St. Mary's Law Journal

Volume 22 | Number 2 Article 3

1-1-1990

Punitive Damages for Breach of Contract - A Principled Approach.

Frank J. Cavico Jr.

PUNITIVE DAMAGES FOR BREACH OF CONTRACT—A PRINCIPLED APPROACH

FRANK J. CAVICO, JR.*

* Assistant Professor of Business Law & Ethics, Friedt School of Business & Entrepreneurship, Nova University; LL.M., University of San Diego, 1987; J.D., St. Mary's University, 1976; member, Texas & Florida Bars. I would like to thank my colleague, Dr. William McLeod, for his helpful and perceptive comments on a draft of this article. Many of the economic theses asserted in this article were influenced by Bill's observations and thinking. I also would like to thank my student assistant, Juliet Sallette, for her assiduous and able work at various stages of this article.

I. INTRODUCTION

The penchant of attorneys to cloak legal confusions in arcane historical raiment is particularly apparent in the area of punitive damages for breach of contract. The orthodox doctrine governing the field has found so little favor in some jurisdictions that their courts resort to many exceptions and subterfuges to mitigate the perceived harshness to its rule. In these jurisdictions, the "general rule" is so perforated with "exceptions" as to gainsay the legitimacy of the or-

thodox doctrine and the honesty of its application. In other jurisdictions, however, the courts so rigidly cling to the orthodox doctrine that they actually shield outrageously immoral conduct committed in breaching a contract from the force of the law.

The issue of punitive damages for breach of contract cases not only underscores the ever-present perplexity concerning the proper classification of actions that include both tort and contract elements, but also the perplexity concerning the proper standards for the imposition of punitive damages.† Standards already imprecise become even more obscure when applied to cases that cannot be classified readily as tort or contract. The issue also focuses attention on the important, yet conflicting, policy objectives of economic efficiency, individual freedom, and fairness, particularly the need to promote personal morality and punish and deter immoral conduct. The consequence of the wide variety of conflicting holdings, underpinned by clashing policy rationales, enunciating vague or overly rigid standards, is to spawn unpredictability, instability, unfairness, and disrespect in this area of the law.

This article strives to solve the legal and theoretical puzzlement concerning the availability of punitive damages in breach of contract cases. This paper is based principally on an examination of statutes, case law, and commentary of the last decade. Although the paper is national in scope, Texas and Florida law is highlighted where appropriate.

II. Traditional Distinctions Between Tort and Contract

A. *Goals*

Although tort and contract law are derived from a common source, the common law has recognized distinct differences between tort and breach of contract actions. Historically, the law has assigned different objectives to tort and contract actions. Tort law, although concerned with compensation, is also concerned with the deterrence and punish-

† The discussion of punitive damage standards is timely since the U.S. Supreme Court recently has agreed to review the Alabama Supreme Court's decision upholding a substantial punitive award against an insurance company. The case, *Pacific Mutual Life Insurance Co. v. Haslip*, 553 So. 2d 537 (Ala. 1989), raises the question of whether such awards, issued with few limits on a jury, violate the 14th Amendment guarantee of "due process."

ment of misconduct.[1] Fault and motive emerge as key determinants of liability. Tort law, consequently, protects members of society from wrongdoing by imposing standards of conduct. In tort law, a public policy decision is made to brand certain misconduct a legally actionable "tort."[2]

The primary practical purpose of the law of contracts, of course, is compensation.[3] Contract law is not comprehended as evoking public policy concerns *per se*. Contract law, nevertheless, does afford a degree of security in economic relationships by assuring contracting parties that contract promises will be kept.[4] Contract law serves society by promoting standardized conduct in the performance of promises and produces certain, uniform, stable, and efficient business transactions.[5] Moreover, contract law is said to encourage individual opportunity.[6] The traditional goals of contract law, therefore, stress economic principles, not social justice.

B. *Nature of Liability*

Tort law, traditionally, has been a fault based system of liability. The victim must prove that the actor intentionally or negligently committed the wrongful act. As a general rule, unless there is a duty to act, the failure to act does not trigger tort liability.[7]

In contract law, however, the failure to perform a contractual duty does constitute, as a general rule, a breach of contract. Contract law does not entail proof that the breach was intentionally or negligently

---

1. W. PROSSER & P. KEETON, PROSSER AND KEETON ON THE LAW OF TORTS § 4, at 25 (5th ed. 1984).

2. *See id.* § 1, at 21-23 (moral stigma attached to tort liability); *see also id.* § 92, at 656; Diamond, *The Tort of Bad Faith Breach of Contract: When, If At All, Should It Be Extended Beyond Insurance Transactions?*, 64 MARQ. L. REV. 425, 434-35 (1981); Louderback & Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. REV. 187, 202-06 (1982); Speidel, *The Borderland of Contract*, 10 N. KY. L. REV. 163, 168-74 (1983).

3. 5 A. CORBIN, CORBIN ON CONTRACTS § 1077, at 437-39 (1964).

4. R. POUND, AN INTRODUCTION TO THE PHILOSOPHY OF LAW 133-34 (Yale University Press, 1922); J. JACKSON, CONTRACT LAW IN MODERN SOCIETY 4 (1973).

5. J. JACKSON, *supra* note 4, at 4-5; *see also* B. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 67 (1921); M. COHEN, LAW AND THE SOCIAL ORDER 107 (1933).

6. A. KRONMAN & R. POSNER, THE ECONOMICS OF CONTRACT LAW 1-3 (1979); *see also* H. HAVIGHURST, THE NATURE OF PRIVATE CONTRACTS 88, 91, 131 (1961); Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472, 472-75 (1980).

7. PROSSER & KEETON, *supra* note 1, § 92, at 657.

committed.[8] Consequently, contract law emerges as a type of strict as opposed to fault based liability.

C. *Interest Protected*

Tort law protects the broader social interest by securing one's person, property, and relationships from unauthorized harm, violation, or misappropriation.[9] In contrast, contract law "interest" encompasses the interests protected upon breach of contract and, also, refers to the structuring of remedies available for breach.[10] Specifically, judicial remedies for breach attempt to protect one or more of three interests: expectation, reliance, and restitution.[11]

D. *Duties*

Tort duties are defined and imposed by operation of the law and are sufficiently general so as to apply to all members of society.[12] The duties encompass all persons within a legally found range of harm created by the tortfeasor's wrongful conduct.[13]

Contract duties, on the other hand, are created by the will of the contracting parties, not the state. They are decided, defined, and delineated in the contract by the parties themselves.[14] The duties may be confined by contract to the contracting parties or extended to third parties.[15] As a consequence of the parties' capability to limit or expand the scope and content of the duties, the parties theoretically can, and have, adequately safeguarded their interests.

E. *Remedies*

The primary remedial objective in tort, of course, is to restore the victim to the position held before the tort, usually by replacing or

---

8. *Id.* § 92 at 664; *see also* J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS § 12.1, at 455 (2d ed. 1977).

9. PROSSER & KEETON, *supra* note 1, § 92, at 657-8; *see also* Speidel, *supra* note 2, at 163.

10. RESTATEMENT (SECOND) OF CONTRACTS § 344 at 102 (1981).

11. *Id.*; *see also* Speidel, *supra* note 2, at 169-70 (existing interest of individual protected by tort law; reallocation of interest through agreement protected by contract law).

12. PROSSER & KEETON, *supra* note 1, § 92, at 656.

13. *Id.* § 53, at 356-59, § 92, at 655.

14. *Id.* § 92, at 656-58; *see also* Diamond, *supra* note 2, at 433-35; Louderback, & Jurika, *supra* note 2, at 202-03; Speidel, *supra* note 2, at 168-74.

15. CALAMARI & PERILLO, *supra* note 8, § 18.24, at 662.

correcting the loss through compensation.[16] All damages proximately caused may be recovered,[17] frequently including mental distress damages.[18]

The primary remedial goal of contract is to protect the aggrieved party's interests by giving the victim damages equivalent to the value of the breaching party's promised performance.[19] The injured party is thus put into the position that he would have occupied if the contract had been completed as intended.[20] If damages are inadequate to make the victim "whole," specific performance emerges as an alternative remedy.[21] As a general rule, however, courts have refused to award damages for mental suffering for breach of contract, regardless of the willfulness or flagrancy of the breach.[22]

F. *Foreseeability*

Traditionally, tort and contract differ in their application of the foreseeability principle. In tort, the general issue is whether the tortfeasor's misconduct was the "legal" (proximate) cause of the harm, and the resolution thereof revolves about the nature of the conduct and the likelihood of the loss.[23] Foreseeability, of course, is the predominate theory of proximate cause in tort.[24] The precise issue, however, is whether the occurrence of the general type of harm was foreseeable, not whether any precise type of injury was foreseeable.[25] Consequently, if any general type of injury was foreseeable, the de-

16. PROSSER & KEETON, *supra* note 1, § 94, at 672-3.

17. *Id.* § 92, at 665.

18. *Id.* § 12, at 57; *see also* C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 88, at 315 (1935).

19. CORBIN, *supra* note 3, § 992 at 5-7; *see also* MCCORMICK, *supra* note 18, § 137, at 560-1; D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 12.1, at 786-88 (1973). Interests of the aggrieved party are: 1) the restitution interest which is the value of the benefit the victim granted to the breaching party, 2) the reliance interest which is the monetary loss the victim suffered while preparing to fulfill the contract duties or receive the contract performance, or 3) the expectation interest which is the gain the victim would have received if the contract had not been breached. CORBIN, *supra* note 3, § 992, at 5-7.

20. CALAMARI & PERILLO, *supra* note 8, § 14.4, at 521.

21. *Id.* § 16.1, at 581.

22. RESTATEMENT (SECOND) OF CONTRACTS § 353, at 149 (1981); *see also* MCCORMICK, *supra* note 18, § 145, at 592-93.

23. RESTATEMENT (SECOND) OF TORTS § 435A, at 454 (1965); *see also* PROSSER & KEETON, *supra* note 1, § 43, at 272-4.

24. PROSSER & KEETON *supra* note 1, § 43, at 297.

25. RESTATEMENT (SECOND) OF TORTS § 435A, at 454 (1965); PROSSER & KEETON, *supra* note 1, § 43, at 299.

fendant would be required to pay for all injuries that proximately result from the tortious conduct, even though the defendant could not foresee the specific type of harm when the misconduct occurred.[26]

In contract, however, a defendant is only liable for harms foreseeable at the time the contract was formed.[27] The issue is whether the breaching party, at the time the contract was entered into, had reason to foresee that the loss would result as a probable consequence of the breach.[28] The reason to restrict the application of foreseeability in contract is that a contract promise already involves the assumption of a known risk, that is, the liability for damages for non-performance, and, therefore, the contracting party should only assume the risk foreseeable when the contract was made.[29] In practice, therefore, the contract foreseeability interpretation has resulted in a more limited recovery for damages for breach of contract than from the commission of a tort.[30]

G. *Applicability of Punitive Damages*

1. Tort

Various justifications are advanced to support the traditional rule awarding punitive damages for sufficiently aggravated tortious conduct. Primarily, punitive damages are intended to serve as a civil punishment for a wrong done to the public as well as to the victim and also to deter others from engaging in similar misconduct.[31] Based

---

26. CORBIN, *supra* note 3, § 1019, at 114-15.

27. RESTATEMENT (SECOND) OF CONTRACTS § 351, at 135 (1981); *see also* A. FARNSWORTH, CONTRACTS § 12.14, at 876 (1982).

28. A. FARNSWORTH, *supra* note 27, § 12.14, at 876.

29. O.W. HOLMES, THE COMMON LAW 301-02 (1923).

30. *Compare* RESTATEMENT (SECOND) OF TORTS § 431, at 429 (1965) (defining legal cause of harm in tort) *with* RESTATEMENT (SECOND) OF CONTRACT § 351 comment a, at 135 (1981) (even with qualification to recovery in contract, foreseeability requirement limits liability more severely than proximate cause requirement in tort action); see also RESTATEMENT (SECOND) OF CONTRACTS § 352 comment a, at 144 (1981) (courts traditionally have demanded greater certainty in proof of damages for breach of contract than in tort action). *But see* McDowell, *Foreseeability in Contract and Tort: The problems of Responsibility and Remoteness*, 36 CASE W. RES. 286, 289 (1985) (foreseeability in tort and contract function similarly). The significant differences are not in foreseeability but in obligations which on the one hand are based on strict liability and, on the other, arise under traditional fault-based contract and tort theories. *Id.*

31. CORBIN, *supra* note 3, § 1077, at 438; *see also* PROSSER & KEETON, *supra* note 1, § 2, at 9. The underlying ideas from criminal law invade the field of torts when the wrongdoing has the character of outrage associated with a criminal act. *Id.*

on the punishment precepts of the criminal law, punitive damages are directed at the most aggravated misconduct.[32] Lacking evidence that a defendant engaged in flagrant, malicious, reckless, willful or wanton misconduct, a plaintiff will not be awarded punitive damages.[33] Therefore, punitive damages stress the admonitory and educative functions of a traditional fault-based tort system. The imposition of such punishment by the courts voices society's condemnation of aggravated wrongdoings and confirms society's commitment to sustaining its moral and legal foundations.

Moreover, only those wrongs which contravene the duty owed to the public in general, as opposed to the duty owed to a private party, are regarded as suitable subjects to fulfill the purposes of punitive damages.[34] Torts logically fit into this category since the associated duties are implied by law and are based primarily on public policy, not the will or intentions of the parties.[35]

In addition to the paramount punishment and deterrent purposes, punitive damages also provide a motive for private individuals to enforce rules of law and enable them to recover the expenses of so doing. The "private attorney general" function of punitive damages is based on the premise that many wrongs warranting punishment are beyond the grasp of criminal law and the public prosecutor. As a result, punitive damages, by inducing injured private persons to identify and bring wrongdoers to justice, help to remedy a deficiency in the criminal justice system.[36]

Punitive damages permit a plaintiff to recoup actual monetary losses, which can be considerable and not otherwise recoverable as compensatory damages,[37] as well as intangible losses, when the actual monetary loss is minimal, but where the plaintiff sustains a harm for which the defendant should be punished.[38] Punitive damages, finally, serve as a type of private and public revenge carried out by the courts,

---

32. PROSSER & KEETON, *supra* note 1, § 2, at 8-9.

33. *Id.* § 21, at 9-10.

34. Coleman, *Punitive Damages for Breach of Contract: A New Approach*, 11 STETSON L. REV. 250, 277-8 (1982); *see also* CORBIN, *supra* note 3, § 1077, at 438-39; PROSSER & KEETON, *supra* note 1, § 92, at 655-56, 665.

35. PROSSER & KEETON, *supra* note 1, § 92, at 656-57.

36. DOBBS, *supra* note 19, § 3.9, at 205; *see also* PROSSER & KEETON, *supra* note 1, § 2, at 12.

37. PROSSER & KEETON, *supra* note 1, § 2, at 12.

38. MCCORMICK, *supra* note 18, § 77, at 276; *see also* Long, *Punitive Damages: An Unsettled Doctrine*, 25 DRAKE L. REV. 870, 875-76 (1976).

thus preserving the peace.[39]

The allowance of punitive damages in tort cases developed partly from historical contingencies. Early common law juries were often individually acquainted with the facts and parties of the case and originally possessed broad power to ascertain damages.[40] In tort actions, where losses were often indefinite, reviewing courts were hesitant to set aside the jury's determination on damages unless they could concretely measure the extent of the damages. Consequently, large tort damages, including presumably punitive elements, were upheld, and precedent was rapidly established permitting punitive damages in tort actions.[41]

2. Contract

Various policy considerations are cited to support the general rule proscribing punitive damages for breach of contract. According to Oliver Wendell Holmes, "a contract is simply a set of alternative promises either to perform or pay damages for non-performance."[42] Presuming that when compensatory damages are substituted for performance, they equate to the damages caused, then compensatory damages emerge as a sufficient remedy for an aggrieved party to a breached contract,[43] particularly since the purpose of the award is to compensate the victim rather than punish the breacher.[44] Compensatory damages are viewed, moreover, as adequate to deter breaches of contract.[45]

As a logical corollary to the theoretical efficacy of compensatory damages, a further justification offered by economists is the theory that breaches of contract are, in fact, efficient and wealth-producing. According to this "efficient breach" theory, an award of punitive

---

39. Long, *supra* note 38, at 877.

40. Sullivan, *Punitive Damages in the Law of Contract: The Reality and Illusion of Legal Change*, 61 MINN. L. REV. 207, 213-18 (1977); *see also* Strausberg, *A Roadmap Through Malice, Actual or Implied: Punitive Damages in Torts Arising Out of Contract in Maryland*, 13 U. BALT. L. REV. 275, 276-77 (1984).

41. Sullivan, *supra* note 40, at 212-14.

42. O.W. HOLMES, THE COMMON LAW 301 (1923); *see also* Thyssen, Inc. v. S.S. Fortune Star, 777 F.2d 57, 63 (2d Cir. 1985).

43. R. POSNER, ECONOMIC ANALYSIS OF LAW 143 (2d ed. 1977); *see also* Lewis v. Guthartz, 428 So. 2d 223, 223 (Fla. 1982).

44. *See Lewis*, 428 So. 2d at 223.

45. RESTATEMENT (SECOND) OF CONTRACTS § 355, comment a, at 154 (1981); CORBIN, *supra* note 3, § 1002, at 33-34.

damages would entail victimizing the breaching party by compelling the breacher to pay to the non-breaching party more than the amount of its compensable damages. Moreover, if a contract party is concerned about the potentiality of punitive damage liability, that party may be deterred from breaching. The result may be that a party might not breach where it would be efficient to do so. Thus, by encouraging the performance of economically unsound contracts, economic resources are wasted or unwisely allocated, and many beneficial economic interactions are discouraged, all of which results in a net loss for society.[46]

Another view holds that making punitive damages available for breach of contract actions introduces doubt and confusion into business transactions.[47] This uncertainty factor also materializes in a nearly opposite setting to militate against punitive damages for breach of contract. Some commentators note that contract damage principles are sufficiently uncertain to encompass other implicit goals of damage law, such as punishment and deterrence.[48]

The theory of contract damages entails compensation. That is, the promisee should be placed only in as good a position as if the promisor had performed.[49] Moreover, the failure to perform one's contractual promise is not thought to provoke the type of emotional distress,[50] private resentment and revenge, and community outrage as

---

46. *See* Thyssen, Inc. v. S.S. Fortune Star, 777 F.2d 57, 63 (2d Cir. 1985); *see also* R. POSNER, ECONOMIC ANALYSIS OF THE LAW § 4.8, at 88-90 (2d ed. 1977); FARNSWORTH, *supra* note 27, § 12.3, at 817-18; RESTATEMENT (SECOND) OF CONTRACTS § 344 reporter's note, at 106 (1981). The "efficient breach" theory is discussed more fully *infra* in notes 66-77 and accompanying text.

47. Lewis v. Guthartz, 428 So. 2d 223, 223 (Fla. 1982); *see also* FARNSWORTH, *supra* note 27, § 12.14, at 873. The problem of uncertainty in business transactions was raised in the precedential case of *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854), which according to Farnsworth reflected a judicial attempt to promote the developing British enterprise system. *Id.*; *see also* Strausberg, *supra* note 40, at 279; Foley v. Interactive Data Corp., 254 Cal. Rptr. 211, 227 (Cal. 1988) (consideration should be given to important role that predictability of cost plays in commercial system when considering extending tort remedies for breach of contract); Taylor v. Kenco Chem. & Mfg. Corp., 465 So. 2d 581, 589 (Fla. Dist. Ct. App. 1985); Pogge v. Fullerton Lumber Co., 277 N.W.2d 916, 919-20 (Iowa 1979) (punitive damages would lead to uncertainty and confusion in commercial transactions).

48. *See* CORBIN, *supra* note 3, § 1002, at 33 (uncertainty in awarding damages for breach of contract may serve to punish and deter as well as to compensate).

49. CALAMARI & PERILLO, *supra* note 8, § 14.4, at 521; *see also* CORBIN, *supra* note 3, § 992, at 5, § 1002, at 31; S. WILLISTON, 11 WILLISTON ON CONTRACTS § 1338, at 198 (3d ed. and Supp. 1983).

50. MCCORMICK, *supra* note 18, § 145, at 592-93.

do wrongs designated as torts.[51] As a result, in breach of contract cases there is supposedly less need for severe sanctions to satisfy the victim's feelings or to mollify society.

Since parties to a contract create contractual responsibilities by freely entering into the contract, and since failure to perform these self-imposed responsibilities is only a breach of a private duty, which does not technically contravene social norms, the rationale justifying an award of punitive damages is not found in the contract setting.[52] The failure to keep one's promise in an economic relationship apparently does not entail sufficient social approbation to make a damage award comprising punishment and deterrent elements readily acceptable.[53]

The law of contracts deals with essentially economic interactions. The amount of damages required to compensate for the harm can be more readily and precisely measured as opposed to tort law, which must compensate for harm to one's person and personal interests and which is much more difficult to ascertain. This is especially true of intangible losses. Since contract damages are capable of objective assessment, judges are able to curtail a jury's discretion to award damages beyond the actual damages as determined from the agreement. Contract law theoretically does not require a damage principle which would permit a jury to stretch an award to cover non-pecuniary losses in order to adequately compensate a victim, and, concomitantly, to justify such awards when the courts were not inclined to set them aside.[54]

H. *Conclusion*

A potential underlying reason behind any judicial reluctancy to utilize tort type damages in a breach of contract situations may be the perceived traditional distinctions between tort and contract and a

---

51. CORBIN, *supra* note 3, § 1077, at 438; *see also* Thyssen, Inc. v. S.S. Fortune Star, 777 F.2d 57, 63 (2d Cir. 1985).

