1-1-2005

The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?

Emily Houh
University of Cincinnati College of Law, emily.houh@uc.edu

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Emily M.S. Houh*

I. INTRODUCTION

Does good faith matter anymore in American contract law? The *Restatement (Second) of Contracts* provides that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[1] The Uniform Commercial Code, adopted by every state except Louisiana,[2] defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing,"[3] and it explicitly imposes a good faith obligation on the performance and enforcement of every contract falling within its scope.[4] Moreover, while the United Nations Convention on Contracts for the International Sale of Goods—to which the United States is a signatory—does not directly impose a good faith obligation, it does state that, "[i]n the interpretation of this Convention, regard is to be had to . . . the need to promote uniformity in its application and the observance of good faith in international trade."[5]

Yet, the question remains: if good faith does still matter, how does it matter, and why should it continue to matter? What does compliance with the

*Associate Professor of Law, University of Cincinnati College of Law. B.A., Brown University; J.D., University of Michigan Law School. I am thankful to the Harold C. Schott Foundation at the University of Cincinnati College of Law, whose generous support made the writing of this Article possible. I am also grateful to the following people for reading drafts of this Article in various forms and for their insights and comments: Pat Chew, Teri Dobbins, Adam Feibelman, Mike Jacobs, Hiroshi Motomura, Duncan Webb, Verna Williams, Ingrid Brunk Wuerth, and Alfred Yen. Finally, I am especially indebted to Joel Frederic, Kevin Hoskins, Jeanette McClellan, and Michelle Pan for their excellent research assistance. All errors made in this Article are, of course, mine alone.

[1] RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) [hereinafter RESTATEMENT].

[2] David V. Snyder, *Private Lawmaking*, 64 OHIO ST. L.J. 371, 379 (2003).

[3] U.C.C. § 1-201(b)(20) (amended 2003).

[4] "Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement." *Id.* § 1-304.

[5] United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, art. 7(1). Also, in England—the source of our American common law tradition—the good faith obligation finally has begun to emerge as a viable and meaningful contract doctrine. *See* Roger Brownsword et al., *Good Faith in Contract: Concept and Context, in* GOOD FAITH IN CONTRACT: CONCEPT AND CONTEXT 1–2 (Roger Brownsword et al. eds., 1999) ("English law takes a different approach [toward the doctrine of good faith], relying on a number of specific doctrines aimed at securing fair dealing but eschewing any general principle of good faith in contract . . . . During the last decade, however, the situation has been transformed, so much so that, as the millennium approaches, the Lord Chief Justice has felt moved to declare that good faith is the most important contractual issue of our time." (internal quotation marks and citation omitted)).

good faith obligation require of contracting parties, beyond compliance with abstract notions of fairness?[6] In their attempts to answer these questions, commentators and scholars have generated scores of articles.[7] This Article addresses both the positive question of what the good faith doctrine *does* require and the normative question of what it *should* require. More specifically, this Article attempts to assess and evaluate the ways in which courts are currently employing the good faith doctrine in contract disputes as part of a larger project. This project's goal is to reconceive and reinvigorate the private law doctrine of good faith as one that might assist in effecting the public law norm of equality.

I have argued elsewhere that the implied obligation of good faith should be used to prohibit, in the contractual context, subordinating conduct based on categories of identity such as race or, by analogy, subordinating conduct based on gender, sexual identity, age, and other identity categories.[8] Additionally, I have previously identified two leading approaches to the common law good faith doctrine: Professor Robert Summers's "*Restatement*/excluder-analysis" approach and Professor Steven Burton's "foregone opportunities" approach. In short, Professor Burton's foregone opportunities approach is described and justified as an economic analysis of good faith.[9] Summers's *Restatement*/excluder-analysis methodology, on the other hand, is described and validated as a justice or fairness approach.[10] In 1981, the American Law Institute adopted Summers's approach at section 205 of the *Restatement* and in the text of its Official Comments to that section.[11]

In an existing article, *Critical Interventions: Toward an Expansive Equality Approach to the Doctrine of Good Faith in Contract Law*,[12] I argue

[6]E. ALLAN FARNSWORTH, CONTRACTS § 7.16, at 486 (4th ed. 2004) (noting that courts often look to basic principles of justice to determine fairness of exchange).

[7]*See, e.g.*, Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 372 (1980) (proposing foregone opportunities approach to good faith); 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, 586 (1996) (surveying different theoretical and judicial approaches to good faith); Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 816 (1982) [hereinafter Summers, *General Duty*] (proposing excluder-analysis approach to good faith); Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 196 (1968) [hereinafter Summers, *Good Faith*] (same).

[8]Emily M.S. Houh, *Critical Interventions: Toward an Expansive Equality Approach to the Implied Doctrine of Good Faith in Contract Law*, 88 CORNELL L. REV. 1025, 1088 (2003).

[9]*Id.* at 1034–35.

[10]*Id.* at 1035–38.

[11]*See* RESTATEMENT § 205.

[12]Houh, *supra* note 8. *Critical Interventions* uses the theoretical screens of law and market economy theory and critical race theory to effect its critique, and to call for a theory of good faith that more substantively reflects and enables practices that promote communitarian notions of substantive and antisubordination theories of equality. See *id.* at pts. II, III, III.A.2 respectively, for further discussion of law and market economy theory, critical race theory, and conceptions of equality. Using those theoretical lenses, *Critical Interventions* analyzes

that although Summers's excluder-analysis approach explicitly concerns itself with fairness, justice, and community standards, it has been and continues to be employed positively and normatively by the courts to conform the conduct of contracting parties to an economically ideal, efficient contracting world.[13] This Article extends that descriptive critique on a more doctrinally focused level. It argues that, to the extent that courts have applied and/or referenced the foregone opportunities and excluder-analysis models of good faith in decisions adjudicating contractual breach of good faith claims, they have rendered the two approaches operationally and functionally indistinguishable by employing both approaches as analytical proxies for material breach. Moreover, section 205 of the *Restatement* explicitly takes the position that it, "like the Uniform Commercial Code . . . , does not deal with good faith in the formation of a contract."[14] Thus, the common law obligation of good faith fails to reach the most troubling forms of contractual bad faith: those that occur during contract

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employment at-will cases in which plaintiffs sued their former employers and asserted not only violations of federal and/or state antidiscrimination statutes, but also common law claims for contractual—as opposed to tortious—breach of the duty of good faith. With regard to the contractual cases, some courts disallowed the common law breach of good faith claims, asserting that the availability of antidiscrimination remedies precluded such claims. Other courts allowed such common law claims to proceed, either concurrently with, or in lieu of, the federal and/or state civil rights claims. *Id.* at 1066–89.

More specifically, *Critical Interventions* argues that allowing plaintiffs to bring common law good faith claims is important and necessary because civil rights statutes—including amended section 1981 of the Civil Rights Act of 1866, which prohibits racial discrimination in contract formation, performance, and termination—with their emphasis on and obsession with the intentionality of the alleged perpetrators of discrimination, do not afford plaintiffs remedies for the pervasive and "unconscious" forms of discrimination that they still suffer from on a day-to-day basis. *Id.* at 1086–88; *see also* Charles R. Lawrence III, *The Id, the Ego, and Equal Protection: Reckoning with Unconscious Racism*, 39 STAN. L. REV. 317, 318, 322–23 (1987) (critiquing Supreme Court's articulation in *Washington v. Davis*, 426 U.S. 229, 239–41 (1976), of dichotomy between intentional, unconstitutional discrimination and unintentional, constitutional discrimination as false one and introducing theory of "unconscious racism").

[13]Houh, *supra* note 8, at 1042–49. In that regard, the excluder-analysis approach does indirectly and subtextually what the foregone opportunities approach does directly and explicitly: both are overly driven by traditional economic efficiency concerns. As such, it might also be argued that economically efficient outcomes may also be just and fair ones. That position has been argued persuasively and in numerous and varied contexts, and remains at the center of lively scholarly debate. However, it is not an argument with which this Article is particularly concerned. Economic efficiency is not necessarily inconsistent with justice or fairness. For example, Guido Calabresi and A. Douglas Melamed have refuted famously the notion that justice concerns are merely residual in the economic analyses of the law and have argued that "many entitlements that properly are described as based on justice in our society can easily be explained in terms either of broad distributional preferences like equality or of efficiency or of both." Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1105 (1972); *see also* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.13, at 132–33 (6th ed. 2003) (providing economic justification of quasi-contractual restitutionary recovery for benefits conferred to preserve life, health, or property).

[14]RESTATEMENT § 205 cmt. c.

negotiation and formation.[15] Although the *Restatement* drafters have stated that such egregious conduct is sanctionable under the contract doctrines of, for example, incapacity, fraud, and duress,[16] this Article argues that certain forms of bad faith conduct are not captured by those kinds of contract defenses. Therefore, in order to reconcile good faith with its equitable roots, the good faith obligation should apply to contract formation and negotiation.

This Article is divided into three parts. Part II explains the good faith doctrine and explores in some depth the theoretical differences between the Summers/excluder-analysis and Burton/foregone-opportunities approaches to good faith. By demonstrating how courts have employed the two leading approaches as rhetorical frameworks for analyzing underlying breach of contract claims and the doctrine of material breach, Part III argues that breach of good faith claims have transformed into stand-ins for underlying breach of contract claims in contemporary decisions. It does this by examining contractual good faith cases in the general contexts of presumptively arm's-length and non-arm's-length (that is, power-imbalanced) commercial contracts. Specifically, in the category of arm's-length commercial cases, Part III.A examines exemplary cases in the contexts of what I call "vanilla" commercial contracting, commercial lending, contractor cases, and commercial real estate leasing. Part III.B examines exemplary cases involving less equal bargaining power in the contexts of franchisor/franchisee and dealer/distributor cases, lost commissions cases, at-will employment, and consumer contracting. Part III demonstrates that courts, by applying different models of good faith analyses, are not primarily motivated by the articulated theory behind those models. Rather, courts use good faith rhetoric—whatever its source—to supplement and refine arguments relating to the basic underlying breach of contract claims. Thus, good faith doctrine remains, substantively, a nearly empty vessel whose condition is attributable in part to the limitations inherent in the leading theories that aim to give the doctrine life.

In conclusion, Part IV proposes that the good faith doctrine might be given new life in two different ways: first, vis-à-vis its applicability to bad faith conduct in contract formation and negotiation—certainly not a new idea,

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[15]*See, e.g.*, Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817, 827–28 (1991) (explaining results of empirical study that revealed, in context of negotiating for purchase of automobiles in greater Chicagoland area, that white males obtain significantly better deals than African Americans and women); Ian Ayres, *Further Evidence of Discrimination in New Car Negotiations and Estimates of Its Cause*, 94 MICH. L. REV. 109, 109–10 (1995) (same—follow-up to *Fair Driving*); Ian Ayres & Gregory Klass, *Promissory Fraud Without Breach*, 2004 WIS. L. REV. 507, 508–09 (focusing on promissory fraud liability in noncontractual settings, such as settings where parties enter into option contract and one party does not intend from outset to exercise option).

[16]*See* RESTATEMENT § 205 cmt. c ("Bad faith in negotiation, although not within the scope of this Section, may be subject to sanctions. Particular forms of bad faith in bargaining are the subjects of rules as to capacity to contract, mutual assent and consideration and of rules as to invalidating causes such as fraud and duress.").

but one worth serious reconsideration; and second, with respect to performance and termination, vis-à-vis its applicability in the employment context.

II. LEADING MODELS OF THE IMPLIED OBLIGATION OF GOOD FAITH AND FAIR DEALING

Contracts scholars have engaged the doctrine of good faith and fair dealing in a number of ways, using a number of different analytical and theoretical approaches. For example, Professor Robert Summers—whose conception of good faith was ultimately adopted by the American Law Institute at section 205 of the *Restatement*—has argued for an open-ended approach to good faith.[17] This approach can be described most usefully through the exclusion of contextually recognizable forms of bad faith conduct.[18] Professor Steven Burton, on the other hand, has argued for an essentially economic approach to the doctrine of good faith, whereby a party breaches good faith when she has abused discretion contractually reserved to her by attempting to recapture opportunities that she gave up during contract formation.[19] These two models—at least in cases involving alleged common law breaches of contractual good faith—are the leading approaches to the doctrine, and both Summers and Burton are often cited by courts deciding contractual good faith disputes.[20]

*A. The Summers/*Restatement *Approach: Excluder-Analysis*

In 1968, Professor Summers, in an article that has since become one of the most influential in modern contract law, introduced his conceptualization of the contractual obligation of good faith as an "excluder;" that is, as a concept "without general meaning (or meanings) of its own, and serv[ing] to exclude a wide range of heterogeneous forms of bad faith."[21] Central to Summers's theory of good faith is the notion that it is defined as the negative

[17]Summers, *General Duty*, *supra* note 7, at 818–21; *see also infra* Part II.A (discussing Summers/*Restatement* approach to good faith).

[18]*See infra* Part II.A.

[19]Burton, *supra* note 7, at 373; *see also infra* Part II.B (discussing Burton's "foregone opportunities" approach to good faith).

[20]*Compare* Stone Motor Co. v. Gen. Motors Corp., 293 F.3d 456, 466 (8th Cir. 2002) (citing Summers's approach as adopted in *Restatement*), Cadle Co. v. Vargas, 771 N.E.2d 179, 183 (Mass. App. Ct. 2002) (same), Mo. Consol. Health Care Plan v. Cmty. Health Plan, 81 S.W.3d 34, 45 n.3 (Mo. Ct. App. 2002) (same), *and* State v. Peppertree Resort Villas, Inc., 651 N.W.2d 345, 353 (Wis. Ct. App. 2002) (same), *with* Mickle v. Christie's, Inc., 207 F. Supp. 2d 237, 249–50 (S.D.N.Y. 2002) (citing Burton's approach), Dunnigan v. Metro. Life Ins. Co., 99 F. Supp. 2d 307, 323 (S.D.N.Y. 2000) (same), Subaru Distribs. Corp. v. Subaru of America, Inc., 47 F. Supp. 2d 451, 462 (S.D.N.Y 1999) (same), *and* Wilson v. Amerada Hess Corp., 773 A.2d 1121, 1127 (N.J. 2001) (same).

[21]Summers, *Good Faith*, supra note 7, at 201.

corollary of bad faith.[22] As such, good faith performance, according to Summers, cannot be reduced to a definable and specific set of appropriate and acceptable behaviors; rather, its substance derives from "rul[ing] out radically heterogeneous forms of bad faith."[23]

Although he does not accede in his 1968 article to anticipated critiques that his excluder-analysis is too boundless to be of any practical use, Summers does recognize the need for an articulation of good faith that might be more immediately applicable to a given set of facts.[24] As such, Summers catalogs various recurring but "heterogeneous" forms of bad faith conduct that he culled from an expansive review of then-existing good faith cases.[25] In creating this catalog, Summers is careful to point out that his list is exemplary and not exhaustive.[26]

In defining the scope of the good faith obligation, Summers frames his analysis first by delineating four broad categories of bad faith: "Bad Faith in the Negotiation and Formation of Contracts,"[27] "Bad Faith in Performance,"[28] "Bad Faith in Raising and Resolving Contract Disputes,"[29] and "Bad Faith in Taking Remedial Action."[30] In part because the drafters of the *Restatement* chose *not* to imply good faith obligations into the negotiation and formation of contracts,[31] subsequent common law developments in good faith jurisprudence have focused almost exclusively on the second of Summers's categories, "Bad Faith in Performance," and in particular, on the subcategories of such performance. The subcategories of bad faith in performance further delineated by Summers include "Evasion of the Spirit of the Deal," "Lack of Diligence and Slacking Off," "Willfully Rendering Only 'Substantial Performance,'" "Abuse of Power to Determine Compliance," and "Interfering With or Failing to Cooperate in the Other Party's Performance."[32] All of these subcategories contemplate cases in which judges would feel comfortable using their discretionary and equitable powers to find a breach of good faith where the express language of the contract might not otherwise support a claim for breach of contract.[33]

Significantly, in his 1968 article as well as in a 1982 follow-up, Summers is adamant about characterizing his conceptualization of good faith not as a

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[22] *Id.* at 200–01.
[23] *Id.* at 204.
[24] *Id.* at 202.
[25] *Id.* at 203.
[26] *Id.*
[27] *Id.* at 220–32.
[28] *Id.* at 232–43.
[29] *Id.* at 243–48.
[30] *Id.* at 248–52.
[31] *See* RESTATEMENT cmt. c ("This Section . . . does not deal with good faith in the formation of a contract. Bad faith in negotiation, although not within the scope of this Section, may be subject to sanctions.").
[32] Summers, *Good Faith*, *supra* note 7, at 234–43.
[33] *Id.*

rule, but "more in the nature of a principle or maxim"[34] that cannot be reduced to a "vacuous general definition."[35] Summers, like many of his contemporaries,[36] views the preference for a rigid, rule-based legal system as not only undesirable but also "not in accord with relevant reality."[37] Summers further explains:

> In point of fact, our law recognizes many kinds of non-rules as law. Why not similarly recognize the principle requiring contractual good faith? Furthermore, if we are to have doctrines which, among other things, perform safety valve functions, then isn't it inevitable that they will take rather general form? Of course, in their specific applications, they will generate rules.[38]

So, argues Summers, open-ended equitable doctrines such as good faith—in addition to related doctrines such as implied promise, custom and usage, fraud, negligence, and estoppel—operate as important supplements to existing legal rules.[39] These doctrines function not only as independent bases for liability, but perhaps even more importantly to "*limit* and quantify *specific* legal rules and contract terms."[40] As such, the functions performed by these supplemental doctrines "further the most fundamental policy objectives of any legal system."[41] Additionally, according to Summers, the good faith doctrine embodies the potential of the common law system; "[b]y invoking good faith . . . it may be possible for a judge to do justice *and* do it according to law."[42]

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[34]Summers, *General Duty*, *supra* note 7, at 821.

[35]Summers, *Good Faith*, *supra* note 7, at 206, 264–65.

