be excessive, they had the right to terminate the lease or attempt to negotiate a lower rate.

Even assuming that Amoco had an obligation to act reasonably when exercising its discretion to propose new rental amounts, the internal thought processes that it used to arrive at the rental rate were simply irrelevant. If the amount was reasonable, then Amoco's obligation was fulfilled. This point becomes clearer when one considers that, presumably, had Amoco simply changed the formula but still arrived at the same price, it would not have been liable.[142] Imposing liability because the *formula* failed to meet the dealers' expectations unnecessarily and unwisely expands the parties' obligations. According to the Colorado Supreme Court, parties not only have a duty to include terms that meet the reasonable expectations of the other party, but also they must do so for reasons and based upon considerations that are within the reasonable expectations of the other party. Indeed, it becomes a duty of full disclosure in negotiations instead of good-faith performance.[143]

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[140] *See id.* As noted above, the dealers had the right to terminate the lease agreements if the new rental amounts were deemed unacceptable. *See id.* at 497 n.4.

[141] *Id.* at 499.

[142] For instance, had Amoco's formula included a higher percentage for the capital charge but eliminated the charge for each service bay, thus arriving at the same result, the dealers would have had no basis for complaint.

[143] "The duty of honesty, of good faith even expansively conceived, is not a duty of candor." Mkt. St. Assocs. v. Frey, 941 F.2d 588, 594 (7th Cir. 1991).

Not all courts have embraced the view that good faith protects expectations contrary to the contract terms. For example, *Taylor Equipment, Inc. v. John Deere Co.* involved a contract between John Deere and one of its retail industrial equipment dealers, Midcon.[144] The contract stated that Midcon could not assign its dealership "without the prior written consent" of John Deere.[145] Midcon sought John Deere's consent to assign its dealership to Interstate Companies of Minnesota ("Interstate") and John Deere refused Midcon's request.[146] Midcon later assigned the dealership to two other dealers, with John Deere's approval, at a lower price than what Interstate had offered.[147] Midcon then sued John Deere, claiming that its refusal to consent to the assignment to Interstate was a breach of the implied covenant of good faith and fair dealing.[148]

John Deere's stated reason for refusing consent was that Interstate had inadequate equity capital.[149] Midcon claimed that this reason was a pretext and that John Deere had a "secret plan" to eliminate many of its small dealers by approving sales of dealerships only to "key dealers."[150] According to Midcon, the goal was to "rationalize" (or streamline) John Deere's dealer network.[151] The dealers to which Midcon eventually sold its assets were allegedly "key dealers."[152] The jury found that John Deere had breached the duty of good faith and fair dealing, and the trial court denied John Deere's motion for judgment notwithstanding the verdict and motion for new trial.[153]

On appeal, the Eighth Circuit reversed the judgment.[154] Fol-

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144 98 F.3d 1028 (8th Cir. 1996), *cert. denied*, 520 U.S. 1197 (1997).

145 *Id.* at 1030.

146 *Id.* The sale was necessitated by Midcon's breach of an unrelated term of the contract. *Id.* Although the breach gave John Deere the right to terminate the contract immediately, John Deere allowed Midcon to continue as a dealer in good standing for a period of time while it sought to sell the business. *Id.*

147 *Id.*

148 *Id.* The case was governed by the law of South Dakota, which recognized an implied covenant of good faith and fair dealing in every contract. *Id.* at 1031. The South Dakota Supreme Court adopted the South Dakota Uniform Commercial Code's definition of good faith for all contracts: "honesty in fact in the conduct or transaction concerned." *Id.* at 1032 (citing S.D. Codified Laws § 57A-1-201(19) (1988)).

149 *Id.* at 1031.

150 *Id.*

151 *Id.*

152 *Id.*

153 *Id.*

154 *Id.* at 1034.

lowing the logic of prior South Dakota Supreme Court cases, the Eighth Circuit concluded that Midcon's implied covenant claim should fail.

> The purpose of the implied covenant is to honor the parties' *justified* expectations . . . . Midcon's dealer contract granted Deere an express, unrestricted right to disapprove a proposed assignment of Midcon's contract rights. This contract term gave Midcon no justified expectation that Deere was agreeing to surrender its absolute right to choose Midcon's successor. Instead, the no-assignment-without-Deere-approval term *preserved* that right.[155]

As the Eighth Circuit noted, expectations are only justified when they are consistent with the parties' bargain.[156]

Each party should be able to act in their own best interests so long as they comply with the terms of the contract and do not interfere with the other party's ability to perform under it. Not only is this consistent with the conceptualization of the contractual relationship as a set of finite, defined, mutually-agreed-upon obligations, it relieves each party from having to investigate or anticipate what the other party hopes to achieve or receive in anticipated benefits under the contract.

When the evidence shows that both parties understood that the contract included certain obligations, an implied covenant reflecting those obligations is in order.[157] This is simply a matter of contract interpretation. However, when there is a dispute regarding the parties' expectations, and the contract does not inescapably lead to a conclusion that one party's expectations are justified by the contract terms, parties should not be bound by an

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[155] *Id.* at 1033. The court further noted that even if John Deere's true reason for refusing consent was to consolidate its dealerships, then that would be a legitimate business reason that would not violate its duty of good faith. *Id.* at 1034. Note that this court could have implied the duty of good faith because this is a contract granting sole discretion to one party, thereby obligating John Deere to exercise that discretion reasonably. The Eighth Circuit, however, apparently believed that the South Dakota courts were willing to enforce contracts granting absolute discretion without implying a duty of good faith. *Id.* Even if such a duty had been implied, the court's discussion indicates it believed John Deere acted in good faith even though its actions were inconsistent with Midcon's expectations. *Id.* (noting that Deere's stated reasons for disapproving the assignment were "legitimate business reasons").

[156] *Id.* at 1033.

[157] For example, evidence of trade usage, course of dealing, and course of performance will be relevant and admissible, and should be taken into consideration when determining the parties' obligations. However, although such evidence is relevant to determining the parties' actual agreement and mutual understanding, it is not relevant to determining the unexpressed expectations of one party.

obligation of good faith to act in accordance with the first party's expectations.