52. PROSSER & KEETON, *supra* note 1, § 92, at 656-57.

53. O. W. HOLMES, THE COMMON LAW 300-01 (1923); *see also* CORBIN, *supra* note 3, § 1077, at 438.

54. *Thyssen*, 777 F.2d at 63; *see also* Ellis, *Fairness and Efficiency and the Law of Punitive Damages*, 56 S. CAL. L. REV. 1, 13 (1982); Sullivan, *supra* note 40, at 221-22; Strausberg, *supra* note 40, at 276 (tort/contract distinction, primarily arrived at for judical convenience in measuring damages foreshadowed and predated more sophisticated policy arguments that would later arise.)

concomitant sensed necessity to maintain the separate and distinct status of the two classical common law categories. To the degree that such considerations do emerge as significant in the debate centering on punitive damages for breach of contract, such reasoning must be assessed cautiously in light of the increasingly interdependent and complicated nature of society which, in turn, may engender encroachments in traditional legal categories.

III. CONTRACT DAMAGES - LAW AND THEORY

A. *Basic Principles*

Traditional contract law allows a contract party to choose to perform contractual obligations or to pay damages.[55] Compelling adherence to contracts is not a policy of contract law; rather, the assumption that a contract party can breach the contract at will while hazarding only contract damages is one of the keystones of contract law.[56] The compensatory goal of contract law, therefore, is to place the non-breaching party in as good a position as he would have been had the breaching party performed.[57] The expectation measure of damages, defined as the contemplated benefit of the bargain profit at the time of contracting, limits recovery, even if reliance losses exceed expectation.[58]

Since contract law allows the parties the right to breach the contract and pay only contract damages, the traditional law of contract

---

55. RESTATEMENT (SECOND) OF CONTRACTS, ch. 16, Introductory Note, at 100 (1981).

56. R. POSNER, ECONOMIC ANALYSIS OF LAW § 4.9, at 88 (2d ed. 1977); *see also* Holmes, *The Path of the Law*, 10 HARV. L. REV. 475, 462 (1897). According to O. W. Holmes, "the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, - and nothing else. If you commit a tort, you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference. But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can." *But see* G. GILMORE, THE DEATH OF A CONTRACT 94-95 (1974) (the law should encourage parties to keep their promises by imposing greater liability on the breaching party).

57. RESTATEMENT (SECOND) OF CONTRACTS § 344, at 102, § 344 comment a, at 103 (1981); *see also* WILLISTON, *supra* note 49, § 1338, at 198.

58. FARNSWORTH, *supra* note 27, § 12.16 at 890, § 12.1, at 812-13; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 344(a), at 102 (1981). "Expectation interest" is defined as the promisee's interest in the benefit of his bargain, i.e., the interest represented by placing the promisee in as good a position as he would have been in if the contract had been performed. *Id.* § 349, at 124.

remedies does not consider the conduct accompanying the breach.[59] Under this principle, questions regarding the inadvertence or willfulness of the breach, or the breaching party's state of mind, are deemed irrelevant in awarding damages to the non-breaching party.[60]

Under the famous and widely-accepted rule of *Hadley v. Baxendale*,[61] contract damages are limited to losses that are foreseeable at the time the contract is made.[62] *Hadley* thus bars recovery for special damages unless the breaching party knew the particular risks at the time of contracting.[63] The *Hadley* rule, moreover, generally precludes compensation for emotional distress because such distress is not usually a foreseeable result of a breach of contract.[64] The nonbreaching party, finally, must prove contract damages with reasonable certainty.[65]

B. *The Efficient Breach Theory*

From the expectation measure and *Hadley* restrictions arose the theory of the "efficient breach." Ideally, a party to an unprofitable contract can calculate the price of breaching. When the costs of performance, either in actual costs or the loss of foregone profits, exceed

---

59. Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1146 (1970). "Courts in this country . . . expressly reject the notion that remedies for breach of contract have punishment as a goal, and with rare exceptions, refuse to grant 'punitive damages' for breach of contract. In so refusing they purport not to distinguish between aggravated and innocent breach." *Id.*

60. *See id.* (impartiality of traditional contract law to breach not absolute); *see also* RESTATEMENT (SECOND) OF CONTRACTS ch. 11, introductory note, at 309-10 (party may be excused from performance altogether in event of "impossibility," although such defense is strictly construed); RESTATEMENT (SECOND) OF CONTRACTS § 352 comment a, at 144 (willfulness a factor in determining proof of damages with "reasonable certainty").

61. 9 Ex. 341, 156 Eng. Rep. 145 (1854); *see also* CORBIN, *supra* note 3, § 1007 (citing *Hadley* as rule generally followed).

62. *Hadley*, 156 Eng. Rep. at 147; *see also* CALAMARI & PERILLO, *supra* note 8, § 14.5, at 524-25.

63. *See* RESTATEMENT (SECOND) OF CONTRACTS § 351, at 135 (1981); *see also* Farnsworth, *supra* note 59, at 1200-01.

64. RESTATEMENT (SECOND) OF CONTRACTS § 35, at 141 (1981); *see also* CORBIN, *supra* note 3, § 1076. *But see* Sebert, *Punitive and Nonpecuniary Damages in Actions Based Upon Contract: Toward Achieving the Objectives of Full Compensation*, 33 UCLA L. REV. 1565, 1586 (1986). "[I]t is difficult to believe that some emotional distress would not frequently be deemed a foreseeable consequence of many contract breaches. Would it be so unusual to expect emotional distress to arise from a botched home remodeling job, from a defective auto that continually broke down . . . [or] from the unjustified termination of disability insurance payments . . . ." *Id.*

65. CALAMARI & PERILLO, *supra* note 8, § 14.8, at 528.

the cost of placing the nonbreaching party in the same position it would have been if performance occurred, the breaching party can intentionally breach since it would be more profitable to breach than to perform. Then, after compensating the nonbreaching party, the breaching party has available the net gains of the transaction and is free to pursue more profitable ventures.[66]

The "efficient breach" theory, therefore, holds that such economically efficient breaches are beneficial and should not be discouraged.[67] To abrogate the *Hadley* restrictions and to impose liability beyond the expectation interest would extinguish the economic incentive to pursue more profitable ventures, thereby inhibiting breaches of inefficient agreements - breaches which arguably should not be discouraged, but urged.[68] Since it would be inefficient to penalize the breaching party in a net gain situation, it is argued that the law should postulate incentives to invite efficient breaches.

In addition to permitting and encouraging contract parties to make efficient breaches, the law, by implication, should also deter inefficient breaches. An inefficient breach is a breach where the nonbreaching party's losses exceed the benefits the breaching party acquires as a result of the breach, thereby causing a net loss.[69]

The efficient breach theory, with its strategy of encouraging and discouraging certain types of breaches, is based on the premise that it is economically preferable to have societal resources efficiently allocated to their most profitable uses.[70] Encouraging economically effi-

---

66. *See, e.g.*, Foley v. Interactive Data Corp., 254 Cal. Rptr. 211, 227 n.25 (1988); RESTATEMENT (SECOND) OF CONTRACTS ch. 16, at 100-02 (1981) (noting that the traditional presumption against compelling a breaching party to perform is consistent with the conclusions reached by "at least some economic analysis"); R. POSNER, ECONOMIC ANALYSIS OF LAW § 3.8, at 57-8 (1973); DOBBS, *supra* note 19, § 21.1, at 786; FARNSWORTH, *supra* note 27, § 12.3, at 817; Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284 (1970); Diamond, *supra* note 2, at 435-38; Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 114-15 (1981).

67. *See, e.g.*, A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 31-34 (1983); R. POSNER, ECONOMIC ANALYSIS OF LAW § 3.8, at 57-58 (1973); Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277, 278-279 (1972); Birmingham, *supra* note 66, at 284; Farnsworth, 70 COLUM. L. REV. at 1146-49; FARNSWORTH, *supra* note 27, § 12.3, at 817.

68. *See* R. POSNER, ECONOMIC ANALYSIS OF LAW § 4.9, at 89-90 (2d ed. 1977); Strausberg, *supra* note 40, at 292-93.

69. Diamond, *supra* note 2, at 438.

70. RESTATEMENT (SECOND) OF CONTRACTS § 344, at 101-2 (1981); *see also* L. FRIEDMAN, CONTRACT LAW IN AMERICA 126 (1965); R. POSNER, ECONOMIC ANALYSIS OF LAW

cient breaches promotes the reinvestment of the "net gains" from the breach in other economic opportunities, resulting in increased production of goods and services at lower cost to society; discouraging inefficient breaches emphasizes the economic and societal rationales of ensuring that the breaching party's gains are not acquired at a higher cost to the non-breaching party.

The principles of restricted liability, neutrality toward intentional breach, and the efficient breach theory are the traditional premises upon which contract damages are based. These principles are grounded in economic theory; restrictions on liability invite commercial contracting, promote business, and thus support the development of the market economy;[71] neutrality toward breach and the efficient breach theory advance the efficient allocation of societal resources.[72]

These traditional principles apply as well to claims for punitive damages for breach of contract. Thus, it is argued that the availability of punitive damages for breach of contract would discourage a contract party from breaching the contract to pursue more profitable and economically efficient business opportunities.[73]

C. *Problems with the Efficient Breach Theory*

Although the efficient breach theory has materialized as a major premise to the orthodox rule rejecting punitive damage recovery for breach of contract, factors exist which reduce the force of the theory.[74]

The efficient breach theory is founded upon a *classical model*, and accordingly presupposes that: 1) a transaction is between parties of

---

§ 3.8, at 89-90 (2d ed. 1977); FARNSWORTH, *supra* note 27, § 12.3, at 816-817; Diamond, *supra* note 2, at 437; Linzer, *supra* note 66, at 114.

71. L. FRIEDMAN, CONTRACT LAW IN AMERICA 126 (1965); *see also* Farnsworth, *supra* note 59, at 1207.

72. L. FRIEDMAN, CONTRACT LAW IN AMERICA 126 (1965); *see also* R. POSNER, ECONOMIC ANALYSIS OF LAW § 3.8, at 89-90 (2d ed. 1977).

73. RESTATEMENT (SECOND) OF CONTRACTS introductory note, ch. 16, at 100-1 (1981); *see also* FARNSWORTH, *supra* note 27, § 12.3, at 817-18.

74. See generally the following commentators who raise problems with the efficient breach theory: Diamond, *supra* note 2, at 440-43; Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1444-46, 1450-51 (1980); Linzer, *supra* note 66, at 112; Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 ARIZ. L. REV. 733, 736-39 (1982); MacNeil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 954 (1982); Speidel, *supra* note 2, at 192-93.

relatively equal bargaining power, and occurs in a functioning market; 2) the parties to the contract possess the same degree of aversion to risk; 3) the aggrieved party detects the breach and sues for damages as a consequence; 4) a dollar price exists for every type of damage; 5) the victim of the breach recovers compensation in a relatively speedy and costless litigation; 6) the orthodox measure of contract damages supplies a full and true redress for all the harm suffered by the victim; and 7) the parties actually attain an efficient agreement either before or after the breach.

The orthodox view thus does not take into account that contracts generally are not predominantly negotiated documents, but rather "take it or leave it" standard forms. The theory also does not take into account the differences in the degree of risk aversion between the parties to the contract. In an insurance contract, for example, the insured is considerably more risk averse than the insurer. In an employment contract, the average employee risks the loss of livelihood while the employer risks merely the temporary inconvenience of finding a substitute employee. In a contract for financial service, the depositor is much more risk averse than the institution. The harm suffered by the victim of a breach in the preceding contracts, therefore, is potentially greater than the compensation provided by the traditional contract damage analysis.

The injured party, of course, must institute suit to implement the rights that the law of contract does confer. If the probability of detecting the breach is low, the measure of damages necessary to deter such a breach is greater than the amount of damages actually suffered by a victim. Presuming the breach is detected, one must further assume the victim is fully cognizant of the contract terms or has access to competent legal advice. Assuming a lawsuit is instituted, the legal process entails considerable costs and attorneys' fees. Such costs frequently make a full prosecution impracticable to the injured party because it is not sufficiently remunerative, and therefore, the aggrieved party may either fail to institute suit or settle for considerably less than the actual damages. Litigation costs, therefore, can dissuade and hinder a victim from securing full vindication against the wrongdoer. The injustice of the situation is particularly exacerbated when a relatively small loss is caused through intentional breach by a large and powerful entity. Because the amount of money may be too small and the time and energy involved too great to sue for redress, an economically sound and just measure of contract damages that will afford ade-

quate punishment and deterrent demands the imposition of additional contractual damages.

The theory of the efficient breach is thus built on the fundamental foundation that the traditional measure of contract damages truly does compensate the aggrieved party for all the harm suffered. However, to the extent that certain harms and costs are not recoverable and result in a net loss to the victimized plaintiff and a net gain to the breaching defendant, the efficient breach foundation cracks. The inherent, latent defect in the efficient breach theory, that is, the danger that the loss to the victim will equal or exceed the gain to the breacher, is acutely realized where the breacher captures an immediate gain under circumstances where the prospect of full compensation is low.

The law of contract damages posits that the nonbreaching party be placed in the same position which he would have been in had the contract been performed. Such a rule requires that the nonbreaching party's interest be truly fulfilled.[75] The practical application of the traditional maxim, however, may fail to accomplish this objective. Certain reliance losses, for example, emotional distress and further economic losses, are not ordinarily recoverable.

Orthodox contract damage law and theory, moreover, fail to take into account the high transaction costs of a breach. For example, the substantial litigation costs and expenses, lost interest and attorneys' fees generally are not contained in the calculation of a party's expectancy damages. Attorneys' fees, in particular, are not typically included in the traditional compensation for breach of contract.[76]

The concurrence of limited liability and high transaction costs can result in a stinted recovery. Therefore, any under-compensation of contract reduces the expectation that unfilled promises will be sufficiently compensated. The reduced expectation then engenders the under-enforcement of contract rights.

Since breaching parties, moreover, do not expect to pay full damages, promises may be routinely broken even when it is inefficient to do so. Clearly, a contract party who is not liable for full compensation is less constrained to refrain from a breach and, therefore, is not deterred from breaching the contract in a manner that inefficiently

---

75. *See* R. POSNER, ECONOMIC ANALYSIS OF LAW § 3.8, at 90 (2d ed. 1977) (even Judge Posner admits that for breach to be efficient, expectancy damages must be awarded).

76. CALAMARI & PERILLO, *supra* note 8, § 14-35, at 646.

allocates societal resources.[77]

A potential *practical* effect of the efficient breach theory, therefore, may actually be inefficient breach. Under-enforcement and under-compensation cannot only undermine the position of contract damage law of providing compensation and deterring inefficient breaches, but also can render contract law unjust.[78]

Additionally, efficient breach theory can be severely criticized for minimizing the social costs incurred by a neutral attitude towards the breach.[79] The efficient breach theory discounts the probability that both the private interests of the victim and strong public interests will be adversely affected by the breach. The relational aspects of contractual transactions should militate in favor of more, not less, legal protection, particularly for persons with lesser economic power who contract in reliance on the skill, judgment, and probity of others. The orthodox rule, which continually downplays or disregards the wrongfulness of the breaching party's conduct regardless of how outrageously immoral, offends one's sense of fairness and justice and engenders disrespect for the law.

IV. THE ORTHODOX DOCTRINE AND TRADITIONAL EXCEPTIONS THERETO

A. *Introduction*

The orthodox common law doctrine holds that an action for breach of contract will not support a recovery for punitive damages, regard-

77. *See* Diamond, *supra* note 2, at 433 (scrutiny of commercial practice shows that our system sanctions bad faith breaches and, with limitations, actually encourages them); *see also*, Sebert, *supra* note 64, at 1572-73. "If one accepts the economic theory, however, one must recognize that achieving a Pareto-superior allocation of resources requires avoiding undercompensation as well as overcompensation . . . . By systematically undercompensating plaintiffs, we risk encouraging too much breach rather than too little." *Id.*

78. *See* Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 751 (7th Cir. 1988) (applying Ind. law) (some breaches are opportunistic because promisor wants benefit of bargain without assuming agreed upon cost, and exploits inadequacies of purely compensatory remedies); *see also* Diamond, *supra* note 2, at 442 (remedial scheme of contract law based on promisor's acknowledgement of economic consequences of actually paying promisee's damages); Sebert, *supra* note 64, at 1660 (clearly preferable to occasionally discourage an efficient breach by threat of supracompensatory damage liability than to regularly encourage inefficient breach by remedial system that consistently fails to fully compensate aggrieved party).

79. Linzer, *supra* note 66, at 112; *see also* Marschall, *supra* note 74, at 734; Speidel, *supra* note 2, at 192-93.

less how flagrant the breach.[80] The enunciation of this principle has become so ritualized in the law that practically every case and commentary in which the issue of punitive damages for breach of contract is raised commences its discussion by reciting this dogma.[81]

The doctrine excluding punitive damage awards from breach of contract, however, has been subject to exceptions since its inception. Although the courts customarily pay homage to the doctrine, they have long been inclined, whenever possible, to qualify its general rule by creating exceptions.

Consequently, punitive damages traditionally have been awarded in contract cases that have a markedly tortious nature, such as those pertaining to breach of contract to marry, breach of contract by a public utility, breach of contract by fiduciary, breach of contract involving fraudulent-type conduct, and breach of contract involving a concomitant independent tort (the latter significant exception will be discussed in Part V).

B. *Breach of a Contract to Marry*

One of the earliest and most frequently adhered to exceptions entails a breach of a contract to marry.[82] A breach alone, however, is insufficient to support a punitive damage recovery. Rather, as the courts commonly find, the breach must be accompanied by conduct

---

80. *See, e.g.*, G.M. Brod & Co., Inc. v. U.S. Home Corp., 759 F.2d 1526, 1536 (11th Cir. 1985) (applying Florida law) (even flagrant breach of contract will not support punitive damages); Splitt v. Deltona Corp., 662 F.2d 1142, 1145-47 (5th Cir. 1981) (applying Florida law) (even though contract flagrantly breached with an evil mind); Lewis v. Guthartz, 428 So. 2d 223, 223 (Fla. 1982); Rosen v. Marlin, 486 So. 2d 623, 626 (Fla. Dist. Ct. App. 1986); Berryhill v. Hatt, 428 N.W.2d 647, 656 (Iowa 1988) ("belligerent" anticipatory breach does not give rise to punitive damages); Manges v. Guerra, 673 S.W.2d 180, 184 (Tex. 1984) (punitive damages refused even if agreement breached maliciously); Texas Power & Light Co. v. Barnhill, 639 S.W.2d 331, 333-34 (Tex. Civ. App.—Texarkana 1982, no writ) (even breach committed capriciously and with malice); RESTATEMENT (SECOND) OF CONTRACTS § 355, at 154 (1981); CALAMARI & PERILLO, *supra* note 8, § 14-3, at 520; CORBIN, *supra* note 3, § 1077, at 438-39; K. REDDEN, PUNITIVE DAMAGES § 4.3, at 109-10; WILLISTON, *supra* note 49, § 1340, at 210-11; *see also, e.g.*, CAL. CIV. CODE § 3294 (West Supp. 1989) (precluding awards of punitive damages for actions arising out of contract).

81. *See e.g., Lewis*, 428 So. 2d at 223; *Texas Power & Light Co.*, 639 S.W.2d at 333, RESTATEMENT (SECOND) OF CONTRACTS § 355 comment a, at 154-55 (1981); Sullivan, *supra* note 40, at 207.

82. *See, e.g.*, Sandler v. Lawn-A-Mat Chem. & Equip. Co., 358 A.2d 805, 812 (N.J. Super. Ct. App. Div. 1976) (list of "traditional" exceptions to general rule), *cert. denied*, 366 A.2d 658 (N.J. 1976); Stanback v. Stanback, 254 S.E.2d 611, 621 (N.C. 1979); Redden, *supra* note 80, § 2.5, at 41.

that is fraudulent, malicious, ruthless, cruel, or motivated by evil motives.[83]

The courts defend the recovery of punitive damages by declaring that, although the misbehavior does not comprise an independent tort, the wrong closely resembles the tort of intentional infliction of emotional distress.[84] The unique nature of the interest to be protected, the particularly personal as opposed to pecuniary harm suffered by the victim, for example, social disgrace, humiliation, embarrassment,[85] and the difficulty of precisely fixing damages due to the intangible nature of the harm,[86] are cited as justifications for punitive awards. Additionally, the need to punish the wrongdoer,[87] and the public's interest in deterring similar wrongs and in expressing the community's disapproval,[88] are cited as reasons for the award.

A leading criticism of this exception is that, since the breach closely resembles a tort wrong and is comparable to intentional infliction of emotional distress, the law should not permit an essentially tort action to impersonate a contract action.[89]

C. *Breach of Contract by a Fiduciary*

Punitive damages are appropriate where a breach of contract comprises a breach of a fiduciary duty.[90] Even though the relationship

---

83. *See, e.g.*, Smith v. Hawkins, 243 P. 1018, 1019 (Kan. 1926); Sneve v. Lunder, 110 N.W. 99, 100 (Minn. 1907).