[36]*See, e.g.*, Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1740–53, 1762–66, 1776 (1976) (arguing, in relevant part, that economic principles embedded in legal rules and standards are "instrumental to [and not independent of] the pursuit of substantive objectives"); *see also* RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 123–30 (1977) (arguing same principle in regards to "political objectives").

[37]Summers, *Good Faith*, *supra* note 7, at 265.

[38]*Id.*

[39]*Id.* at 198.

[40]*Id.* (emphasis added).

[41]*Id.*

[42]*Id.* Summers's excluder approach to the doctrine of good faith ultimately found its way into the *Restatement* at section 205. The section's official comments state:

> The phrase "good faith" is used in a variety of contexts, and its meaning varies somewhat with the context. 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.
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> . . . [A] complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful

The 1982 adoption of Summers's open-ended and contextual excluder-analysis approach to good faith by the American Law Institute signifies a triumph of legal realism in modern contract law.[43] Since the publication of the *Restatement* in 1981, a vast number of courts have come to rely on the implied obligation of good faith as a sort 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."[44]

B. The Burton/Economic Approach: Foregone Opportunities

The "foregone opportunities" approach to good faith, first theorized by Professor Burton, focuses exclusively on Summers's second general category of bad faith: "bad faith in performance."[45] Burton's approach has been important in the development of the good faith doctrine because it theorizes an explicit economic analysis of the principle of good faith.[46] Burton begins with an economic cost analysis of contractual breach.[47] Based on this analysis, Burton concludes that, from an economic perspective, bad faith breach is analytically similar to simple breach by failure to perform an express promise.[48] Both forms of breach involve a party's attempt to recapture opportunities—in the form of resources committed at the time of contracting to particular uses in the future—foregone in the contracting process.[49] Further, one of Burton's basic premises is that, because contracts often involve an uneven distribution of "discretion in performance" among the contracting

> rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.

RESTATEMENT § 205 cmts. a, d; *see also* Summers, *General Duty*, *supra* note 7, at 821–37 (articulating same concepts).

[43]In the 1920s and 1930s, legal realists criticized the classical rule of law and its application as overly formalistic and as a legal system that, in reality, was driven by policy, economics, and politics cloaked in the myths of neutrality and objectivity. The realists sometimes manifested this critique in the form of "rule skepticism," which recognized that legal rules are "not what they appear to be." MARK TEBBIT, PHILOSOPHY OF LAW: AN INTRODUCTION 29–30 (2000). In more concrete terms, the realists argued that the formalistic notion of the rule of law created an illusion of certainty that masked the unspoken social and political assumptions guiding much of judicial decision making. *Id.* at 30.

Karl Llewellyn, among the most important and well-known of the realists and chief architect of the Uniform Commercial Code, argued that commercial law developed into its modern, stabilized state not because it embodied and formalistically operationalized a set of legal rules, but because particularized social and economic circumstances compelled the judicial creation of a body of law that developed into a coherent doctrine. Note, *'Round and 'Round the Bramble Bush: From Legal Realism to Critical Legal Scholarship*, 95 HARV. L. REV. 1669, 1671–73 (1982).

[44]Summers, *General Duty*, *supra* note 7, at 812.

[45]Burton, *supra* note 7, at 373.

[46]*See id.* at 372.

[47]*Id.* at 373.

[48]*Id.* at 373–78.

[49]*Id.*

parties, a "weaker" party might require some protection against the "stronger" party's assigned discretion.[50] The duty of good faith performance supplies this protection, and, therefore, its application in a given set of circumstances determines legitimacy of the exercise of that discretion.[51]

Burton's analysis also criticizes what he terms the "reasonable contemplation" method of distinguishing legitimate from illegitimate uses of discretion.[52] According to this approach, the duty of good faith performance permits parties to exercise their discretion "for any purpose . . . reasonably within the contemplation of the parties."[53] Therefore, under the reasonable contemplation approach, bad faith conduct includes any exercise of discretion beyond the range of the parties' reasonable contemplation.[54] Burton criticizes this approach as too reliant on "an amorphous totality of the circumstances at the time of formation," and disapproves of the open-ended and far-reaching factual inquiry it may require to discern "the parties' intentions and reasonable expectations."[55]

Burton thus formulates his foregone opportunities approach so as to "make[] it possible to identify with greater particularity the relevant expectations and motives that have been held to constitute bad faith."[56] The foregone opportunities approach assumes that during the contract formation process, contracting parties forego opportunities to enter into other agreements.[57] Burton describes bad faith conduct as the exercise of contractual discretion on the part of one party in an attempt to "recapture" those opportunities foregone during contract formation, because parties to the resulting contract should have known that the contract precluded the subsequent recapture of those opportunities.[58] He argues that application of this foregone opportunities approach is desirable because it enables courts to employ a less amorphous and more factually particularized inquiry in their assessment of whether a party has breached the implied obligation of good faith in any given case.[59]

C. Summers-Burton: Divergence and Convergence

Generally, Burton's introduction of the foregone opportunities model of good faith has been well-received.[60] However, Summers has expressed

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[50] *Id.* at 380–84.
[51] *Id.* at 382–85.
[52] *Id.* at 387.
[53] *Id.* at 385–86.
[54] *Id.* at 386.
[55] *Id.* at 387.
[56] *Id.*
[57] *Id.* at 388.
[58] *Id.* at 388–89.
[59] *Id.* at 390–92.
[60] *See* cases cited *supra* note 20.

reservations about Burton's attempt to craft a more defined and economically-based approach to good faith. In particular, Summers argues that good faith should not and cannot be defined in or justified by economic terms; he promotes the more open-ended excluder-analysis as the better approach to good faith.[61] On a theoretical level, Summers objects to the positive economic impulse—as prevalent now as then—that compels the rationalization of legal rules and doctrines as being economically efficient.[62] More precisely, Summers critiques Burton's traditional economic analysis of good faith and the assumptions of rationality underlying it:

> [Burton's] claimed economic rational requires several responses. First, it is ahistoric. As already indicated, the historical evidence favors other rationales. Second, these other rationales, at least so far as good-faith performance is concerned, are largely moral and include the principle *pacta sunt servanda* ("the obligation to keep agreements"). . . . Third, it is in any case rather speculative that the rationale is economic—even in regard to a duty of good-faith performance. . . . Fourth, it is one function of rationales to generate, in light of facts and law, specific reasons for the decisions of particular cases. The extent to which an economic rationale such as the one proffered can do this efficiently and otherwise satisfactorily is, as yet, undemonstrated and problematic . . . .[63]

Thus, Summers suggests that economic analysis should not play a major role in the further development and application of the good faith doctrine and that attempts to justify the doctrine as an amoral one—at least as it relates to contract performance—are misguided. Rather, Summers argues, good faith has everything to do with morality insofar as morality has something to do with the effectuation of "'justice and justice according to law.'"[64]

Summers's explicit and consistent attempts to incorporate justice-oriented norms into contract law vis-à-vis the good faith doctrine are admirable and—more than twenty years later—refreshing given the dominance of economic analyses in contemporary legal scholarship.[65] Unfortunately, and somewhat regrettably, this Article argues that despite the American Law Institute's adoption of the rhetoric of justice and "community standards of decency . . . [and] fairness,"[66] and despite the courts' use of such rhetoric, the excluder-analysis has been employed primarily to bring about and promote economic efficiency. While this Article and the larger project of which it is a part do not

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[61] Summers, *General Duty*, *supra* note 7, at 821, 827.

[62] *Id.* at 825–27.

[63] *Id.* at 827.

[64] *Id.* at 826 (quoting Summers, *Good Faith*, *supra* note 7, at 198).

[65] *See infra* at Part III; *see also* Houh, *supra* note 8, at 1038 ("Summers's call for the primacy of justice should be meaningfully revived.").

[66] RESTATEMENT § 205.

take the position that efficiency of transactional exchange should not be *one* goal of contract law, it contends that in many cases, Summers's call for the genuine consideration of justice norms in the contractual context should be meaningfully revived.

The body of work that can be characterized as law and economics or economic analysis of the law is far too abundant to describe here in any depth.[67] For purposes of this Article, the relevant applications of conventional law and economic analysis suggest that, in a perfect contracting environment, judicial interventions would be necessary to invalidate contracts only in the most egregious of circumstances.[68] For example, this would include cases involving fraudulent inducement to enter into a contract.[69] According to this view, judicial intervention would be inappropriate if the agreement were merely unfair to one of the parties. As succinctly stated by Professor Robin Paul Malloy, a law and economics scholar who has been critical of traditional economic analyses of the law, "[t]he market does not care about . . . fairness or justice. . . . As long as there are no artificial barriers to success, no one should be offended by the functioning of the market."[70] This view is inconsistent with both the *Restatement*'s goals of, and Summers's rationale for, good faith: both aim to promote justice and ensure fairness in the contracting process.[71] Despite such explicitly stated goals, this Article contends that normative applications of the excluder-analysis/*Restatement* iteration of good faith have had their greatest success not in promoting justice and community standards of decency, but rather in their promotion and construction of economically ideal contracting conditions.

For example, Summers catalogs several specific forms of bad faith conduct and their good faith counterparts.[72] One form contemplates the seller who acts in bad faith by concealing a defect in his product; the good faith counterpart is the seller's full disclosure to the buyer of material facts concerning the goods.[73] This translates easily into an essential characteristic of the economically ideal contracting environment: that all contracting parties have access to "full information about the nature and consequences of [their] choices."[74] Another example of bad faith conduct catalogued by Summers involves the contractor who "openly abus[es] [his] bargaining power to coerce an increase in the contract price" (i.e., coercive modification); the good faith

[67]For a summary and discussion of some basic principles of law and economics, as well as "post-law and economics," see *Houh*, *supra* note 8, at 1038–41.

[68]*See* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 261–64, 275–77 (3d ed. 2000).

[69]*Id.* at 275–77.

[70]ROBIN PAUL MALLOY, LAW AND ECONOMICS: A COMPARATIVE APPROACH TO THEORY AND PRACTICE 32 (1990).

[71]Summers, *General Duty*, *supra* note 7, at 826.

[72]Summers, *Good Faith*, *supra* note 7, at 203.

[73]*Id.* (citing Stewart v. Wyo. Cattle Ranche Co., 128 U.S. 383, 388 (1888)).

[74]ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 235 (1988).

analogue is "refraining from the abuse of such bargaining power."[75] Similarly, a party acts in bad faith when it hires a broker to enter into an agreement and then prevents the other party from deriving the benefits of that agreement by preventing the broker from "consummating the deal." The good faith counterpart is to act "cooperatively."[76] These excluder-analysis prohibitions against abusive or uncooperative conduct primarily function to deter contracting parties from behaving opportunistically toward one another which, in turn, "obviate[s] costly self-protective measures."[77] Because a perfect contracting environment requires minimal transaction costs, these good faith prohibitions further economic goals by preventing contracting parties from incurring extraneous transaction costs that would arise after contract formation (in the form of settlement and litigation costs).[78] The excluder-analysis certainly has the potential to effect justice in a broader, noneconomic sense, but in its original iteration it was, and is, quite susceptible to almost exclusively economically driven applications by the courts. In this regard, Summers's argument—that the pursuit of justice provides a better rationale for the good faith obligation than does economic efficiency—is significantly weakened.[79]

Summers's and Burton's ostensibly divergent approaches to good faith in fact converge significantly in theoretical and practical ways. Moreover, both approaches are concerned, normatively speaking, with how to correctly

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[75]Summers, *Good Faith*, *supra* note 7, at 203 (citing Lingenfelder v. Wainwright Brewery Co., 15 S.W. 844, 848 (Mo. 1891)).

[76]*Id.* (citing Carns v. Bassick, 175 N.Y.S. 670, 673 (N.Y. App. Div. 1919)).

[77]POSNER, *supra* note 13, § 4.1, at 95.

[78]COOTER & ULEN, *supra* note 74, at 236; MALLOY, *supra* note 70, at 34–38.

[79]The ongoing work of Professor Juliet Kostritsky, a noted contracts scholar, is particularly illuminating in this regard. In a recent paper delivered at a symposium held at the University of Wisconsin Law School on "Freedom *From* Contract," Kostritsky argued that legal intervention in enforcing contracts is economically justified because it helps to enhance first best outcomes between contracting parties in an economically imperfect world. Juliet P. Kostritsky, *Taxonomy for Justifying Legal Intervention in an Imperfect World: What to Do When Parties Have Not Achieved Bargains or Have Drafted Incomplete Contracts*, 2004 WIS. L. REV. 323, 324–30. The imperfections that make the world economically inefficient are structural in nature and are comprised of the following: (1) uncertainties relating to externalities, adverse selection, and moral hazard; (2) contracting parties' human tendencies toward opportunism; and (3) sunk costs that are lost in the event of opportunistic behavior during the course of contract performance (these sunk costs might also be referred to as reliance costs). *Id.* Kostritsky argues that, in light of such structural impediments to efficiency, legal intervention required to deal with those impediments is ultimately less costly than private strategies that parties might otherwise use. *Id.*

With respect to Kostritsky's "taxonomy" for analyzing the structural impediments to efficiency, the question arose at the "Freedom *From* Contract" symposium: what *is* "opportunism"? A lively discussion ensued. This Article responds that opportunism in the context of economic inefficiency is simply bad faith conduct, not only as defined explicitly by Burton, but also in the nature of the types of conduct catalogued by Summers. Consistent with Kostritsky's argument that judicial intervention—even to the extent it might curb freedom of contract—best serves the parties' joint instrumental goals, in many breach of contract cases, such judicial intervention takes the form of the courts' upholding parties' good faith claims.

redistribute existing resources among contracting parties through the prohibition of various forms of advantage taking in the contracting process. Substantively, their approaches diverge only to the extent that they define "advantage taking" differently. Burton narrowly defines advantage taking as opportunistic conduct on the part of one of the parties after contract formation, whereas Summers more broadly defines advantage taking as not only post-formation opportunistic conduct, but also as opportunistic conduct during the phases of contract negotiation, formation, termination, and dispute resolution.[80] While this disagreement over the scope of good faith has significant practical implications, it does nothing—from a critical perspective—to challenge the fundamentally economic conceptualization of good faith, notwithstanding the rhetoric of "justice." Moreover, this disagreement has had little impact on how courts have applied the good faith doctrine in contract cases.

III. THEORY INTO DOCTRINE? THE NEARLY EMPTY VESSEL OF GOOD FAITH

Despite the articulated difference in their rationales and perhaps because of their demonstrated congruence, both the excluder-analysis and foregone opportunities approaches have greatly assisted courts, on a practical level, in applying the notoriously abstract notion of good faith to hard facts. But does contractual good faith doctrine, as it has developed thus far, actualize the articulated normative aspects of the leading models? This Article argues that the long-standing scholarly debates about good faith, discussed above, have not in fact resulted in a doctrine that embodies the theoretical and normative dichotomy between the two leading approaches. In fact, in looking at how courts have employed good faith analyses in breach of contract cases, it appears that the scholarly debate over what good faith should require has mattered very little to the courts, even to those courts that have relied explicitly on either the excluder-analysis approach or the foregone opportunities approach (or, in some cases, both) for their articulation of an applicable good faith standard.

Moreover, to the extent courts have taken breach of good faith claims seriously by discussing them at all, this Part argues that they have done so merely to bolster rhetorically their analyses of the underlying breach of contract claims. To be clear, this Part does not argue that courts are necessarily misunderstanding or misapplying the good faith doctrine. In fact, the good faith models provide extremely useful rhetorical tools that have been employed by the courts to deepen their breach of contract analyses. In that respect, good faith jurisprudence, as it has developed thus far, has done quite a lot to develop the economic analysis of contract law. This Part further contends that courts may be limited in how they effect good faith analyses, in part because of the limitations of the leading theories discussed in Part II of this Article. Thus, this Part's descriptive argument critiques the good faith obligation, both as it has

[80] Summers, *Good Faith*, *supra* note 7, at 220–62.

been conceived by scholars and applied by courts, as having almost no identifiable value as an independent contract obligation. Rather, good faith is an empty vessel which functions rhetorically and analytically as a proxy for simple breach of contract and has not been used by the courts to actuate the theory or policy underlying it.

At the outset, all of the cases analyzed in this Part involve only contractual claims for breach of good faith. The cases are first grouped under two general subheadings: presumably arm's-length contracting cases involving parties that have equal bargaining power, and cases involving presumably unequal bargaining power. Under each of these general groupings, the cases are further subcategorized. What I refer to as "vanilla" commercial contracting cases—commercial lender and foreclosure cases, commercial contractor cases, and commercial real estate and development cases—fall under the former general heading; franchisor/franchisee and dealer/distributor cases, lost commissions cases, employment cases involving termination of at-will employees, and consumer contract cases fall under the latter.

Analysis of these cases shows that, notwithstanding the principles of justice and fairness that theoretically justify the *Restatement*/excluder-analysis approach, good faith analysis is used consistently to effect economic outcomes and norms and as a proxy and rhetorical framework for breach of contract analyses. What is particularly significant about this descriptive claim is that it applies not only to the obvious arm's-length commercial contracting cases, but also to cases involving presumably unequal bargaining power—cases which, one might assume, may lend themselves best to analyses adopting the fairness approach to good faith. This may be due in part to the obvious (at least to some of us) reality that all transactions are to some extent both commercial (read, economic) and, for lack of better words, human and personal. But even if this were the case, why do good faith analyses across categories of cases defer so easily to purely economic analyses, even in the face of the *Restatement*'s explicit justice-oriented rationale?