While some benefits or "fruits" may be fairly obvious from the subject matter of the contract itself, parties often have unstated or tangential reasons for entering into a specific agreement on particular terms. If a party acts in furtherance of those undisclosed goals and its actions conflict with the undisclosed goals of the other party, a breach of the duty of good faith could be found even though the party has complied with all of its contractual obligations. The only way to prevent such unintentional breaches of the implied good-faith duty would be to disclose all hopes, expectations, and anticipated benefits to the other party before entering into the contract. Such a requirement is unwise and contrary to sound business practices.[158]

B. Obligation Not to Interfere

Conceptualizing the duty of good faith as a prohibition on actions that will negatively affect the expected benefits of the other party is most attractive in contexts where one party's actions prevent or seriously impair the other party's ability to perform under the contract. In essence, it prevents one party from interfering with the other party's performance. If the person or entity interfering with a party's performance under the contract is not a party to the contract, then a cause of action for tortious interference with contract may be available. However, most jurisdictions do not allow a claim for tortious interference against a party to the contract. In other words, a party cannot interfere with its own contract. Courts have used the implied covenant of good faith to provide a remedy when tortious interference is unavailable.

In *Electronics Store, Inc. v. Cellco Partnership*, Electronics entered into an agreement with Bell Atlantic to market Bell Atlantic's cellular phone services.[159] Electronics could not offer any services competitive to Bell Atlantic, nor was it allowed to solicit existing Bell Atlantic purchasers or subscribers.[160] Bell Atlantic expressly reserved the right to market its cellular services through its own employees in the same area in which Electronics

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[158] *See* Mkt. St. Assocs. v. Frey, 941 F.2d 588, 594 (7th Cir. 1991) (noting that duty of good faith is not a duty of candor).

[159] 732 A.2d 980, 983 (Md. Ct. Spec. App. 1999).

[160] *Id.*

worked.[161] Moreover, the agreement provided: "Nothing herein shall restrict or prohibit Bell Atlantic from, in its sole discretion, offering potential Subscribers in the Area, through its direct sales force or otherwise, volume discounts, promotional offers, new or modified price plans or any other special offers of [cellular service]."[162]

Electronics filed suit after Bell Atlantic refused to allow Electronics to enroll members of the Cedar Point credit union, but soon thereafter enrolled Cedar Point members through its direct sales force.[163] Electronics claimed that Bell Atlantic's direct sales force improperly interfered with its potential sales to Cedar Point, causing Electronics to suffer lost commissions, lost revenues, and lost sales.[164] The complaint included allegations of breach of contract, tortious interference with contract, tortious interference with business relations, unfair competition, concerted refusal to deal, and civil conspiracy.[165]

Electronics appealed the judgment on the breach of contract, tortious interference, unfair competition, and civil conspiracy claims.[166] The court of appeals summarily dismissed Electronics's tortious interference claims because Bell Atlantic—the alleged tortfeasor—was a party to the contract.[167] Applying New Jersey law, the court reversed the summary judgment in favor of Bell Atlantic on the breach of contract claim. It held that a jury should decide whether Bell Atlantic breached its implied duty of good faith and fair dealing by refusing to quote a price for Cedar Point, even though the contract expressly allowed Bell Atlantic, in its sole discretion, to reject the enrollment of any subscriber, and it was undisputed that Bell Atlantic had complied with the express terms of the agreement.[168]

The court noted that Bell Atlantic's direct sales agents were in

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161 *Id.* ("Bell Atlantic reserves the right to market [cellular service] through its own direct sales organization, or other Agents, resellers, or otherwise, in the Area.").

162 *Id.*

163 *Id.* at 984. Bell Atlantic informed Electronics that the proposed pricing plan for Cedar Point was denied because Cedar Point was a credit union. *Id.*

164 *Id.*

165 *Id.*

166 *Id.*

167 *Id.* at 990-91.

168 *Id.* at 988 ("Read literally and technically, Bell Atlantic has fully performed its obligations under the Agreement because the subscribers were not accepted by Bell Atlantic.").

direct competition with Electronics and argued that the jury could find that Bell Atlantic had acted dishonestly in telling Electronics that it "did not 'do credit unions.'"[169] Additionally, Bell Atlantic may have breached the good-faith covenant by refusing to quote a price to Electronics because one former Bell Atlantic executive testified that he would not have instructed Electronics not to submit the pricing request.[170] According to the court, this permitted an inference that Bell Atlantic's refusal to quote a price to Electronics was a self-serving tactic designed to allow Bell Atlantic's direct sales force to execute the contract with Cedar Point at a lower cost to Bell Atlantic than if the deal had been closed by Electronics.[171]

> The commissions were the "fruits of the contract" to be earned by Electronics. When Bell Atlantic claimed that it did not deal with credit unions and refused to authorize a price for Electronics to offer to Cedar Point, and almost immediately signed up Cedar Point itself, it may have deprived Electronics of the "fruits" of the Agreement.[172]

Thus, the court effectively held that Bell Atlantic might be liable for breach of contract even though the express language of the agreement allowed its actions. In fact, at the time the contract was signed, all parties were aware that Bell Atlantic's direct sales employees would be competing with Electronics for customers, and that Bell Atlantic expressly reserved the right to have its direct sales force offer "volume discounts, promotional offers, new or modified price plans or any other special offers."[173] Realistically, Electronics should have expected to lose some of its potential commissions to Bell Atlantic's direct sales agents who might have been in a position to offer a better deal than Electronics was authorized to offer. Simply losing business to its competition—in this case, Bell Atlantic—did not deprive Electronics of the "fruit" of its bargain.

Instead, the heart of Electronics's complaint was that Bell Atlantic deliberately prevented Electronics from signing up Cedar

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169 *Id.* at 989-90 (citing RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. d (1981)).

170 *Id.* at 990.

171 *Id.*

172 *Id.*

173 *Id.* at 983. The court acknowledged that under the unambiguous terms of the agreement "Bell Atlantic's in-house sales department was not restricted by the contract from marketing its service in the same area in which Electronics was authorized to market Bell Atlantic's services." *Id.*

Point so that it could obtain the business from its direct sales force. In essence, Bell Atlantic interfered with Electronics's performance of the contract. However, as noted above, there is no tort cause of action when a party interferes with its own contract.[174] There is, however, a well-settled principle of contract law that one party cannot prevent the other party from performing under a contract.[175]

In some jurisdictions, this principle is considered a part of the duty of good faith and fair dealing.[176] However, many jurisdictions recognize it as a separate duty, including Texas, which does not recognize the broader implied duty of good faith in every contract.[177] Under this principle, Bell Atlantic may have been liable to Electronics for damages caused by Bell Atlantic's actions in unjustly preventing Electronics from signing up Cedar Point as a customer. Application of this principle would honor the parties' bargain as expressed in their agreement while ensuring a basic level of fair dealing between the parties.