84. *See, e.g.*, CORBIN, *supra* note 3, § 1077, at 442; DOBBS, *supra* note 19, § 12.4, at 819-20; REDDEN, *supra* note 80, § 2.5, at 41, § 4.3, at 110; *cf.* Brown v. Douglas, 122 S.E.2d 747, 748 (Ga. App. 1961).

85. DOBBS, *supra* note 19, § 12.4, at 819-21.

86. Sullivan, *supra* note 40, at 222-23.

87. CORBIN, *supra* note 3, § 1077, at 441-42.

88. *Id.* § 1077, at 440-43, § 1076, at 430-32; Coleman, *supra* note 34, at 272-73; Sullivan, *supra* note 40, at 223.

89. Standard v. Bolin, 565 P.2d 94, 96 (Wash. 1977); *see also* Coleman, *supra* note 34, at 273; *cf.* CORBIN, *supra* note 3, § 1077, at 442.

90. *See, e.g.*, Ramsey v. Culpepper, 738 F.2d 1092, 1099 (10th Cir. 1984) (applying New Mexico law) (failure of a realtor to disclose important information to fiduciary, if willful or wanton, can be basis for punitive damage award); Wagman v. Lee, 457 A.2d 401, 404 (D.C. App. 1983) (escrow-depositor relationship); Pelletier v. Schultz, 276 S.E.2d 118, 120 (Ga. App. 1981) (corporation's directors and managers breached fiduciary duty to major shareholder); Capitol Fed. Sav. and Loan Ass'n v. Hohman, 682 P.2d 1309, 1310 (Kan. 1984) (defendant vendor's breach of fiduciary duty to purchasers constituted independent tort that supported award of punitive damages); Purcell v. Automatic Gas Distrib., 673 P.2d 1246, 1250-51 (Mont. 1983); Bumgarner v. Tomblin 306 S.E.2d 178, 183 (N.C. App. 1983) (fiduciary relationship between legal and equitable title holders of land who agreed to same for resale);

may arise from the contract, recovery is grounded upon breach of the implied-in-law duty created by the relationship rather than from breach of the contract itself.[91] Accordingly, the focal point of this exception is to determine whether or not the contract creates an independent fiduciary relationship between the parties.

Courts, of course, possess a great deal of flexibility in determining whether a fiduciary relationship exists. Some courts, for example, hold that merely entering into a contract frequently makes one party so dependent on the other that a fiduciary relationship arises.[92]

This very flexibility, however, underscores the vagueness and subjectiveness of the term.[93] Stating that a relationship is "fiduciary" says nothing about those functional characteristics that lead the courts to impose punitive damages. As a result, the determination of whether a fiduciary relationship exists emerges as a difficult and unpredictable undertaking, and is ripe for contradictory consequences. The use of the conclusionary expression, "fiduciary," therefore, adds little to the analysis.

D. *Breach of a Public Service Contract*

Another time-honored and frequently adhered to exception to the general rule permits punitive damages for breach of a contract by a

---

Manges v. Guerra, 673 S.W.2d 180, 184-85 (Tex. 1984) (mineral cotenants relationship); Douglas v. Aztec Petroleum Corp., 695 S.W.2d 312, 319 (Tex. Civ. App.—Tyler 1985, no writ) (principal-agent relationship); Mulder v. Mittelstadt, 352 N.W.2d 223, 230 (Wisc. App. 1984); 22 AM. JUR. 2D *Damages* § 45, at 69 (1965); J. MCCARTHY, PUNITIVE DAMAGES IN BAD FAITH CASES § 2.10, at 110-11 (2d ed. 1978); Coleman, *supra* note 34, at 269-72; Ford, *Unconventional Theories of Lender Liability in Florida*, FLA. B.J., July/Aug. 1989, at 45 (case law suggests breach of fiduciary duty theory may play important role in evolution of lender liability law).

91. Vale v. Union Bank, 151 Cal. Rptr. 784, 790 (Cal. Ct. App. 1979); *see also* MCCARTHY, *supra* note 90, § 2.10, at 110-11; Sullivan, *supra* note 40, at 226-27; *Wagman*, 457 A.2d at 404; Fletcher v. Western Nat'l Life Ins. Co., 89 Cal. Rptr. 78, 95 (Cal. Ct. App. 1970); Interfirst Bank Dallas v. Risser, 739 S.W.2d 882, 907 (Tex. App.—Texarkana 1987, no writ) (trustee—beneficial owners relationship) ("intentional breach of a fiduciary duty is a tort"); Wilson v. Donze, 692 S.W.2d 734, 739-40 (Tex. App.—Ft. Worth 1985, no writ) ("tortious nature" of secret profits of real estate broker).

92. Sullivan, *supra* note 40, at 227, 229; *cf. Fletcher*, 89 Cal. Rptr. at 95.

93. *See* DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L. REV. 879, 892-901 (comparison of fiduciary obligation with good faith). According to DeMott, "(b)oth are . . . protean in their operation, resisting attempts to capture their meanings in general definitions." *Id.* at 892; *see also* Sullivan, *supra* note 40, at 229 n.119 (criticizing vague nature of fiduciary terminology).

public service entity.[94] This exception originated in the early English common law concerning "common callings."[95] These common callings were enterprises or persons that held themselves out as offering particular services or products to the public, such as the innkeeper, the seller of food, the blacksmith, and the common carrier.[96] Due to the public nature of their calling, the common law imposed concomitant duties to serve equally all customers on a reasonable basis and to perform the service and provide the product one could expect from their economic status.[97] A rationale for the imposition of these special duties was the monopolistic position enjoyed by these common callings and the consequent potential for oppression and abuse of the public.[98]

The doctrine of common callings evolved into a modern exception that permits punitive damages in breach of contracts by enterprises affected by a public interest or in cases involving a special relationship between the provider of goods and services and the public.[99] Accordingly, courts impose punitive damages on telegraph and telephone companies, common carriers, innkeepers, water companies, gas and electric companies, and other entities which enjoy a monopoly or quasi-monopoly position in the community, when they fail to discharge their contractual responsibilities to their customers.[100]

Wrongdoing in the public service cases, of course, involves both contract and tort elements. As in marriage cases, the association may be deemed personal in that the public service entities supply necessary services to individuals.[101] Because such wrongdoing contravenes the

---

94. *See* CORBIN, *supra* note 3, § 1077, at 444; *see also* REDDEN *supra* note 80, § 4.4(A), at 110-111; WILLISTON, *supra* note 49, § 1340, at 213; Burdick, *The Origin of the Peculiar Duties of Public Service Companies*, 11 COLUM. L. REV. 514, 518 (1911).

95. PROSSER & KEETON, *supra* note 1, § 92, at 662; *see also* Burdick, *supra* note 94, at 515; Sullivan, *supra* note 40, at 223-24; Tobriner & Grodin, *The Individual and the Public Service Enterprise in the New Industrial State*, 55 CALIF. L. REV. 1247, 1249 (1967).

96. Tobriner & Grodin, *supra* note 95, at 1249-50; *see also* Rawlings v. Apodaca, 726 P.2d 565, 575 (Ariz. 1986).

97. Tobriner & Grodin, *supra* note 95, at 1249-50; *see also Rawlings*, 726 P.2d at 575.

98. Sullivan, *supra* note 40, at 224.

99. *Id.* at 224-25; *see also* Tobriner & Grodin, *supra* note 92, at 1249-50.

100. *See, e.g.*, Commodore Cruise Line, Ltd. v. Kormendi, 344 So. 2d 896, 898 (Fla. Dist. Ct. App. 1977); Williams v. Western Union Tel. Co., 136 S.E. 218, 221 (S.C. 1927); Southwestern Gas & Elec. Co. v. Stanley, 45 S.W.2d 671, 674 (Tex. Civ. App.—Texarkana, 1931), *aff'd*, 70 S.W.2d 413 (1934).

101. *See, e.g.*, Birmingham Water Works Co. v. Keiley, 56 So. 838, 841 (Ala. App. 1911);

public interest,[102] punitive damages are appropriate to punish and deter.

The exception is further justified by the rationale that, since a public service entity is conferred a special status by the public, it owes a "legal" duty to serve all applicants and to perform in a suitable manner.[103] The breach of this duty, of which the contract is merely an incident, is really comparable to the breach of a tort duty, which will support a punitive damage award.[104]

Moreover, the courts cognizant of the disparity of bargaining power and economic power resulting from the political and economic dominance of major enterprises, have employed punitive damages as a means to protect the public from exploitation and abuse inherent in a monopoly position.[105]

Also, courts are aware that when a public service company capitalizes on its customer's vulnerable status by curtailing necessary services, more than the mere loss of a commercial bargain occurs. As a result, more than the standard contract damages are justified in order to punish exploitation and the abuse of economic power.[106]

Courts, however, disagree as to the standard of conduct the victim must show in order to receive punitive damages. Particularly, the courts lack agreement as to whether the misconduct must be negligently performing services or merely providing negligent services.[107] The public service cases, although at first glance appearing as a stan-

---

Cumberland Tel. & Tel. Co. v. Hobart, 42 So. 349, 351 (Miss. 1906); Sullivan, *supra* note 40, at 226.

102. *Cumberland Tel. & Tel. Co.*, 42 So. at 351; *see also* CORBIN, *supra* note 3, § 1077, at 444; Sullivan, *supra* note 40, at 224-25.

103. *See, e.g.*, Woodbury v. Tampa Waterworks Co., 49 So. 556, 562 (Fla. 1909); Commodore Cruise Line, Ltd. v. Kormendi, 344 So. 2d 896, 898 (Fla. Dist. Ct. App. 1977); Southwestern Gas & Elec. Co. v. Stanley, 45 S.W.2d 671, 674 (Tex. Civ. App. —Texarkana, 1931), *aff'd*, 70 S.W.2d 413 (1934); CORBIN, *supra* note 3, § 1077, at 443; Coleman, *supra* note 34, at 274; Sullivan, *supra* note 40, at 224.

104. *See, e.g.*, *Woodbury*, 49 So. at 562; *Southwestern Gas & Elec. Co.*, 45 S.W.2d at 674; CORBIN, *supra* note 3, § 1077, at 443; WILLISTON, *supra* note 49, § 1340, at 213; Coleman, *supra* note 34, at 274; Sullivan, *supra* note 40, at 224; *cf. Commodore Cruise Line, Ltd.*, 344 So. 2d at 897-98.

105. *See, e.g.*, Cumberland Tel. & Tel. Co. v. Hobart, 42 So. 349, 351 (Miss. 1906); DOBBS, *supra* note 19, § 3.9, at 217; MCCORMICK, *supra* note 18, § 81, at 288-289; Sullivan, *supra* note 40, at 224, 226.

106. Birmingham Water Works Co. v. Keiley, 56 So. 838, 841 (Ala. App. 1911).

107. MCCORMICK, *supra* note 18, § 81, at 288-289; *see also* PROSSER & KEETON, *supra* note 1, § 92, at 658-63.

dard and traditional exception to the general rule, reveal theories that have been utilized by modern courts to carve out far-reaching exceptions to the general rule.

V. THE INDEPENDENT TORT EXCEPTION

A. *Statement and Nature of the Exception*

Punitive damages are imposed for a breach of contract when the breach constitutes or amounts to a separate and distinct independent tort, the commission of which is sufficiently aggravated.[108] Punitive damages technically are not recoverable for the actual breach of contract, but rather are predicated on a tort duty separate from the contract.[109] This exception, therefore, is not a real exception to the general rule,[110] even though it is termed an exception by courts and commentators that employ it.[111]

If a distinct and independent tort is lacking, punitive damages will generally not be awarded solely on the breach itself[112] regardless of the flagrant nature of the breach.[113] Pleading and proving the sepa-

---

108. *See, e.g.*, Griffith v. Shamrock Village, 94 So. 2d 854, 858 (Fla. 1957) (acts constituting breach of contract also amount to cause of action in tort and breach must be attended by some intentional wrong, insult, abuse, or gross negligence); Boyd v. Oriole Homes Corp., 515 So. 2d 300, 301 (Fla. Dist. Ct. App. 1987) (breach of contract and fraud), *rev. dism'd* 525 So. 2d 876 (Fla. 1980); *Wilson*, 692 S.W.2d at 740 ("[A] tort may grow out of, be made a part of or be coincidental with a breach of contract thereby permitting the recovery of exemplary damage if committed willfully and maliciously."); Hamilton v. Texas Oil & Gas Corp., 648 S.W.2d 316, 324 (Tex. App.—El Paso 1982, no writ) (breach of contract and gross negligence); CORBIN, *supra* note 3, § 1077, at 439.

109. *See* Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986) (act of party may breach either tort or contract duties alone or may breach both at same time); *see also* PROSSER & KEETON, *supra* note 1, § 92, at 656, 665.

110. Southern Bell Tel. & Tel. Co. v. Hanft, 436 So. 2d 40, 42 (Fla. 1983) "Once an independent tort is established in a breach of contract suit, the question of whether punitive damages are proper is decided under principles traditionally applicable to such questions in tort cases . . . ." *Id.*

111. Nicholas v. Miami Burglar Alarm Co., 339 So. 2d 175, 178 (Fla. 1976); *see also* Sebert, *supra* note 64, at 1600-01.

112. *See, e.g.*, Grossman Holding Ltd. v. Hourihan, 414 So. 2d 1037, 1040 (Fla. 1982); Club Eden Roc, Inc. v. Fortune Cookie Restaurant, 490 So. 2d 210, 211-12 (Fla. Dist. Ct. App. 1986); Mobile Chem. Co. v. Hawkins, 440 S.W.2d 378, 381 (Fla. Dist. Ct. App. 1983); Texas Power & Light Co. v. Barnhill, 639 S.W.2d 331, 333-34 (Tex. Civ. App.—Texarkana 1982, no writ) (termination of employment contract "arbitrary, capricious, and unwarranted" and done with "malicious intent").

113. *See, e.g.*, Southern Bell Tel. & Tel. Co. v. Hanft, 436 So. 2d 40, 42 (Fla. 1983) (omission of doctor from Yellow Pages twice despite numerous communications merely breach of contract); Lewis v. Guthartz, 428 So. 2d 223, 223-24 (Fla. 1982). "Even where landlord

rate tort is the key element to recovery herein.

B. *Unavailability of Punitive Damages for Independent Tort*

Even assuming an independent tort is present in a contract setting, punitive damages may still not be recoverable due to the absence of sufficiently egregious conduct,[114] the lack of actual[115] or nominal damages,[116] or the running of the tort statute of limitations.[117]

C. *Problems with Certain Independent Torts*

1. Fraud

a. Introduction

The common law tort of fraud committed by a contract party may serve as a foundation for punitive damage liability. The foundation, however, is a particularly shaky one as the efficacy of the tort of fraud is weakened by the presence of several technical requirements.

---

flagrantly, unjustifiably, and oppressively breached contract, and attempted to conceal breach by criminal act of making false statements to government, tenants had to plead and prove that landlord committed an independent tort against them in order to recover punitive damages." *Id.*; *Texas Power & Light Co.*, 639 S.W.2d at 333-34 (no punitve damages award even if breach committed "capriciously and with malice").

114. *See, e.g.*, Floyd v. Video Barn, Inc., 538 So. 2d 1322, 1324-25 (Fla. Dist. Ct. App. 1989) (breach of contract and gross negligence, arising out of defendant's failure to videotape plaintiff's daughter's wedding, not enough for award of punitive damages absence reckless indifference); Porter v. Wilson, Walch, Fortner, Robinson & Besse, 384 So. 2d 190, 191-92 (Fla. Dist. Ct. App. 1980) (breach of and tortious interference with contract but lacked malice for punitive damages due to reliance on advice of attorney), *petition for review denied*, 392 So. 2d 1378 (Fla. 1980); Cadillac Vending Machine Co. v. Haynes, 402 N.W.2d 31, 33 (Mich. App. 1986) (actions causing intentional interference with contractual relations but malicious, willful, wanton, or reckless conduct absent); Enright v. Lubow, 493 A.2d 1288, 1295-96 (N.J. Sup. Ct. 1985) (negligence in preparing survey resulting in mislocated easement but conduct found neither wanton nor reckless).

115. *See, e.g.*, City Prods. Corp. v. Berman, 610 S.W.2d 446, 450 (Tex. 1980); National Mortgage Corp. of Am. v. Stephens, 723 S.W.2d 759, 762 (Tex. App.—El Paso), *rev. in part on other grounds*, 735 S.W.2d 474 (Tex. 1987); Menchio v. Rymer, 348 S.E.2d 76, 78-79 (Ga. App. 1986); Gulftide Gas Corp. v. Cox, 699 S.W.2d 239, 245 (Tex. App.—Houston 1985, writ ref'd n.r.e.).

116. *See* Norman's Heritage Real Estate Co. v. Aetna Cas. & Sur. Co., 727 F.2d 911, 916 (10th Cir. 1984) (applying Oklahoma law). *But see* Ault v. Lohr, 538 So. 2d 454, 456 (Fla. 1989) (nominal damages presumed when established right is violated).

117. *See*, Frazier v. Metropolitan Life Ins. Co., 169 Cal. App. 3d 90, 105-06, 214 Cal. Rptr. 883, 891-92 (Cal. Dist. Ct. App. 1985).

b. The Specificity Requirement

An axiom of the common law is that the circumstances constituting a cause of action for fraud must be pled in the complaint with certainty, specificity, and particularity.[118] The allegations, of course, must satisfy all the elements of an independent tort of fraud.[119]

c. Breach of a Promise of Future Act

Since the elements of common law fraud must be pled specifically and with certainty, a cause of action for fraud cannot be predicated solely on the failure to perform a contractual promise in the future.[120] However, there is an exception to the preceding rule that holds that if the misrepresenting defendant had no specific intention to perform the contractual promise at the time the promise was made, a cause of action for fraud will lie.[121] The difficulty in obtaining proof is obvious. The burden of demonstrating that the defendant's representations of performance were purposefully false when the contract was entered into is so onerous as to render this exception almost academic.[122] The exception is further weakened if the evidence indicates that the representations of future performance were made with a pur-

---

118. *See, e.g.*, American Int'l Land Corp. v. Hanna, 323 So. 2d 567, 570 (Fla. 1975); Rosen v. Marlin, 486 So. 2d 623, 626, (Fla. Dist. Ct. App. 1986); Jewelcor Jewelers and Distrib., Inc. v. Southern Ornamentals, Inc., 499 So. 2d 850, 852 (Fla. Dist. Ct. App. 1986), *review denied*, 509 So. 2d 1118 (Fla. 1987). *But see* Life Ins. Co. of Va. v. Murray Inv. Co., 646 F.2d 224, 229 (5th Cir. 1981) (applying Texas law), *cert. denied*, 454 U.S. 1163 (1982).

119. *See*, American Int'l Land Corp. v. Hanna, 323 So. 2d 567, 569-70 (Fla. 1975); *see also* Charter Air Center, Inc. v. Miller, 348 So. 2d 614, 616 (Fla. Dist Ct. App. 1977).

120. *See, e.g.*, John Brown Automation, Inc. v. Nobles, 537 So. 2d 614, 618 (Fla. Dist. Ct. App. 1988); Lake Placid Holding Co. v. Paparone, 508 So. 2d 372, 377 (Fla. Dist. Ct. App. 1987), *review denied*, 515 So. 2d 230 (Fla. 1987); Lone Star Steel Co. v. Scott, 759 S.W.2d 145, 155-56 (Tex. App.—Texarkana 1988, writ denied) (no evidence that at time promise made promisor intended not to perform).

121. New Process Steel Corp., Inc. v. Steel Corp. of Tex., Inc., 703 S.W.2d 209, 214 (Tex. App.—Houston 1985, writ ref'd n.r.e.) (lack of present intent to perform inferred from party's denial of making agreement and party's failure to perform); *see also* John Brown Automation, Inc. v. Nobles, 537 So. 2d 614, 618 (Fla. Dist. Ct. App. 1988); Lake Placid Holding Co. v. Paparone, 508 So. 2d 372, 377 (Fla. Dist. Ct. App. 1987); Sebert, *supra* note 64, at 1607 (theory and cause of action for promissory fraud supported both by many authorities and case law from wide range of jurisdictions).

122. *See Lake Placid Holding Co.*, 508 So. 2d at 377 (underscoring lack of evidence that defendant had formed intention to deprive plaintiff of commission at moment commission agreement executed); *see also* Jim Walter Homes, Inc. v. Samuel, 701 S.W.2d 351, 353 (Tex. App.—Beaumont 1986, no writ) (no evidence to show lack of intent to complete home when contract made). *But see* Chase Chem. Corp. v. Datapoint Corp., 774 S.W.2d 359, 367 (Tex. App.—Dallas 1989, reh'g denied). Fraudulent intent found if it is determined that: (1) there

pose to partially perform some part of the promise. If this is the case, the cause of action for fraud will not lie.[123]

d. Fraud Independent of Breach

If the victim alleges that the misrepresenting defendant fraudulently breached the contract, the full scope of tort damages for fraud may be available. The burden of proof here is, of course, less difficult to overcome than in a fraudulent inducement case.