A. Arm's-Length Commercial Cases

1. "Vanilla" Commercial Contracting Cases

John B. Conomos, Inc. v. Sun Co.,[81] a Pennsylvania case decided in 2003, exemplifies the sort of breach of good faith claims in the commercial context that I refer to as "vanilla" commercial contracting cases. *Conomos* involved a contract for the painting of industrial piping at a Pennsylvania refinery owned by defendant Sun Company.[82] As is typical of the commercial bidding process, the bid specifications issued to interested painters by Sun Company included

[81] 831 A.2d 696 (Pa. Super. Ct. 2003).
[82] *Id.* at 700.

quality control requirements that conformed to industry-wide standards.[83] Conomos won the bid.[84] However, by the second or third day of work, it began to experience conflict with Sun Company's inspector, Don Desroches.[85] Desroches, according to Conomos, imposed overly burdensome inspection standards that exceeded both industry and contractually required standards.[86] Notwithstanding these objections, Conomos complied with Desroches's requirements and consequently incurred additional expenses.[87] Conomos repeatedly requested in writing an increase to the contract price as compensation for these additional expenses, which eventually led Sun Company to cancel the contract.[88] Since Sun Company refused to pay Conomos the additional expenses, Conomos sued Sun Company, in part for the additional charges.[89]

The trial court held that Sun Company had breached the contract in bad faith and ultimately awarded Conomos contractual damages in an amount reflecting both the additional expenses incurred by Conomos and its lost profit.[90] The appellate court engaged in an unusually thorough examination of the doctrine of contractual good faith. First and foremost, it accepted section 205 of the *Restatement* and found that, in Pennsylvania, the "duty of good faith performance [is imposed] on each party in general commercial contracts."[91] The court went on to describe Pennsylvania's closely related common law doctrine of "necessary implication," which states: "[i]n the absence of an express term, the doctrine of necessary implication may act to imply a requirement necessitated by reason and justice without which the intent of the parties is frustrated."[92] The court linked the doctrine of necessary implication to that of good faith, stating that neither doctrine could be used to argue that terms merely implied by the contract would trump the contract's express provisions.[93] Such a restriction, the court explained, conformed to general contractual principles that privilege unequivocal and express contract terms

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[83] *Id.* at 701 n.1.

[84] *Id.* at 701.

[85] *Id.*

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] *Id.* at 701–02. In the meantime, Sun Company had hired another company to replace Conomos and complete the job. Significantly, the new painter likewise experienced problems with Desroches relating to his excessive inspection standards. The problems eventually led to the hiring of a mediator to resolve the dispute between the replacement and Sun Company, which ultimately was resolved against Sun Company. *Id.* at 702.

[90] *Id.* at 702. The trial court also found that Sun Company violated Pennsylvania's Contractor Payment Act and, as such, assessed approximately $30,750 in penalties and attorney's fees against it. *Id.* at 702–03. As a result of posttrial motions, this figure was increased further. *Id.*

[91] *Id.* at 705–06 (citing Donahue v. Fed. Express Corp., 753 A.2d 238, 242 (Pa. Super. Ct. 2000)).

[92] *Id.* (citing Somers v. Somers, 613 A.2d 1211, 1214 (Pa. Super. Ct. 1992)).

[93] *Id.* (citing Kaplan v. Cablevision of Pa., Inc., 671 A.2d 716, 720 (Pa. Super. Ct. 1996)).

over inconsistent default rules or gap-fillers.[94] The court further explained that the doctrine's content and its articulated parameters enabled courts "to harmonize the reasonable expectations of the parties with the intent of the contractors and the terms in their contract."[95]

The *Conomos* court's examination of the doctrines of necessary implication and good faith is illuminating in several respects, and provides a useful framework for how to think about and apply the implied duty of good faith. First, of course, the court cited section 205 of the *Restatement* and said the duty of good faith was an implied provision of the contract. Second, the language used to articulate the doctrine of necessary implication echoes that of the Official Comments to section 205—and, consequently, of Summers's conceptualization of good faith—in that it imposes obligations on the contracting parties that are "necessitated by reason and justice" and "without which the intent of the parties . . . [would be] frustrated."[96] Third, this same language emphasizes that the duty of good faith is to be applied in order to effect the intent of the parties at the time of contract formation. Fourth, in discussing at length the idea that the implied duty of good faith may not in any circumstances be used to effect an end-run around the unequivocal and express terms of the contract, the court made clear that the implied duty of good faith is, at its core, a default standard that governs the performance of contracts generally. As a default standard, the court further stated that "'this obligation of good faith is tied specifically to and is not separate from the [express] duties a contract imposes on the parties.'"[97]

In terms of what constitutes good faith's content, the court again stated that good faith conduct is that which will best effect the intent of the parties. It also employed the rhetoric of "reasonable expectations": "[b]oth the implied covenant of good faith and the doctrine of necessary implication are principles for courts to harmonize the *reasonable expectations* of the parties with the *intent of the contractors* and the *terms of their contract.*"[98] This language is derivative of then-Judge Cardozo's opinion in the famous case, *Wood v. Lucy, Lady Duff-Gordon*,[99] which is widely read as one of the earliest American cases to imply a duty of "best" or "reasonable" efforts. Of the contract at issue in *Lucy, Lady Duff-Gordon*, the court stated:

> The agreement . . . has a wealth of recitals. The defendant insists, however, that it lacks the elements of a contract. She says that the plaintiff does not bind himself to anything. It is true that he does not promise in so many words that he will use reasonable efforts to

[94] *Id.*

[95] *Id.* at 707.

[96] *Id.* at 706 (citation omitted).

[97] *Id.* at 706–07 (alteration in original) (quoting Murphy v. Duquesne Univ. of the Holy Ghost, 777 A.2d 418, 434 n.11 (Pa. 2001)).

[98] *Id.* at 707 (emphasis added).

[99] 118 N.E. 214 (N.Y. 1917).

> place the defendant's indorsements and market her designs. We think, however, that such a promise is fairly to be implied. The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be 'instinct with obligation,' imperfectly expressed. If that is so, there is a contract.
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> . . . .
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> The implication is that the plaintiff's business organization will be used for the purpose for which it is adapted. . . . Unless [plaintiff] gave his efforts, [defendant] could never get anything. Without an implied promise, the transaction cannot have such business 'efficacy, as both parties must have intended that at all events it should have.'[100]

The language of effecting the "intent of the parties" and their "reasonable expectations" under the contract and of carrying forward the "purpose of the contract" in such a way that it "does not contravene the express terms of the contract" crops up again and again in common law good faith cases.[101] While some courts vary the terms—for example, they might refer to the parties' reasonable expectations as the reasonably expected "fruits" or "benefit of the bargain"[102]—the rhetoric used to describe the content of the common law contractual duty of good faith remains largely consistent and is almost never further developed in any meaningful way.[103] Moreover, where courts also have referenced the common law good faith notions of "justice" (as the *Conomos* court did), "fairness," and "community standards," they usually mean little more than reasonable expectations under the contract.[104] At most, when courts expand upon the common law rhetoric of good faith, they borrow from the language and jurisprudence of the Uniform Commercial Code which defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[105]

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[100]*Id.* at 214–15 (citations omitted).

[101]*See, e.g.*, James v. Whirlpool Corp., 806 F. Supp. 835, 843 (E.D. Mo. 1992) (explaining such concepts in good faith discussion); *In re* Enron Corp., 292 B.R. 752, 782–83 (Bankr. S.D.N.Y. 2003) (same); Wells Fargo Realty Advisors Funding, Inc. v. Uioli, Inc., 872 P.2d 1359, 1363 (Colo. Ct. App. 1994) (same).

[102]*See, e.g.*, Healy v. Carlson Travel Network Assocs., Inc., 227 F. Supp. 2d 1080, 1090 (D. Minn. 2002) (explaining good faith in such terms); Piantes v. Pepperidge Farm, Inc., 875 F. Supp. 929, 938 (D. Mass. 1995) (same); Brown v. Moore, 973 P.2d 950, 954 (Utah 1998) (same).

[103]*See infra* Part III.C.

[104]*See infra* Part III.C.

[105]U.C.C. § 1-201(20) (amended 2003). "Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement." *Id.* § 1-304 (alteration in original). Moreover, the implied obligation of good faith may not be disclaimed in U.C.C.-governed contracts. *Id.* § 1-302(b) ("The obligations of good faith,

While the American common law doctrine of good faith originated as a matter of justice to convert potentially illusory contracts into valid and enforceable ones—as exemplified in *Lucy, Lady Duff-Gordon*—the *Conomos* analysis exemplifies how it presently serves two primary purposes, often in interrelated ways. First, it enables efficient exchange transactions by minimizing otherwise prohibitive transaction costs at the negotiation phase of contracting. That is, if parties were required at the contract formation stage to negotiate every potential and discrete form of performance-related conduct that might or might not be expected under the contract, they very well might not bother entering into the contract in the first place. Thus, reasonable expectations are implied as part of the duty of good faith in contract performance in order to minimize negotiation-related transaction costs.[106] Moreover, from a relational perspective,[107] the notion of having to explicitly negotiate over each party's integrity in contract performance risks infusing the relationship with the sort of distrust and bad feeling that could ultimately destroy it. Thus, that each party will use its best efforts to actuate the purpose of the contract and the intent of the parties is also assumed under the rubric of good faith.

The second primary purpose served by the good faith doctrine is that it provides a rhetorical framework for the analysis and adjudication of material breach; thus it also teaches us something about the related doctrine of constructive conditions.[108] The *Conomos* court's application of the doctrines of

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diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable." (alteration in original)).

[106]In other words, as a federal district court in Oregon put it:

> If in each contract the parties had to expressly describe and prohibit every artifice by which the parties could potentially deprive each other of the fruits of their agreement, then contracts would soon become as long as the tax code, as difficult to interpret, and (like the tax code) still contain innumerable loopholes available to a party that wished to avoid the spirit of the bargain. The better approach . . . is to treat a contract for what it is—an exchange of solemn promises—and enforce the objectively reasonable expectations of the parties.

Or. RSA No. 6, Inc. v. Castle Rock Cellular of Or. Ltd. P'ship, 840 F. Supp. 770, 776 (D. Or. 1993), *aff'd in part, rev'd in part*, 76 F.3d 1003 (9th Cir. 1996).

[107]*See* Ian R. MacNeil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483, 525 (surveying behavioral, legal, and scholarly dimensions of relational contract law and arguing that acquisition of "greater knowledge of . . . essential human social patterns" is required to fully understand discrete contractual exchanges).

[108]In contract law, constructive conditions are those implied by a court, absent express contract terms, so that it may determine the extent to which one party's duty to perform under a contract is conditioned upon performance by the other party. The doctrine of constructive conditions provides an analytical framework for courts in cases where one party claims it did not yet have a duty to perform because of the other party's failure to render its performance. As such, the doctrine of constructive conditions is directly related to that of substantial performance (and also material breach). In short, in the absence of express terms, the substantial performance

necessary implication and good faith demonstrates how the good faith doctrine functions in this way. In describing the standard of conduct required of Conomos under the contract, the court stated:

> Sun's obligation to inspect Conomos's work—and, if deemed to satisfy the requirements of the contract to approve the work and render payment therefor—is necessary to Conomos's enjoyment of the contract's benefits. The contract requires Conomos to perform a specific level of work. As the trial court observed, a certain level of subjectivity goes into evaluating the work. The contractual standard for the required work, however, was specific enough to prescribe the necessary procedures in relation to other levels of work along a spectrum. . . . These objective guidelines created reasonable expectations regarding the basis upon which Sun was to inspect the work. Because the contract necessarily implies that Sun will not defeat Conomos's reasonable expectation that work of sufficient quality will be compensated as agreed, the contract reflects that *Sun had an implied duty of good faith in the inspection of Conomos's surface preparation and painting.*
>
> The trial court found that Sun's foreman demanded a higher level of work than the contract required. *The court found that because of its "true motivation," Sun did not inspect Conomos work in good faith.*[109]

Although in this case Conomos sued Sun Company, the good faith analysis is used here not only to determine whether Sun breached the contract by inspecting the pipes in bad faith, but to determine whether Sun Company's payment obligation under the contract was excused due to Conomos's failure to satisfy a constructive condition of the contract—Conomos's own good faith preparation of the pipes at a level that would satisfy the demanding inspector.[110]

As in many cases involving satisfaction requirements,[111] whether express or implied, application of the doctrine of good faith enabled the court to determine, correctly, that Conomos had not failed to satisfy such a constructive condition, because such a constructive condition in fact did not exist. Under the express terms of the contract, Conomos was required to prepare the pipes

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of a contract serves as a constructive condition of performance of the counter-party (usually payment).

[109]*Conomos*, 831 A.2d at 707 (emphasis added) (citations omitted).

[110]*Id.*

[111]*See, e.g.*, Morin Bldg. Prods. Co. v. Baystone Constr., Inc., 717 F.2d 413, 415–17 (7th Cir. 1983) (holding that while subjective standard of good faith applies when contract involves personal aesthetics, such as painting portrait, when satisfaction clause is part of commercial contract, objective standards might allow court to evaluate commercial quality or utility, and commercial reasonableness standard is to be applied).

to a commercially reasonable level.[112] Sun Company could not reasonably expect that Conomos should perform at a higher level; if extra-high-quality pipe preparation had been important to Sun, it should have negotiated expressly for such performance in the first place. Conomos's refusal to comply with Desroches's excessive standards without further compensation by Sun Company thus did not result in a breach of contract on Conomos's part, and Sun Company could not legally suspend or discharge its payment obligations to Conomos for the extra work that was not contemplated at the time of contract formation. Moreover, even if compliance with Desroches's demands could be characterized as a constructive condition, it appears that Conomos substantially performed[113] and would have been entitled to restitutionary compensation in the modification amount it had requested.

In 2002, the Superior Court of New Jersey decided *Seidenberg v. Summit Bank*,[114] another example that may become a leading case on commercial breach of good faith. *Seidenberg* provides a textbook review of good faith doctrine and also illustrates how the treatment of good faith claims in the context of arm's-length transactions between sophisticated parties differs from the treatment of such claims in the context of transactions involving parties with unequal bargaining power.[115] The two plaintiffs in *Seidenberg* were sole shareholders of Pennsylvania insurance brokerage companies;[116] they eventually sold the stock in their companies to the defendant Summit Bank.[117] In consideration for the sale, the plaintiffs received a substantial number of shares of stock in Summit's parent corporation and also retained their executive positions in the after-acquired firms.[118] As part of the deal, the two also negotiated to manage and run similar insurance brokerage firms to be acquired by Summit, and to take a cut in their executive salaries in exchange for bonus compensation based on the anticipated growth of the businesses.[119] The relationship between the plaintiffs and Summit later deteriorated, however, and the two plaintiffs were eventually fired.[120] Soon thereafter, the plaintiffs filed a breach of good faith lawsuit, alleging that Summit had deprived them of their reasonable expectations under the contracts by failing to develop both potential customers and relationships with other entities that might have resulted in the acquisition of additional insurance brokerage firms.[121]

[112] *Conomos*, 831 A.2d at 701.

[113] *Id.*

[114] 791 A.2d 1068 (N.J. Super. Ct. App. Div. 2002).

[115] *See infra* Part III.B.

[116] *Seidenberg*, 791 A.2d at 1072. In other words, plaintiffs' companies marketed and sold health insurance benefits plans to employers. *Id.*

[117] *Id.*

[118] *Id.*

[119] *Id.* at 1072–73.

[120] *Id.* at 1073.

[121] *Id.* Specifically, Seidenberg and Raymond claimed that Summit failed to introduce them to potential customers in the form of vendors with whom Summit did business, failed to give them information they needed in order to provide potential customers with advice concerning

The plaintiffs also asserted a claim sounding in what has been referred to as promissory fraud.[122] They alleged that "Summit 'never had any intention to perform to begin with,' and that Summit 'from the start, . . . never [was] committed to developing the business with [plaintiffs], but rather simply wanted to acquire the business and seek out their own broker to run it or grow it.'"[123] In other words, the plaintiffs alleged that Summit had contracted with them simply to learn the insurance brokerage business and then to eliminate them as competition, so that Summit could develop its own firms.

The lower court dismissed the good faith claims on parol evidence grounds, noting that it was "not dealing with unsophisticated people. [Plaintiffs] . . . are very sophisticated businessmen. . . . And with the assistance of very able counsel entered into certain contracts with the bank. . . . [They] leaned back in reliance on things that were said to them during the course of the negotiations . . . ."[124] The appellate court found that, in so holding, the lower court had "represent[ed] an erroneous interpretation of the evolving implied covenant of good faith and fair dealing."[125] Consequently, it reversed the dismissal and remanded for further proceedings.[126]

The court stated that the obligation of good faith is implied in all contracts, and repeated the familiar doctrinal rhetoric: "'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.'"[127] The court further provided a concise overview of the significant ways in which the doctrine had been used: to prevent opportunism and exploitation in situations involving a plaintiff's "inadequate bargaining power" or other "financial vulnerability"; to ensure that the parties' expectations were consistent with the contract's express terms; and to thwart a defendant's bad faith or dishonesty.[128] By emphasizing the good faith doctrine's applicability to cases involving parties with unequal bargaining power, the lower court misunderstood the nature of the good faith claim.[129] Although leading good faith cases had considered disparate bargaining power as a "critical aspect" and "prominent feature" of the good faith doctrine's application and analysis, "it is not the *sine qua non* of such a

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health and other employee benefits, "unreasonably delayed a direct mail campaign" to solicit customers, "thwarted a joint marketing campaign," and "failed to advise" them about an attempt to acquire "another entity which [they] claim[ed] would fall within their ambit and right to operate." *Id.* at 1072–73.

[122] *See generally* Ayres & Klass, *supra* note 15, at 508–09 (focusing on promissory fraud liability in noncontractual settings, such as settings where parties enter into option contract and one party does not intend from outset to exercise option).

[123] *Seidenberg*, 791 A.2d at 1073 (quoting plaintiffs' complaint).

[124] *Id.* at 1074 (quoting trial court's ruling).

[125] *Id.*

[126] *Id.* at 1080.

[127] *Id.* at 1074 (quoting Sons of Thunder, Inc. v. Borden, Inc., 690 A.2d 575, 587 (N.J. 1997); Palisades Props., Inc. v. Brunetti, 207 A.2d 522, 531 (N.J. 1965)).