C. Obligations Contrary or in Addition to Express Contract Terms

Two of the most controversial issues related to the duty of good faith are: (1) whether a party can violate the duty of good faith if the party exercises a right expressly granted to it in the contract; and (2) whether a party can breach the implied covenant of good faith without breaching any express contract

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174 *Id.* at 990.

175 *See* Parker v. Columbia Bank, 604 A.2d 521 (Md. Ct. Spec. App. 1992).

176 "Under Maryland law, a duty of good faith and fair dealing is an implied term in certain contracts . . . but this duty simply prohibits one party to a contract from acting in such a manner as to prevent the other party from performing his obligations under the contract." *Id.* at 531. However, this principle was stated in the First Restatement: "Prevention or hindrance by a party to a contract of any occurrence or performance requisite under the contract for the creation or continuance of a right in favor of the other party, or the discharge of a duty by him, is a breach of contract, unless (a) the prevention or hindrance is caused or justified by the conduct of the other party, or (b) the terms of the contract are such that the risk of such prevention or hindrance as occurs has been assumed by the other party." RESTATEMENT (FIRST) OF CONTRACTS § 315 (1932). This principle is now subsumed in the good-faith provision of the Second Restatement. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. d (1981).

177 *See* Dorsett v. Cross, 106 S.W.3d 213, 217 (Tex. App. 2003) ("When the obligation of a party to a contract depends upon a certain condition's being performed, and the fulfillment of the condition is prevented by the act of the other party, the condition is considered fulfilled.").

term.[178] Those who answer these questions in the affirmative argue that the duty of good faith is an obligation that is distinct from and in addition to the express contract terms. Thus, a party can violate the implied covenant by performing in bad faith even though the party has complied with all of the express contract terms. Likewise, a party may act in bad faith by exercising a right granted to that party in the contract with an improper motive.

This interpretation of the implied duty of good faith is troubling on both theoretical and practical levels. From a theoretical perspective, it is difficult to reconcile the notion that a party can be in breach of a contract for taking actions consistent with the contract terms with the notion that parties' obligations are defined by the bargain of the parties themselves. If a party bargains for certain rights, but cannot exercise those rights without fear of liability, then the right is worthless and that party loses the benefit of its bargain. From a practical standpoint, no matter how clear the language or how unambiguous the terms, a party cannot rely on the agreement to determine its rights and obligations if simply complying with the contract terms is not enough to avoid a breach of contract action.

The view that a party can breach the implied covenant of good faith by exercising an express contractual right is justified by the argument that the duty of good faith enforces "community standards of decency, fairness or reasonableness."[179] Thus, the duty of good faith becomes a much more flexible, and therefore potentially more attractive, tool of equity than other doctrines such as unconscionability. Although the doctrines may not apply in precisely the same circumstances,[180] the more compelling differ-

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[178] *See* Goren, *supra* note 5, at 259-60 (identifying question of whether breach of implied covenant of good faith gives rise to an independent cause of action as one problem that has arisen nationally in confronting the covenant). *Compare, e.g.,* Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 588 (N.J. 1997) ("[A] party to a contract may breach the implied covenant of good faith and fair dealing in performing its obligations even when it exercises an express and unconditional right to terminate."), *with* Adams v. G.J. Creel & Sons, Inc., 465 S.E.2d 84, 85 (S.C. 1995) ("[T]here is no breach of an implied covenant of good faith where a party to a contract has done what provisions of the contract expressly gave him the right to do.").

[179] RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981) ("Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness.").

[180] Unconscionability focuses on the fairness of contract terms at the time of contract formation. In contrast, the duty of good faith focuses on performance, and in

ence between them is in the level of "unfairness" that must exist before the court may intervene.

A contract or its terms may be objectively unfair or disproportionately beneficial or detrimental to one party without giving rise to a claim of unconscionability. Instead, according to the traditional definition, a term is only unconscionable if it is "'such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other . . . .'"[181] This is not a standard of reasonableness or fairness, and courts have generally exercised great caution in cases alleging unconscionability, striking down or refusing to enforce such terms only in the most egregious instances. To the extent that courts require both procedural and substantive unconscionability, the distinction between good faith and unconscionability is even clearer in light of the fact that courts can impose liability for breach of the duty of good faith even absent a showing of any defect or disparity of bargaining power at the time of contracting. Consequently, the doctrine of good faith sets a lower standard. Requiring compliance with general standards of fairness and reasonableness implies that a court can find a breach of the duty simply because one party's performance of the contract is, in some indefinable sense, unfair or unreasonable, even if that conduct is sanctioned by an agreement that was willingly and knowingly entered into by the other party.

Many courts, including the Seventh Circuit, have been critical of this expansive view of good faith.[182] In *Kham & Nate's Shoes No. 2 v. First Bank*, the bankruptcy judge subordinated a bank's claims based on the bank's alleged "inequitable conduct."[183] The debtor had sought financing to relieve a serious cash-flow prob-

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the formulation currently under discussion, it can be breached even if the terms of the agreement itself are not objectionable. *Compare* RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981), *with* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). However, this distinction is often illusory. In good-faith cases where the party has exercised a right under the contract but is found to have violated the duty of good faith, the court is, in a sense, finding that the contract term that allowed the party to exercise that right is unfair or inequitable—at least as applied to the facts of that case.

[181] RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. b (1981) (quoting Hume v. United States, 132 U.S. 406, 411 (1889)).

[182] *See, e.g.*, L.A.P.D., Inc. v. Gen. Elec. Corp., 132 F.3d 402, 404 (7th Cir. 1997) (applying Illinois law and noting that "[l]itigants may not seek to litigate issues of 'good faith' in lieu of abiding by explicit provisions of contracts.").