While the proof may be easier, however, the fraudulent breach avenue is blocked by another obstacle, the requirement that the tortious, fraudulent conduct occur independently of the conduct which constitutes the breach of contract.[124] If the conduct is not independent, but rather part of the breach itself,[125] or an essential ingredient,[126] or illustrates how the contract was breached,[127] the tort of fraud as the punitive damage vehicle will not lie no matter how malicious and oppressive the breach.[128]

e. Fraud Plus

If the independent tort of fraud is artfully pled and proved in a

---

was a promise, (2) the promisor denies making the promise and (3) the promisor fails to perform. *Id.*

123. *See* Canada Dry Corp. v. Nehi Beverage Co., Inc., 723 F.2d 512, 525 (7th Cir. 1983) (applying Ind. law) (no clear basis for awarding punitive damages even if party did not intend wholeheartedly to fulfill contract).

124. *See, e.g.*, Taylor v. Kenco Chem. & Mfg. Corp., 465 So. 2d 581, 590 (Fla. Dist. Ct. App. 1985); C & C Partners v. Sun Exploration & Prod. Co., 783 S.W.2d 707, 719 (Tex. App.—Dallas 1989, no writ) (no cause of action where some proof of fraud but no evidence of injury proximately resulting from alleged fraud apart from damages suffered as result of breach of contract). *But see* Sebert, *supra* note 64, at 1602. "Somewhat more interesting, because they represent examples of punitive damages assessed for conduct that is clearly breach of contract rather than misbehavior in the bargaining process, are those cases in which punitive damages are awarded for misrepresentation made during course of contract performance." *Id.*

125. *Cf. Lake Placid Holding Co.*, 508 So. 2d at 377 (fraud and breach of fiduciary duty "arose out of same conduct which constituted breach of contract"); *C & C Partners*, 783 S.W.2d at 719-20; John Brown Automation Inc. v. Nobles, 537 So. 2d 614, 618 (Fla. Dist. Ct. App. 1988) (negligent representation associated with performance of contract).

126. *Cf. Lake Placid Holding Co.*, 508 So. 2d at 377; *C & C Partners*, 783 S.W.2d at 719-20; *John Brown Automation, Inc.*, 537 So. 2d at 618.

127. *See* Marcoin, Inc. v. McDaniel, 320 S.E.2d 892, 899 (N.C. App. 1984).

128. *See* Lake Placid Holding Co. v. Paprone, 508 So. 2d 372, 376-77 (Fla. Dist. Ct. App. 1987) (regardless of "degree of enmity"). *But see* Life Ins. Co. of Va. v. Murray Inv. Co., 646 F.2d 224, 229 (5th Cir. 1981). "[F]acts which, if proven, would constitute common law fraud . . . were incorporated by reference within [breach of contract] claim for relief." *Id.*

breach of contract setting, the courts may still impose additional prerequisites for a punitive damage recovery. Some courts, for example, require "actual malice," that is, an evil motive influenced by hate, for punitive damage recovery in a fraud case arising out of contract.[129] This malice dichotomy has been severely criticized by one judge:

> Why should one who lies or cheats in connection with the performance of a contract escape liability because he is motivated by greed instead of hate for the other contracting party? Even in a *laissez-faire* free market system, commercial cheating should not be condoned. It seems to me that there is as much societal benefit in punishing and deterring cheating that arises out of a contract as there is in a pure tort fraud case. I perceive no societal advantage in encouraging such conduct by applying a greater obstacle to punitive damages in a contract-related fraud case than in a pure fraud case.[130]

Other courts hold that fraud "necessarily" encompasses sufficient malice for a punitive damage recovery, even in a contract setting.[131] Some courts impose a requirement that the fraudulent representations must be directed at the "public" in order for a party to recover punitive damages for fraud.[132] In these cases, a court must find public fraud in a private transaction, and since contract cases usually involve private wrongs, punitive damages are not usually available for fraud.[133]

---

129. *See, e.g.*, New Summit Assocs. Ltd. Partnership v. Nistle, 533 A.2d 1350, 1357 (Md. App. 1987); Miller Bldg. Supply v. Rosen, 485 A.2d 1023, 1027-28 (Md. App. 1985).

130. *Miller Bldg. Supply*, 485 A.2d at 1031 (Adkins, J. concurring).

131. *See, e.g.*, Mark Keshishian, & Sons, Inc. v. Washington Square, 414 A.2d 834, 842 (D.C. 1980); Sebert, *supra* note 64, at 1603 (bulk of more recent decisions reject additional malice requirements). "For example, [the courts have held] that the mere showing of an intentional and material misrepresentation is sufficient to justify punitive damages. The latter decisions seem clearly preferable since there is no economic or other justification for misrepresentation." *Id.*

132. *See, e.g.*, Hauser v. Harcourt Brace Jovanovich, Inc., 530 N.Y.S.2d 431 (N.Y. Ct. App. 1988) (plaintiff's claim that defendant's misconduct interfered with public's right to buy and read his book was not "totally devoid of merit"); J.G.S., Inc. v. Lifetime Cutlery Corp., 448 N.Y.S.2d 780, 781 (N.Y. App. Div. 1982); Hoffman v. Ryan, 422 N.Y.S.2d 288, 291-92 (N.Y. Civ. Ct. 1979) (punitive damages recoverable for consumer fraud by apartment referral agency).

133. *See, e.g.*, O'Dell v. New York Property Ins. Underwriting Assn., 535 N.Y.S.2d 777, 778 (N.Y. App. Div. 1988) (lengthy investigation of fire insurance claim not shown to have affected a public right); *J.G.S., Inc.*, 448 N.Y.S.2d at 781.

2. Intentional Infliction of Emotional Distress

The difficulty with employing the tort of infliction of emotional distress as a vehicle to the recovery of punitive damages in breach of contract setting is apparent when one encounters the obstacles to obtaining mental anguish damages for breach of contract. When recovery is sought for mental distress suffered as the result of a breach of contract, the courts routinely deny recovery.[134] It is generally acknowledged that pecuniary loss inflicted on a person by breach of contract may often cause that person to suffer disappointment and mental distress.[135] Yet, courts regularly cite the policy rationale that such damages are too remote to have been in the contemplation of the parties to the contract.[136] Courts, moreover, deny recovery on the ground of limiting contractual risk with or without the formal application of the *Hadley v. Baxendale* test.[137]

Traditional exceptions to the general rule have been continued in cases involving a breach of contract by a telegraph company,[138] innkeeper,[139] or common carrier,[140] and a breach of contract to marry,[141] a "modern" exception for the breach of a contract which is personal as opposed to pecuniary in nature.[142]

Additionally, recovery is allowed for mental anguish damages when the breach of contract is accompanied by the independent tort of intentional infliction of emotional distress.[143] The tort is extensively

---

134. *See, e.g.*, Floyd v. Video Barn, Inc., 538 So. 2d 1322, 1324-25 (Fla. Dist. Ct. App. 1989) (parents brought breach of contract action when photographer who agreed to photograph daughter's wedding appeared at wrong church and mistakenly videotaped different wedding); Crenshaw v. Sarasota County Public Hosp. Bd., 466 So. 2d 427, 429 (Fla. Dist. Ct. App. 1985); DOBBS, *supra* note 19, § 12.4, at 819; MCCORMICK, *supra* note 18, § 145, at 592.

135. *See* MCCORMICK, *supra* note 18, § 145, at 592-93.

136. *See, e.g.*, Brunson v. Ranks Army Store, 73 N.W.2d 803, 807 (Neb. 1955).

137. *See* Seidenbach's Inc. v. Williams, 361 P.2d 185, 187 (Okla. 1961); Hall v. Encyclopedia Britannica, 37 N.W.2d 702, 704 (Mich. 1949).

138. *See* Betts v. Western Union Tel. Co., 83 S.E. 164, 165 (N.C. 1914).

139. *See* Dold v. Outrigger Hotel, 501 P.2d 368, 372-73 (Haw. 1972).

140. *See* Southeastern Greyhound Corp. v. Graham, 26 S.E.2d 371, 373 (Ga. Ct. App. 1943).

141. *See* Allen v. Baker, 86 N.C. 105, 108 (1882).

142. *See, e.g.*, Carroll v. Roundtree, 237 S.E.2d 566, 572 (N.C. Ct. App. 1977), *aff'd on reh'g*, 243 S.E.2d 821 (N.C. Ct. App. 1978); Stewart v. Rudner, 84 N.W.2d 816, 823-24 (Mich. 1957); Lamm v. Singleton, 55 S.E.2d 810, 813 (N.C. 1949); DOBBS, *supra* note 19, § 12.4, at 819.

143. *See* Dominquez v. Equitable Life Assurance Soc'y of the United States, 438 So. 2d 58, 59 (Fla. Dist. Ct. App. 1983).

used as an attempted avenue to mental anguish awards in a contract setting.[144] The severe disadvantage to the tort of emotional distress, however, is that the courts usually demand proof of extreme and outrageous conduct.[145] This requirement emerges as the major problem in utilizing the tort as a means not only to a mental anguish award but also to a punitive damage recovery.

3. Conversion

While the tort of conversion may provide the basis for a punitive damage award in a contract setting,[146] the efficacy of the conversion approach is severely tested by two well-entrenched, common law conversion rules: one holds that a conversion action cannot be predicated on a mere breach of contract where the damages sought are merely for the breach of contract;[147] the other holds that a mere obligation to pay money generally may not be enforced by a conversion action.[148]

4. Intentional Interference with Contractual Relations

The tort of intentional interference with contractual relations proscribes the purposeful and improper obstruction of the rights to the benefits of a contractual relationship with a third party.[149] The grava-

144. *See, e.g.*, Fletcher v. Western Nat'l Life Ins. Co., 89 Cal. Rptr. 78, 90 (Cal Ct. App. 1970); World Ins. Co. v. Wright, 308 So. 2d 612 (Fla. Dist. Ct. App. 1975), *cert. denied*, 322 So. 2d 913 (Fla. 1975); Stanback v. Stanback, 254 S.E.2d 611, 621-22 (N.C. 1979).

145. *See, e.g.*, Metropolitan Life Ins. Co. v. McCarson, 467 So. 2d 277, 279 (Fla. 1985) (medical insurer withholding of benefits in reckless disregard for tragic consequences not "so outrageous in character, and so extreme in degree, as to go beyond all possible bounds of decency"); Quayside Assocs., Ltd. v. Triefler, 506 So. 2d 6, 7 (Fla. Dist. Ct. App. 1987); Henry Morrison Flagler Museum v. Lee, 268 So. 2d 434, 437 (Fla. Dist. Ct. App. 1972).

146. *See, e.g.*, Fraser v. Doubleday & Co., 587 F.Supp. 1284, 1288 (S.D.N.Y. 1984); National Mortgage Corp. of Am. v. Stephens, 723 S.W.2d 759, 762 (Tex. App.—El Paso 1987) *rev. in part on other grounds*, 735 S.W.2d 474 (Tex. 1987); Ward v. Shiro Corp., 579 S.W.2d 257, 261-62 (Tex. Civ. App.—Dallas 1978, no writ); PROSSER & KEETON, *supra* note 1, § 2, at 11.

147. *See, e.g.*, Fraser v. Doubleday & Co., 587 F. Supp. 1284, 1288 (S.D.N.Y. 1984) (plaintiff must allege that acts are unlawful or wrongful as distinguished from acts that are mere violations of contractual rights in order to sustain conversion claim); Capital Bank v. G & J Invs. Corp., 468 So. 2d 534, 535-36 (Fla. Dist. Ct. App. 1985) (punitive damages not available for breach of contract claim arising out of dispute concerning depositor's stop payment order).

148. *See, e.g.*, Rosen v. Marlin, 486 So. 2d 623, 627 (Fla. Dist. Ct. App. 1986); Schimmel v. Merril Lynch, 464 So. 2d 602, 605 (Fla. Dist. Ct. App. 1985); National Mortgage Corp. of Am. v. Stephens, 723 S.W.2d 759, 762 (Tex. App.—El Paso 1987), *rev. in part on other grounds*, 735 S.W.2d 474 (Tex. 1987).

149. PROSSER & KEETON, *supra* note 1, § 129, at 978.

men of the wrong is the improper attempt to obstruct the pursuit of the economic benefits of a contractual or business relationship.[150] The tort, however, does not address the use of outrageous conduct to obstruct a contracting party's ability to obtain redress for the unfulfilled promise. Additional support is the axiom of common law that a contract party cannot tortiously interfere with its own contract, but rather merely breach it.[151]

D. *Distinguishing Tort from Contract - Theoretical Difficulties*

It is axiomatic that tortious conduct may arise in relation to contractual undertakings. A single act or course of conduct may constitute not only a breach of contract but also a separate and independent tort. The tort would arise out of the contractual setting when an act of inducing or breaching the contractual agreement gave rise to a separate and independent cause of action in tort.

Therefore, in order to plead a cause of action properly, the prudent attorney must be aware of the theoretical assumptions distinguishing tort from contract. Tort and contract, of course, have different sources of duty. In order to initially ascertain if a case sounds in contract or tort, one must pinpoint the origin of the duty alleged to have been contravened. Contract duties arise solely from the agreement of the contracting parties; whereas tort duties are imposed by law independent of any promises made.[152] A key question to be determined, therefore, "is whether the actions or omissions complained of constitute a violation of duties imposed by law, or of duties arising by virtue of the . . . agreement between the parties."[153] If the duty derives from contract, then the action for breach is perforce on the contract; whereas if the duty is implied by law, the action is in tort.[154]

Most importantly, however, is the fact that the manner of conduct

---

150. *Id.*

151. *Id.* at 990; *see also* Transcontinental Gas v. American Nat. Petroleum Co., 763 S.W.2d 809, 821 (Tex. App.—Texarkana 1988, no writ).

152. Atkinson v. Orkin Exterminating Co., Inc., 625 P.2d 505, 511 (Kan. Ct. App. 1981).

153. *Id.*; see also Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 617 (Tex. 1986).

154. Merrill Lynch v. Anderson, 501 So. 2d 635, 638 (Fla. Dist. Ct. App. 1986), *review denied*, 511 So. 2d 297 (Fla. 1986); *see also* Bowman v. Doherty, 686 P.2d 112, 122 (Kan. 1984). Failure to timely execute sell order, conspiracy to cover up error and foist resulting loss on client merely constituted breach of contract and not gross negligence since only duty to client arose out of contract. *Merrill Lynch*, 501 So. 2d at 638.

sufficient to breach a tort duty is distinguishable from that sufficient to breach a contract duty.

Nonfeasance is the total non-performance (or such an ineffective performance that it is the equivalent thereof) of a contract duty.[155] Non-performance, without justification, equals a simple breach of contract which entitles the aggrieved party to pursue relief without the need to prove that the breach was intentional, negligent, or otherwise wrongful.[156] Unlike nonfeasance, misfeasance is an attempted but flawed performance that *may* amount to a separate and independent tort if: 1) the affirmative conduct also breaches a tort duty which arose independently of the contract, and 2) if the intentional or negligent wrong or conduct created an unreasonable danger.[157] The essence of this important distinction, according to one commentator, is to be found by differentiating "existing entitlements" from "disappoint(ed) expectations:"

> If A in a bargain has promised a particular result and through negligent performance leaves B worse off than before, A may be liable to B in both Contract and Tort. Thus, in a construction contract, A's negligent and defective performance may both damage B's property and delay the promised completion date.
>
> In this case, B should have a remedy for both the damage to his existing property (Tort) and the delay (Contract) . . . . If A's negligent, defective performance both damages B's existing entitlements and disappoints expectations, B has a claim in both Tort and Contract.[158]

Many courts, by subscribing to an "entitlements" versus "expectations" rationale, have held that a negligent, defective performance

---

155. PROSSER & KEETON, *supra* note 1, § 92, at 659-662.

156. *Cf.* Travelers Ins. Co. v. King, 287 S.E.2d 381, 383 (Ga. Ct. App. 1981); McClellan v. Brown, 632 S.W.2d 406, 407 (Ark. 1982) (no tort liability for failure to act).

157. L. L. Cole & Son, Inc. v. Hickman, 665 S.W.2d 278, 281 (Ark. 1984); *see also* Autumn Grove Joint Venture v. Rachlin, 405 N.W.2d 759, 763 (Wis. Ct. App. 1987). "Wisconsin does not recognize an inherent cause of action in tort for every negligent performance of a contractual obligation. However, where a tort duty coincides with an obligation undertaken by contract, either a contract or a tort action will lie for its breach." *Id.* For a discussion of the nonfeasance versus misfeasance distinction see PROSSER & KEETON, *supra* note 1, § 92, at 658-62; Coleman, *supra* note 34, at 255-56; Speidel, *supra* note 2, at 168-69; Sullivan, *supra* note 40, at 237-38.

158. Speidel, *supra* note 2, at 183; *see also* Moorman Mfg. Co. v. National Tank Co., 435 N.E.2d 443, 455 (Ill. 1982) (Simon, J., concurring). Wrongful conduct which causes "physical harm. . .usually represents an invasion of a right existing apart from any conduct - a tort interest," however, if the promisor "simply fails to live up to its promise, if it does not accomplish what it was supposed to do, that is only an invasion of a contract-like interest." *Id.*

that results only in economic loss, that is, loss of the benefit of the bargain, will not be actionable in tort.[159] Consequently, finding the line of distinction between actions in tort and contract emerges as the critical task.[160] The determination of exactly what is nonfeasance and misfeasance in a particular case is often a most difficult task.[161] A significant criticism, therefore, of the independent tort exception concerns the contract versus tort distinction upon which it is based and the presumption of a precise dividing line that is very difficult to draw.[162] Even though the demarcation point between breach of contract and tort is often hazy, with many fact patterns being as readily appropriate for one category as another,[163] the independent tort approach assumes that the line between contract and tort can be drawn precisely.

E. *Distinguishing Tort from Contract - Practical Difficulties*

When a tortious injury arises in a breach of contract setting, a prudent attorney, aware of the shaky theoretical framework, will strive to draft the complaint in terms of tort, wherever possible, since tort damages are recoverable if an independent tort is present. If the plaintiff's attorney does not precisely formulate the tort count of the complaint and does not differentiate the tort from contract claims, the plaintiff runs the risk of having a court grasp at technical pleading requirements to deny any recovery,[164] to dismiss the case,[165] or to deny the punitive damages aspect of the case under the traditional

---

159. *See, e.g.*, AFM Corp. v. Southern Bell Tel. & Tel. Co., 515 So. 2d 180, 181-82 (Fla. 1987); Florida Power & Light Co. v. Westinghouse, 510 So. 2d 899, 899-900 (Fla. 1987); John Brown Automation, Inc. v. Nobles, 537 So. 2d 614, 617 (Fla. Dist. Ct. App. 1988); Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986); *accord* Edens v. Kole Constr. Co., 450 A.2d 1161, 1165 (Conn. 1982); Redarowicz v. Ohlendorf, 441 N.E.2d 324, 327 (Ill. 1982).

160. PROSSER & KEETON, *supra* note 1, § 92, at 664-67.

161. Hamner v. Mutual of Omaha Ins. Co., 270 So. 2d 87, 90 (Ala. App. 1972) (distinction between tort and contract actions often nebulous).

162. CORBIN, *supra* note 3, § 1077, at 440; Coleman, *supra* note 34, at 252-53; Sullivan, *supra* note 40, at 237.

163. *See. e.g.*, McClellan v. Brown, 632 S.W.2d 406, 407, 409 (Ark. 1982) (majority found failure of insurance agent to obtain policy even though paid was nonfeasance precluding tort action, however, dissenting minority found tort action.).

164. *See* Orkin Exterminating Co. v. Thrift, 269 S.E.2d 53, 54 (Ga. App. 1980).

165. Hamner v. Mutual of Omaha Ins. Co., 270 So. 2d 87, 91 (Ala. App. 1972) "[A] charge of breach of contract in the cancelling of the policy and an effort to turn such breach into a tort by charging that such cancellation was done negligently, willfully, and wantonly . . ." resulted in "a misjoinder of causes of action in these counts." *Id.*

principles of recovery.[166]

The tortious act must be pled separately and with specificity[167] so as to "prevent confusion and surprise to the defendant and preclude recovery of punitive damages for breach of contract where there is not tortious conduct."[168] If the facts indicate that either an action in contract or one in tort is possible, the plaintiff must specifically plead a cause of action in tort. Otherwise, the presumption ordinarily will be that the action is one in contract.[169]

The nebulous dividing line between tort and contract, however, gives the creative attorney the opportunity and challenge to structure the facts and pleadings in such a manner as to trigger the independent tort exception. As a practical concern, a plaintiff's attorney should plead additional conduct as the basis for the tort claim and avoid utilizing the same facts in the breach of contract claims as in the tort claim.[170] Moreover, in the independent tort claim, damages greater

---

166. *See, e.g.*, Greer v. Williams, 375 So. 2d 333, 334 (Fla. Dist Ct. App. 1979); B & J Holding Corp. v. Weiss, 353 So. 2d 141, 144 (Fla. Dist. Ct. App. 1977); Jewelcor Jewelers & Distrib., Inc. v. Southern Ornamentals, Inc., 499 So. 2d 850, 852 (Fla. Dist. Ct. App. 1986), *review denied*, 509 So. 2d 1118 (Fla. 1987); Triland Inv. Group v. Warren, 742 S.W.2d 18, 27-28 (Tex. App.—Dallas 1987), *rev'd on other grounds*, 779 S.W.2d 808 (Tex. 1989) (no punitive damages due to "improper election" of remedies); Nelson Cash Register v. Data Terminal Sys., Inc., 671 S.W.2d 594, 598 (Tex. App.—San Antonio 1984, writ denied) (no punitive damages since no issue on any "separate and distinct" tort submitted to jury).