[128] *Id.*

[129] *Id.*

cause of action. It is merely one factor among many to be considered."[130] Thus, the appellate court held that claims for breaches of good faith may be actionable, even as between equally sophisticated contracting parties.[131]

Having clarified the good faith doctrine's general applicability to both arm's-length and non-arm's-length transactions, the court then surveyed three more specific ways in which the good faith doctrine has been applied. First, the court stated that "the covenant permits the inclusion of terms and conditions which have not been expressly set forth in the written contract. . . . The covenant acts in . . . instances to include terms 'the parties must have intended . . . because they are necessary to give business efficacy' to the contract."[132] Second, the court explained, the good faith covenant has been used "to allow redress for the bad faith performance of an agreement even when the defendant has not breached any express term."[133] Finally, the court stated that the good faith obligation has been used "to permit inquiry into a party's exercise of discretion expressly granted by a contract's terms."[134] In other words, with respect to this third way in which the covenant has been applied, the court described (and later cited to) Burton's foregone opportunities approach to good faith.[135] With respect to all of these categories of application, the court, citing section 205 of the *Restatement* for support, set forth a "guiding principle" in its application: "The guiding principle in the application of the implied covenant of good faith and fair dealing emanates from the fundamental notion that a party to a contract *may not unreasonably frustrate its purpose*."[136]

In its attempt to follow this guiding principle, the court synthesized and applied the three models of analysis just described. In reversing the lower court's order of dismissal, the court first found that the plaintiffs had alleged an expectation—notwithstanding Summit's express contractual right to terminate the contract—that Summit could not terminate the agreement in bad faith.[137]

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[130] *Id.* at 1075 (citing Emerson Radio Corp. v. Orion Sales, Inc., 253 F.3d 159, 173 (3d Cir. 2001)); *see also Sons of Thunder*, 690 A.2d at 588–90 (finding that despite presence of termination clause, clam purchaser breached obligation of good faith in terminating contract because of lack of honesty of fact).

[131] *Seidenberg*, 791 A.2d at 1075.

[132] *Id.* at 1076 (quoting N.J. Bank v. Palladino, 389 A.2d 454, 461 (N.J. 1978)).

[133] *Id.*

[134] *Id.*

[135] *See id.* at 1078 (citing Wilson v. Amerada Hess Corp. 773 A.2d 1121, 1127 (N.J. 2001), for support in formulating its discretionary approach to good faith). The *Wilson* court quoted Burton, *supra* note 7, at 386, with approval. *See Wilson*, 773 A.2d at 1127.

[136] *Seidenberg*, 791 A.2d at 1077 (emphasis added).

[137] *Id.* at 1078. This is consistent with one strain of at-will employment cases, as well. For example,

> [i]n *Wagenseller v. Scottsdale Memorial Hospital*[, 710 P.2d 1025 (Ariz. 1985)], the Supreme Court of Arizona delineated three general categories of exceptions to the rule that an employer may terminate an at-will employee for any reason or no reason: the public policy exception, the implied-in-fact employment contract exception, and the good faith and fair dealing exception. . . . [T]he good faith and fair dealing exception establishes a [contractual] duty imposed by law where the

Second, the court found that, in failing to invest its time and energy into developing potential customers and growing other firms to be managed and run by the plaintiffs, Summit may have abused discretion reserved to it under the contract in an opportunistic fashion.[138] That is, in refusing to exercise its discretion to develop the insurance firms that would jointly benefit the plaintiffs, Summit had attempted to improperly recapture an opportunity that it had presumably given up by entering into the contract with the plaintiffs: the opportunity to develop independently its own brokerage firm business(es) exclusively for its own benefit.

The court then dedicated a significant amount of space to analyzing the application of the good faith covenant to cases involving bad faith performance and/or "ill motive" on the part of the allegedly breaching party.[139] The court correctly described this application of good faith as explicitly equitable in nature, hence, dependent upon the court's careful discretionary employment of the doctrine.[140] The court explained, for example, that judges are not to engage in "overly ambitious" applications of good faith, thus, they should not use the covenant to "supplant the prohibition on judicial rewriting of contracts or [to] provide undue protection to contracting parties who can protect themselves.'"[141] Rather, the court stated, analyses in such cases should turn on whether the defendant "'acted in bad faith or violated any commercially reasonable standard thereby depriving plaintiffs of their right to make a reasonable profit.'"[142] Here, the court clearly was relying on U.C.C. articulations of good faith standards and definitions.[143] As to parties acting in "bad faith," the court analogized such bad faith to a party's abuse of discretion under the contract, further clarifying that "'[w]ithout bad motive or intention, discretionary decisions that happen to result in economic disadvantage to the other party are of no legal significance.'"[144] Here again, although it did not specifically cite Burton, the court relied on the foregone opportunities approach to the conceptualization of good faith.

Then, in a refreshing turn, the court proceeded to acknowledge that all of the good faith rhetoric that it had been discussing "provide[s] little guidance" to the court, which "'must distinguish bad faith from mere sharp commercial

> contract itself is silent, which requires that neither party do anything that will injure the right of the other to receive the benefits of their agreement.

Houh, *supra* note 8, at 1067–68 (internal quotation marks and citations omitted).

138 *Seidenberg*, 791 A.2d at 1078.

139 *Id.* at 1078–80.

140 *Id.* at 1079.

141 *Id.*

142 *Id.* (quoting Wilson v. Amerada Hess Corp., 773 A.2d 1121, 1131 (N.J. 2001)).

143 The U.C.C. defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing." U.C.C. §§ 1-201(20), 2-103(1)(b) (amended 2003). The New Jersey courts' reliance on the Uniform Commercial Code's articulation of good faith definitions and standards is well placed.

144 *Seidenberg*, 791 A.2d at 1079 (quoting *Wilson*, 773 A.2d at 1130).

practice.'"[145] Yet the court correctly insisted that trial courts and juries are in the best position to make such judgments, because "[i]n the final analysis, bad faith must be judged not only in light of the proofs regarding the defendant's state of mind but also in the context from which the claim arose."[146]

In yet another refreshing turn, the court expressed its comfort with the good faith doctrine's inherent vagueness: "Any attempt to provide greater definition is to expect some 'delusive exactness' which, as Justice Holmes said, is 'a source of fallacy throughout the law.'"[147] The court's confidence in judges and juries to make good faith determinations—while discomforting to some—precisely reflects the nature of equitable doctrines and the intended application of them.

In its lengthy discussion of good faith, the *Seidenberg* court succeeded where most courts dealing with good faith have failed: it set forth a nuanced and comprehensive treatment of the good faith doctrine. The *Seidenberg* court's application of the good faith doctrine also demonstrates the functional equivalence of Summers's and Burton's purportedly opposing conceptualizations of good faith by demonstrating that Burton's model simply describes a category of radically negative conduct prohibited by Summers's excluder-analysis approach.[148] If good faith is what bad faith is not (in Summers's words), then good faith is (in Burton's words) a contracting party's refusal to abuse contractual discretion reserved to it in a way that would deprive the counter-party of her reasonable expectations under the contract.

A close reading of the *Seidenberg* opinion supports this Article's claim that good faith rhetoric and analyses, while equitable in nature, serve largely to assist courts in determining whether there was a breach of the underlying contract. In focusing on and synthesizing three distinct models of good faith analysis—each of which ultimately aims to protect the reasonable expectations of the parties—the court exemplified how the development of the good faith doctrine has diverged from its *Wood v. Lucy, Lady Duff-Gordon*[149] roots and

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[145] *Id.* at 1079 (quoting Emerson Radio Corp. v. Orion Sales Inc., 80 F. Supp. 2d 307, 311 (D.N.J. 2000), *rev'd, in part, on other grounds*, 253 F.3d 159, 175 (3d Cir. 2001)).

[146] *Id.*

[147] *Id.* at 1080 (quoting Truax v. Corrigan, 257 U.S. 312, 342 (1921) (Holmes, J., dissenting)).

[148] For example, Robert Summers lists the following forms of conduct as "radically heterogeneous forms of bad faith":

> 1. seller concealing a defect in what he is selling[;] 2. builder willfully failing to perform in full, though otherwise substantially performing[;] 3. contractor openly abusing bargaining power to coerce an increase in the contract price[;] 4. hiring a broker and then deliberately preventing him from consummating the deal[;] 5. conscious lack of diligence in mitigating the other party's damages[;] 6. arbitrarily and capriciously exercising a power to terminate a contract[;] 7. adopting an overreaching interpretation of contract language[; and] 8. harassing the other party for repeated assurances of performance[.]

Summers, *Good Faith, supra* note 7, at 203–04.

[149] 118 N.E. 214 (N.Y. 1917).

other equitably implied obligations, such as the implied obligation of habitability.[150] The *Seidenberg* court's treatment of good faith shows how the covenant has come to be used "in aid and furtherance of other terms of the agreement,"[151] rather than to imply separate, equity-based obligations into the contract terms. Most contracts scholars would argue that this is precisely how the doctrine should be understood and applied. This Article opposes this current understanding and employment of the doctrine. It argues that this understanding of good faith could just as easily be subsumed in the doctrinal and theoretical rubric of material breach, leaving good faith open to other readings and applications.

2. Commercial Lending Cases

Because of the nature of agreements between equally sophisticated lenders and borrowers, courts dealing with breach of good faith claims in commercial lending and foreclosure contexts tend to employ Burton's foregone opportunities approach.[152] The agreements generally reserve to lenders a certain amount of discretionary authority to, among other things, advance and/or freeze credit lines or adjust interest rates. Such cases cannot always be described as involving parties with unequal bargaining power; sophisticated borrowers often successfully negotiate advantageous loan terms and conditions. However, they do usually involve the lender's alleged opportunistic abuse of contractually reserved discretion.[153]

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[150]This implied obligation, in stark contrast to the principal caveat emptor (let the buyer beware), which applied presumptively when land was often more important than the structures on it, protects lessees in rental contracts for residential and other properties. A majority of states recognize this implied warranty, compelling landlords to comply with building codes, make repairs, and generally provide fit living conditions.

> Article 2 of the Uniform Commercial Code . . . provides consumers with a set of warranties applying to transactions in goods. Subsequent[ly] . . . federal and state legislatures enacted legislation to further protect consumers. However, these laws excluded consumers of housing—residential tenants. To lessen this disparity, courts and legislatures created an implied warranty of habitability to govern housing conditions.

Barbara Jo Smith, Note, *Tenants in Search of Parity with Consumers: Creating a Reasonable Expectations Warranty*, 72 WASH. U. L.Q. 475, 475 (1994) (citations omitted). Moreover, in 1972, the American Law Institute adopted the Uniform Residential Landlord and Tenant Act, 7B U.L.A. 527 (2000), which incorporates the common law warranty of habitability and specifically defines the related duties owed by landlords to their tenants.

[151]Ripplemeyer v. Nat'l Grape Coop. Ass'n, Inc., 807 F. Supp. 1439, 1452 (W.D. Ark. 1992).

[152]*See, e.g.*, M/A-COM Sec. Corp. v. Galesi, 904 F.2d 134, 136 (2d Cir. 1990) (noting that courts employ good faith doctrine to protect parties' expectations); Tufankjian v. Rockland Trust Co., 782 N.E.2d 1, 5 (Mass. App. Ct. 2003) (holding that jury was reasonable to conclude that bank sought to recapture foregone opportunities and secure better deal in violation of duty of good faith and fair dealing).

[153]*See, e.g.*, Wells Fargo Bank v. Ariz. Laborers Local No. 395 Pension Trust Fund, 38 P.3d 12, 17, 20, 31, 37 (Ariz. 2002) (allowing claim to proceed where interim lender for

Southwest Savings and Loan Ass'n v. SunAmp Systems, Inc.[154] is an exemplary case. There, SunAmp, a small manufacturing company, executed a loan agreement and revolving credit note with Southwest Savings and Loan for the purpose of expanding its business operations.[155] Southwest required personal guarantees from SunAmp's investors before it would extend the loans; SunAmp's president, director, and its major investor subsequently provided the guarantees.[156] As a matter of policy, Southwest did not accept loan guarantees without spouses' signatures.[157] However, the terms of SunAmp's loan agreement and guarantees did not expressly require spouses' signatures, and the major investor's spouse never signed the guarantees.[158]

Under the terms of the loan agreement, and in accord with commercial loans of this nature, Southwest acquired a security interest in SunAmp's assets as collateral to secure the credit line.[159] The agreement also provided for the advancement of funds and credit, the amounts of which were based on the value of SunAmp's collateral.[160] Upon execution of the loan documents, Southwest began advancing SunAmp cash and letters of credit.[161] After Southwest had committed funds in excess of $200,000 to SunAmp, it discovered that SunAmp's investor's spouse had never signed the personal guarantee.[162] Consequently, Southwest refused to advance any further funds.[163] However, it did attempt—unsuccessfully—to obtain the missing signature.[164] Southwest's additional efforts to save the deal failed,[165] and it eventually

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construction project brought action against permanent lender; permanent lender counterclaimed for, among other things, breach of implied contractual covenant of good faith and fair dealing); Bike Fashion Corp. v. Kramer, 46 P.3d 431, 435–36 (Ariz. Ct. App. 2002) (holding, in part, that it was prejudicial error to give jury instruction that owner could not be liable for breach of implied covenant of good faith and fair dealing if partnership agreement had express provision on related subject, where partners sued other general partners for breach of contract, accounting, breach of implied covenant of good faith and fair dealing, and fraudulent transfer and conveyance regarding sale of partnership real estate without consent of fifty-one percent of partners); Olympus Hills Shopping Ctr., Ltd. v. Smith's Food & Drug Centers, Inc., 889 P.2d 445, 465–66 (Utah Ct. App. 1994) (denying summary judgment for claim that lessee breached covenant of good faith and fair dealing in commercial lease, after lessee converted use from supermarket to warehouse discount store).

[154] 838 P.2d 1314 (Ariz. Ct. App. 1992).

[155] *Id.* at 1315.

[156] *Id.*

[157] *Id.* at 1315–16, 1317.

[158] *Id.* at 1316.

[159] *Id.*

[160] *Id.*

[161] *Id.*

[162] *Id.*

[163] *Id.*

[164] *Id.*

[165] For example, Southwest's loan officer obtained SunAmp's financial statements in order to determine whether it had sufficient assets to collateralize credit that had already been extended on the line. *Id.* Based on her analysis of the financial statements, she determined that SunAmp's borrowing base was sufficient to support neither the cash already advanced to

terminated SunAmp's credit line and requested a plan for immediate repayment of the loan.[166] After the deal fell through, Southwest sued SunAmp for repayment of the loan.[167] SunAmp's counterclaims included a claim for breach of the implied covenant of good faith and fair dealing. SunAmp alleged that the breach occurred when Southwest froze SunAmp's credit line, directed it to stop using the letters of credit, terminated its line of credit, and demanded the establishment of an immediate repayment plan.[168]

Like the *Conomos* and *Seidenberg* courts, the *SunAmp* court addressed the relationship between the implied covenant of good faith and express contract terms.[169] In so doing, the court critiqued fairness-based notions of good faith as particularly unhelpful, and further acknowledged that while "'the duty to act in good faith does not alter the specific obligations of the parties under the contract. . . .[,] [a]cts in accord with the terms of one's contract cannot *without more* be equated with bad faith.'"[170]

The court ameliorated its discomfort with the vague phrasing "without more" by adopting Burton's approach.[171] Acknowledging that commerce would come to a standstill if parties were forced to reduce all of their expectations to express contract terms, the court invoked Burton's approach to address unexpressed obligations relating to discretionary authority retained under a contract.[172] The court quoted Burton:

> The good faith performance doctrine may be said to permit the exercise of discretion for any purpose—including ordinary business purposes—reasonably within the contemplation of the parties. A contract thus would be breached by a failure to perform in good faith if a party uses its discretion for a reason outside the contemplated

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SunAmp, nor the $120,000 already committed in the letters of credit that it had issued on behalf of SunAmp. *Id.* In other words, due to its heavy reliance on the defective guarantee, Southwest from the start had allowed SunAmp to exceed the borrowing base, in contravention of the express terms of the loan agreement. Southwest continued to hold out hope, attempting to obtain more current financial information from SunAmp that might enable Southwest to "thaw" the credit freeze and proposing alternative ways to structure the loan so that the defective guarantee would not be necessary. *Id.* at 1317. While waiting on the financial information, which SunAmp could not immediately provide because it was in the midst of an internal audit and computer system conversion, Southwest directed SunAmp to stop using one of the letters of credit. *Id.* Unfortunately, the financial data, once it became available, revealed that SunAmp was not in good financial shape. *Id.*

166 *Id.*

167 *Id.* at 1318.

168 *Id.* at 1317–18.

169 *Id.* at 1319.

170 *Id.* (alteration in original) (quoting Balfour, Guthrie & Co. v. Gourmet Farms, 166 Cal. Rptr. 422, 427 (Cal. Ct. App. 1980) (second alteration in original)).

171 *Id.* at 1319–20.

172 *Id.* at 1319.

> range—a reason beyond the risks assumed by the party claiming a breach.[173]

Significantly, the court cited comment (a) to section 205 of the *Restatement* to support its adoption of the foregone opportunities approach.[174] It explained that "[c]onsistently with these Burton and Restatement formulations, our supreme court has decided in a variety of contexts that a contracting party may exercise a retained contractual power in bad faith"; it then discussed such findings in the contexts of insurance bad faith cases and at-will employment cases.[175] The court's conflation of the Burton and *Restatement*/Summers approaches was not unwarranted. Rather, given the language in comment (a) to section 205 of the *Restatement*—stating that "[g]ood faith performance . . . of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party"[176]—the court was perfectly justified in conflating the two approaches.