[183] 908 F.2d 1351, 1353 (7th Cir. 1990).

lem.[184] The bank agreed to loan the money, but only after the debtor filed a Chapter 11 bankruptcy petition and the bankruptcy judge granted an order giving the bank's loan "super-priority."[185] The loan agreement allowed for cancellation on five-day notice and stated "nothing provided herein shall constitute a waiver of the right of the Bank to terminate financing at any time."[186] The bank gave the debtor a $300,000 line of credit, but less than two months after the agreement was signed, and after the debtor had drawn only $75,000 on the credit line, the bank notified the debtor that it would not make any further advances.[187] The bankruptcy judge concluded that the bank acted inequitably in terminating the line of credit.[188]

According to the judge, the "Bank was fully aware of the Debtor's plight, and its reliance upon the line of credit, and disregarded the consequences for the Debtor and its creditors."[189] The debtor claimed that the bank's conduct was inequitable and unfair, even though the bank complied with all of the contract terms.[190] The Seventh Circuit disagreed. Writing for the court, Judge Easterbrook explained:

> [W]e are not willing to embrace a rule that requires participants in commercial transactions not only to keep their contracts but also do 'more'—just how much more resting in the discretion of a bankruptcy judge assessing the situation years later. Contracts specify the duties of the parties to each other, and each may exercise the privileges it obtained . . . . Unless pacts are enforced according to their terms, the institution of contract, with all the advantages private negotiation and agreement brings, is jeopardized.[191]

Judge Easterbrook defined "inequitable conduct" in commercial dealings as "breach *plus* some advantage-taking."[192] He stressed that parties are entitled to enforce their agreements "to

184 *Id.*

185 *Id.* The loan had priority even over the administrative expenses of the bankruptcy. *Id.*

186 *Id.*

187 *Id.* at 1353-54.

188 *Id.* at 1354.

189 *Id.* at 1356. When the bank refused to advance more funds, the debtor closed its head office in a prominent Michigan Avenue location, and, according to the debtor, the loss of this prestigious address made suppliers hesitant to deliver shoes on credit. *Id.* at 1354. The result was that the debtor closed three of its four stores, including two in "ritzy locations." *Id.*

190 *Id.* at 1356.

191 *Id.* at 1356-57.

192 *Id.* at 1357.

the letter, even to the great discomfort of their trading partners."[193] He explained that the good-faith obligation is not a substitute for compliance with negotiated terms, but is only "a compact reference to an implied undertaking not to take opportunistic advantage in a way that could not have been contemplated at the time of drafting, and which therefore was not resolved explicitly by the parties."[194] It cannot be used to contradict the terms of the contract.[195]

Judge Easterbrook's definition, while more restrictive, reflects a better understanding of the parties' *reasonable* or *justified* expectations. First and foremost, the parties can reasonably and justifiably expect enforcement of their contract's express terms. Parties should feel confident that they will not incur liability for exercising their express contractual rights or for failing to do more than what is required under the contract. Second, if the contract is silent with respect to a matter that could not have been contemplated when the contract was entered into, parties can reasonably and justifiably expect the other party to act in good faith with respect to that matter.

A party can only reasonably or justifiably expect conduct in addition or contrary to the contract terms if the contract has been modified, the contract or certain terms are unconscionable or violate a statute, the other party's conduct constitutes a waiver of a contractual right or obligation, the other party's conduct gives rise to an estoppel claim, or if the conduct involves taking opportunistic advantage in a way that could not have been contemplated by the parties when they entered into the agreement. While this will certainly leave some parties disappointed and wishing that they had been more careful in drafting their contracts, the certainty and predictability of this approach make it the more prudent option. This is especially true in light of the fact that the law does not require that contracts (or contracting parties) be objectively "fair" or "equitable."[196]

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193 *Id.*

194 *Id.* This is consistent with use of the covenant of good faith as a gap-filler or interpretive aid. *See* discussion *supra* Part II.C. Approval of Judge Easterbrook's conceptualization of good faith should not be interpreted as approval (or disapproval) of the decision or application of the law in *Kham.*

195 *Id.*

196 *See* RESTATEMENT (SECOND) OF CONTRACTS § 79 (1981) ("If the requirement of consideration is met, there is no additional requirement of . . . equivalence in the values exchanged . . . or 'mutuality of obligation.'").

D. Motive as Determining Factor

Some courts have made motive the (or at least a) determining factor when deciding whether a party has performed in good faith.[197] According to these courts, a party may be liable for breach of the implied covenant of good faith by exercising rights expressly granted to it under the contract if the party's motive is deemed to be improper.[198] In other words, the party's contractual rights vary according to the party's motive for exercising them.

If a party is merely enforcing or exercising its rights under the express terms of the contract, then motive should be irrelevant.[199] Even if the party knows that the other party will be adversely affected, and even if that is the desired result, there should be no liability if the agreement clearly allows such action. To hold otherwise is to require a party to relinquish bargained-for rights solely for the benefit of the other party. While it may be socially desirable for a party to relinquish such rights if that party is not thereby harmed (and many relinquishing parties will do so voluntarily for a variety of reasons),[200] to require such action is to deprive a party of the benefit of their bargain and to require altruism.[201]

When the inquiry is whether a party has exercised discretion in good faith, the motive for the party's actions may be relevant, but only to the extent that it sheds light on whether the exercise of discretion was reasonable, consistent with the parties' reasonable expectations, or not arbitrary or capricious.[202] If the exercise of

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197 *See, e.g.*, Wilson v. Amerada Hess Corp., 773 A.2d 1121, 1129 (N.J. 2001) (noting "the importance of demonstrating bad motive in order to assert successfully a claim of breach of the implied covenant of good faith and fair dealing").

198 *See, e.g.*, Amoco Oil Co. v. Ervin, 908 P.2d 493 (Colo. 1996).

199 *See* Mkt. St. Assocs. v. Frey, 941 F.2d 588, 594 (7th Cir. 1991) ("[E]ven after you have signed a contract, you are not obliged to become an altruist toward the other party and relax the terms if he gets into trouble in performing his bargain. Otherwise mere difficulty of performance would excuse a contracting party—which it does not.") (citation omitted).

200 In many cases, parties will do so voluntarily in order to preserve a relationship, create goodwill, preserve or increase their reputation in the community, or to encourage reciprocal benevolence in the future.

201 *See* Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992) ("Contract law does not require parties to behave altruistically toward each other; it does not proceed on the philosophy that I am my brother's keeper.").

202 *See, e.g.*, *Wilson*, 773 A.2d at 1130 ("[A] party exercising its right to use discretion in setting price under a contract breaches the duty of good faith and fair dealing

discretion was reasonable, then motive should be irrelevant. Thus, a discretion-exercising party may set the date for performance under a contract at a point in time where it knows that the other party will not be able to perform, so long as the discretion-exercising party provides an objectively reasonable time for performance that is consistent with the parties' reasonable expectations at the time of contracting and is not arbitrary or capricious. This is so even if the motive for setting the date is to force the other party to breach.[203] This approach may be unsettling, as it appears to reward what may be termed undesirable behavior, but it is simply enforcing the parties' bargain.