167. *See, e.g.*, Greer v. Williams, 375 So. 2d 333, 334 (Fla. Dist. Ct. App. 1979); Texas Power & Light Co. v. Barnhill, 639 S.W.2d 331, 333-34 (Tex. App.-Texarkana 1982, writ ref'd n.r.e.); Kamlar Corp. v. Haley, 299 S.E.2d 514, 518 (Va. 1983).

168. Dailey v. Integon Gen. Ins. Corp., 291 S.E.2d 331, 333 (N.C. App. 1982), *review denied*, 336 S.E.2d 399 (N.C. 1985).

169. L.L. Cole & Sons, Inc. v. Hickman, 665 S.W.2d 278, 281 (Ark. 1984). The complainant sought punitive damages for tortious breach of contract. However, the record reflected confusion as to whether the plaintiff claimed damages for breach of contract, for tortious interference with contract, or for tortious misfeasance incidental to the breach of contract. *Id.*

170. Southern Bell Tel. & Tel. Co. v. Hanft, 436 So. 2d 40, 42 (Fla. 1983); *see also* Floyd v. Video Barn, Inc., 538 So. 2d 1322, 1324 (Fla. Dist. Ct. App. 1989) ("some additional conduct" required); Merrill Lynch v. Anderson, 501 So. 2d 635, 638 (Fla. Dist. Ct. App. 1986), *review denied*, 511 So. 2d 297 (Fla. 1986) (tortious conduct separate from the conduct which constituted a breach of parties' agreement must be established); Club Eden Roc. Inc. v. Fortune Cookie Restaurant, 490 So. 2d 210, 211 (Fla. Dist. Ct. App. 1986) (mere "rephrasing of the underlying contract dispute" insufficient to support independent tort); Taylor v. Kenco Chem. & Mfg. Corp., 465 So. 2d 581, 590 (Fla. Dist. Ct. App. 1985); Overseas Equip. v. Aceros Arquitectonicos, 374 So. 2d 537, 539 (Fla. Dist. Ct. App. 1979) (lacked facts on which to establish compensatory loss over that presented under breach of contract claim), *modified on other grounds*, 376 So. 2d 475 (Fla. Dist. Ct. App. 1979). *But see* Von Hagel v. Blue Cross & Blue Shield of N. C., 370 S.E.2d 695, 698 (N.C. App. 1988) (tort may constitute or accom-

than or different in kind from those sought in the contract claim should be specified.[171]

Technical procedural requirements also emerge as an impediment to punitive damage recovery at the instruction[172] and verdict[173] stages of a lawsuit. The practice of strictly construing and applying pleading and procedural requirements has been criticized for usurping the discretion of the trial court,[174] stressing form over substance,[175] placing ". . . an emphasis on artful pleading at the expense of the rights of the parties,"[176] and evidencing a ". . . judicial hesitation to acknowledge that there is a gray area between the metaphorical black and white of tort and contract law."[177] Consequently, some courts are more liberal in reviewing the pleadings and the proof in order to effectuate a punitive damage tort recovery.[178] Such an approach at least recognizes that the line between tort and contract is frequently thin and often nebulous.

---

pany breach of contract); *accord* Salvator v. Admiral Merchants Motor Freight, 509 N.E.2d 1349, 1361 (Ill. App. 1987), *pet. for leave to appeal denied*, 515 N.E.2d 126 (Ill. 1987) (plaintiff need only allege facts which would bring his claim for punitive damages within a recognized tort theory).

171. *Aceros Arquitectonicos*, 374 So. 2d at 539; *see also* Rosen v. Marlin, 486 So. 2d 623, 626 (Fla. Dist. Ct. app. 1986); Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617, 618 (Tex. 1986); C & C Partners v. Sun Exploration & Prod. Co., 783 S.W.2d 707, 719 (Tex. App.—Dallas 1989, no writ).

172. *See* Atkinson v. Orkin Exterminating Co., Inc., 625 P.2d 505, 510-14 (Kan. Ct. App. 1981) (court found negligence, breach of contract and evidence of wanton misconduct but no punitive damages because instructions expressly stated punitive damages recoverable for "wanton breach of contract").

173. Loom Treasures, Inc. v. Terry Minke Advertising Design, Inc. 635 S.W.2d 940, 942 (Tex. App.—Ft. Worth 1982, no writ) (plaintiff failed to request special issue on punitive damages).

174. McClellan v. Brown, 632 S.W.2d 406, 410 (Ark. 1982)(Hays, J., dissenting) (trial court should have discretionary power to treat pleadings and proof as sounding in tort rather than contract).

175. L. L. Cole & Son, Inc. v. Hickman, 665 S.W. 2d 278, 282 (Ark. 1984). "(O)n appeal the fine wording of the complaint should not concern us so much as whether under the appellee's pleading and proof punitive damages are recoverable under our law." *Id.*

176. Strausberg, *supra* note 40, at 297.

177. Bolla, *Contort: New Protector of Emotional Well-Being in Contract?*, 19 WAKE FOREST L. REV. 561, 563 (1983).

178. *See, e.g.*, Life Ins. Co. of Va. v. Murray Inv. Co., 646 F.2d 224, 229 (5th Cir. 1981); Hubbard Business Plaza v. Lincoln Liberty Life Ins. Co., 596 F. Supp. 344, 347 (D. Nev. 1984); Bazal v. Belford Trucking Co. Inc., 442 F. Supp. 1089, 1101 (S.D. Fla. 1977); All-West Design, Inc. v. Boozer, 228 Cal. Rptr. 736, 740-43 (Cal. Ct. App. 1986); Frazier v. Metro. Life Ins. Co., 214 Cal. Rptr. 883, 889 (Cal. Ct. App. 1985).

F. *Broad Definitions of the Independent Tort Exception*

Another difficulty emerges when the facts do not conclusively indicate whether the case sounds in tort or contract. If the independent tort exception is used rigidly, no degree of outrageous conduct in the contractual transaction will compel the court to award punitive damages if an independent tort is not present. In order to remedy such misconduct some courts are disposed to broadly define existing torts so as to provide a basis for punitive damage recovery in a contract setting. The term tort, of course, is conceded to be an "elastic" one which can be expansively employed to protect additional interests.[179]

Some courts, already predisposed to rectify and punish contractual wrongdoing, seize upon the independent tort exception as the chosen vehicle so quickly that no mention is made in the decision as to the precise independent tort. Rather, after stating the exception, and the presence of the tort, the discussion revolves about the severity of the conduct and the concomitant need for punitive damages.[180]

In order to reach conduct that does not precisely equate to an independent tort, other courts broadly define the independent tort exception to encompass contract breaches which "amount to" or are "analagous to" an independent tort.[181] This broad construction of the exception does not mean that the breach must actually be a separate and distinct tort, but rather means that the breach must "amount to" or be "analagous to" a tort.[182] That is, the conduct, while not fitting into a well-defined tort category, must be malicious, wanton, or oppressive so as to "amount to" a tort, and thus should be punished and deterred by punitive damages.[183] Where a precise tort cannot be

---

179. RESTATEMENT (SECOND) OF CONTRACTS § 355 comment b (1981); *see also* Sebert, *supra* note 64, at 1604. "The independent tort relationale provides a potentially fertile ground for greatly expanding the availability of punitive damages in actions that are fundamentally contract actions. It would not be surprising to see courts stretching to find an independent tort for the primary purpose of imposing punitive damages . . . . If one looks, one can find examples of . . . 'stretching' in decisions from other jurisdictions." *Id.*

180. *See, e.g.*, Bankers Life and Casualty Co. v. Crenshaw, 483 So. 2d 254, 269 (Miss. 1985), *aff'd*, 461 U.S. 71 (1988); Standard Life Ins. Co. v. Veal, 354 So. 2d 239, 248 (Miss. 1977); Sweet v. Grange Mut. Casualty Co., 364 N.E.2d 38, 41-42 (Ohio App. 1975).

181. United States v. Snepp, 595 F.2d 926, 936-37 (4th Cir. 1979); *see also* Srour v. Barnes, 670 F. Supp. 18, 21 (D.D.C. 1987) (breaches "merge with and assumes character" of tort); Dold v. Outrigger Hotel, 501 P.2d 368, 372 (Haw. 1972) (breach "intertwined" with tort); Bedell v. Inver Housing, Inc., 506 A.2d 202, 206-07 (D.C. 1986).

182. Kamlar v. Haley, 299 S.E.2d 514, 519 (Va. 1983)(Compton, J. dissenting).

183. *Id.* at 521.

found, the "amounting to [rule] . . . served the beneficial purpose of civilly punishing the wrongdoer in those exceptional cases based on a breach of contract where . . . the conduct of the breaching party was egregious."[184] Finally, courts may be predisposed to create new torts, for example, a tort of willful and wanton misconduct[185] or a tort of economic duress.[186]

G. *Expansive Definition of Fraud*

Courts, alternatively, may redefine established torts to make them more expansive. The most striking and frequent example occurs when courts define the tort of fraud so broadly so as to encompass a wide variety of wrongdoing.[187] By using the traditional independent tort exception as a base, some courts naturally expanded the recovery of punitive damages to contract actions involving fraudulent behavior. This expanded approach, often designated as a separate "exception" to the general rule,[188] resembles and encroaches on the traditional exception for a breach of contract that also comprises an independent tort. It is important to note, however, that an independent tort of fraud is not precisely required.[189] Technically, all that is necessary to trigger the "exception" is a satisfactory showing that the breach was accompanied by sufficiently fraudulent behavior.[190]

However, requirements for fraudulent breach of contract have been

---

184. *Id.* at 520.

185. *See, e.g.*, Morrow v. L.A. Goldschmidt Assoc., Inc., 468 N.E.2d 414, 418 (Ill. App. 1984), *modified*, 492 N.E.2d 181, 185 (Ill. 1986) (tort of willful and wanton misconduct limited to those situations where willful and wanton breach of contract caused physical injuries and damages); Sebert, *supra* note 64, at 1605 (some courts' opinions suggest that new "tort" cause of action created primarily for purpose of assessing punitive damages breach of contract cases).

186. *See, e.g.*, W.A. Wright, Inc. v. KLD Sylvan Pools, Inc., 569 F. Supp. 589, 592-93 (D.N.J. 1983); Adams v. Crater Well Drilling, Inc., 556 P.2d 679, 681-82 (Oreg. 1976); *cf.* Highland Const. Co. v. Union Pacific R.R. Co., 683 P.2d 1042, 1049 (Utah 1984) (insufficient evidence of economic duress).

187. *See, e.g.*, Texas Oil & Gas v. Hagen, 683 S.W.2d 24, 30 (Tex. Civ. App.—Texarkana 1984) (fraud "synonymous with bad faith and overreaching"), *rev'd on other grounds*, 760 S.W.2d 960 (Tex. 1988); Hill v. Pinelawn Memorial Park, 275 S.E.2d 838, 842 (N.C. App. 1981), *rev'd on other grounds*, 282 S.E.2d 779 (N.C. 1981); Oestreicher v. American Nat'l Stores Inc., 225 S.E.2d 797, 809 (N.C. 1976).

188. *See, e.g.*, Sebert, *supra* note 64, at 1601-2.

189. *See, e.g.*, F.D. Borkholder Co., Inc. v. Sandock, 413 N.E.2d 567, 570 (Ind. 1980) ("tort-like" conduct "mingles" in fraudulent breach); Jones v. Abriani, 350 N.E.2d 635, 648 (Ind. App. 1976) (actor with a fraudulent state of mind may be subject to liability for punitive damages, even if act was committed conclusively shown to be actionable fraud).

190. *See* Peterson v. Culver Educ. Found., 402 N.E.2d 448, 454-56 (Ind. Ct. App. 1980).

variously defined. Some jurisdictions allow punitive damages when the breach of contract is accomplished through "fraudulent conduct;"[191] others require a breach accompanied by a "fraudulent act."[192]

Even though the wide meaning to the term "fraud" allows judicial flexibility, it also poses problems for members of the bar. The problem with this fraud formulation revolves about the vagueness and complexity of the concept of fraud. The problem is particularly exacerbated since courts often define fraud expansively and since fraudulent conduct can accompany all contractual relations. A term so obscure can encompass a perplexing variety of divergent conduct[193] and may lead to unpredictable results since the level of proof required to show fraud may often be unclear.[194]

H. *Conclusion*

The expansive use of the independent tort exception epitomizes judicial uneasiness in the field of punitive damages for breach of contract. Quite possibly, the expansive use of the exception was the result of difficult cases where the facts of the breach did not add up precisely to a recognized tort but when the failure to award tort damages would shield, and might encourage, egregious wrongful conduct.

The judicial freedom derived from such an interpretation of the independent tort exception is not without a price, however. Perplexity in this field of law ensues, perhaps inevitably, since it is certainly troublesome to utilize uniformly a principle which many courts have continually construed in a most general and inclusive manner. Such a "catch-all" exception naturally yields inexplicable decisions.[195] Con-

---

191. *See, e.g.*, Cecil Crews Chevrolet-Oldsmobile, Inc. v. Williams, 394 So. 2d 912, 915 (Ala. 1981); Mark Keshishian & Sons, Inc. v. Washington Square, 414 A.2d 834, 842 (D.C. 1980); *cf.* Kiser v. Gilmore, 587 P.2d 911, 916-17 (Kan. Ct. App. 1978).

192. *See, e.g.*, Ateyeh v. Volkswagen of Florence, Inc., 341 S.E.2d 378, 379-80 (S.C. 1986); Scott v. Mid Carolina Homes, Inc. 359 S.E.2d 291, 294 (S.C. Ct. App. 1987); Floyd v. Country Squire Mobile Homes, Inc., 336 S.E.2d 502, 503-04 (S.C. Ct. App. 1985).

193. Coleman, *supra* note 34, at 261-62; Sullivan, *supra* note 40, at 230.

194. Wright v. Public Sav. Life Ins. Co., 204 S.E.2d 57, 59 (S.C. 1974) "Fraud assumes so many hues and forms, that courts are compelled to content themselves with comparatively few general rules for its discovery and defeat, and allow the facts and circumstances peculiar to each case to bear heavily upon the conscience and judgment of the court or jury in determining its presence or absence." *Id.*

195. *Compare* Standard Life Ins. Co. v. Veal, 354 So. 2d 239, 249 (Miss. 1977) (independent tort exception used but no indication of what independent tort committed) *with* Sands v. R.

sequently, the broad independent tort formulations have been criticized as vague and obscure concepts[196] which make predictions of results in future cases particularly difficult.[197] Such an expansive approach may arrive at morally defensible outcomes but is condemned as a deceptive practice which conveniently masks legally indefensible decisions.[198]

This "traditional" exception, therefore, becomes very important because its application can markedly add to the number of punitive damage awards. The occurrence of tort-type misconduct transverses the total compass of contracting, and independent torts, particularly fraud, frequently are defined quite broadly.

VI. BAD FAITH TORT - INTRODUCTION - INSURANCE CASES

A. *Introduction*

The conventional nonpartisan stance of contract law toward purposeful breach has been converted directly by the doctrine that every contract contains an implied covenant of good faith and fair dealing.[199]

Both the *Uniform Commercial Code* and the *Restatement (Second) of Contracts* impose a duty of good faith in the performance and enforcement of contracts. Section 205 of the *Restatement (Second) of Contracts* provides: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement."[200] Good faith, according to the *Restatement*, requires faithfulness to the agreed common purpose and protects the justified expectations of the parties, while the duty prohibits "bad faith" conduct which contra-

---

G. McKelvey Bldg. Co., 571 S.W.2d 726, 733 (Mo. Ct. App. 1978) (laborious attempt to find a precise independent tort).

196. Coleman, *supra* note 34, at 261; Sullivan, *supra* note 40, at 229-36.

197. Coleman, *supra* note 34, at 261; Sullivan, *supra* note 40, at 231.

198. Sullivan, *supra* note 40, at 235-36.

199. *See generally* CORBIN *supra* note 3, § 541. at 98; FARNSWORTH, *supra* note 27, § 3.26, at 187, § 7.17, at 526-27; S. WILLISTON, 5 WILLISTON ON CONTRACTS, § 670, at 159 (3d ed. & Supp. 1983); Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 369 (1980); Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code*, 67 IOWA L. REV. 1, 1 (1981); Summers, *The General Duty of Good Faith - Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 812 (1982); Summers, *Good Faith in General Contract Law and the Sales Provision of the Uniform Commercial Code*, 54 VA. L. REV. 195, 199 (1968).

200. RESTATEMENT (SECOND) OF CONTRACTS § 205, at 99 (1981).

venes community standards of fairness and reasonableness.[201] Section 1-203 of the *Uniform Commercial Code* (U.C.C.) provides that every contract or duty under the U.C.C. imposes an obligation of good faith in its performance or enforcement.[202] Section 1-201(19) defines good faith as "honesty in fact in the conduct or transaction concerned."[203] Section 2-103(1)(b) imposes on merchants a higher standard of "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[204] Although the U.C.C. permits the parties by agreement to determine the standards by which the obligation of good faith will be measured, the parties can neither exclude the obligation nor establish manifestly unreasonable standards.[205]

Under common law, the implied duty of good faith and fair dealing in every contract prohibits the contracting parties from destroying or impairing the other party's right to receive the benefits of the agreement.[206] A breach of the covenant occurs when a contract party engages in bad faith conduct that injures or frustrates the non-breaching party's right to receive the expected benefits of the bargain.[207]

Although the courts invariably recognize the implied covenant of good faith and fair dealing, the courts differ as to the character of the cause of action that arises from its breach. Courts initially employed the covenant as an extension of contract law, thereby treating the breach of the covenant as a breach of contract and awarding contract damages.[208] The weight of present authority still views the covenant as a contract term and recommends contract damages for its breach.[209] The *Restatement*, however, may support alternative remedies by stating that the "appropriate remedy for a breach of the duty of good faith . . . varies with the circumstances."[210]

---

201. *Id.* comment a, at 99-100.

202. U.C.C. § 1-203 (1988).

203. *Id.* § 1-201(19).

204. *Id.* § 2-103(1)(b).

205. *Id.* § 1-102(3).

206. *See, e.g.*, Rawlings v. Apodaca, 726 P.2d 565, 569-70 (Ariz. 1986); Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1040 (Cal. 1973); Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163, 167 (N.Y. 1933); CORBIN, *supra* note 3, § 541, at 97; FARNSWORTH, *supra* note 27, § 3.26, at 187, § 7.17, 526-27; WILLISTON, *supra* note 199, § 670, at 159.

207. *See Rawlings*, 726 P.2d at 569-70; CORBIN, *supra* note 3, § 541, at 97.

208. *See, e.g., Kirke La Shelle Co.*, 188 N.E. at 167-68; Burton, *supra* note 199, at 404 (list of cases).

209. *See* Fortune v. National Cash Register Co., 364 N.E.2d 1251, 1257 (Mass. 1977).

210. RESTATEMENT (SECOND) OF CONTRACTS § 205 comment a, at 100 (1981).

B. *Bad Faith Breach as a Tort*

The suppleness of the good faith standard has enabled the courts to shift away from the nonpartisan stance toward contract breach. The court's break with conventional contract compensation principles coheres with an inclination to impose a higher degree of damage in breach of contract cases and a desire to punish and deter certain misconduct attendant to the breach. These objectives—compensation, punishment, and deterrence—have prompted the tort action for breach of contract.

Consequently, the courts have held that breaching a contract in bad faith results in a tort action arising from the breach of the implied covenant of good faith and fair dealing. Moreover, the tort remedy is separate and distinct from the cause of action for breach of contract. A tort action, of course, lies for a breach of a duty imposed by law, whereas a contract action lies for a breach of duty imposed by the mutual consent of the parties.[211] Liability in tort for breach of the implied covenant is justified by the rationale that the duty of good faith and fair dealing does not rise from the terms of contract, but rather the duty is a responsibility superimposed on the contracting parties by law.[212] To determine whether a breach of contract is "tortious," therefore, one must examine the character of the duty breached. If the breach contravenes a purely contractual promise, the cause of action is contract; if the breach violates the superimposed duty of good faith, the action is tort.[213]

The classification of the breach of the implied covenant as tortious portends momentous consequences because tort damages are not strictly limited unlike common law contract damages.[214] Moreover, a tort cause of action can also serve as the predicate for punitive damages.

The implied covenant of good faith and fair dealing, therefore, has a significant impact on both contract and tort law. Today the courts continually address whether the remedy in tort for the bad faith

---

211. Rawlings v. Apodaca, 726 P.2d 565, 570 (Ariz. 1986); PROSSER & KEETON, *supra* note 1, § 92, at 655-56.

212. Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1037 (Cal. 1973); Chitsey v. National Lloyds Ins. Co., 738 S.W.2d 641, 643 n.1 (Tex. 1987); *Rawlings*, 726 P.2d at 570.