The remainder of the court's good faith discussion focused on SunAmp's "justified expectations" under the contract, which—in the absence of any allegation of ill will or spite on Southwest's part—turned on whether it was "objectively reasonable" for Southwest to require and secure a valid guarantee on the part of both the investor and his wife.[177] In a manner again consistent with both Summers's and Burton's approaches to good faith, the court emphasized the importance of context and fact specificity in good faith inquiries; it held that, given the circumstances, SunAmp had no justifiable expectation that a reasonable lender in the commercial lending industry would act differently.[178]

3. *Contractor Cases*

Contractors suing owners for breach of construction contracts often additionally assert breach of good faith claims in their lawsuits.[179] *Designer*

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[173] *Id.* at 1319–20.
[174] *Id.* at 1320.
[175] *Id.*
[176] RESTATEMENT § 205 cmt. a.
[177] *SunAmp Sys.*, 838 P.2d at 1320–21.
[178] *Id.* at 1321–22.
[179] *See, e.g.*, Story v. City of Bozeman, 791 P.2d 767, 776 (Mont. 1990) (holding that, while covenant of good faith is implied in all contracts, claims for tortious breach of good faith are available only in exceptional circumstances); Whitlock Constr., Inc. v. South Big Horn County Water Supply Joint Powers Bd., 41 P.3d 1261, 1269–70 (Wyo. 2002) (adopting approach of *Restatement* section 205 to good faith in holding that municipal water board did not breach implied covenant of good faith and fair dealing or act arbitrarily and capriciously when it canceled contract due to subsequent state agency disapproval of contractor in suit on public contract by contractor against municipal water board); *see also* Scherer Constr., LLC v. Hedquist Constr., Inc., 18 P.3d 645, 658–59 (Wyo. 2001) (holding that contractor breached implied covenant of good faith and fair dealing by not providing sufficient time for subcontractor to

Direct, Inc. v. DeForest Redevelopment Authority,[180] a case originating in the United States District Court for the Western District of Wisconsin, provides a comprehensive discussion of good faith in the context of construction contracts. In *Designer Direct*, the plaintiff, doing business as Levin Associates Architects ("Levin"), entered into a contract with the DeForest Redevelopment Authority ("DRA") for the redevelopment of DeForest Village's downtown area.[181] Pursuant to the redevelopment plan, Levin was to buy downtown property from the DRA and construct buildings on it.[182] Things began to go wrong between Levin and the DRA almost immediately. First, the express contract terms required the DRA to provide Levin with a full-time liaison, but the DRA provided only a part-time liaison. To resolve this problem, and over Levin's explicit objections, the DRA outsourced the liaison services at substantial additional cost.[183] Next, a dispute arose over a piece of the redevelopment property known as Carriage Way.[184] The DRA failed to competently prepare parcels of Carriage Way so that they could be conveyed to Levin, per the agreement, for construction and development.[185] This failure forced Levin to make expensive changes to its own architectural drawings and engineering plans, and prevented Levin from purchasing the Carriage Way parcels on the contractually specified closing date, which the DRA refused to push back.[186]

A dispute over plans to construct a public library immediately precipitated Levin's lawsuit. The redevelopment plan involved procuring an "anchor tenant" for the downtown area.[187] Pursuant to the redevelopment agreement, Levin had acquired the right to purchase and develop the site.[188] The DRA wanted to place a library on the anchor tenant site, so it persuaded Levin to give up its right to develop the site by promising Levin that it would be in charge of the library design and construction.[189] Having agreed to this compromise, Levin drafted an agreement for the construction of the library on the site, which the DRA inexplicably refused to sign.[190] Levin alleged, and the district court found, that the DRA had made other attempts to delay

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remedy alleged deficiencies brought about by city property owner's postcontractual change in street reconstruction project in suit by subcontractor against general contractor).

[180] 313 F.3d 1036 (7th Cir. 2002).

[181] *Id.* at 1039.

[182] *Id.*

[183] *Id.* at 1039–40. The DRA eventually paid for the outsourced services. *Id.* at 1042.

[184] *Id.* at 1040.

[185] *Id.*

[186] *Id.* The DRA's inability to prepare the parcels in an organized and timely manner ultimately resulted in Levin incurring additional costs in the amount of $490,000. *Id.*

[187] *Id.*

[188] *Id.*

[189] *Id.*

[190] *Id.*

construction of the library.[191] Shortly thereafter, Levin terminated its contracts with the DRA and sued, asserting breach of contract and breach of the implied covenant of good faith and fair dealing.[192] The district court found in favor of Levin on the good faith claim.[193] The Court of Appeals for the Seventh Circuit affirmed.[194]

In setting forth Wisconsin's good faith law, the Seventh Circuit quoted directly from comment (d) to section 205 of the *Restatement*, which adopts Summers's excluder-analysis approach to good faith.[195] While it declined to "pigeonhole" the DRA's conduct into the categories of bad faith conduct described in comment (d), the court found that the DRA's conduct violated the covenant of good faith in both general and specific ways and that "the DRA's conduct as a whole . . . violated the standards of fairness and reasonableness."[196] For example, the court held that the DRA was "uncooperative, evasive, and at times uninterested in the project."[197] Moreover, the court characterized the liaison-related delays, which adversely impacted Levin's performance, as "[u]nreasonable" and its performance overall as "disorganized."[198] Finally, the court found that the DRA had abused its discretionary power in interfering with Levin's attempt to develop a public library on the anchor site.[199]

The court's discussion of good faith makes clear that Wisconsin has adopted the *Restatement*'s and Summers's excluder analysis approach to good faith. Moreover, when the implied good faith analysis is read in conjunction with its breach of contract analysis relating to the Carriage Way property, the opinion provides some important insights into the function of the good faith doctrine in modern contract law.

With respect to the DRA's inability to prepare the Carriage Way parcels for conveyance to and development by Levin, the DRA did not deny that it had breached the contract; thus, the court focused its analysis on whether the DRA's breach was material.[200] The court explained that in order for a breach to be material, "it must be so serious as to destroy the essential object of the agreement."[201] In another portion of the opinion (which addressed material breach of contract relating to the liaison dispute), the court further explained

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[191] *Id.* at 1041. For example, the DRA secretly managed to convince the DeForest Library Board to postpone signing the multiparty agreement in order to delay the library construction. *Id.* at 1040.

[192] *Id.* at 1040, 1045.

[193] *Id.* at 1046.

[194] *Id.* at 1047.

[195] *Id.* at 1046–47.

[196] *Id.* at 1047.

[197] *Id.*

[198] *Id.*

[199] *Id.*

[200] *Id.* at 1043.

[201] *Id.* at 1043–44 (citing Ranes v. Am. Family Mut. Ins. Co., 580 N.W.2d 197, 200 (Wis. 1998)).

that breaches are material when they affect "the 'core purpose,' the 'very essence of the Agreement.'"[202]

What is interesting about the court's discussion of materiality is that it sounds in the rhetoric of good faith, especially where the court describes a material breach as one that destroys "the essential object" of the contract, and that affects its "core purpose" and "very essence."[203] Moreover, section 241 of the *Restatement*, which provides several different factors for courts to consider in determining whether a breach is material, explicitly lists as two of its factors "the extent to which the injured party will be deprived of the benefit which he reasonably expected,"[204] and "the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing."[205] Thus, the *Restatement* makes clear the relationship between good faith and material breach: whether a breaching party has acted in bad faith will assist courts in determining whether the breaching party has committed a material breach, thereby justifying the nonbreaching party's suspension of his performance under the contract.

It is important to recognize the *Restatement*'s linking of good faith and material breach, and to understand that the *Restatement* does not equate absolutely good faith with material breach as a theoretical matter. Yet, for all practical purposes, good faith rhetoric—with its emphasis on the reasonable expectations of the parties and its prohibition on the evasion of the spirit or essence of the contract—corresponds very closely with the rhetoric of material breach.

4. *Commercial Real Estate Leases*

Cases involving commercial leases of real estate often implicate good faith because, even between equally sophisticated lessors and lessees, the lessor has reserved discretionary authority under the contract to approve, for example, subsequent subleasing of the property by the lessee.[206] *Carma*

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[202] *Id.* at 1042 (quoting district court findings). The difference between a material and nonmaterial breach is important because it determines the performance obligations of the nonbreaching party. If the breaching party commits a material breach, the nonbreaching party is entitled to suspend her performance obligations under the contract; moreover, she may later cancel the contract and discharge her obligations if that material breach ripens into a total breach due to failure to cure within a reasonable time. RESTATEMENT §§ 237, 241, 242. On the other hand, if the breach is a nonmaterial one, the nonbreaching party is not entitled to suspend her performance under the contract; she must continue to perform or, if she wrongly believes she may suspend performance, risk committing material breach of the contract herself. *Id.* In particular, section 241 provides guidance on how to determine whether a breach is material. *Id.* § 241.

[203] *Designer Direct*, 313 F.3d at 1042–44.

[204] RESTATEMENT § 241(a).

[205] *Id.* § 241(e).

[206] *See, e.g.*, Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc., 826 P.2d 710, 712 (Cal. 1992) (involving recapture clause allowing termination of lease upon request to sublet or

Developers (Cal), Inc. v. Marathon Development California, Inc.[207] is such a case. Since it was decided by the Supreme Court of California in 1992, it has become a leading case on commercial good faith. The *Carma* opinion not only provides its readers with a thorough survey of the different models of good faith, but it also speaks to the issue of how and why the law distinguishes between contractual and tortious breaches of good faith.[208]

In *Carma*, Marathon leased the thirtieth floor of a large office building to Carma for a term of ten years at a base rental rate of $22 per square foot per year.[209] As is typical in the commercial leasing industry, the lease included two provisions relating to Carma's subleasing and assignment rights.[210] First, the lease required Carma to obtain Marathon's written consent—which Marathon could not unreasonably withhold—before assigning and subletting any portion of the lease and property to a third party.[211] Second, the lease required Carma to provide Marathon with written notice identifying the intended sublessee or assignee and disclosing to Marathon the specific terms of any intended sublease or assignment by Carma.[212] Significantly, this latter provision also gave Marathon the right, within thirty days of receipt of notice from Carma, to terminate the lease with Carma and thereafter to enter into a new lease for the premises with the sublessee or assignee previously identified in the written notice.[213] In other words, this lease provision contractually enabled Marathon exclusively to capture any profit to be made on such a subletting or assignment.

During the first few years of the lease term, Carma made major improvements to the premises.[214] About five years into the lease term, Carma decided to relocate its headquarters to another city.[215] Subsequently, Carma submitted a written notice requesting Marathon's permission to sublet the floor to an identified third-party subtenant, Grubb & Ellis, at a sublet rate of approximately $33 per square foot per year, which exceeded Carma's rental rate by about $11 per square foot per year.[216] Predictably, Marathon declined to

assignment); Warner v. Konover, 553 A.2d 1138, 1140–41 (Conn. 1989) (reserving landlord's discretionary authority to withhold consent of lease assignment).

[207] 826 P.2d 710 (Cal. 1992).

[208] For further discussion of the tortious and contractual breaches of good faith, see *infra* Part II.B.3.

[209] *Carma*, 826 P.2d at 712–13.

[210] *Id.* at 713.

[211] *Id.* Paragraph 15(a) of the lease stated: "Tenant shall not, without the prior written consent of Landlord, which consent shall not be unreasonably withheld, assign this Lease or any interest herein or sublet the Premises or any part thereof, or permit the use or occupancy of the Premises by any person other than Tenant." *Id.*

[212] *Id.*

[213] *Id.*

[214] *Id.*

[215] *Id.*

[216] *Id.* Carma presumably set this higher sublet rate to reflect the value of the improvements it had made to the premises.

give its consent, terminated the lease with Carma, and attempted to enter into a new lease agreement with Grubb & Ellis.[217]

Upon Marathon's termination of the lease, Carma sued for breach of the lease, as well as for breach of the implied covenant of good faith and fair dealing and interference with prospective economic advantage.[218] On Carma's motion for summary judgment, the trial court held that Marathon violated the lease terms by unreasonably withholding its consent to sublease the premises to Grubb & Ellis.[219] The court also implied a "commercial reasonableness" standard into the lease and found that Marathon's attempts to "appropriate sublease profits was not commercially reasonable."[220] Finally, the court ruled that "Marathon's refusal to consent to the sublease, termination of the lease, and refusal to permit Carma to recover the unamortized value of its improvements breached the covenant of good faith and fair dealing."[221]

In its lengthy discussion of the covenant of good faith, the California Supreme Court drew from the approaches of Burton, Summers, and the U.C.C. in order to piece together a comprehensive articulation of good faith.[222] The court initially identified the case as one involving a "situation[ ] where one party is invested with a discretionary power affecting the rights of another."[223] It invoked Burton's foregone opportunities approach, stating that in such cases, "[s]uch power must be exercised in good faith."[224] The court then looked, in part, to the U.C.C.'s approach to good faith and suggested that good faith analysis "has both a subjective and objective aspect—subjective good faith and objective fair dealing. A party violates the covenant if it subjectively lacks belief in the validity of its act or if its conduct is objectively unreasonable."[225] The court further observed that Burton's foregone opportunities model tended

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[217] *Id.* The deal between Marathon and Grubb & Ellis never materialized, however, and it took Marathon an additional year or so to secure another tenant for the thirtieth floor. *Id.*

[218] *Id.*

[219] *Id.* at 713–14.

[220] *Id.*

[221] *Id.* The damages claim relating to the breach of contract and breach of good faith duty were tried to a jury, as was the claim for interference with prospective economic advantage. *Id.* at 714. The jury awarded Carma $14,468.83 on the breach of contract claim, and $300,649.49—reflecting the unamortized value of Carma's improvements to the premises—on the breach of good faith claim. *Id.* The trial court further awarded Carma costs, expenses, and attorneys fees in the amount of $142,578.08. *Id.* Marathon appealed and the intermediate appellate court affirmed in all respects but one: it remanded on the issue of costs. *Id.* The California Supreme Court addressed a host of property-related issues, including the issues of whether the recapture clause set forth in Paragraph 15(b) of the parties' contract constituted an unlawful restraint on alienation, and whether the contract terms could be interpreted in a manner consistent with policy set forth in state statutes which favored transferability of leaseholds. *Id.* at 715–21.

[222] *Id.* at 726–28.

[223] *Id.* at 726.

[224] *Id.*

[225] *Id.* at 727.

toward the objective aspect of good faith.[226] The court also acknowledged Summers's approach to good faith—which had been adopted by the *Restatement*—and recognized that Summers's approach differed theoretically, or at least rhetorically, from Burton's, in its negative definition of good faith.[227]

Rather than choosing one approach over another, the court culled from its survey of decisions some principles that were—with one exception—consistent with *both* the Burton and Summers approaches. To begin with, the court noted that "breach of a specific provision of the contract is not a necessary prerequisite" for a contractual good faith claim,[228] a statement with which neither Burton nor Summers would disagree.[229] Next, the court observed that although dishonesty may result in bad faith conduct, it is *not* a required element of a breach of good faith claim, at least under Summers's excluder analysis and Burton's economic approaches.[230] As the court put it, "[d]ishonesty presupposes subjective immorality; the covenant of good faith can be breached for objectively unreasonable conduct, regardless of the actor's motive."[231] The court also stated that the good faith covenant may not be applied to prohibit what a party may do under the express terms of the contract.[232] Ultimately, the court used this particular component of the good faith doctrine to reverse the lower courts on the issue of good faith. The court held that Marathon's termination of the lease with Carma—even assuming that its motivation for termination was to appropriate the increased value of the premises, as reflected in Carma's proposed sublease to Grubb & Ellis—was "expressly permitted by the agreement."[233] Thus, Carma could not employ the good faith covenant in order to circumvent what the contract expressly permitted.

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[226]*See id.* ("In the case of a discretionary power, it has been suggested the covenant requires the party holding such power to exercise it 'for any purpose within the reasonable contemplation of the parties at the time of formation—to capture opportunities that were preserved upon entering the contract, interpreted objectively.'" (quoting Burton, *supra* note 7, at 373)).

[227]*Id.* ("[I]t has also been suggested the covenant is not susceptible to firm definition but must be examined on a case-by-case basis. Instead of defining what is consistent with good faith and fair dealing, it is more meaningful to concentrate on what is prohibited." (citing Summers, *Good Faith*, *supra* note 7, at 204–06)).

[228]*Id.* (citing Conoco, Inc. v. Inman Oil Co., 774 F.2d 895, 908 (8th Cir. 1985)).

[229]*See* Burton, *supra* note 7, at 386 (asserting that breach of contract can occur if "a party uses its discretion for a reason outside the contemplated range"); Summers, *Good Faith*, *supra* note 7, at 199 (noting potential of good faith to be independent theory that can be used to prevent abuses, even in absence of elements of estoppel).

[230]*Carma*, 826 P.2d at 727 (citing Summers, *Good Faith*, *supra* note 7, at 204–06); *see also* Burton, *supra* note 7, at 378 (defining failure to perform in good faith in breach of contract).

[231]*Carma*, 826 P.2d at 727.

[232]*Id.* at 728. It is important to note, however, that such an express provision could be invalidated on other equitable grounds such as unconscionability or misrepresentation.

[233]*Id.* at 729.

The court found it necessary to expand on the fact that good faith may not be used to prohibit a party from doing that which the contract expressly permits, and asserted that:

> the scope of conduct prohibited by the covenant of good faith is circumscribed by the purposes and express terms of the contract. . . . [for] the implied covenant of good faith is read into contracts "in order to protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purpose."[234]

While such a statement may be entirely consistent with Burton's economic approach to good faith, it is not clear that it is consistent with Summers's approach, in light of Summers's emphasis on community standards and fairness, and on the doctrine's potential to "do justice *and* do it according to law."[235] The court's discussion in this regard is interesting because, while it recognized the theoretical distinction between the Summers and Burton approaches to good faith, it demonstrated how a fused Summers-Burton approach can be employed to effect a somewhat schizophrenic result that is consistent with both models' prescriptions against using good faith to circumvent express terms of a contract. At the same time, it is seemingly *in*consistent with Summers's overarching focus on fairness and justice *and* Burton's overarching focus on the prevention of opportunistic behavior. In other words, the good faith doctrine is important and necessary in contract law because it functions to prevent opportunism, unfairness, and injustice—exemplified by Marathon's conduct—but if the contract expressly authorizes such opportunism and injustice, then it is all right to forego those important principles.