E. If No Bad Faith, then Good Faith

Professor Summers first articulated this approach in his influential 1968 article.[204] He posited that good faith was incapable of precise definition and should instead be understood as prohibiting various forms of "bad faith."[205] His hope was that the courts would develop a body of case law that would define the contours of good faith.[206] The Restatement (Second) of Contracts adopted Professor Summers' approach, declining to define good faith, but including the "excluder analysis" in the comments, along with Professor Summers' list of examples of bad faith.[207] Unfortunately, more than thirty-five years later, courts have failed to live up to Professor Summers' aspiration.

Some of the fault may lie with the examples listed in Professor Summers' article and Comment d to Restatement (Second) of

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if that party exercises its discretionary authority arbitrarily, unreasonably, or capriciously, with the objective of preventing the other party from receiving its reasonably expected fruits under the contract."); Dayan v. McDonald's Corp., 466 N.E.2d 958, 972 (Ill. App. Ct. 1984) ("[T]he courts of this state have held that a party vested with contractual discretion must exercise that discretion reasonably and with proper motive, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.").

203 *Original Great American Chocolate Chip Cookie Co.*, 970 F.2d at 280 ("The law generally . . . does not provide remedies for spiteful conduct or refuse enforcement of contractual provisions invoked out of personal nastiness.") (citing Rideout v. Knox, 19 N.E. 390 (Mass. 1889) (Holmes, J.)). The discretion-exercising party may do so in order to take advantage of other business opportunities or to sever an unpleasant or unproductive relationship. If the party's actions and accompanying motives are tortious or violate some other contract doctrine, then, of course, the party should face liability.

204 Summers, *Good Faith*, *supra* note 6, at 201.

205 *Id.*

206 *Id.* *See* Van Alstine, *supra* note 14, at 1250-51.

207 *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. d.

Contracts section 205, since those examples can be more confusing than enlightening. Some of the alleged examples of bad faith, such as willful rendering of imperfect performance, lack of diligence, and slacking off, may constitute a breach of contract. If "imperfect" performance, lack of diligence, or slacking off result in failure to comply with the contract terms, the performing party is in breach and is liable for damages. If it does not amount to a breach, but is simply less than what was hoped for, it should not be actionable. If a certain level of performance is required, it should be specified.[208] Otherwise, a party should be free to divert its efforts elsewhere if it will be more profitable or less burdensome, so long as this diversion does not violate the contract.

Defining "evasion of the spirit of the bargain" as bad faith is troubling because it assumes that the "spirit" of an agreement can be discerned, and because it ignores the fact that the parties negotiate or agree to terms, not a general concept or "spirit." If the parties agree to terms contrary to the "spirit" of the bargain, the terms should prevail. Moreover, a party should be allowed to take advantage of opportunities that arise after contracting that are contrary to the spirit but consistent with the terms. Indeed, the circumstances may change for both parties in such a way that the original motivations for entering into the agreement are no longer valid, but are replaced by new and different motivations and expectations. To the extent that this can be done without breaching the contract, it should be allowed.

Other examples of "bad faith," such as interference with or failure to cooperate in the other party's performance, can be dealt with by other contract doctrines or can exist separately as independently defined and recognized duties.[209] This leaves "abuse of the power to specify terms" as the sole example of performance that requires an implied obligation of good faith. As discussed above, use of the implied covenant of good faith in this context is not contested.

F. Forgone Opportunities

Few courts appear to rely expressly and exclusively upon Pro-

[208] In the case of an open price or quantity term, courts hold that a reasonable price or reasonable quantity is required. *See* U.C.C. § 2-305 (2001); S.C. Gray, Inc. v. Ford Motor Co., 286 N.W.2d 34, 39 (Mich. Ct. App. 1979); Burnside Air Conditioning & Heating, Inc. v. T.S. Young Corp., 113 S.W.3d 889, 895 (Tex. App. 2003).

[209] *See* Van Alstine, *supra* note 14, at 1253 n.118, and discussion *infra* Part V.

fessor Burton's conceptualization of good faith, which holds that a party breaches the implied covenant when it uses its discretion "to recapture forgone opportunities."[210] Courts may be reluctant to rely on this conceptualization because it requires them to determine what opportunities a party gave up when entering into a contract. This undertaking seems even more difficult than identifying the parties' reasonable expectations.

One court that has employed this approach seemed to equate "recapture of forgone opportunities" with attempts to use changed circumstances to obtain a favorable modification of the contract.[211] In that case, the plaintiff, Tufankjian, sought financing to purchase an automobile dealership.[212] A representative from Rockland Bank ("Bank") approached Tufankjian regarding floor-plan financing.[213] Tufankjian was not interested in this type of financing, but entered into negotiations with the Bank regarding other financing options.[214] According to Tufankjian, a Bank representative offered to lend him part of the purchase price at a fixed interest rate of 7.5 percent, with the remaining financing provided though a Small Business Administration (SBA) loan at a guaranteed interest rate of 6.5 percent or less.[215] Tufankjian signed a commitment letter that did not mention the SBA loan interest rate.[216] This loan was conditioned on procurement of the SBA loan.[217]

The SBA refused to lend Tufankjian the balance of the purchase price at 6.5 percent, and there was testimony that the Bank made disparaging comments about Tufankjian to the SBA and otherwise obstructed his efforts to perform under the agreement.[218] Additionally, the Bank attempted to convince Tufankjian to change the terms of their agreement by agreeing to loan him the entire amount if he agreed to a higher interest rate, and by including floor-plan financing as part of the agreement.[219] "The Bank, by its actions, was seeking 'to recapture opportuni-

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[210] Burton, *supra* note 4, at 378.

[211] *See* Tufankjian v. Rockland Trust Co., 782 N.E.2d 1 (Mass. App. Ct. 2003).

[212] *Id.* at 3.

[213] *Id.*

[214] *Id.*

[215] *Id.* at 3-4.

[216] *Id.* at 4.

[217] *Id.*

[218] *Id.* at 4-5. It is unclear from the opinion what performance was obstructed by the Bank.