213. Bolla, *Contort: New Protector of Emotional Well-Being in Contract*, 19 WAKE FOREST L. REV. 561, 574-75 (1983).

214. PROSSER & KEETON, *supra* note 1, § 92, at 665-66.

breach of the covenant should be curtailed and limited to particular categories of contract cases, or extended to all breach of contract cases.

C. *Bad Faith Tort — Insurance Cases — Distinguishing First from Third Party Actions*

Before grappling with the tort of bad faith in the insurance context, one must first grasp the important distinction between first and third party actions. First party insurance is insurance that is purchased to protect against some casualty, such as life, accident, health, disability, fire, and homeowner's insurance; the insurance company agrees to indemnify the insured for harm sustained thereto. Consequently, a first party bad faith tort action is predicated on proof that an insurer intentionally embarked on a course of misconduct in order to avoid a proper obligation to the insured party. The gravamen of the cause of action emerges as the wrongful denial of coverage with the insurer and the insured the only two parties involved.[215]

Third party insurance refers to insurance that protects the insured against liability for injury caused by the insured to the person or property of a third person. Accordingly, a third party bad faith tort is predicated on proof that the insurer wrongfully failed to settle a third party claim within the policy limits, which results in a judgment awarded to the third party that exceeds the policy limits and causes the insured to be liable for the difference.[216]

D. *Bad Faith Tort - Third Party Insurance Cases*

That an insurer owes its insured an independent duty of good faith and fair dealing in the processing of policy settlements and in the defending of the insured is a long established principle that has been widely recognized in the context of third party claims.[217] Recovery

---

215. *Rawlings*, 726 P.2d at 575-76; *see also* Employers Equitable Life Ins. Co. v. Williams, 665 S.W.2d 873, 873-74 (Ark. 1984); K. Harvey & T. Wiseman, *First Party Bad Faith: Common Law Remedies and a Proposed Legislative Solution*, 72 KY. L. J. 141, 145 (1983-84); Sebert, *supra* note 64, at 1614-15.

216. *Employers Equitable Life Ins. Co.*, 665 S.W.2d at 874; *see also* Rawlings v. Apodaca, 726 P.2d 565, 570-71 (Ariz. 1986); Harvey & Wiseman, *supra* note 215, at 145-46; Sebert, *supra* note 64, at 1614-15.

217. *See, e.g.*, State Farm Mut. Auto Ins. Co. v. Smoot, 381 F.2d 331, 334-35 (5th Cir. 1967) (applying Georgia law), *cert. denied*, 391 U.S. 1005 (1967); Hart v. Republic Mut. Ins.

under a tort theory of bad faith in the first party context, however, is a more recent development.

California courts have pioneered the principle of the tort cause of action in third party insurance cases.[218] In the seminal case of *Comunale v. Traders and General Insurance Co.*,[219] the California Supreme Court confronted the problem of extra-contractual recovery in the third party context when an insurer refused to settle a claim within policy limits. The court held that in every insurance contract there is an implied covenant of good faith and fair dealing that obligates the insurer to refrain from any act which might impair the right of the insured to receive the benefits of the agreement.[220] The court also stated that the breach of this covenant could give rise to a cause of action, not only in contract but also in tort, and that the insured could elect to choose between recovery based in contract or tort damages.[221] This new concept was subsequently employed in *Crisci v. Security Ins. Co.*,[222] where the California Supreme Court expressly stated that the breach of the implied covenant in the third party context would support a remedy in tort and an award of tort damages.[223]

Presently, courts in most jurisdictions not only impose the implied-in-law duty of good faith and fair dealing in the field of third party insurance contracts, but also maintain that if bad faith on the part of the insurer is present, the insurer is subject to tort liability.[224] The

---

Co., 87 N.E.2d 347, 349 (Ohio 1979); Hilker v. Western Auto Ins. Co., 231 N.W. 257, 260-61 (Wis. 1930).

218. Some states are compelled to classify a bad faith breach as a tort because of state statutes permitting punitive damages only for the breach of obligations *not* arising out of contract. *See* CAL. CIV. CODE § 3294 (Deering Supp. 1990).

219. 328 P.2d 198 (Cal. 1958).

220. *Id.* at 200.

221. *Id.* at 201-02. The California Supreme Court, however, adhered to contract principles and denied any recovery for consequential damages beyond the excess judgment amount. *Id.*

222. 426 P.2d 173 (Cal. 1967).

223. *See id.* at 178-79 (plaintiff could recover damages for mental distress caused by insurance company's breach of good faith duty).

224. *See, e.g.*, Wolfe v. Continental Casualty Co., 647 F.2d 705, 709 (6th Cir.) (applying Ohio law), *cert. denied*, 454 U.S. 1053 (1981); Butchikas v. Travelers Indem. Co., 343 So. 2d 816, 817-18 (Fla. 1976); Farris v. United States Fidelity & Guar. Co., 587 P.2d 1015, 1018 (Oreg. 1978); Transamerica Title Ins. Co. v. San Benito Bank & Trust Co., 756 S.W.2d 772, 776 (Tex. App.—Corpus Christi 1988), *rev'd*, 773 S.W.2d 13 (Tex. 1989); Beck v. Farmer's Ins. Exch., 701 P.2d 795, 799 (Utah 1985). *But see* Guarantee Abstract & Title Co. v. Interstate Fire and Casualty Co., 652 P.2d 665, 668 (Kan. 1982) (tort of bad faith not recognized in Kansas).

rationale commonly asserted to justify the imposition of the bad faith tort in the third party arena is based on the fiduciary relationship existing between the insurer and insured.[225] Since the insurer is deemed to act as agent for the insured,[226] and since the insured is wholly dependent on the insurer to safeguard the insured's best interests,[227] the law imposes on the insurer-agent the fiduciary obligation to the insured concerning affairs within the scope of the agency.[228]

The application of the bad faith tort doctrine manifests itself most frequently in the specific third party context of an insurance company's failure to settle a claim within policy limits, and thereby exposing the insured to a judgment in excess of policy limits. The third party liability insurer's failure to accept a settlement offer within policy limits may constitute the bad faith breach.[229]

The standard of conduct of the insurer in its relationship to the insured is ordinarily represented by the rules of negligence law. In *Crisci*,[230] the California Supreme Court revealed the test to be "whether a prudent insurer without policy limits would have accepted the settlement offer."[231] According to the Supreme Court of Colorado, "[t]he question of whether an insurer has breached its duties of good faith and fair dealing with its insured is one of reasonableness under the circumstances. The relevant inquiry is whether the facts pleaded show the absence of any reasonable basis for denying the claim . . . ."[232] The Supreme Court of Montana has discerned further that while "the failure to settle may have been the result of either bad faith or negligence . . . , there is no clear distinction . . . between the two terms in such cases . . . . [T]here may be theoretical differences

---

225. *See, e.g.*, Farmers Group, Inc. v. Trimble, 691 P.2d 1138, 1142 (Colo. 1984) ("quasi-fiduciary"); *Butchikas*, 343 So. 2d at 817-18; Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783, 785 (Fla. 1980), *cert. denied*, 450 U.S. 922 (1981); Gibson v. Western Fire Ins. Co., 682 P.2d 725, 730 (Mont. 1984); *Beck*, 701 P.2d at 799; Sebert, *supra* note 64, at 1614.

226. *Beck*, 701 P.2d at 799.

227. *See id.* (in third party actions, insurer controls disposition of claims against insured; insured relinquishes right to negotiate on own behalf); *see also Transamerica Title Ins. Co.*, 756 S.W.2d at 775 (insurer has duty to protect interests of insured).

228. Beck v. Farmer's Ins. Exch., 701 P.2d 795, 800 (Utah 1985).

229. Crisci v. Security Ins. Co., 426 P.2d 173, 176-77 (Cal. 1967).

230. 426 P.2d 173 (Cal. 1967).

231. *Id.* at 176; *see also* Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783, 785 (Fla. 1980)(negligence relevant to question of insurer's good faith).

232. Farmers Group Inc. v. Trimble, 691 P.2d 1138, 1142 (Colo. 1984); *accord Boston Old Colony*, 386 So. 2d at 785 (settle within policy limits "where a reasonably prudent person would do so").

between bad faith and negligence, [but] the resulting neatness is highly illusory, and the two tests have tended to coalesce."[233]

In third party cases, therefore, the determination of bad faith has evolved into the application of a reasonable insurer test. Consequently, when an insurer contravenes the "reasonableness" standard, breaching the good faith duty and exposing the insured to an excess judgment, the insured may recover the "excess" and other potential tort damages including punitive damages.[234]

E. *Bad Faith Tort - First Party Insurance Cases*

1. Introduction

Extra-contractual liability based on a breach of the implied covenant of good faith and fair dealing in a first party insurance context materializes as a relatively recent phenomenon. California emerges as the first jurisdiction to extend the tort of bad faith from third party to first party cases in the momentous decision of *Gruenberg v. Aetna Insurance Company*.[235] In *Gruenberg*, the California Supreme Court ruled that an insurer's bad faith refusal to pay an insured's valid first party claim was a breach of the implied in law duty of good faith and fair dealing, thereby rendering the insurer responsible for the independent tort of bad faith,[236] and permitting the insured to recover not only compensatory but also punitive damages.[237] The California Supreme Court reasoned that, despite the inherent differences between first and third party claims, a breach of either covenant entails "merely two different aspects of the same duty."[238]

In the aftermath of *Gruenberg*, courts in other states encountered no difficulty in applying the same duty to both third and first party cases and, thus, also began to hold insurers liable in tort for the bad

233. Gibson v. Western Fire Ins. Co., 682 P.2d 725, 731 (Mont. 1984). The *Gibson* court, however, did enunciate a six factor test to determine whether an insurer acted with bad faith. *Id.* at 736-37.

234. *See id.* at 740 (reckless indifference by insurance company rendered punitive damages proper issue for jury); *see also* Henderson v. U.S.F. & G. Co., 620 F.2d 530, 536-37 (5th Cir. 1980) (punitive damages appropriate when insurance company intentionally hid existence of coverage), *cert. denied*, 449 U.S. 1034 (1980); Liu v. Interinsurance Exch., 252 Cal. Rptr. 767, 776 (Cal. Ct. App. 2d 1988); Butchikas v. Travelers Indem. Co., 343 So. 2d 816, 819 (Fla. 1976).

235. 510 P.2d 1032 (Cal. 1973).

236. *Id.* at 1038.

237. *Id.*

238. *Id.* at 1037.

faith denial of first party claims.[239]

While a majority of state courts that have confronted the problem recognize the first party cause of action, a significant minority still remain unwilling to extend the bad faith tort action to a first party case.[240] Those courts refusing to recognize the tort argue that, in a third party liability case, the insurer is acting in a fiduciary capacity as the insurer's agent, rendering the insured totally dependent on the insurer for protection from the claims of third parties; whereas in a first party case, the insurer has neither exclusive control nor the ability to subject the insured to excess liability.[241] The "first" parties, moreover, are in an adversarial relationship because the insured claims that he is owed money under the policy, while the insurer contends that he is not.[242]

2. Rationales

In developing the bad faith tort doctrine in the first party insurance realm, the courts have posited legitimate public policy concerns and special attributes of the insurance relationship that raise insurance contracts beyond the reach of general contract and damage law. The paramount public policy rationales, moreover, closely resemble those developed in the old public service cases.

The insurance industry (and thus the insurance contract) is re-

---

239. *See, e.g.*, Chavers v. National Security Fire & Casualty Co., 405 So. 2d 1, 6-7 (Ala. 1981); Noble v. National Am. Life Ins. Co., 624 P.2d 866, 867-68 (Ariz. 1981); Aetna Casualty & Surety Co. v. Broadway Arms Corp., 664 S.W.2d 463, 465 (Ark. 1984); Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315, 1319-20 (Ohio 1983); Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980); Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167-68 (Tex. 1987); Anderson v. Continental Ins. Co., 271 N.W.2d 368, 376-77 (Wis. 1978); Comment, *The Other Insurance Crisis: Bad Faith Refusal to Pay First Party Benefits*, 15 FLA. ST. L. REV. 521, 522 (1987) (list of jurisdictions).

240. *See, e.g.*, Baxter v. Royal Indem. Co., 317 So. 2d 725, 726 (Fla. 1975); Industrial Fire & Casualty Ins. Co. v. Romer, 432 So. 2d 66, 67 (Fla. Dist. Ct. App. 1983), *petition denied*, 441 So. 2d 633 (Fla. 1983); Heinson v. Porter, 772 P.2d 778, 785 (Kan. 1989); Federal Kemper Ins. Co. v. Hornback, 711 S.W.2d 844, 845 (Ky. 1986); English v. Fischer, 660 S.W.2d 521, 523 (Tex. 1983); Beck v. Farmer's Ins. Exch., 701 P.2d 795, 800 (Utah 1985); *see also* O'Neill v. Blue Cross, 366 N.W.2d 816, 818-19 (S.D. 1985); Comment, *supra* note 239, at 523.

241. *See* Federal Kemper Ins. Co. v. Hornback, 711 S.W.2d 844, 845 (Ky. 1986); Lawton v. Great S.W. Fire Ins. Co., 392 A.2d 576, 581 (N.H. 1981); *see also* Spencer v. Aetna Life and Casualty Ins. Co., 611 P.2d 149, 155 (Kan. 1980).

242. *Spencer*, 611 P.2d at 155-56; *see also* Sebert, *supra* note 64, at 1614.

garded by the courts as "quasi-public" in nature.[243] An entity to which the public interest attaches will have the duty of good faith and fair dealing imposed upon it for the purpose of "encouraging fair treatment of the public whom the enterprise serve."[244] The fact that the insurance industry is already subject to widespread government regulation gives credence to the quasi-public nature of the industry.[245] Moreover, insurance is regarded as a necessity; doing without insurance is regarded as an alternative with little viability for most people in today's society.[246]

The prospective insured, however, ordinarily is subject to unequal bargaining power. The courts construe the bargaining power between insurer and insured as "inherently unbalanced" when they enter into a contract.[247] Due to the uneven bargaining positions, insurance contracts are often condemned by the courts as contracts of adhesion.[248] The insurer has the luxury of "negotiating" a contract filled with fine print terms; the insured's only alternative is either complete adherence or outright rejection.[249] If the insured was in an inferior bargaining position and subject to a take-it-or-leave-it contract, then the possibility of extra-contractual recovery would "reflect . . . an attempt to restore balance in the contractual relationship."[250]

The insured manifests no commercial motive in seeking the insurance contract; the very purpose of the contract is to provide coverage against loss the insured would suffer had he not secured the policy.[251] Rather, the insured enters into the contract in order to obtain peace of

---

243. *See* Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141, 146 (Ca. 1979), *cert. denied*, 445 U.S. 912 (1980); *see also Noble*, 624 P.2d at 867.

244. *See* Fletcher v. Western Nat'l Life Ins. Co., 89 Cal. Rptr. 78, 95 (Cal. Ct. App. 1970).

245. *See* Phillips v. Aetna Life Ins. Co., 473 F. Supp. 984, 990 n.4 (D. Vt. 1979); *see also* First Sec. Bank v. Goddard, 593 P.2d 1040, 1047 (Mont. 1979); Sebert, *supra* note 64, at 1615.

246. *See Egan*, 620 P.2d at 146; *see also* Eckenrode v. Life of Am. Ins. Co., 470 F.2d 1, 5 (7th Cir. 1972).

247. *See* Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987); *see also* Rawlings v. Apodaca, 726 P.2d 565, 570 (Ariz. 1986); Noble v. National Am. Life Ins. Co., 624 P.2d 866, 867 (Ariz. 1981); Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141, 146 (Cal. 1979), *cert. denied*, 445 U. S. 912 (1980); Sebert, *supra* note 64, at 1615.

248. *See Egan*, 620 P.2d at 146; *see also* D'Ambrosio v. Pennsylvania Nat. Mut. Casualty Ins. Co., 396 A.2d 780, 785 (Pa. Super. Ct. 1978), *aff'd* 431 A.2d 966 (Pa. 1981).

249. *See Egan*, 620 P.2d at 144-45; *see also* Fletcher v. Western Nat'l Life Ins. Co., 89 Cal. Rptr. 78, 95 (Cal. Ct. App. 1970).

250. *Egan*, 620 P.2d at 146.

251. *Id.* at 145; *see also* Rawlings v. Apodaca, 726 P.2d 565, 571 (Ariz. 1986); Sebert, *supra* note 64, at 1615.

mind, emotional security, mental well-being, and protection against the financial and psychological stresses of calamity.[252] To condone insurer misconduct that impairs the insured's right to receive the benefit of the agreement is to vitiate the insured's justifiable interest that securing the agreement would afford shelter from misfortune.[253] Should the insurer in bad faith deny a valid claim, the insured suffers not only an immediate monetary loss, but also a deprivation of security and serenity, resulting in foreseeable mental anxiety.[254]

The insurer, moreover, is not only regarded as the supplier of a vital service, quasi-public in nature, but also as a fiduciary—a relationship where trust and confidence are accentuated.[255] Moreover, the insured is heavily dependent upon the insurer's skill and judgment. Since the insured is relying so heavily for emotional and financial security on the insurer, the strong possibility exists that the insured, experiencing financial difficulties and emotional strain at the time of making the claim, will be particularly vulnerable to the insurer's pressure in seeking settlement.[256] The dependency aspect inherent in the insurance association, and the potentially dire economic position of an emotionally distraught insured, leave the insured especially exposed to bad faith or outrageous conduct by the economically more powerful entity.[257]

The insurer, in addition, may be in the enviable position of being able to arbitrarily refuse to pay a claim yet suffer virtually no penalty. In the absence of extra-contractual damages, the most adverse consequence threatening the company may be that it will be compelled eventually to remit only what is owed in the first instance. In the interim, however, the company is allowed to hold the contested funds

---

252. *See* Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141, 145 (Ca. 1979), *cert. denied*, 445 U. S. 912 (1980); *see also* Eckenrode v. Life of Am. Ins. Co., 470 F.2d 1, 5 (7th Cir. 1972); Rawlings v. Apodaca, 726 P.2d 565, 571 (Ariz. 1986); Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 404, 89 Cal. Rptr. 78, 95 (Cal. Ct. App. 1970); Crisci v. Security Ins. Co., 426 P.2d 173, 179 (Cal. 1967); Sebert, *supra* note 64, at 1615.

253. *See Eckenrode*, 470 F.2d at 4; *see also Rawlings*, 726 P.2d at 570-71.

254. Stewart v. Rudner, 84 N.W.2d 816, 824 (Mich. 1957); *see also* Speidel, *supra* note 2, at 190-91.

255. Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987); *see also Egan*, 620 P.2d at 145.

256. *See Arnold*, 725 S.W.2d at 167; *see also* Noble v. National Am. Life Ins. Co., 624 P.2d 866, 868 (Ariz. 1981); Grand Sheet Metal Prod. Co. v. Protection Mut. Ins. Co., 375 A.2d 428, 429 (Conn. 1977).

257. *See* Eckenrode v. Life of Am. Ins. Co., 470 F.2d 1, 5 (7th Cir. 1972); *see also* Crisci v. Security Ins. Co., 426 P.2d 173, 179 (Cal. 1967).

at a very high rate of interest and, additionally, to take advantage of the statistical certainty that a significant number of claimants will be cajoled to surrender or compromise their claims. Without the threat of extra-contractual damages, the insured lacks a dominant force to counterbalance the insurer's denial to pay directly. A mere contract action for the amount of the policy may be wholly inadequate when the insured has been financially ruined by either personal or commercial loss.[258]

The presence of these factors has prompted the courts' conclusion that an insured should be permitted more than a contract action for the policy amount when the insurer acts in bad faith. The nature of the insurance industry and the insurance contract render such a contract suitable for the courts to recognize that its bad faith breach should be actionable in tort. The deliberate denial of a claim, moreover, violates the trust and confidence of a fiduciary relationship and destroys the proper expectation of the insured of a prompt and equitable settlement. The total pattern of behavior, therefore, emerges as tortious in nature, consisting of something more than a standard contract breach, and amounting to a wrong that society has an interest in punishing and deterring. This type of bad faith breach has emerged as the tort of bad faith breach.[259]

3. First Party Standard

Once the duty of good faith is found to exist independently of the terms of an insurance contract, a court must still confront the difficult task of determining exactly what conduct constitutes a tortious breach of this duty. The precise definition of a tortious bad faith breach differs from state to state. The state supreme courts that have struggled with the problem have failed to enumerate precisely the elements of the tort of bad faith breach.[260]

In examining the first party caselaw, one can deduce that a bad faith, tortious breach typically involves: 1) an insurance company's

---

258. *Arnold*, 725 S.W.2d at 167; *see also* Rawlings v. Apodaca, 726 P.2d 565, 575-76 (Ariz. 1986); Speidel, *supra* note 2, at 190-91; Sebert, *supra* note 64, at 1615-16.

259. *Rawlings*, 726 P.2d at 574-75; *see also* Speidel, *supra* note 2, at 190-91.