B. Cases Involving Unequal Bargaining Power

Although this Part is divided into the two analytically useful categories of 'arm's-length commercial cases' and 'cases involving unequal bargaining power,' it does not suggest that any given transaction, commercial or not, may be so easily characterized. In most cases, there is neither perfect equality of sophistication, nor drastic imbalance of power between contracting parties. Rather, in most cases, contracting parties possess differing levels of sophistication and/or naivete relating to different aspects of the transaction. To the extent there exists an imbalance of power and sophistication between the parties, the imbalance exists to varying degrees. For the purposes of this Article, and in order to determine whether the application of good faith to non-arm's-length transactions differs from its application to arm's-length ones, this

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[234] *Id.* at 727 (quoting Foley v. Interactive Data Corp., 765 P.2d 373, 394 (Cal. 1988)).
[235] Summers, *Good Faith*, *supra* note 7, at 198.

Part focuses on particular categories of transactions that are characterized by varying degrees of power imbalance between the contracting parties. Thus, the following discussion examines a spectrum of such cases, beginning with a look at cases involving contracting parties—whose relationships are characterized inherently by a small degree of power or sophistication imbalance—and ending with a look at cases involving parties whose relationships are characterized inherently by a greater degree of power imbalance. As such, this Part looks at four different categories of cases: franchisor/franchisee and dealer/distributor cases, lost commissions cases, at-will employment cases, and consumer contract cases.

1. Franchisor/Franchisee and Dealer/Distributor Cases

Wilson v. Amerada Hess Corp.,[236] discussed at length by the *Seidenberg* court,[237] is another leading commercial good faith case. The facts in *Wilson* exemplify the sorts of disputes that arise in franchise and distributor cases, which generally arise out of the franchisor's or distributor's discretionary price-setting authority.[238] Amerada Hess Corporation ("Hess"), the defendant in *Wilson*, produced, refined, and distributed gasoline and other related petroleum products.[239] The three plaintiffs were independent franchise dealers of Hess gasoline, each of whom leased and operated a gasoline station pursuant to a dealership agreement ("Agreement") with Hess.[240] The Agreement provided in relevant part that the gasoline prices were to be set by Hess according to competing prices in the geographic area and that the gas prices were "subject to change at any time without notice."[241]

The disputes between Hess and the plaintiffs arose from changes to Hess's business practices over the course of approximately twenty years, during which time Hess gradually transformed from an independent dealer-based distributorship to a cooperative-based business.[242] In shifting to a cooperative-based business, Hess replaced its pricing policy with one that, plaintiffs alleged, reduced their profits so drastically that plaintiffs would

[236] 773 A.2d 1121 (N.J. 2001).

[237] *See supra* Part II.A. (describing Burton's foregone opportunities approach to good faith).

[238] For another example of this type of dispute, see Amoco Oil Co. v. Ervin, 908 P.2d 493, 498 (Colo. 1995) (explaining that duty of good faith applies when either party has "discretionary authority to determine certain terms of contract," such as price).

[239] *Wilson*, 773 A.2d at 1124.

[240] *Id.*

[241] *Id.*

[242] *Id.* In dealing with dealers such as the plaintiffs, Hess's initial approach allowed independent dealers, like the plaintiffs, a profit margin by setting the retail price on the gasoline at a level "significantly below the price charged by major national brands" and by contractually restricting them from providing automotive services. *Id.*

eventually be forced out of business altogether.[243] The plaintiffs asserted that Hess used different pricing practices with its own cooperative stations, practices designed to allow the cooperatives to achieve reasonable levels of profitability; in contrast, plaintiffs alleged that Hess "knowingly set[] its . . . prices at a level that [would] not allow the dealers [like plaintiffs] to cover operating expenses and achieve profit."[244] In other words, the plaintiffs alleged that Hess discriminated against independent dealers by employing different price-setting practices in order to drive out independent dealers so that Hess could replace them with its own cooperative stations.

The court began its good faith analysis with the standard mantras: "Although the implied covenant of good faith and fair dealing cannot override an express term in a contract, a party's performance under a contract may breach that implied covenant even though that performance does not violate a pertinent express term."[245] The court also pointed out that, "[u]nlike many other states, in New Jersey, '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.'"[246] In discussing what constitutes good faith performance, the court also predictably and aptly referred to the U.C.C.'s definition of good faith ("honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade"[247]), and the *Restatement*'s "reasonable expectations" and excluder-analysis approaches to good faith.[248] The court engaged in a lengthy analysis of Burton's foregone opportunities model of good faith and, ultimately, chose correctly to apply that model in this context, because it did not involve a problem of gap-filling but of the unilateral discretionary authority reserved to one party under the contract.[249] The court further explained that Burton's approach—which it noted maximized economic efficiency—could be subsumed within the "reasonable expectations" definition of good faith.[250] The

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[243] *Id.* at 1124–25. In fact, one of the plaintiffs had been forced out of business at the time the lawsuit was filed. *Id.* at 1125. In terms of the pricing practices themselves, the plaintiffs claimed that Hess's new practices resulted in prices comparable to major-brand prices and substantially higher than unbranded gasoline prices. *Id.* Because major-brand stations offered far more services to offset their higher retail prices, which services plaintiffs were contractually restricted from offering, plaintiffs could not compete with the major brand stations. *Id.*

[244] *Id.*

[245] *Id.* at 1126.

[246] *Id.* (quoting Sons of Thunder, Inc. v. Bordon, Inc., 690 A.2d 575, 587 (N.J. 1997)).

[247] *Id.* (quoting N.J. STAT. ANN. § 12A:2-103(i)(b) (West 2004)).

[248] *Id.* at 1126–27. "Good faith performance . . . 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." RESTATEMENT § 205 cmt. a.

[249] *Wilson*, 773 A.2d at 1127.

[250] *Id.* The court stated: "Here we are confronted with the question of the appropriate force of the implied covenant of good faith and fair dealing in reviewing the actions of a contracting party expressly vested with unilateral discretionary authority over pricing. Stated differently, the task here is to identify in that context the parties' reasonable expectations." *Id.*

court also undertook a comprehensive review of the relevant decisions and reasoned that it was obligated to "respect and give effect" to Hess's express right under its Dealership Agreements to set, within its discretion, the price of the gasoline it sold to the plaintiffs.[251] "But," the court continued, "the discretion afforded to Hess is not unbridled discretion. Hess's performance under the contract is tempered by the implied covenant of good faith and fair dealing and the reasonable expectations of the parties."[252]

The court took the further step of refining and restating the test for good faith in the context of discretionary price setting by franchisors and/or distributors such as Hess:

> [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.[253]

While the *Wilson* court must be commended for this valiant attempt at refining the good faith standard, it did little more than synthesize and restate the various approaches to good faith, albeit in a more specific context. And while this was certainly no small task, given the messy state of the doctrine, the "new" test remains rhetorically tautological, in that words like "arbitrarily," "unreasonably," and "capriciously" simply signal forms of conduct opposite to good faith, or, forms of bad faith conduct. In this regard, then, the test most closely resembles Summers's excluder-analysis model of good faith.[254]

Finally, the court's comprehensive review of the relevant decisions did turn up the issue of motive, which the *Wilson* court—unlike the *Carma* court—found was an element of the discretionary bad faith claim.[255] The court found that Hess's specific intent to destroy the plaintiffs' ability to compete in the gasoline market, as well as its specific intent to replace independent franchise dealers with its own cooperative stations through its discriminatory price-setting practices, was an improper motive.[256] The court remanded the case on the improper motive issue, requiring the lower court to give the plaintiffs the opportunity to discover circumstantial evidence to support their allegations of Hess's bad motive.[257]

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[251] *Id.* at 1130.

[252] *Id.*

[253] *Id.*

[254] *See* Summers, *Good Faith*, supra note 7, at 201.

[255] *Wilson*, 773 A.2d at 1128. In particular, the court found through its survey of the cases that "various courts have stated that a party must exercise discretion reasonably *and with proper motive* when that party is vested with the exercise of discretion under a contract." *Id.* (emphasis added).

[256] *Id.* at 1131.

[257] *Id.* at 1132.

2. Lost Commissions Cases

Lost commissions cases are, in a sense, the original and classic good faith cases. The typical case involves an independent contractor or at-will employee working on commission, who invariably asserts that her employer has attempted in bad faith to avoid paying already-earned commissions by terminating the employment relationship just prior to a predetermined vesting date. It is easy to see how all of the articulations of good faith discussed in this Article might be implicated in lost commissions cases: the independent contractor or employee feels that she has been deprived of the fruits of the bargain and of her reasonable expectations under the contract—the already earned commissions—and that this deprivation has been effected by the employer's abuse of discretion in terminating her employment in the at-will employment context. An exemplary case is *McCollum v. XCare.net, Inc.*,[258] decided by the United States District Court for the Northern District of California in 2002. Its discussion of good faith supplements this Article's prior discussions of discretionary bad faith by demonstrating the interplay between lost commissions cases and more traditional at-will employment cases (which are discussed at length in Part II.B.3, *infra*).

In mid-2000, XCare.net ("XCare") hired Anne McCollum as a regional sales manager, compensating her both on a salary and commissions basis.[259] McCollum was immediately assigned the task of consummating a comprehensive contract with XCare's single existing customer in the region, Foundation Health Systems ("FHS"), which contract was worth approximately $10 million. Initially, McCollum was able to secure a signing date with FHS for late September.[260] However, FHS pushed the signing back a few weeks to mid-October.[261] Pending the ongoing negotiations over the larger contract, FHS and XCare entered into an interim agreement so that XCare could earn revenue from its ongoing dealings with FHS.[262]

Less than one week later, XCare terminated McCollum, effective October 11 at the close of business, because of her purportedly substandard work performance. XCare also informed McCollum that, although she had been removed officially from the FHS account, she would receive commissions on the account through September thirtieth.[263] In mid-October, McCollom received her last paycheck, which reflected both her salary and commission on the interim agreement that had been signed by FHS and XCare. McCollum, however, refused to sign her resignation agreement because it precluded her

[258]212 F. Supp. 2d 1142 (N.D. Cal. 2002).
[259]*Id.* at 1144.
[260]*Id.*
[261]*Id.*
[262]*Id.*
[263]*Id.* at 1144–45.

from receiving a commission on the larger FHS contract, which was executed on October twentieth.[264] XCare refused to pay her the commission on the larger contract, which amounted to almost $600,000, claiming that McCollum had already resigned.[265] McCollum filed suit, alleging breach of contract, breach of the implied covenant of good faith, and unconscionability of XCare's compensation plan.[266]

As usual in lost commissions cases, the court employed the discretionary approach to good faith.[267] Quoting *Locke v. Warner Bros., Inc.*,[268] a well-known California good faith decision, the court stated that "'where a contract confers one party with discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing.'"[269] The *McCollum* court analogized *Locke* and held that in lost commissions cases, contractually reserved discretion must not be exercised in a manner that would frustrate the purpose of the underlying contract or the counter-party's reasonable expectations; good faith exercise of discretion does not as a practical or theoretical matter eliminate the express granting of such discretionary authority.[270]

The court also clarified that, with respect to good faith analyses, some lost commissions cases are distinguishable from at-will employment cases in an important way, even though both obviously implicate the doctrine of at-will employment.[271] Specifically, the court pointed out that in at-will employment cases, the good faith doctrine may not be used in California to "impose substantive limits on an employer's authority to terminate an at-will employee," while the doctrine could be used to invalidate bad faith termination in an at-will context where the employee could show that her termination "'was a mere pretext to cheat the worker out of another contract benefit to which the employee was clearly entitled.'"[272] The court held that because

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[264] *Id.* at 1145.

[265] *Id.*

[266] *Id.* at 1145–52.

[267] *Id.* at 1152; *see also* Trent Partners & Assocs., Inc. v. Digital Equip. Corp., 120 F. Supp. 2d 84, 101–02 (D. Mass. 1999) (holding that principal cannot terminate agent to deny commission due without "good cause"); Winfree v. Educators Credit Union, 900 S.W.2d 285, 289 (Tenn. Ct. App. 1995) (prohibiting defendants from retaining benefits acquired from acts committed in good faith); Wilder v. Cody Country Chamber of Commerce, 868 P.2d 211, 221 (Wyo. 1994) (finding compensatory damages available to hold employers accountable for breach of implied covenant).

[268] 66 Cal. Rptr. 2d 921 (Ct. App. 1997).

[269] *McCollum*, 212 F. Supp. 2d at 1152 (quoting *Locke*, 66 Cal. Rptr. 2d at 925). *Locke* was not a lost commissions case, but rather involved Warner Bros.'s alleged bad faith in its exercising of a satisfaction clause relating to a "no pay, no play" provision. The *Locke* court ultimately held that such inherently discretionary satisfaction clauses must be exercised in good faith—that is, they must be exercised honestly. *Locke*, 66 Cal. Rptr. 2d at 925.

[270] *McCollum*, 212 F. Supp. 2d at 1152.

[271] *Id.* at 1152–53.

[272] *Id.* at 1153 (quoting Guz v. Bechtel Nat'l, Inc., 8 P.3d 1089, 1112 n.18 (Cal. 2000)); *see also* Houh, *supra* note 8 at 1066–88 (demonstrating how implied obligation of good faith in

McCollum's case exemplified the latter situation—the classic lost commissions situation—she could proceed with her good faith claim.[273]

3. At-Will Employment Cases

Courts are split on whether, and to what extent, the implied covenant of good faith applies to at-will employment contracts. For example, states like New York, Texas, Illinois, Maryland, and Oregon do not recognize the covenant in the at-will employment context,[274] while states like New Jersey, Delaware, Arizona, New Hampshire, and Connecticut do.[275] And, in states like

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contract law can provide alternate remedies to at-will employees when they are not able to obtain civil rights remedies).

[273] *McCollum*, 212 F. Supp. 2d at 1153.

[274] *See, e.g.*, Zick v. Verson Allsteel Press Co., 623 F. Supp. 927, 930 (N.D. Ill. 1985) (holding that under Illinois law, there is no implied covenant of good faith and fair dealing in at-will employment contract); Suburban Hosp., Inc. v. Dwiggins, 596 A.2d 1069, 1076–77 (Md. 1991) (ruling that there is no general requirement of good faith and fair dealing in at-will employment contract); Sabetay v. Sterling Drug, Inc., 506 N.E.2d 919, 922 (N.Y. 1987) (ruling that although New York recognizes obligation of good faith and fair dealing in cases where such obligation would aid and further other terms of contract, such covenant does not apply in employment contract); Sheets v. Knight, 779 P.2d 1000, 1007–08 (Or. 1989) (deciding that duty of good faith and fair dealing does not modify term of at-will employment contract); City of Midland v. O'Bryant, 18 S.W.3d 209, 216 (Tex. 2000) (finding that there is no duty of good faith and fair dealing in employment context); *see also* Dickens v. Snodgrass, Dunlap & Co., 872 P.2d 252, 261 (Kan. 1994) (holding that rule that every contract imposes duty of good faith and fair dealing in its performance does not apply to employment at-will contracts); Martin v. Sears, Roebuck & Co., 899 P.2d 551, 555 (Nev. 1995) (finding that breach of contract and bad faith discharge are not applicable to at-will employment contracts); Bourgeous v. Horizon Healthcare Corp., 872 P.2d 852, 852–57 (N.M. 1994) (declining to recognize claims for breach of covenant of good faith and fair dealing in at-will employment contracts, but recognizing that in non-at-will contexts, claims for tortious breach of good faith may be cognizable); Burk v. K-Mart Corp., 770 P.2d 24, 26 (Okla. 1989) (ruling that there is no implied obligation of good faith and fair dealing in relation to termination of at-will employment contract); Breen v. Dakota Gear & Joint Co., 433 N.W.2d 221, 224 (S.D. 1988) (holding that covenant of good faith and fair dealing is not implied in at-will employment relationship).

[275] *See, e.g.*, Franco v. Yale Univ., 238 F. Supp. 2d 449, 454–55 (D. Conn. 2002) (deciding that Connecticut imposes duty of good faith and fair dealing in all contracts, including employment contracts); Wagenseller v. Scottsdale Mem'l Hosp., 710 P.2d 1025, 1040 (Ariz. 1985) (finding that although covenant of good faith and fair dealing does not protect at-will employee from no-cause termination, covenant does protect employee from discharge based on employer's desire to avoid payment of benefits already earned by employee, as with lost commissions cases); E.I. DuPont de Nemours & Co. v. Pressman, 679 A.2d 436, 440 (Del. 1996) (ruling that in at-will employment context, covenant of good faith and fair dealing permits cause of action against employer for "deceitful acts of its agent in manufacturing materially false grounds to cause an employee's dismissal"); Monge v. Beebe Rubber Co., 316 A.2d 549, 551 (N.H. 1974) (holding that termination by employer of at-will employment contract "which is motivated by bad faith or malice or based on retaliation" is not in best interest of economic system or public good and constitutes breach of employment contract); Wade v. Kessler Inst., 778 A.2d 580, 584 (N.J. Super. Ct. App. Div. 2001) (deciding that "obligation to perform in good faith exists in every contract including where the contract is terminable at will"); *see also* Johnson v. Kimberly Clark Worldwide, Inc., 86 F. Supp. 2d 1119, 1122 (D. Utah 2000) (holding

California, the courts take a bifurcated approach to good faith claims in the at-will context, recognizing claims for contractual breach of good faith but not tortious breach of good faith.[276]

Jordan v. Duff and Phelps, Inc.,[277] decided by the Seventh Circuit in 1987, is generally regarded as a case about closely held corporations, shareholder abuse, and federal securities fraud,[278] but it also can teach us about the implied obligation of good faith in the at-will employment context. James Jordan was employed as a securities analyst at Duff and Phelps ("Duff"), a Chicago securities/consulting firm. Because Jordan was an at-will employee, Duff could terminate him when it wished, and Jordan could likewise quit the firm when he wished. After several successful years, Jordan was allowed to enter into a share purchase agreement with the firm, and he bought 188 shares at book value.[279] The share purchase agreement also required Jordan to resell the stock to the firm at book value in the event that his employment with Duff terminated.[280]

In the meantime, Jordan decided to relocate to Houston, where he had accepted a position with a firm at roughly twice his Duff salary. Immediately upon his return from Houston, Jordan tendered his letter of resignation to the firm.[281] In an attempt to maximize the book value of his Duff shares, which Jordan was required contractually to resell to Duff upon his separation from the firm, Jordan and the firm worked out a deal whereby Jordan would remain

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that under Utah law, even indefinite-term, at-will employment contracts are subject to implied covenant of good faith); Somers v. Somers, 613 A.2d 1211, 1213 (Pa. Super. Ct. 1992) (ruling that duty of good faith "does not evaporate merely because the contract is an employment contract, and the employee has been held to be an employee at will").