[219] *Id.* at 5.

ties forgone on contracting' as determined by [Tufankjian's] reasonable expectations and to secure a better deal from him."[220]

To the extent that "recapturing forgone opportunities" is synonymous with attempts to modify agreements, the pressured party has the option of refusing to agree to the modifications. Moreover, if the pressuring party is interfering with another contract or business relationship, a remedy is available in tort.[221] Finally, even jurisdictions that do not recognize a duty of good faith in every contract prohibit one party from impairing or preventing the other party's performance.[222] Thus, no implied covenant of good faith is necessary to vindicate the rights of the parties in these circumstances.

G. Use of the Implied Covenant of Good Faith to Save On Transaction Costs

One justification for the implied covenant of good faith is that it allows parties to enter into binding contracts without requiring that they spell out every term. The good-faith covenant is one of several "gap-fillers" that allegedly give effect to those of the parties' intentions that they had not bothered to spell out. While use of the implied good-faith covenant may be justified as a gap-filler to address situations that the parties could not have anticipated at the time of contract, it is inadvisable to encourage parties to deliberately leave terms open for the courts to fill in later.

The fallacy lies in the assumption that the courts can and will effectively discern the parties' intentions, or that all parties had the same expectations. More importantly, any savings from choosing not to spell out the contract terms are spent in litigation costs. Because the parties' performance will be judged based on subjective, largely abstract criteria, a party can never be certain that the other party and the court will agree that it has complied with all of its implied obligations.[223] Merely performing or exer-

220 *Id.* (quoting Anthony's Pier Four, Inc. v. HBC Assocs., 583 N.E.2d 806, 821 (Mass. 1991) (internal quotation marks omitted)).

221 "The elements of tortious interference with a contract are: (1) the existence of a contract subject to interference; (2) the occurrence of an act of interference that was willful and intentional; (3) the act was a proximate cause of the claimant's damage; and (4) actual damage or loss occurred." Baty v. ProTech Ins. Agency, 63 S.W.3d 841, 856-57 (Tex. App. 2001).

222 *See* discussion *infra* Part VI.

223 *See* Seidenberg v. Summit Bank, 791 A.2d 1068, 1079-80 (N.J. Super. Ct. App. Div. 2002) ("We recognize that expressions such as 'bad faith,' 'improper motive,' and other similar words and phrases used to describe the requisite state of mind

cising discretion honestly and—in the opinion of that party—reasonably is not enough; instead, the party must be able to *convince the court or jury* that it performed with honorable intentions and within the reasonable expectations of the other party. This can rarely be resolved on summary judgment, and certainly not without a fair amount of discovery. Even the most straightforward case may languish on the docket for months or even years before finally being resolved by summary judgment or a trial. Appeals may delay resolution even longer. Viewed from this perspective, little is saved by encouraging parties to leave contract terms open and allowing courts to fill in those blanks with the implied covenant of good faith.

IV

Issues of Contract Interpretation

There are courts and scholars who view *Taylor*, *Kham*, and similarly decided cases as regrettable retractions of the law of good faith.[224] Some view the rise of the "textualist" approach to good faith as "a return to the formalist presumptions of late nineteenth-century contract law" when courts refused to look beyond the four corners of the contract to determine the parties' intent.[225] This fear is largely unfounded. There is a middle ground between formalism and an expansive view of good faith. Respecting the primacy of the parties' agreement does not mean relying exclusively on the agreement's text. Instead, it means that the agreement cannot be disregarded in favor of more equitable or "fairer" terms as determined ex post facto by the court or jury. The parties' bargain, as determined based upon all admissible evidence, will be respected even if the result seems somewhat unfair or the actions of one party seem unkind.

Supporters of the good-faith duty argue that critics place too

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provide little guidance. . . . Ultimately, . . . the presence of bad faith is to be found in the eye of the beholder or, more to the point, in the eye of the trier of fact.").

[224] *See* Van Alstine, *supra* note 14, at 1263-65 (describing *Taylor* as illustrative of the decline of the duty of good faith); Dennis M. Patterson, *A Fable from the Seventh Circuit: Frank Easterbrook on Good Faith*, 76 Iowa L. Rev. 503, 506, 522 (1991) (criticizing Judge Easterbrook's opinion in *Kham & Nate*, stating that he "advances a conception of good faith that is completely at odds with all of the operative conceptualizations of good faith").

[225] Van Alstine, *supra* note 14, at 1265. "Like its classical ancestor, this rejuvenated textualism proceeds on the premise that every express contract term reflects the parties' final agreement on the subject." *Id.*

much emphasis on the express language of contracts.[226] To the extent that courts look only to contract language and ignore context, this criticism may be valid. However, ignoring contractual language in favor of the parties' perceived expectations is equally imprudent. Instead, courts should—consistent with applicable interpretive rules—determine the full scope of the parties' agreement, including any oral or collateral agreements, course of dealing, usage of trade, course of performance, modifications, or information that resolves latent or patent ambiguities.[227]

If the parties agreed to something other than what is reflected in the express terms of the writing, then the court should enforce that agreement, not based on good faith, but rather based on the parties' bargain. If the agreement has been modified, or a party's words or actions have induced reliance by another party, the doctrine of waiver or estoppel may provide the relying party with relief. In these ways, expectations based on the agreement or the parties' intentional actions are protected without imposing liability for expectations based solely on inference or hope. Indeed, in many cases where the implied covenant of good faith is invoked, it is because one party has made statements or taken actions upon which the other party relied. Rather than rely on the traditional contract doctrines or argue that the parties' actual bargain varies from the written agreement, the courts rely on the doctrine of good faith.

Admittedly, jurisdictions that embrace the plain-meaning rule, or that confine their inquiry to the four corners of the agreement when the terms appear to be unambiguous, may fail to interpret the contract in accordance with the parties' intentions and understanding.[228] Nonetheless, a change in the rule of contract inter-

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[226] *See id.* at 1272.

[227] The parol evidence rule may present an obstacle, but in reality, it bars only a relatively narrow range of evidence. Evidence of subsequent agreements or modifications is not barred. Nor is evidence of prior consistent additional agreements barred, unless the contract is fully integrated. If there is convincing evidence that the parties entered into collateral agreements, the court is unlikely to find that the agreement is fully integrated. Even evidence of conflicting terms or agreements is not barred if the parties did not intend for the writing to be the final expression of their agreement. *See* RESTATEMENT (SECOND) OF CONTRACTS § 213 (1981) (Parol Evidence Rule).