260. For a discussion of the bad faith tort doctrine and, in particular, for an examination of the state standards for a bad faith, first party, tortious breach see Sebert, *supra* note 64, at 1618; Kornblum, *The Current State of Bad Faith and Punitive Damage Litigation in the U.S.*, 23 TORT & INS. L.J. 812, 832-36 (1988); Harvey & Wiseman, *supra* note 215, at 156-57; Freeland & Freeland, *Bad Faith Litigation: A Practical Analysis*, 53 MISS. L.J. 237, 245-48 (1983).

intentional refusal to pay a claim due under a policy; 2) the absence of any legitimate, justifiable, or reasonable reason for the refusal or delay; and 3) the insurer's knowledge that the denial was lacking any legitimate, justifiable, or reasonable basis.[261] The gravamen of the cause of action appears to be the absence of a reasonable basis for the insurer's denial of the claim.[262]

The problem, of course, in employing an objective standard of reasonableness as the essential ingredient of the test, is that reasonableness is an element customarily associated with a negligence standard. The bad faith test, however, if correctly applied, denotes more than mere negligence by demanding an element of willfulness.[263] Once the insured establishes that no reasonable basis existed for the refusal to pay the claim, the insured then must demonstrate that the insurer intentionally denied the claim despite knowledge that it lacked an objective, reasonable basis to do so.[264]

Under a correct elucidation and application of the reasonable basis test not every intentional denial of an insurance claim will trigger bad faith tort liability.[265] Accordingly, the presence of a reason for the refusal that rises to the level of a "reasonable basis" emerges as the key issue. Cases from several jurisdictions suggest the types of dis-

---

261. *See, e.g.*, Pierce v. Combined Ins. Co. of Am., 531 So. 2d 654, 656 (Ala. 1988); National Security Fire and Casualty Co. v. Bowen, 417 So. 2d 179, 183 (Ala. 1982); Rawlings v. Apodaca 726 P.2d 565, 576 (Ariz. 1986); Noble v. National Am. Life Ins. Co., 624 P.2d 866, 868 (Ariz. 1981); Dolan v. Aid Ins. Co., 431 N.W.2d 790, 794 (Iowa 1988); Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167-68 (Tex. 1987); Anderson v. Continental Ins. Co., 271 N.W.2d 368, 376 (Wis. 1978); Sebert, *supra* note 64, at 1617-18.

262. *See, e.g.*, Pierce v. Combined Ins. Co. of Am., 531 So. 2d 654, 656 (Ala. 1988); Gulf Atl. Life Ins. Co. v. Barnes, 405 So. 2d 916, 924 (Ala. 1981) (adopting *Anderson* reasonable basis test); *Rawlings*, 726 P.2d at 576; Noble v. National Am. Life Ins. Co., 624 P.2d 866, 868 (Ariz. 1981); Dolan v. Aid Ins. Co., 431 N.W.2d 790, 794 (Iowa 1988); Nichols v. State Farm Mut. Auto. Ins. Co., 306 S.E.2d 616, 619 (S.C. 1983); *Arnold*, 725 S.W.2d at 167-68; Anderson v. Continental Ins. Co., 271 S.W.2d 368, 377 (Wis. 1978) (under circumstances of case insurer was reasonable); Gruenberg v. Aetna, 510 P.2d 1032, 1038 (Cal. 1973).

263. *See, e.g.*, Prudential Ins. Co. v. Coleman, 428 So. 2d 593, 598-99 (Ala. 1983); *Rawlings*, 726 P.2d at 576; Consolidated Am. Life Ins. Co. v. Touche, 410 So. 2d 1303, 1306 (Miss. 1982); *Noble*, 624 P.2d at 868; Harvey & Wiseman, *supra* note 215, at 156-57 (criticizing "reasonable basis" as vague standard commonly associated with negligence cause of action).

264. *See* Gulf Atl. Life Ins. Co. v. Barns, 405 So. 2d 916, 924 (Ala. 1981); *see also Rawlings*, 726 P.2d at 576; Heninger, *Bad Faith in Alabama: An Infant Tort in Intensive Care*, 34 ALA. L. REV. 563, 571-73 (1983).

265. Anderson v. Continental Ins. Co., 271 N.W.2d 368, 377 (Wisc. 1978); *see also Rawlings*, 726 P.2d at 573. "[A]n insurance company . . . may challenge claims which are fairly debatable and will be found liable only where it has intentionally denied . . . a claim without a reasonable basis." *Anderson*, 271 N.W.2d at 377.

putes that amount to a "reasonable basis" and preclude bad faith tort liability.[266] If a reasonable basis exists, moreover, bad faith tort liability is precluded even if the plaintiff-insured later prevails on the merits.[267]

4. Punitive Damages

Since recovery for a bad faith refusal to pay a first party claim is premised in tort, punitive damages surely should be recoverable. Although the *Gruenberg* court did not address the issue, the California Supreme Court, in *Silberg v. California Life Insurance Co.*,[268] subsequently held that punitive damages may be recovered in a first party

---

266. Disputes that prevent bad faith tort liability encompass: (1) *legal questions, see, e.g.*, Bard's Apparel Mfg., Inc. v. Bituminous Fire & Marine Ins. Co., 849 F.2d 245, 249 (6th Cir. 1988) (applying Tennessee law) (legitimate uncertainty as to whom check should be sent due to bankruptcy of insured); Gillespie v. Safeco Life Ins. Co., 533 So. 2d 521, 523 (Ala. 1988) (legal efficacy of cancellation); Schipes v. Hanover Ins. Co., 687 F. Supp. 601, 603-4 (M.D. Ga. 1988) (doubtful question of law and case of first impression); Palmer v. Farmers Ins. Exch., 761 P.2d 401, 409 (Mont. 1988) (issue of constitutionality); (2) *factual questions, see, e.g.*, Healy Tibbitts Constr. Co. v. Insurance Co. of N. Am., 679 F.2d 803, 804-5 (9th Cir. 1982) (applying California law) (question of coverage under policy); National Sav. Life Ins. Co. v. Dulton, 419 So. 2d 1357, 1362 (Ala. 1982) (dispute over facts essential to liability); Dolan v. Aid Ins. Co., 431 N.W.2d 790, 794 (Iowa 1988) (question as to whether residual disability existed when accident occurred); (3) *policy construction questions, see, e.g.*, ALFA Mut. Ins. Co. v. Smith, 540 So. 2d 691, 694-95 (Ala. 1988) (insured's name no longer appeared on policy as named insured); King v. Public Sav. Life Ins. Co., 290 S.E.2d 134, 135 (Ga. App. 1982) (contract clause susceptible to two reasonable constructions); Lake v. Farm Bureau Mutual Ins. Co., 624 S.W.2d 28, 29 (Mo. App. 1981) (question of policy lapse); Transcontinental Ins. Co. v. Washington Pub. Utils. Dists.' Util. Sys., 760 P.2d 337, 347 (Wash. 1988) (reasonable but incorrect interpretation); (4) *disputes concerning damages, see, e.g.*, Pierce v. Combined Ins. Co. of Am., 531 So. 2d 654, 656-57 (Ala. 1988) (question as to whether insured was compensated previously); Sexton v. Liberty Nat. Life Ins. Co., 405 So. 2d 18, 22 (Ala. 1981); Sigue Trucking, Inc. v. Insured Lloyds, 417 So. 2d 97, 100 (La. App. 1982); (5) *evidence of misconduct by the insured, see, e.g.*, Union Bankers Ins. Co. v. McMinn, 541 So. 2d 494, 497 (Ala. 1989) (wrong information in application); McLaughlin v. Alabama Farm Bureau Mut. Cas. Ins. Co., 437 So. 2d 86, 91 (Ala. 1983) (misrepresentation by insured on application); Federated Guar. Life Ins. Co. v. Wilkins, 435 So. 2d 10, 13 (Ala. 1983) (evidence of suicide); Lasma Corp. v. Monarch Ins. Co. of Ohio, 764 P.2d 1118, 1122-23 (Ariz. 1988); Meshell v. Insurance Co. of N. Am., 416 So. 2d 1383, 1389 (La. App. 1982) (lack of cooperation in supplying information); Trico Servs. Corp. v. Houston Gen. Ins. Co., 414 So. 2d 1313, 1322 (La. App. 1982) (exaggerated claim amount); Cook v. Detroit Auto Inter-Ins. Exch., 318 N.W. 2d 476, 478 (Mich. App. 1982) (question of statutory construction or constitutional law); English v. Home Ins. Co., 316 N.W.2d 463, 466 (Mich. App. 1982) (question concerning statute of limitations); Helmick v. Republic-Franklin Ins. Co., 529 N.E.2d 464, 468 (Ohio 1988) (evidence of arson).

267. Manis v. Hartford Fire Ins. Co., 681 P.2d 760, 762 (Okla. 1984); *see also* Dueringer v. General Am. Life Ins. Co., 853 F.2d 283, 287 (5th Cir. 1988).

268. 521 P.2d 1103, 1110 (Cal. 1974).

bad faith action. Decisions from other jurisdictions also disclose that punitive damages are permissible in a bad faith tort cause of action.[269]

Mere proof, however, that an insurer acted in bad faith toward its insured, by itself, should not support a punitive damage award. *Silberg* appears to have established the principle that to sustain an award of punitive damages, there must be proof beyond that required to show bad faith. There also must be evidence demonstrating that the insurer acted in a flagrant manner, with an intent to injure or vex the insured, or otherwise consciously disregard the insured's rights.[270] Other courts are in accord in ruling that mere proof of the elements of the bad faith tort alone is insufficient to justify an automatic award of punitive damages.[271]

Although the bad faith tort is appropriately regarded as a species of intentional tort, the bad faith tort initially comprehends only an intentional breach of the implied duty of good faith and fair dealing; the proper test for punitive damages then impels an examination of the character of the insurer's conduct in breaching the covenant of good faith and fair dealing.[272] The imperative analytical task, therefore, is to discern the distinction between the type of conduct that contravenes the implied duty of good faith and the type of conduct that additionally compels a punitive sanction.

Although the exact standard for determining whether an insurer's behavior breaches the good faith duty may differ, there is greater agreement among the courts as to the elements essential to sustain an award of punitive damages once the bad faith tort has been established. Even in those jurisdictions employing a reasonableness standard for bad faith, the punitive damage recovery requires that the

---

269. *See, e.g.*, Dempsey v. Auto Owners Ins. Co., 717 F.2d 556, 561-62 (11th Cir. 1983) (applying Alabama law); Gulf Atl. Life Ins. Co. v. Barnes, 405 So. 2d 916, 925 (Ala. 1981); Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co., 279 N.W.2d 638, 645 (N.D. 1979); Sentry Ins. v. Siurek, 748 S.W.2d 104, 106-07 (Tex. Civ. App.—Houston 1987, no writ); Lee v. Safemate Ins. Co., 737 S.W.2d 84, 87 (Tex. App.—El Paso 1987, writ dism'd); Anderson v. Continental Ins. Co., 271 N.W.2d 368, 377-79 (Wis. 1978).

270. Silberg v. California Life Ins. Co., 521 P.2d 1103, 1110 (Cal. 1974).

271. *See, e.g.*, Gulf Atl. Life Ins. Co. v. Barnes, 405 So. 2d 916, 925 (Ala. 1981); Rawlings v. Apodaca, 726 P.2d 565, 577-78 (Ariz. 1986); Farmers Group, Inc. 768 P.2d 1243, 1247 (Colo. Ct. App. 1988); Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co., 279 N.W.2d 638, 645 (N.D. 1979); Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980); Izaguirre v. Texas Employers' Ins. Assoc., 749 S.W.2d 550, 553 (Tex. App.—Corpus Christi 1988, writ denied).

272. Anderson v. Continental Ins. Co., 271 N.W. 2d 368, 368 (Wis. 1978); *see also Rawlings*, 726 P.2d at 577-78; Heninger, *supra* note 264, at 579-80.

insured show, in addition to misconduct constituting the breach of the duty of good faith, that the insurer's misbehavior rose to the height of fraud, malice, or oppression.[273]

As a result, in most jurisdictions, the level of misconduct compulsory to uphold a claim for punitive damages is, and should be, higher than that required for initial recovery under a bad faith claim.[274] Consequently, not every bad faith claim should produce a punitive recovery,[275] and relying on the advice of counsel may preclude a finding of punitive liability.[276]

The traditional justifications for the imposition of punitive damages in tort cases are to punish the wrongdoer and to deter others who may consider similar misbehavior.[277] Motivated by these traditional rationales, the courts impose punitive damages to punish insurers for their flagrant bad faith behavior and to deter other insurers from engaging in similar misconduct.[278]

Protecting the public from flagrant bad faith behavior is particularly acute in the insurance field. The necessity of insurance, the prev-

---

273. *See, e.g., Gulf Atl. Life Ins. Co.*, 405 So. 2d at 925; *Rawlings*, 726 P.2d at 578; Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141, 146 (Cal. 1979); Von Hagel v. Blue Cross & Blue Shield, 370 S.E.2d 695, 699 (N.C. App. 1988); McCorkle v. Great Atl. Ins. Co., 637 P.2d 583, 586 (Okla. 1981); Aetna Cas. and Sur. Co. v. Joseph, 769 S.W.2d 603, 607 (Tex. App.—Dallas 1989, no writ); Underwriter's Life Ins. Co. v. Cobb, 746 S.W.2d 810, 817 (Tex. App.—Corpus Christi 1989, no writ); *Anderson*, 271 N.W.2d at 379.

274. *See, e.g., Rawlings*, 726 P.2d at 577-78; Dailey v. Integon Gen. Ins. Corp., 331 S.E.2d 148, 154-55 (N.C. App. 1985); Timmons v. Royal Glove Ins. Co., 653 P.2d 907, 918-19 (Okla. 1982); McCorkle v. Great Atl. Ins. Co., 637 P.2d 583, 586-88 (Okla. 1981); Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 168 (Tex. 1987); Sebert, *supra* note 64, at 1617-18.

275. *See, e.g.*, Franceschi v. American Motorists Ins. Co., 852 F.2d 1217, 1220 (9th Cir. 1988); McMillan v. State Farm Fire and Cas. Co., 379 S.E.2d 88, 90 (N.C. App. 1989); Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315, 1322 (Ohio 1983); McLaughlin v. National Benefit Life Ins. Co., 772 P.2d 383, 389 (Okla. 1988); Izaguirre v. Texas Employers' Ins. Assoc., 749 S.W.2d 550, 553 (Tex. App.—Corpus Christi 1988, writ denied) (differentiating between bad faith tort damages and punitive damages); Anderson v. Continental Ins. Co., 271 N.W.2d 368. 379 (Wis. 1978).

276. *See, e.g.*, Henderson v. U.S.F. & G. Co., 695 F.2d 109, 113 (5th Cir. 1983); Cotton States Mut. Ins. Co. v. Trevethan, 390 So. 2d 724, 728 (Fla. Dist. Ct. App. 1980); Gordon v. Nationwide Mut. Ins. Co., 334 N.Y.S.2d 601, 605 (1972), *cert. denied*, 410 U.S. 431 (1972).

277. PROSSER & KEETON, *supra* note 1 § 2, at 9.

278. Employers Equitable Life Ins. Co. v. Williams, 665 S.W.2d 873, 874 (Ark. 1984). "Compensatory damages for bad faith in an occasional lawsuit would not deter the wrongdoing insurance company, or others, from seeking a wrongful gain by similarly victimizing hundreds of other policyholders. Punitive damages will have a deterrent effect in a case of this type." *Id.*

alent sale of policies, and the special relationship between the parties create an unreasonable risk of harm from outrageous practices that must be patrolled by the courts.[279] Without the potential of punitive damages, there may actually be an incentive for an insurer to use flagrant bad faith tactics to delay or deny the settlement of a claim.[280]

F. *Conclusion to Bad Faith Tort - Insurance Cases*

The California bad faith decisions and their progency developed two significant principles with regard to the tort of an insurer's bad faith denial of a claim: 1) an insurer's conduct generally is to be measured by the test of reasonableness in both first and third party cases; and 2) damages include punitive, as well as compensatory damages, when there is evidence of flagrant bad faith misconduct. These two principles, and the rationales therefor, provide the starting point for an examination of those decisions that extend the bad faith tort from the insurance to other fields.

G. *Insurance Statutes*

Several states have enacted statutory schemes regulating insurers that proscribe certain unfair, unreasonable, or bad faith insurance practices and that prescribe extra-contractual recovery for the insured.[281] Presently, some statutes include a provision providing for a potential punitive damage recovery.[282]

---

279. Heninger, *supra* note 264, at 579-80.

280. An example of a particularly disturbing case where flagrant bad faith tactics were used by an insurance company is Kewin v. Massachusetts Mut. Life Ins. Co., 295 N.W.2d 50 (Mich. 1980). *See* Comment, *supra* note 239, at 536-37; *see also* Lissmann v. Hartford Fire Ins. Co., 848 F.2d 50, 52-53 (4th Cir. 1988) (applying Virginia law) (no punitive damages even though insurer adopted a plan to lull insured into inaction until statute of limitations had expired); United Dept. Stores Co. No. 1 v. Continental Cas. Co., 534 N.E.2d 878, 882 (Ohio App. 1987) (no punitive damages even though insurer failed to respond to insured's repeated requests until limitations period had run).

281. *See, e.g.*, FLA. STAT. ANN. § 624.155(1) (West Supp. 1990); GA. CODE ANN. § 33-4-6 (1982); MO. ANN. STAT. § 375.420 (Vernon Supp. 1990); TENN. CODE ANN. § 56-7-105 (Vernon Supp. 1989); TEX. INS. CODE ANN. art. 21.21 (Vernon Supp. 1990). For a detailed analysis of the Florida statute see Berezin, *First Party Bad Faith - A Right of Action Now Legislatively Sanctioned in Florida*, THE FLA. B.J., Feb. 1989, p. 53; Comment, *supra* note 239, at 540-43.

282. *See, e.g.*, HAW. REV. STAT. §§ 431-455 (1985); TEX. INS. CODE ANN. art. 21.21, § 16(b) (Vernon Supp. 1990); *see also* Vail v. Texas Farm Bureau Mut. Ins. Co., 754 S.W.2d 129, 135-36 (Tex. 1988); FLA. STAT. ANN. § 624.155(4) (West Supp. 1990); Comment, *supra* note 239, at 542-43.

Courts in several states have construed these statutory provisions as evidence of legislative intent to establish an exclusive remedy for violation of the proscribed practices. Accordingly, these courts have held that the statutory remedy has preempted the field of insurance and thus has precluded a cause of action in tort against the insurer for bad faith breach of the insurance contract.[283]

Conversely, several courts have rejected the proposition that the states' statutory remedy preempts the bad faith tort.[284] Still other courts have held that the states' statutes, rather than precluding the action in tort, actually imply a common law cause of action in tort against an insurance company for bad faith conduct.[285]

VII. BAD FAITH TORT - NON-INSURANCE CASES

A. *Introduction*

Since the inception of the bad faith tort doctrine, the constant challenge confronting the courts has been to enunciate a policy to determine when the covenant of good faith and fair dealing, found in every contract, rises to a tort duty upon which a punitive damage recovery may be based in the event of a flagrant breach. Although valid arguments can be asserted for not extending the tort of bad faith breach of

283. *See, e.g.*, Kohlmeier v. Shelter Ins. Co., 525 N.E.2d 94, 104 (Ill. App. 1988). "From the standpoint of the insurance bad faith plaintiff . . . these statutes present a major risk. The risk is that the statute will be deemed an exclusive statement of the insured's rights, thus denying the potentially more lucrative common-law recovery of punitive damages. . . ." Seeman v. Liberty Mut. Ins. Co., 322 N.W.2d 35, 42 (Iowa 1982); Spencer v. Aetna Life & Casualty Ins. Co., 611 P.2d 149, 156-57 (Kan. 1980); Kewin v. Massachusetts Mut. Life Ins. Co., 295 N.W.2d 50, 56 (Mich. 1980); Haagenson v. National Farmers Union Prop. & Casualty Co., 277 N.W.2d 648, 652 (Minn. 1979); D'Ambrosio v. Pennsylvania Nat'l Mut. Casualty, 431 A.2d 780, 970 (Pa. 1978); Sebert, *supra* note 64, at 1626.

284. *See, e.g.*, State Farm Fire & Casualty Co. v. Nicholson, 777 P.2d 1152, 1157-58 (Alaska 1989); Employers Equitable Life Ins. Co. v. Williams, 665 S.W.2d 873, 874 (Ark. 1884); Roberts v. Western-Southern Life Ins. Co., 568 F. Supp. 536, 547-49 (N.D. Ill. 1983).

285. *See, e.g.*, First Sec. Bank v. Goddard, 593 P.2d 1040, 1048-49 (Mont. 1979); Christian v. American Home Assurance Co., 577 P.2d 899, 902-3 (Okla. 1977); Jenkins v. J.C. Penney Casualty Ins. Co., 280 S.E.2d 252, 259 (W. Va. 1981); *see also* Opperman v. Nationwide Mut. Fire Ins., 515 So. 2d 263, 266 (Fla. Dist. Ct. App. 1987), *review denied*, 523 So. 2d 478 (Fla. 1988) (remedy recognized in first party context but unclear as to whether statutory or common law remedy); *cf.* Jones v. Continental Ins. Co., 670 F. Supp. 937, 942 (S.D. Fla. 1987) (statutory cause of action recognized pursuant to Florida statute for first party claims). *But see* Lee v. Safemate Life Ins. Co., 737 S.W.2d 84, 86 (Tex. App.—El Paso 1987, writ dism'd) (art. 21.21 not provide individual with private cause of action against insurer).

all contracts, no policy can fairly and logically be formulated that limits its application solely to insurance contracts.