[276]*See* Foley v. Interactive Data Corp., 765 P.2d 373, 395 (Cal. 1988); Houh, *supra* note 8, at 1085 (noting California courts' adoption of narrow *Restatement* approach to good faith and its concerns that doctrine of good faith might lead to convergence of contract and tort law); *see also* McIlravy v. Kerr-McGee Corp., 119 F.3d 876, 882 (10th Cir. 1997) (holding that "[u]nder Wyoming law, every contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement"; however, there is no duty that termination be for good cause or for fair and honest reasons and to assert tortious breach of good faith, plaintiff must show existence of "special relationship" of trust and reliance between former employee and employer).

[277]815 F.2d 429 (7th Cir. 1987).

[278]In this regard, the case is also well known because Judge Easterbrook, who penned the majority opinion, and Judge Posner, who dissented, disagreed vehemently over whether Jordan could assert an SEC Rule 10b-5 claim against Duff and Phelps. In the end, Judge Easterbrook won out, and held that Jordan could indeed assert such a cause of action. *Id.* at 438.

[279]*Id.* at 432.

[280]*Id.* Jordan later discovered, however, that Carol Franchik, a terminated employee who had been having an affair with Duff's chairman, had been allowed by board resolution to retain the stock she had purchased as an employee. Although the scope of this resolution was not entirely clear, it apparently applied to all fired employees, but not to employees who quit voluntarily. *Id.*

[281]*Id.*

with the firm for the rest of the year.[282] Thus, Jordan worked through December and then tendered his stock to the company, ultimately receiving $23,225 for the book value of the shares he had owned.[283] Jordan subsequently learned from an announcement made by Duff a little more than a week after his resignation that it had negotiated what then appeared to be a successful new merger agreement with another large securities firm, which merger was valued at $50 million.[284] Had he been an employee of Duff on the date of the announcement, he would have received no less than $452,000 in cash for his shares.[285] As a result, Jordan refused to cash his check for $23,225 and demanded his stock back.[286] When Duff ignored these demands, Jordan filed suit, requesting damages reflecting the value his stock would have had under the merger.[287]

In holding, for Rule 10b-5 purposes, that Duff and Phelps should have disclosed to Jordan the material information relating to the impending merger when it repurchased Jordan's shares, Judge Easterbrook, writing for the majority and against dissenting Judge Posner, commented on the general nature of the at-will employment relationship in Illinois.[288] First, Judge Easterbrook stated that an employer may not terminate an at-will employee, simply because of his at-will status, for "every reason."[289] He further noted that Illinois had, in fact, placed some limitations on the at-will employment doctrine.[290] Judge Easterbrook also acknowledged the potential for opportunism in employment relationships generally, particularly on the part of the employer, the inherently stronger party.[291] He recognized that, from an economic efficiency perspective, "[o]ne term implied in every written contract . . . is that neither party will try to take opportunistic advantage of the other" and quoted from Judge Posner's book *Economic Analysis of Law* to emphasize

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[282] *Id.* What Jordan did not know was that, at the time of his resignation, Duff and Phelps management had been attempting for several months to negotiate a merger between Duff and a subsidiary of Security Pacific, which negotiations had failed. *Id.* Duff did not disclose this information to Jordan at the time of Jordan's resignation, nor did Duff disclose to Jordan at this time that it was then in the process of another round of merger discussions with Security Pacific. *Id.* Instead, Duff simply allowed Jordan to work through the end of 1983 so that he would be able to take advantage of the higher book value that would then apply to the stock repurchase. *Id.* at 433.

[283] *Id.*

[284] *Id.*

[285] *Id.*

[286] *Id.*

[287] *Id.* This second attempted merger between Duff and Security Pacific ultimately failed. *Id.* Two years later, however, Duff was acquired, again at a very high price, in a leveraged buyout by an employee trust. *Id.* In order to capture the benefit of that buyout, Jordan sued for rescission but was allowed only damages. *Id.* at 440.

[288] *Id.* at 438.

[289] *Id.*

[290] *Id.*

[291] *Id.*

the point.[292] Judge Easterbrook also noted that the opportunism issue presents difficult proof problems: did the employer-defendant discharge the employee opportunistically or because of the employee's poor performance? Judge Easterbrook further observed that courts and juries must ferret out the reasons for such discharge so they can discern between the two motivations.[293] To emphasize that he was not eviscerating the doctrine of employment at-will or capitulating to some feel-good, fuzzy notion of good faith discharge in this context, Judge Easterbrook further stated, that "no one, not even Professor [Richard] Epstein, doubts that an *avowedly* opportunistic discharge is a breach of contract, although the employment is at-will."[294]

Throughout most of his analysis, Judge Easterbrook did not use the words "good faith," even though (Burton's model of) the good faith doctrine was precisely what he was applying in the case. When he finally did recognize explicitly that the court's admonition against opportunistic behavior was really an affirmation of the applicability of the implied covenant of good faith in the context of at-will employment, he did so in order to assure us (or Judge Posner) of his commitment to classically liberal notions of freedom of contract. He wrote:

> The element of good faith dealing implied in a contract "is not an enforceable legal duty to be nice to or to behave decently in a general way." It is not a version of the Golden Rule, to regard the interests of one's contracting partner the same way you regard your own. An employer may be thoughtless, nasty, and mistaken. Avowedly opportunistic conduct has been treated differently, however.[295]

Thus, Judge Easterbrook predictably opined, good faith and economic efficiency are perfectly consistent, even in the context of inherently power-imbalanced relationships—just as Burton has asserted all along.[296]

The New Jersey courts engaged in less explicitly economic and more conventional analyses of good faith in the at-will employment context. *Wade v.*

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[292]*See id.* ("'[T]he fundamental function of contract law (and recognized as such at least since Hobbes's day) is to deter people from behaving opportunistically toward their contracting parties, in order to encourage the optimal timing of economic activity and to make costly self-protective measures unnecessary.'" (quoting RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 81 (3rd ed. 1986))); *see also* Houh, *supra* note 8, at 1041 (explaining that contract law discourages opportunistic behavior and promotes efficiency).

[293]*Jordan*, 815 F.2d at 438.

[294]*Id.*

[295]*Id.* (citation omitted).

[296]Judge Posner's dissent rested on the notion that, due to the at-will nature of Jordan's employment, he could not in any event have demanded a higher price for his stock. Thus, he was not entitled to the higher price for the stock. Given his decision to relocate to Houston, and pursuant to the terms of the agreement, Jordan simply could not refuse to sell his shares back to the firm upon his separation from it, just as Jordan, under the doctrine of at-will employment, could not have refused to stop working if Duff had fired him. *Id.* at 446 (Posner, J., dissenting).

Kessler Institute[297] is a typical at-will termination case that involves policies set forth in an employee handbook. In *Wade*, plaintiff Sheila Wade worked her way up to unit secretary during her nine years of employment at the Kessler Institute. One of her duties involved collecting money from her co-workers for various "special" occasions, such as weddings, showers, and funerals.[298] She would place anonymous cash donations made by her co-workers in an envelope and then, once all the money was collected, present the cash-filled envelope to its recipient.[299] After she had been doing this for about five years, her supervisor asked her to begin collections for a co-worker. Wade started to collect the money, took an eight-day medical leave, and then, upon her return from leave, completed the collection of the money for the co-worker plus two other co-workers.[300]

Shortly after her return, Wade's supervisor Joan Alverzo suspended her for allegedly mishandling the collection moneys, which had not yet been given to their intended recipients.[301] When Wade met with Alverzo to give her the suspect collections, Alverzo fired Wade for improperly handling the money. Wade's arguably reasonable explanations made no difference.[302] Alverzo also claimed that one of the envelopes was missing five dollars, which Wade denied.[303] Because she felt that her firing was unjustified, Wade availed herself of the grievance procedures set forth in the employee handbook.[304] She made several written requests to various upper level managers, to no avail; in fact, she received no responses at all.[305] Wade became so despondent over the fact that "no one would believe her" that she became suicidal.[306]

Consequently, Wade sued the hospital for wrongful discharge and breach of the implied covenant of good faith and fair dealing.[307] At trial, the jury decided in Wade's favor on the good faith claim.[308] The hospital appealed on the grounds that the trial court "failed to instruct the jury that a breach of the implied covenant of good faith and fair dealing required a finding of bad faith on the part of the defendant."[309] Wade, of course, disagreed and argued that bad faith was not an element of a breach of good faith claim.[310] The court

[297] 778 A.2d 580 (N.J. Super. Ct. App. Div. 2001).
[298] *Id.* at 582.
[299] *Id.* at 582–83.
[300] *Id.* at 583.
[301] *Id.*
[302] *Id.*
[303] *Id.*
[304] *Id.*
[305] *Id.*
[306] *Id.*
[307] *Id.* at 582–83.
[308] *Id.* at 583.
[309] *Id.* at 584.
[310] *Id.* at 588.

ultimately reversed and remanded on other grounds,[311] but in further analyzing the good faith issue, the court emphasized that in New Jersey, the implied obligation of good faith inheres in all contracts, including at-will employment contracts.[312] And, although the court did not definitively hold that bad faith is a required element of a breach of good faith claim in all cases, the court made clear that both the U.C.C.'s definition of good faith and the *Restatement*'s adoption of Summers's excluder-analysis approach were particularly valuable and useful in cases such as the one before it.[313] The court also found useful Alaska's approach to good faith in the at-will employment context:

> "This covenant [of good faith and fair dealing] does not lend itself to precise definition, but it requires at a minimum that an employer not impair the right of an employee to receive the benefits of the employment agreement. . . . The covenant of good faith and fair dealing . . . includes an objective standard, under which the employer must act in a manner which a reasonable person would regard as fair. The covenant also includes a subjective element. An employer engages in subjective bad faith when it discharges an employee for the purpose of depriving him or her of one of the benefits of the contract."[314]

Thus, the court applied a comprehensive *Restatement* approach that defined good faith as the absence of bad faith, and further defined bad faith as the discharging of an employee for the purpose of depriving her of her reasonable expectations and benefits under the employment contract. In other words, like the court in *Wilson v. Amerada Hess Corp.*,[315] the *Wade* court noted that, in the employment context in particular, bad motive or intention to deprive the employee of her reasonable expectations plays an essential role.[316]

4. Consumer Contract Cases

Consumer cases implicate the most inherently power-imbalanced contractual relationships and transactions. It should be no surprise, then, that such cases often involve not only alleged violations of state and federal consumer protection statutes, but also claims for breach of the implied

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[311] *Id.* The appellate court found that the trial court failed to instruct the jury that, in order for it to find a breach of good faith in the absence of an express contract, it first had to find the existence of an underlying implied contract. *Id.*

[312] *Id.* at 584.

[313] *Id.* at 584–85. In describing the excluder-analysis approach, the court quoted extensively from both Comment (a) to section 205 of the *Restatement* and from Summers's 1968 good faith article.

[314] *Id.* at 585 (quoting Holland v. Union Oil Co., 993 P.2d 1026, 1032 (Alaska 2000)).

[315] 773 A.2d 1121 (N.J. 2001).

[316] *Wade*, 778 A.2d at 585 (citing *Wilson*, 773 A.2d at 1132).

obligation of good faith and fair dealing.[317] In fact, in some cases, such as the oft-cited *Best v. United States National Bank of Oregon*,[318] plaintiffs forego statutory claims entirely and assert only common law claims. In the *Best* case, decided by the Supreme Court of Oregon in 1987, Lonnie and Teresa Best, representing themselves as well as a class of bank depositors, sued the U.S. National Bank of Oregon ("Bank") for its allegedly unlawful setting of nonsufficient fund ("NSF") fees.[319] Specifically, the Bests claimed that the Bank's increase of its NSF fees—from three to five dollars per check over the course of six years—was unlawful because those fees greatly exceeded the cost for processing NSF checks.[320] The trial court class-certified three of the Bests' claims: the Bank had breached its duty of good faith in setting the NSF fees; the fees were unconscionable; and the fees constituted an unlawful penalty for bank depositors' breach of contract.[321] With respect to the good faith claim, the Bests asserted that, in setting the NSF fees so high, the Bank did not act in good faith.[322] The trial court granted summary judgment to the Bank on each of the three claims, and while the intermediate appellate court affirmed on the unconscionability and penalty claims, it reversed and remanded on the good faith claim.[323]

Although the depositors' account agreement contained no express limitations on the Bank's discretionary authority to set NSF fees, the court held that the implied obligation of good faith—which applied to the performance and enforcement of all Oregon contracts—in effect operated to limit that very authority.[324] Furthermore, the court adopted Summers's excluder-analysis definition of good faith, and offered theoretically and practically compelling reasons for doing so:

> The purpose of the good faith doctrine is to prohibit improper behavior in the performance and enforcement of contracts. Because the doctrine must be applied to the entire range of contracts, definitions of good faith tend to be either too abstract or applicable only to specific contexts. For this reason, Professor Summers has argued that good faith should be conceptualized as an "excluder," by which he means that good faith should be defined only by identifying

[317] *See, e.g.*, *In re* Keach, 243 B.R. 851, 855–56 (B.A.P. 1st Cir. 2000) (discussing filing of good faith bankruptcy plan proposal under § 1325 of Bankruptcy Code); *In re* Cannon, 230 B.R. 546, 591–94 (Bankr. W.D. Tenn. 1999) (discussing good faith transfers under § 548(c) of federal Bankruptcy Code); Peterson v. BASF Corp., 618 N.W.2d 821, 823–25 (Minn. Ct. App. 2000) (employing "good faith" to describe unconscionable commercial conduct prohibited by New Jersey Consumer Fraud Act).

[318] 739 P.2d 554 (Or. 1987).

[319] *Id.* at 555.

[320] *Id.*

[321] *Id.*

[322] *Id.* at 556–57.

[323] *Id.* at 556.

[324] *Id.* at 557.

> various forms of bad faith. . . . This is also the approach adopted by the Restatement (Second) of Contracts § 205.[325]

The court, however, also sympathized with Burton's critique of the excluder-analysis approach as being too "*ad hoc* and standardless," and, therefore, not practically operational.[326] And while the court explicitly acknowledged that Burton and Summers were in "substantial disagreement with each other" on how to set forth useable good faith standards, it had no problem adopting Burton's approach as well, in a manner consistent with Summers's approach.[327] The court explained that both conceptualizations of good faith aimed in the broadest sense to "effectuate the reasonable contractual expectations of the parties."[328] Particularly in cases involving some power imbalance between the contracting parties—where discretionary authority has been reserved contractually by only one party—such "reasonable contractual expectations" require the exercising of that discretion for "particular purposes."[329] If the party holding the discretion exercises it for purposes "not contemplated by the parties," that party "has performed in bad faith."[330]

Here, the Bests did not argue that the Bank's discretionary setting of the NSF fees did not conform with their reasonable expectations under the contract. Rather, they conflated the equitable doctrines of good faith and unconscionability by arguing that the Bank had set the NSF fees in bad faith because they were unconscionably high, given the relatively low cost of processing NSF checks.[331] The court, while recognizing the overlap between the doctrines of good faith and unconscionability, generously inferred from the Bests' doctrinally confused argument that they had asserted a breach of good faith claim.[332] That is, the Bests' reasonable contractual expectation under the depositor agreement was that the Bank would charge NSF fees in amounts reflecting only the costs of processing NSF checks. Because the Bank had charged NSF fees far in excess of those costs, the Bank arguably had exercised its discretion in setting those fees for a purpose not contemplated by the parties: maximizing the Bank's profit on the NSF checks.[333] Thus, the court reversed the lower court and ordered it to proceed on the good faith claim.[334]

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[325] *Id.* (citations omitted).
[326] *Id.* at 558.
[327] *Id.*
[328] *Id.*
[329] *Id.*
[330] *Id.* (citing Burton, *supra* note 7, at 391–92).
[331] *Id.* at 559.
[332] *Id.*
[333] *Id.*
[334] *Id.*

C. Summary: Clarifying Common Law Good Faith Standards

Based on the foregoing discussion of exemplary cases in the categories of arm's-length and non-arm's-length cases, one thing about common law good faith doctrine is clear: despite the courts' common usage of certain good faith rhetoric and their apparent reliance on both Summers's excluder-analysis/*Restatement* approach and/or Burton's foregone opportunities approach, common law good faith standards remain remarkably murky. To a certain extent, this continued state of disarray is understandable, given the ad hoc way in which the good faith doctrine was meant to be applied. Notwithstanding the hyper-contextual nature of the doctrine, this Part attempts to clarify the ways in which good faith standards are articulated and applied, based on the categories of arm's-length and power-imbalanced transactions.

First, with respect to both arm's-length commercial cases and cases involving some degree of inequality in bargaining power between the parties, the implied obligation of good faith and fair dealing requires that neither of the contracting parties perform in a such way that would deprive a counter-party of its reasonable expectations under the contract.[335] This rhetoric of not depriving the parties of their reasonable expectations can be found in each of the cases discussed thus far. Deprivation of a party's reasonable expectations or "fruits" of the contract, courts often opine, violates certain "standards of fairness," a phrase that is found both in Summers's work on good faith and in the official comments to section 205 of the *Restatement*.[336] Moreover, courts often discuss fairness in economic terms and, more specifically—as Burton would put it—as the appropriate exercise of discretionary authority by the party who has reserved such authority under the contract.[337] Thus, a party would deprive her counter-party of her reasonable expectations under the contract by opportunistically exercising its contractually reserved discretionary authority, as in *McCollum v. XCare.net, Inc.*[338] and *Jordan v. Duff & Phelps, Inc.*[339] In those cases, the party attempted to terminate the counter-party's at-will employment to deprive an employee of commissions or other compensation. Yet, if the contract terms expressly authorize such opportunistic conduct, as in *Carma Developers (California), Inc. v. Marathon Dev. California, Inc.*,[340] those express terms will prevail.