[228] *See* W.W.W. Assocs., Inc. v. Gianconteri, 566 N.E.2d 639 (N.Y. 1990) (holding that extrinsic evidence is inadmissible to prove that a contract is ambiguous if it is unambiguous on its face). *But see* Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641 (Cal. 1968) (holding that extrinsic evidence is admissible to determine whether a contract term is ambiguous).

pretation to determine the parties' actual agreement is preferable to a pretense of enforcing the contract by adding implied terms that give effect to the parties' presumed expectations.[229]

Although the result may be the same, the danger with the implied covenant of good faith is that the court may go beyond enforcing the parties' agreement to enforcing the agreement that it believes the parties *should have made.* Often, this means that the court enforces what it considers to be a *fair* bargain, as opposed to the bargain actually negotiated by the parties. It is another way of ensuring adequacy of consideration or mutuality of obligations, although courts have consistently denied any such requirements.[230] Moreover, no party risks being bound by expectations or obligations of which they were unaware.

V

AVAILABILITY OF OTHER REMEDIES

Reliance on the implied duty of good faith is often unnecessary to achieve the equitable result desired by courts. Instead, the party allegedly acting in bad faith has often breached the contract in some other respect, or may have committed a tort. Recovery under either of these options is preferable to resorting to the duty of good faith. For example, in *Sons of Thunder, Inc. v. Borden, Inc.*,[231] Sons of Thunder sued Borden for breach of a long-term supply contract for clams.[232] Sons of Thunder claimed breach of several express contract terms.[233] In addition, it sought damages for breach of the implied covenant of good faith in connection with Borden's performance under the contract.[234] Although the UCC governed the contract, the court relied on the common law in reaching its decision.[235]

As an initial matter, there was confusion regarding the basis for the alleged breach of the duty of good faith.[236] The jury in-

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229 This is so because a more comprehensive approach to contract interpretation allows the court to discern the parties' actual agreement, not simply what was included in a writing, without unnecessary resort to implied covenants.

230 *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 79 (1981).

231 690 A.2d 575 (N.J. 1997).

232 *Id.* at 581.

233 *Id.*

234 *Id.* at 585.

235 *Id.* at 587 ("Although the UCC governs this case, the obligation to perform in good faith found in our common law will also influence the result.").

236 *Id.* at 584-87.

struction had merely asked whether Borden "breached its obligation of good faith and fair dealing to plaintiff . . . in terminating the Contract by its letter of May 8, 1987."[237] The jury answered the question in the affirmative.[238] Because it was undisputed that Borden had an unrestricted right to terminate the contract on ninety-day notice,[239] the appellate court held that the trial court erred when it denied Borden's motion for judgment notwithstanding the verdict on that question.[240]

Borden was also found liable for breach of contract for failing to purchase the required amount of clams and failing to pay the contract price for those clams purchased.[241] Borden agreed to pay the assessed damages for these breaches and withdrew its claims that the trial court erred in other respects.[242] This left the alleged breach of the good-faith duty as the only issue on appeal.[243]

The appellate court held that the express terms of the contract allowed Borden to terminate with ninety-day notice, and that Borden's exercise of that right "cannot be overridden or eliminated by an implied covenant of good faith and fair dealing."[244] The New Jersey Supreme Court disagreed that the good-faith claim was based on Borden's termination of the contract.[245] Instead, it agreed with the trial court that the claim was based on Borden's *performance* of the contract, not its termination.[246]

The court determined that the jury could reasonably have found that Borden breached its obligation to perform in good faith.[247] In support of this conclusion, the court noted various

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237 *Id.* at 582.

238 *Id.*

239 Note that the ninety-day notice provision prevents Borden's promises from being illusory. Thus, there is no need for the implied covenant of good faith in order for the contract to be enforceable.

240 Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 584 (N.J. 1997).

241 *Id.* at 582-83.

242 *Id.* at 583-84.

243 *Id.* at 584.

244 *Id.*

245 *Id.* at 585.

246 *Id.* ("Question 3 suggests that the good faith issue deals only with Borden's termination of the contract. In fact, the majority's opinion was premised on that interpretation. However, after reading the jury instructions as a whole, we have no doubt that the trial court designed Question 3 to deal with Borden's good faith in *performing*, not terminating, the contract and that the jury understood that instruction.").

247 *Id.* at 589.

ways in which Borden breached the contract.[248]

> Borden knew that Sons of Thunder depended on the income from its contract with Borden to pay back the loan. Yet, Borden continuously breached that contract by never buying the required amount of clams from the Sons of Thunder. Furthermore, . . . [a Borden Manager] . . . told [a principal of Sons of Thunder] that he would not honor the contract with Sons of Thunder.[249]

The court also noted that Borden was aware that Sons of Thunder was guaranteeing the loans of Sea Work (a company affiliated with Sons of Thunder) and knew that the corporations were dependent upon one another so that if one failed, the other would also likely fail.[250] Borden terminated its contract with Sea Work after a short time, leaving Sea Work with no market for its products.[251] Borden also charged Sea Work for services for which it had not previously charged and pressured the company's principles to obtain financing to repay an advance from Borden, despite Borden's knowledge of the company's precarious financial position.[252]

> Accepting these facts and the reasonable inferences therefrom offered as true, we determine that the jury had sufficient evidence to find that Borden was not "honest in fact," as required by the UCC. Because its conduct destroyed Sons of Thunder's reasonable expectations and right to receive the fruits of the contract, Borden also breached the implied covenant of good faith found in New Jersey's common law.[253]

To the extent that Borden's actions were contrary to the express terms of the contract, the implied covenant of good faith is irrelevant; indeed, these actions were the basis of the damage award for breach of contract. Thus, allowing recovery for breach of the good-faith covenant based on these actions would be duplicative and unnecessary. To the extent that Borden acted dishonestly, Sons of Thunder may have had an action for fraud or misrepresentation.[254] If Borden made statements or took action

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248 *Id.*

249 *Id.*

250 *Id.*

251 *Id.*

252 *Id.*

253 *Id.*

254 "The elements of fraud are: (1) a material misrepresentation (2) made knowingly (scienter) (3) with intent to induce the plaintiff to act or refrain from acting (4) upon which the plaintiff justifiably relies (5) with damages." Beeck v. Kapalis, 302 N.W.2d 90, 94 (Iowa 1981).