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[335]*See, e.g.*, McCollum v. XCare.net, Inc., 212 F. Supp. 2d 1142, 1152 (N.D. Cal. 2002) (discussing breach of implied covenant of good faith and fair dealing when one party frustrates other parties' "legitimate expectations"); *Wade*, 778 A.2d at 584–85 (discussing *Restatement*'s approach to good faith as including justified expectations of parties); *Best*, 739 P.2d at 558 (applying good faith doctrine to effectuate reasonable expectations of parties).

[336]*See* RESTATEMENT § 205 cmt. a; Summers, *General Duty*, *supra* note 7; Summers, *Good Faith*, *supra* note 7.

[337]*See* Burton, *supra* note 7, at 378 (arguing that "party fails to perform in good faith when it uses . . . discretion to recapture foregone opportunities").

[338]212 F. Supp. 2d 1142 (N.D. Cal. 2002).

[339]815 F.2d 429 (7th Cir. 1987).

[340]826 P.2d 710 (Cal. 1992).

In both arm's-length and non-arm's-length cases, courts also often employ Summers's excluder-analysis approach, adopted by the *Restatement*. They define performance that deprives a party of his reasonable expectation under the contract as bad faith, one form of which is the opportunistic exercise of contractually reserved discretionary authority, in the manner of Burton's foregone opportunities model of good faith.[341] Finally, both arm's-length and non-arm's-length cases make clear that contracting parties may not use the implied obligation of good faith to circumvent express contractual obligations, as demonstrated most starkly in the *Carma* case.[342]

Interestingly, however, common law good faith doctrine begins to splinter when courts discuss ill motive as either an element or nonelement of the breach of good faith claim. For example, in some arm's-length cases, as in *Seidenberg v. Summit Bank*,[343] courts require bad motive or intention as an element of the breach of good faith claim. Some of those cases have adopted a U.C.C.-like approach to good faith in that they generally define ill motive as dishonesty or noncompliance with reasonable commercial standards.[344] But in other arm's-length cases, such as *Carma*, courts specifically have stated that the breach of good faith claim does not require bad motive.[345]

As for non-arm's-length good faith cases, courts have consistently required ill motive or intent as part of the breach of good faith claim, usually as such motive relates to the improper exercise of discretionary authority reserved to the stronger party under the contract.[346] For example, in *Wilson v. Amerada Hess Corp.*,[347] the plaintiffs were required to present evidence relating to the defendant's intent to drive them out of the gas station business by employing discriminatory pricing practices.[348] And in lost commissions cases like *McCollum v. XCare.net, Inc.*,[349] courts have focused on the employer's specific intent to avoid paying the employee compensation owed to him in the form of commissions already earned, by conveniently terminating him just prior to the commission's vesting date.[350] In at-will employment cases, courts have focused on the employer's tendency toward opportunism in exercising its discretion to

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341 *See* Burton, *supra* note 7 at 380–87.

342 *See Carma*, 826 P.2d at 728 (asserting that good faith may not be used to prohibit one from doing that which is expressly authorized in agreement).

343 91 A.2d 1068 (N.J. Super. Ct. App. Div. 2002).

344 *See supra* text accompanying notes 130 and 181. However, at least one court has held that dishonesty is not required to make a breach of good faith claim. *See Carma*, 826 P.2d at 727.

345 *See Carma*, 826 P.2d at 728 (asserting that good faith may not be used to prohibit one from doing that which is expressly authorized in agreement).

346 *See supra* text accompanying notes 257–58.

347 773 A.2d 1121 (N.J. 2001).

348 *See id.* at 1131 (discussing plaintiff's need to show bad motive to demonstrate lack of good faith).

349 212 F. Supp. 2d 1142 (N.D. Cal. 2002).

350 *See id.* at 1155 (discussing whether defendant's actions were conducted in bad faith to frustrate plaintiff's expectations under compensation plan).

terminate the employee.[351] Alternatively, in consumer cases, courts have directed their analyses at limiting the authority reserved by the stronger party under the contract in such a way as to broaden the scope of what kind of conduct constitutes an abuse of that discretion and a breach of good faith.[352] And finally, in many of these cases, courts, on a broader level, assessed the alleged wrongdoer's apparent intent to commit a species of "promissory fraud," which involves demonstrating the stronger party's intent *not* to perform[353] Given the more intent-specific analyses undertaken in non-arm's-length cases and the commercial reasonableness analyses applied in arm's-length cases, it follows that the cases can be read together to require more specificity of proof in proving ill motive in non-arm's-length cases than in arm's-length cases. On a pragmatic level, this makes sense in light of the fact that non-arm's-length cases also tend to involve more individualistic, context-specific contracts—with the exception of consumer contracts, which almost always involve form or adhesion contracts.

What does this all mean in terms of the usefulness of the excluder-analysis and foregone opportunities approaches to good faith and the purported distinction between those approaches? In terms of the purported distinction, it means that that the excluder-analysis and foregone opportunities models of good faith are being employed to achieve the same ends: to ensure that the parties are performing in a way that does not deprive counter-parties of their reasonable expectations under the contract. Summers and Burton merely disagree on how reasonable expectations should be defined.

To Summers, reasonable expectations are potentially limitless, because of the contextual and equitable nature of the good faith doctrine; hence, what is reasonable to Summers is that performance which is not in bad faith. Burton defines reasonable expectations more narrowly: to Burton, a contracting party may reasonably expect that her counter-party will not attempt to recapture foregone opportunities during contract performance. The foregone opportunities model is easily subsumed as one of Summers's categories of bad faith. Thus, when courts apply these models, the difference is not so much one of definition, but of scope. In the end, both approaches—whether articulated in terms of reasonable expectations, commercial reasonableness, or absence of ill motive—are applied in order to aid in the actualization of the express terms of the contract and to free the contracting parties from having to negotiate over their intent to perform.[354]

Thus, the leading approaches to good faith are operationally conflatable. But does the good faith analysis serve merely as a proxy for breach of contract claims? At least one court—the United States District Court for the Southern District of New York—has recognized the arguably duplicative nature of the

[351] *See supra* Part II.B.3 (discussing implied covenant in at-will employment cases).

[352] *See supra* Part II.B.4 (discussing implied covenant in consumer cases).

[353] *See* Ayres & Klass, *supra* note 15, at 507–10.

[354] *See id.* at 511–14 (discussing examples of promissory fraud in absence of good faith).

good faith claim: "Although New York law implies a duty of good faith and fair dealing in every contract, *a breach of that duty is merely a breach of the underlying contract.* The implied obligation is simply 'in aid and furtherance of other terms of the agreement of the parties.'"[355] Given that the obligation is "simply in aid and furtherance of other terms of the agreement,"[356] and in light of the courts' consistent mandates against using good faith to contravene express terms of the contract, this Article argues that current judicial applications of good faith have stripped the doctrine of its equitable roots by employing good faith rhetoric—in turn supplied by the *Restatement* and Burton's foregone opportunities model—to determine whether there has been a material breach of the contract. This is made perfectly clear in section 241 of the *Restatement*, which sets forth "Circumstances Significant in Determining Whether a Failure Is Material." Significantly, section 241 includes at subsection (e) a good faith factor.[357] That good faith currently functions primarily to determine whether one party has materially breached the contract—thus entitling the nonbreaching party to suspend her own performance under the contract—is also made clear in good faith cases, such as those discussed *supra*, that do not explicitly discuss material breach. These cases effectively analyze and determine whether there has been a breach of contract, vis-à-vis their analyses of the breach of good faith claims, in the absence of (violations of) express contractual terms.

To be clear, this Article does not claim that the rhetorical and analytical functions just described are useless; to the contrary, they are quite valuable. Nor does this Article argue that a new conceptualization of good faith should entirely supplant the current ones. In fact, the rhetorical development of the good faith doctrine, as well as its efficiency-driven aspects, has enabled generations of lawyers, judges, legal scholars, law professors, and law students to better comprehend how not to breach contracts that do not provide an abundance of express terms. This Article *does* claim that, while the good faith doctrine as it has developed in the caselaw has enormous value for purposes of analyzing and better understanding issues of material breach, it has strayed from its originally conceived equitable purpose, to serve some broader notion of fairness and justice in contracting.

[355]Centre-Point Merch. Bank Ltd. v. Am. Express Bank Ltd., 913 F. Supp. 202, 209 (S.D.N.Y. 1996) (emphasis added) (quoting Murphy v. Am. Home Prods. Corp., 448 N.E.2d 86, 91 (N.Y. 1983)); *see also* Bekhor v. Josephthal Group, Inc., No. 96-CIV.-4156(LMM), 2000 WL 1521198, at *5 (S.D.N.Y. Oct. 13, 2000) (stating in dicta that claims for breach of contract and for breach of duty of good faith and fair dealing are duplicative).

[356]*Center-Pointe*, 913 F. Supp. at 209 (internal quotation marks omitted).

[357]RESTATEMENT § 241. Section 241 states in relevant part: "In determining whether a failure to render or to offer performance is material, the following circumstances are significant: . . . (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing." *Id.* § 241(e).

Another look back to *Wood v. Lucy, Lady Duff-Gordon*,[358] one of the most important good faith cases in American common law, further supports the argument that good faith as it is presently employed functions not as an equitable doctrine, but rather as a set of rhetorical devices relating to material breach. As most readers will recall, Otis Wood sued Lucy, Lady Duff-Gordon, "a creator of fashions" whose "favor helps a sale."[359] In his suit, Wood alleged that Lady Duff-Gordon had breached what amounted to an exclusive distributorship contract with him by placing her brand name on "fabrics, dresses, and millinery without [Wood's] knowledge, and withheld the profits."[360] In her defense against Wood's claim, Lady Duff-Gordon argued that there was in fact no contract between them, or that the contract with Wood was illusory, because Wood had not expressly bound himself to anything; that is, he had not expressly promised to use his "reasonable efforts to place [Lady Duff-Gordon's] indorsements and market her designs."[361] Then-Judge Cardozo, at that time a member of New York's highest court, famously stated that while the contract contained no express promise to use reasonable efforts on Wood's part, "such a promise is fairly to be implied. . . . A promise may be lacking, and yet the whole writing may be instinct with an obligation, imperfectly expressed. If that is so, there is a contract."[362]

It is not so much Judge Cardozo's articulation of the content of the good faith obligation that distinguishes it from its modern conceptualization, but rather his reason for invoking the obligation in the first place: Judge Cardozo employed good faith as a matter of equity, to establish the existence of a nonillusory contract between Wood and Lady Duff-Gordon, one that included the element of mutuality of obligation.[363] Contemporary applications of good faith function in a different, albeit related, way: they are used to determine whether a party has materially breached the express terms of the contract by performing them in a particular way. In other words, generally speaking, current applications of good faith are used to determine whether there has been a breach of the underlying contract or one of its terms, rather than to determine whether the contract exists at all, which is how Judge Cardozo originally employed the doctrine. Judge Cardozo's justification for employing good faith is more true to conceptions of implied obligations as equitable gap fillers, such as the common law implied warranty of habitability (which has morphed into the more specific implied warranty of quality in the sale of a new home by a

[358] 118 N.E. 214 (N.Y. 1917).

[359] *Id.* at 214.

[360] *Id.*

[361] *Id.*

[362] *Id.* (internal quotation marks and citations omitted).

[363] Mutuality of obligation in bilateral contracts is synonymous with consideration, in that each promise, or obligation, acts as consideration for the other. Each party must be obligated to perform her promises—otherwise the contract will lack consideration, and so will not be valid.

builder-vendor)[364] and the U.C.C.'s implied warranties of merchantability[365] and fitness for a particular purpose.[366]

IV. CONCLUSION: RELOADING THE VESSEL

One of the goals of this Article has been to provide a nuanced understanding of what the good faith obligation presently requires and to argue that the good faith doctrine in its contemporary condition is a nearly empty vessel. Courts have come to apply good faith not as a substantive implied obligation, but as a rhetorical proxy for underlying material breach analyses. Such contemporary applications of good faith are of great value for purposes of deepening our understanding of the doctrines of material breach and constructive conditions; pragmatically speaking, they greatly assist courts in their determinations of what nonmaterially-breaching performance of express terms requires. Given the doctrine's great functional value, why is it still necessary to conceive of good faith as a distinct duty, as opposed to a subduty related to material breach and constructive conditions?

One might respond to this question by suggesting the elimination of the doctrine altogether, or its explicit incorporation into the doctrines of material breach and constructive conditions. But this Article argues that such a response would be misguided, for it would erode in a more general sense the important "implicit dimensions"[367] of American contract law. Moreover, the doctrine of good faith should continue to be available as a tool, in Summers's words, "to do justice according to law."[368]

This Article proposes that the good faith doctrine may be resuscitated as an implied obligation in two different ways: first, vis-à-vis its applicability to bad faith conduct in contract negotiation (this is certainly not a new idea, but one worth serious reconsideration); and, second, in the context of performance and termination, vis-à-vis its applicability in the employment context. With respect to the former, scholars and commentators have developed a rich body of literature around not only whether a common law[369] good faith obligation

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[364] *See* Jeff Sovern, *Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty Advocates, Law and Economics Mavens, and Consumer Psychologists Under One Roof*, 1993 WIS. L. REV. 13, 15–21 (discussing implied warranty of quality in sale of new homes by builder-vendor recognized in at least thirty states).

[365] U.C.C. § 2-314 (2003).

[366] *Id.* § 2-315.

[367] This phrase is borrowed explicitly from an international collection of essays. *See* IMPLICIT DIMENSIONS OF CONTRACT: DISCRETE, RELATIONAL, AND NETWORK CONTRACTS (David Campbell et al. eds., 2003).

[368] *See* Summers, *Good Faith*, *supra* note 7, at 198.

[369] A requirement to negotiate in good faith is in some instances statutorily required. For example, employers and labor unions are required to negotiate collective bargaining requirements in good faith under the National Labor Relations Act. *See* 29 U.S.C. §§ 158 (a)(5), 158(d) (2000) (governing unfair labor practices and requiring employer "to bargain collectively with the representatives of his employees" where bargaining collectively means, in part, "the

ought to apply to contract negotiation, but also what such an obligation should require.[370] The obligation to negotiate in good faith is commonly referred to as *culpa in contrahendo*, a term taken from Jhering's work on the German jurisprudence of "faulty negotiating," which term was introduced into American contract jurisprudence in 1964 by Fredrich Kessler and Edith Fine in their famous article, Culpa in Contrahendo, *Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*.[371] As discussed *supra*, Robert Summers has advocated broadening the scope of good faith's applicability so that it extends not only to contract performance and enforcement, but also to the preliminary stages of formation and negotiation.[372] Others have taken a more moderate position, arguing that while the obligation to negotiate in good faith ought not apply to *all* contracts, it should apply to render enforceable the controversial "agreement to agree."[373] Fortunately for this author, these scholars have given careful thought and functional content in their written work to what the obligation to negotiate in good faith should require.

In my broader work on good faith, I am concerned more with how the good faith doctrine might be reloaded with content in the contractual phases of performance, enforcement, and termination, and in the specific context of employment. Although good faith might be revived in a number of different ways, I argue elsewhere that courts should use the doctrine of good faith in contract law to prohibit improper considerations of race, gender, and sexuality in contract performance and should recognize the doctrine as a device for

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performance of the mutual obligation of the employer and the representative of the employees to confer in good faith with respect to wages, hours, and other terms and conditions of employment").

[370] *See, e.g.*, E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 239–43 (1987) (demonstrating why "era of deals" requires good faith negotiation and offering possible content of obligation to negotiate in good faith); Friedrich Kessler & Edith Fine, Culpa in Contrahendo, *Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 408–09 (1964) (discussing German doctrine of faulty negotiating—*culpa in contrahendo*—and its expression in American common law vis-à-vis doctrines of irrevocable offers, mistake, misrepresentation, reliance, negligence, and implied contract); Charles L. Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673, 673–86 (1969) (arguing for enforceability of "agreements to agree" and applicability of good faith obligations to such agreements); Summers, *Good Faith*, *supra* note 7 at 220–32 (describing several categories of bad faith in contract formation and negotiation, such as negotiation without serious intent to contract, abusing privilege to withdraw proposal or offer, entering deal without intention to perform or with intent to recklessly disregard prospective inability to perform, seller's nondisclosure of known defects in goods, and taking advantage of another in driving bargain); John Spencer, Note, *A Call for a Common Law* Culpa in Contrahendo *Counterpart*, 15 U.S.F. L. REV. 587, 604–14 (1980–1981) (arguing that common law good faith obligation ought to apply to contract negotiation, in light of existing inadequacies in remedies for injuries suffered by those falling victim to faulty negotiation).

[371] *See* Kessler & Fine, *supra* note 370, at 401.

[372] *See* Summers, *Good Faith*, *supra* note 7, at 220–32.

[373] *See* Farnsworth, *supra* note 370, at 269–84; Knapp, *supra* note 370, at 721–23.

eliminating racial and sexual subordination that can function beyond the scope of conventional civil rights jurisprudence.[374]

The use of good faith in this way raises many important and difficult questions: How does one justify incorporating public law norms against discrimination into the quintessentially private domain of contract law? What would such a model of good faith require of contracting parties? Why is such a good faith application necessary?[375] But such use explicitly attempts to reload the nearly empty vessel of good faith with one important call in mind: "to do justice according to law."[376] As such, this Article comprises an important doctrinal leg of a larger project whose more theoretical and normative goal is to reconceive and reinvigorate the private law doctrine of good faith as one that might assist in effecting a public law norm of equality.

[374] *See* Houh, *supra* note 8, at 1095–96.

[375] For a lengthy discussion of these questions, among others, see Emily M.S. Houh, *Critical Race Realism: Re-Claiming the Antidiscrimination Principle Through the Doctrine of Good Faith in Contract Law*, 66 U. PITT. L. REV. (forthcoming 2005); *see also* Houh, *supra* note 8, at 1066–89 (discussing equality and discrimination in cases analyzing and applying good faith doctrine in at-will employment context).

[376] *See* Summers, *Good Faith*, *supra* note 7, at 198.