with the intention of inducing Sons of Thunder to incur additional debt or otherwise act in detrimental reliance on Borden's actions,[255] then Borden may have been liable for fraud, estopped from asserting its right to terminate, or found to have waived its right to terminate. Conversely, if Borden's actions were consistent with the language of the contract, and it did nothing to justify Sons of Thunder's belief that it would not exercise its right to terminate, a finding that it breached the duty of good faith is erroneous.[256]

The court seemed concerned by Borden's decision to exercise its contractual rights and take actions that were not in violation of the contract when those actions had a detrimental effect on Sons of Thunder and its related companies. However, Sons of Thunder had no reason to believe that Borden would keep the contract in force indefinitely, irrespective of changes in the market, Borden's management, or any other market force.[257] Sons of Thunder certainly had no right to hold Borden responsible for the success of companies related to Sons of Thunder that were not parties to the contract.[258] Borden, on the other hand, had every reason to believe that it had the right to terminate the contract on ninety-day notice because the contract unambiguously conferred that right.[259]

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255 It is interesting to note that the court was influenced by Borden's statements to the Bank on behalf of Sons of Thunder that it "expected the contract to run for five years" but acknowledged that the contract could be terminated within one year. *Sons of Thunder*, 690 A.2d at 578. This testimony makes clear that Borden (and Sons of Thunder) hoped to continue the contract on a long-term basis, but that Borden continued to acknowledge its right to terminate the contract in the short term. Moreover, this statement did not induce Sons of Thunder to seek the loan; instead, it simply helped to convince the Bank to approve the loan that Sons of Thunder had sought before the statements were made. *Id.* The Bank or Sons of Thunder could have insisted that Borden amend the contract so that it had a definite five-year term, but apparently no such agreement or modification was sought or agreed to.

256 *See* Taylor Equipment, Inc. v. John Deere Co., 98 F.3d 1028, 1033 (8th Cir. 1996) (holding that plaintiff had no *justified* expectation that Deere was surrendering its absolute right to refuse to consent to assignment of plaintiff's dealership when contract gave Deere absolute right to refuse).

257 One of the reasons given for terminating the contract was Borden's discovery that due to an accounting error, the project would not be profitable and it was recommended that the project be terminated. *Sons of Thunder*, 690 A.2d at 580.

258 In fact, Sons of Thunder's principal sought additional financing for a related company even after one of Borden's managers stated that he did not intend to abide by the Sons of Thunder contract at all. *Id.* at 579. At least at that point, Sons of Thunder knew that Borden was likely to exercise its termination rights at any time.

259 Assuming, of course, that it did nothing that would constitute a waiver of that

VI

AN ALTERNATIVE: SPECIFIC DUTIES THAT MAY BE IMPLIED OR BEHAVIOR PROHIBITED WITHOUT THE DUTY OF GOOD FAITH

One disadvantage of refusing to include the implied covenant of good faith in every contract is the potential impact that this may have on associated contractual duties. Many courts have included several discrete duties under the umbrella of the general duty of good faith, and if the duty of good faith is not included in the contract at issue, then it might be feared that those duties do not exist either. For example, the duty of disclosure and the duty of cooperation are often invoked as part of the duty of good faith.[260] Likewise, a party may be prohibited from preventing or impairing the other party's performance.[261]

Yet it is possible for jurisdictions to recognize these duties without recognizing a general duty of good faith.[262] Decreeing the existence of a general duty of good faith, particularly when that duty is defined in vague or confusing terms, does not provide contracting parties or courts much guidance as to which specific actions are prohibited or required. If a particular duty is recognized in a jurisdiction, the scope and application of that duty can

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right or take any action to induce Sons of Thunder to justifiably rely on its continuation of the contract.

260 "There is in every contract an implied duty of good faith and fair dealing. This duty obligates the parties to cooperate with each other so that each may obtain the full benefit of performance." Badgett v. Security State Bank, 807 P.2d 356, 360 (Wash. 1991); *see also, e.g.*, Mkt. St. Assocs. v. Frey, 941 F.2d 588, 594 (7th Cir. 1991) (implying that implied covenant of good faith includes duty to disclose contract rights to other party to avoid taking advantage of their oversight); Miss. Comm'n on Envtl. Quality v. Desai, 868 So. 2d 381 (Miss. Ct. App. 2004) (recognizing duty to cooperate as part of definition of good faith).

261 *See* discussion *supra* Part III.B. *See also* Parker v. Columbia Bank, 604 A.2d 521, 531 (Md. Ct. Spec. App. 1992) ("Under Maryland law, a duty of good faith and fair dealing is an implied term in certain contracts, but this duty simply prohibits one party to a contract from acting in such a manner as to prevent the other party from performing his obligations under the contract.") (citation omitted); RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. d (1981).

262 Texas does not recognize an implied covenant of good faith in every contract, but does prohibit interference with the other party's performance. *See* Dorsett v. Cross, 106 S.W.3d 213, 217 (Tex. App. 2003) ("When the obligation of a party to a contract depends upon a certain condition's being performed, and the fulfillment of the condition is prevented by the act of the other party, the condition is considered fulfilled."); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 161 (1981) (recognizing duty of disclosure when non-disclosure is equivalent to an assertion).

be defined with a degree of specificity that may be lacking when it is placed under the umbrella of the general duty of good faith.

CONCLUSION

The implied covenant of good faith can be a useful tool for interpreting and enforcing the parties' bargain. However, it is useful only if the rights and obligations imposed can be defined with a reasonable degree of certainty, and if those rights and obligations reflect the parties' agreement. Thus far, courts and scholars have been unable to settle on a meaningful conceptualization of the duty of good faith when that duty is implied in every contract. Worse yet, courts have begun to embrace an expansive view of good faith that imposes obligations contrary to the express terms of the parties' agreement. This trend needs to be reversed.

The implied covenant of good faith should not be included in every contract. Instead, the duty of good faith should be imposed only when necessary to interpret or fill gaps in parties' agreements, in cases where there is a special relationship between the parties, or when courts or legislatures have defined the duty of good faith in specific terms that are applicable to the conduct at issue. Finally, the duty of good faith, when it is recognized, should not be used to impose obligations in addition or contrary to those included in the parties' agreement, or to make otherwise enforceable contracts "fair." So long as the terms are not unconscionable and do not violate public policy, the agreement of the parties should be respected and enforced.