The courts, however, generally have limited the availability of a cause of action for the tort of bad faith breach to cases involving insurance contracts. By identifying certain central significant characteristics of insurance contracts that stem from the fiduciary relationship between the insurer and the insured, courts have managed to confine the tort mainly to the insurance context.

If the underlying predicate for recovery in bad faith insurance cases emerges as the presence of special factors involved in the relationship, the presence of these special factors in other types of contracts presumably should trigger the bad faith tort. An inequality of position between contractual parties is certainly not confined to the insurance context.[286] The rationale that the insurance industry is highly regulated applies equally well to other businesses, which are also regulated by government, for example, banks.[287] Contracts of adhesion are also not unique to the insurance industry; as today many, if not most, contracts with the general public are standardized.[288] Additionally, many contracts intertwine a profit motive and the desire for security.[289] Finally, the quasi-fiduciary nature of the relationship found in insurance contracts should not be dispositive of the issue of tort liability for a bad faith breach, since a relationship of trust and confidence can arise in any type of contract.

The rationale that allowed courts to extend the bad faith tort to insurance contracts, should, logically and fairly, allow courts to extend the doctrine to other contracts.[290] In fact some courts have extended the bad faith tort to encompass contracts other than insurance contracts.[291] And a few courts have even applied the tort to ordinary commercial contracts.[292] However, an examination of bad faith caselaw beyond the realm of insurance discloses the continuing diffi-

---

286. Freeland, *supra* note 260, at 239 (example of manufacturer-seller not honoring warranty made to consumer-buyer); *see also* Sebert, *supra* note 64, at 1650-52.

287. Blan, *The Tort of Bad Faith—A Defense Viewpoint*, 34 ALA. L. REV. 543, 557-58 (1983).

288. *Id.* at 558; *see also* Sebert, *supra* note 64 at 1650-52.

289. Farris v. U.S. Fidelity and Guar. Co., 587 P.2d 1015, 1021-22 (Oreg. 1978) (most contracts made for economic and financial peace of mind).

290. The Oregon Supreme Court in *Farris*, however, employed this logical extension rationale to *reject* the bad faith tort in an insurance context. *Id.*

291. *See infra* notes 312-315 and accompanying text.

292. *See infra* notes 345-358 and accompanying text.

culty courts confront in determining rational limiting principles for the doctrine.[293]

B. *Employment Cases*

The next stage in the development of the bad faith tort doctrine was the expansion of the tort to non-insurance contracts in the area of employment contracts.[294] The genesis of the doctrine in this field can be traced to the decision of *Monge v. Beebe Rubber Co.*[295] In *Monge*, the New Hampshire Supreme Court declared that "(i)n employment, whether at-will or for a definite term, the employer's interest in running his business as he sees fit must be balanced against the interest of the employee in maintaining his employment, and the public's interest in maintaining a proper balance between the two."[296] The Court then held that unjustified employer actions in terminating an employee "motivated by bad faith or malice or based on retaliation" were "not in the best interest of the economic system or the public good."[297]

Although the *Monge* court failed to denominate the implied covenant of good faith and fair dealing, the court's recognition of an extra-contractual duty not to terminate in bad faith fulfills the covenant's essential function.[298] There appears to be some confusion in the decision, however, as to whether the cause of action created therein sounded in tort or contract.[299]

---

293. The Utah Supreme Court rejected the tort theory of recovery in a first party insurance context in part due to the "analytical straining necessitated by the tort approach." Beck v. Farmers Inc. Exch., 701 P.2d 795, 800-01 (Utah 1985). Commentators, however, have attempted to establish boundaries for the tort. *See* Louderback & Jurika, *supra* note 2, at 221-23 (relevant factors are: contract of adhesion, security rather than profit motive, inequality of bargaining power, and the level of bad faith by the party with greater bargaining power); Diamond, *supra* note 2, at 448-49 (emphasis on encouraging efficient breach and discouraging inefficient breach; accordingly, tort applicable "only if it can be established that at the time of wilful breach the promisor could not have reasonably believed his gains would exceed the promisee's compensable pecuniary losses"); Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CALIF. L. REV. 1291, 1305 (1985).

294. For a review of cases and a discussion of the implied covenant in the employment context see Kornblau, *Common Law Remedies for Wrongfully Discharged Employees*, 9 INDUS. REL. L. J. 660, 691-96 (1987); Mallor, *Punitive Damages for Wrongful Discharge of At Will Employees*, 26 WM. AND MARY L. REV. 449, 456-59 (1985).

295. 316 A.2d 549, 552 (N.H. 1974) (press machine operator discharged for her refusal to date foreman).

296. *Id.* at 551.

297. *Id.*

298. Mallor, *supra* note 294, at 468.

299. Monge v. Beebe Rubber Co., 316 A.2d 549, 551 (N.H. 1974).

The breach of the implied covenant of good faith and fair dealing was articulated expressly by the Massachusetts Supreme Court in *Fortune v. National Cash Register Co.*[300] In *Fortune*, however, the duty of good faith was employed solely as the basis of a substantive right to contest the employment-at-will doctrine. Although the court based the breach of contract action on the contravention of the covenant,[301] the court demurred to theorize as to the presence of a tort cause of action.[302]

The California Supreme Court, in *Tameny v. Atlantic Richfield Co.*,[303] strongly suggested that tort remedies for breach of the implied covenant would be appropriate in an employment contract setting.[304] Shortly thereafter, the California Court of Appeals, in *Cleary v. American Airlines*,[305] expressly held that a wrongfully discharged employee could maintain an action in tort for breach of the implied covenant of good faith and fair dealing.[306] Consequently, the California courts had utilized the *tort* to attack a variety of bad faith conduct in the employment setting.[307]

Authority exists in other jurisdictions to the effect that a breach of the duty to deal fairly and in good faith in an employment setting is a tort.[308] However, it must be noted that even in those jurisdictions not

---

300. 364 N.E.2d 1251, 1257-58 (Mass. 1977) (employer discharged salesman to decrease commissions he otherwise would have received for a large sale).

301. *Id.*

302. *Id.* at 1255, n.7; Mallor, *supra* note 294, at 469.

303. 610 P.2d 1330, 1336-37 (Cal. 1980) (discharge after 15 years of service for refusing to participate in an illegal scheme to fix prices).

304. *Id.* at 1337 n.12.

305. 168 Cal. Rptr. 722 (Cal. Ct. App. 1980).

306. *See id.* at 728 (arbitrary discharge of employee after 18 years of satisfactory service despite existing procedures for dismissal).

307. *See, e.g.*, Rulon-Miller v. IBM Corp., 208 Cal. Rptr. 524, 532-33 (Cal. Ct. App. 1984) (plaintiff alleged that IBM committed tortious breach of covenant by terminating her employment because of her romantic relationship with an employee of a competitor); Wallis v. Kroehler Mfg. Co., 207 Cal. Rptr. 123, 128-29 (Cal. Ct. App. 1984) (employer stopped payment without cause under an agreement not to compete).

308. *See, e.g.*, Carter v. Catamore Co., 571 F. Supp. 94, 97 (N.D. Ill. 1983); Gates v. Life of Montana Ins. Co., 638 P.2d 1063, 1066-67 (Mont. 1983) (employer obtained plaintiff's resignation by deceptive means and contrary to employer's personnel policies), *aff'd on reh'g*, 668 P.2d 213, 216 (Mont. 1983) (upholding compensatory award and reinstating punitive award); K-Mart Corp. v. Ponsock, 732 P.2d 1364, 1370 (Nev. 1987) (discharge with motive of defeating retirement benefits); Hall v. Farmers Ins. Exch., 713 P.2d 1027, 1031 (Okla. 1985); *see also* Nilsson v. Mapco, 764 P.2d 95, 100 (Idaho Ct. App. 1988) (discharge in bad faith directed personally at employee may give rise to independent ground of employer liability); *cf.* Southwest Forest Indus., Inc. v. Sutton, 868 F.2d 352, 354, 357 (10th Cir. 1989) (applying Kansas

all conduct attendant to a discharge triggers the bad faith tort.[309]

The adoption of the bad faith tort in the employment context perforce raises the question of the appropriateness of an award of punitive damages for outrageous breach of the covenant. Accordingly, authority exists permitting the recovery of punitive damages when the employer's misconduct not only violates the covenant but also contravenes the applicable standard for punitive culpability.[310]

Courts have offered similar rationales to support adoption of the bad faith tort in employment cases. The Montana Supreme Court, for example, reasoned that the duty created by the implied covenant in an employment contract is very similar to the duty to act in good faith in discharging contractual insurance obligations. Thus, since the duty is imposed by operation of the law, its breach should reap a remedy in

---

law) (punitive damages in retaliatory discharge action); Motsch v. Pine Roofing Co., Inc., 533 N.E.2d 1, 7 (Ill. App. 1988) (tort action for retaliatory refusal to recall employee after employee filed claim under Workers' Compensation Act); Boudar v. E.G. & G., Inc., 742 P.2d 491, 495 (N.M. 1987) (tort of retaliatory discharge plus bad faith conduct will support award of punitive damages). *But see* Jarvinen v. HCA Allied Clincal Laboratories, Inc., 552 So. 2d 241, 242 (Fla. Dist. Ct. App. 1989) (no common law tort for retaliatory discharge recognized in Florida).

309. *See, e.g.*, Luedtke v. Nabors Alaska Drilling, Inc., 768 P.2d 1123, 1130 (Alaska 1989) (drug test did not violate covenant due to public concern for employee safety); Shapiro v. Wells Fargo Realty Advisors, 199 Cal. Rptr. 613, 619 (Cal. Ct. App. 1985) (plaintiffs failed to allege facts sufficient to show that defendant acted in bad faith in order to trigger tort cause of action); Siles v. Travenol Laboratories, Inc., 433 N.E.2d 103, 106 (Mass. Ct. App. 1982), *rev. denied*, 440 N.E. 2d 1176 (1982) (employee's discharge for reasons of personal dislike or as result of careless or sloppy business practice does not constitute breach of covenant); Combs v. Gamer Shoe Co., 778 P.2d 855, 887 (Mont. 1989) (employer must give "fair and honest reason" for discharge; here, "financial difficulties [created] . . . economic necessity"); Barrett v. ASARCO, Inc., 763 P.2d 27, 32 (Mont. 1988) (employee dishonesty), *modified on other grounds*, 772 P.2d 315, 316 (Mont. 1989); Dare v. Montana Petroleum Mktg. Co., 687 P.2d 1015, 1020 (Mont. 1984) (tort liability available only if employer's representations created a reasonable belief employee had job security and would not be discharged without cause); Larson v. SYSCO Corp., 767 P.2d 557, 560 (Utah 1989) (poor performance by employee).

310. *See, e.g.*, Carter v. Catamore Co., 571 F. Supp. 94, 97 (N.D.Ill. 1983) (punitive damages allowed for discharge of employee in violation of duty of good faith if plaintiff establishes discharge willful and malicious); Gates v. Life of Montana Ins. Co., 668 P.2d 213, 214-15 (Mont. 1983) (employer's coercing resignation letter by duress and misrepresentation and refusing return thereof subjects employer to punitive damage liability); *see also* Caplan v. St. Joseph's Hosp., 233 Cal. Rptr. 901, 905 (Cal Ct. App. 1987) (retaliatory withholding of employee's back wages for disclosing illegal business practices affecting public was malicious, thus entitling employees to seek punitive damages for breach of covenant); Monge v. Superior Court, 222 Cal. Rptr. 64, 67-68 (Cal. Ct. App. 1986) (sufficient allegations of malice and oppression, in form of sexual discrimination and harassment, basis for award of punitive damages); Flanigan v. Prudential Fed. Sav. & Loan, 720 P.2d 257, 265 (Mont. 1986), *cert. dismissed*, 479 U.S. 980 (1986).

tort.[311] The court, in *Wallis v. Superior Court*,[312] stressed the insurance rationale by stating that a non-insurance contract could be tortiously breached if the contract contained characteristics similar to those in an insurance contract.[313] The *Wallis* court then enumerated five "similar characteristics" to an insurance contract that would make breach of the implied covenant tortious.[314] The *Wallis* court then concluded that the characteristics of an insurance contract are also present in most employer-employee contractual relationships.[315]

It is important to discern that the extra-contractual damages awarded in employment cases are prone to be punitive rather than compensatory. Apparently, in employment context, courts appear to be motivated by a preference to redress the abuses stemming from an inequality of bargaining power between employer and employee rather than by a requirement to supersede traditional contract damage rules in order to fully compensate employee-plaintiffs.[316] The punitive remedy provides a device to punish and deter outrageous abuses in the exercises of the employer's superior, discretionary authority.[317] Although most courts have not yet addressed the issue, several courts have expressly refused to recognize the existence of an action for tortious breach of the implied covenant in the employment context.[318]

---

311. Gates v. Life of Montana Ins. Co., 668 P.2d 213, 214-15 (Mont. 1983).

312. 207 Cal. Rptr. 123 (Cal. Ct. App. 1984).

313. *Id.* at 127.

314. *Id.* at 129 (inherently unequal bargaining position, non-profit contract motivation, inadequacy of ordinary damages, one party especially vulnerable, other party aware of vulnerability).

315. *Id.* at 127.

316. *See* Rulon-Miller v. IBM Corp., 208 Cal. Rptr. 524, 534-35 (Cal. Ct. App. 1984) (underscoring that employer's conduct was designed "to emphasize that she (employee) was powerless to do anything to assert her rights as an IBM employee . . . " and that ". . . such powerlessness is one of the most debilitating kinds of human oppression"); *see also* Cleary v. American Airlines Inc., 168 Cal. Rptr. 722, 725, 729 (Cal. Ct. App. 1980) (underscoring that at-will doctrine "easily leads to harsh results for employee" and that implied right to job security is necessary to ensure social stability).

317. Gates v. Life of Montana Ins. Co., 668 P.2d 213, 216 (Mont. 1983) (employer's conduct warranted "sting of punitive damages" to deter future employers from using similar tactics).

318. *See, e.g.*, Kelley v. Gill, 544 So. 2d 1162, 1164 (Fla. Dist. Ct. App. 1989) (neither tort of retaliatory discharge nor obligation of good faith recognized in Florida where wrongful dismissal claimed); Martin v. Federal Life Ins. Co., 440 N.E.2d 998, 1006 (Ill. App. Ct. 1982), *rev'd on other grounds*, 518 N.E.2d 306 (Ill. App. Ct. 1987); Burk v. K-Mart Corp., 770 P.2d 24, 26 (Okla. 1989); McClendon v. Ingersoll-Rand Co., 757 S.W.2d 816, 819-20 (Tex. App.—Houston 1988), *rev'd on other grounds*, 779 S.W.2d 69, 70 (Tex. 1989) (no view expressed as to tort duty of good faith); Lumpkin v. H.C. Communications, Inc., 755 S.W.2d 538, 540 (Tex.

Concerns that prompted these courts to reject the tort approach include a fear that the covenant could compel an employer to demonstrate just cause for every termination,[319] and a fear that the covenant could subject employers to unpredictable lawsuits in which sympathetic juries would be permitted to decide whether the employer's conduct comported with the good faith standard.[320] The inherent nebulousness and subjectivity of the standard,[321] the difficulty of applying the standard,[322] and the adequacy of existing principles of tort law[323] are also cited as additional reasons. Moreover, some courts comprehend that "[c]are must be taken to prevent the transmutation of every breach of contract into an independent tort action through the bootstrapping of the general contract principle of good faith and fair dealing."[324]

Recently, the California Supreme Court in a decision portentous to the development of the bad faith tort doctrine in the employment and commercial context, *Foley v. Interactive Data Corp.*,[325] held that "we are not convinced that a 'special relationship' analogous to that between insurer and insured should be deemed to exist in the *usual* employment relationship which would warrant recognition of a tort action for breach of the implied covenant."[326]

The *Foley* court reasoned that the employer-employee relationship is not "sufficiently similar"[327] to that of insurer and insured to war-

---

App.—Houston 1988, writ denied) (implied covenant not recognized in employer-employee relationship); Brockmeyer v. Dunn and Bradstreet, 335 N.W.2d 834, 842 (Wis. 1983); Chasson v. Community Action of Laramie County, Inc., 768 P.2d 572, 575 n.1 (Wyo. 1989).

319. *See* Daniel v. Magma Cooper Co., 620 P.2d 699, 703 (Ariz. Ct. App. 1980).

320. *See* Rozier v. St. Mary's Hosp., 441 N.E.2d 50, 53-55 (Ill. 1980).

321. *See* Martin v. Federal Life Ins. Co., 440 N.E.2d 998, 1006 (Ill. App. Ct. 1982) ("vague notion of fair dealing"); *see also* Parnar v. Americana Hotels, Inc., 652 P.2d 625, 629 (Haw. 1982); Brockmeyer v. Dunn and Bradstreet, 335 N.W.2d 834, 842 (Wis. 1983).

322. *See* Redgrave v. Boston Symphony Orchestra, 557 F. Supp. 230, 238 (D. Mass. 1983), *aff'd in part and vacated and remanded in part on other grounds*, 855 F.2d 888 (1st Cir. 1988); *see also Martin*, 440 N.E.2d at 1006.

323. *Martin*, 440 N.E. 2d at 1006; *see also Redgrave*, 557 F. Supp. at 236.

324. *Redgrave*, 557 F. Supp. at 237; *accord* McClendon v. Ingersoll-Rand Co., 757 S.W.2d 816, 819-20 (Tex. App.—Houston 1988), *rev'd on other grounds*, 779 S.W.2d 69, 70 (Tex. 1989) (fear of "putting every commercial contract under the umbrella" of insurance).

325. 254 Cal. Rptr. 211 (Cal. 1988). An executive employee of six years and nine months alleged he was given repeated oral assurances of job security, consistent promotions, salary increases and bonuses during the term of his employment and that these assurances contributed to his reasonable expectation that he would not be discharged except for good cause. *Id.*

326. *Id.* at 233 (emphasis added).

327. *Id.* at 234.

rant the tort remedy "in view of the countervailing concerns about economic policy and stability, the traditional separation of tort and contract law . . . and the numerous protections against improper terminations already afforded employees."[328] The "imprecision" of the bad faith standards thus far formulated[329] and the concomitant fear that "[v]irtually any firing (indeed any breach of a contract term in any context) could provide the basis for a pleading alleging the discharge was in bad faith . . ."[330] were also cited by the court as reasons for rejecting the tort remedy. The court further explained that the determination of liability and compensation in the employment termination context involves "significant policy judgments affecting social policies and commercial relationships" and thus "arguably is better suited for legislative decisionmaking."[331]

The *Foley* court noted, however, that an employee still may sue in *tort* for discharges based on breaches of public policy.[332] The *Foley* decision and conflicting state caselaw underscore the difficulty of defining the employer's duty of good faith in the employment setting. The bad faith doctrine can be utilized in a variety of ways: to preclude a wrongful at-will discharge, to equate to good cause for discharge, to equal a tort, or to be the tort foundation to support a punitive recovery.[333] Precisely defining the employer's duty of good

---

328. *Id.* at 235.

329. *Id.* at 238.

330. *Id.* at 239.

331. *See id.* at 235 n.31 (Court specifically referred to Montana "Wrongful Discharge from Employment Act"); *accord* McClendon v. Ingersoll-Rand Co., 757 S.W.2d 816, 820 (Tex. App.—Houston 1988), *rev'd on other grounds*, 779 S.W.2d 69, 70 (Tex. 1989) "(T)here is no want of legislation which restricts an employer's ability to dissolve an employment contract. It would be impertinent for us to arrogate to ourselves the right to pass additional laws under the guise of deciding cases." *Id.*

332. *Foley*, 254 Cal. Rptr. at 234 n.30; *see also* Wilkerson v. Wells Fargo Bank, 261 Cal. Rptr. 185, 191 (Cal. Ct. App. 1989) (evidence insufficient to raise issue that termination was racially motivated in violation of public policy).

333. *See* Clement v. Farmers Ins. Exch., 766 P.2d 768, 775-76 (Idaho 1988)(Huntley, J., dissenting) (good faith does not equal good cause for termination). Since Justice Huntley contends that lack of good faith is not a good cause for termination, the requirement that good faith be exercised in an at-will contract does *not* require good cause for discharge. Good cause, however, does tend to negate the existence of bad faith. Therefore, a termination without good cause does *not* equal bad faith but is merely a *factor* in determining bad faith. *Clement*, 766 P.2d at 77 (Huntley J. dissenting); *see also Foley*, 254 Cal. Rptr. at 238 n.39 (expressing judicial fear that if covenant equated to good cause, . . . "then all at-will contracts would be transmuted into contracts requiring good cause for termination"); Sebert, *supra* note 64, at 1634-35 (discussing various uses of covenant).

faith ultimately will depend upon a careful evaluation of the policy, and theoretical and practical considerations involved in the employment context.

The critical issue on which courts should focus in the employment arena is the employer's abuse of superior, discretionary power to the detriment of the employee, rather than the employer's failure to perform contract duties.[334] Since it is outrageous conduct, rather than the mere breach of contract, that should be punished and deterred, an appropriate tort-like sanction must be capable of precise elucidation so as to punish and deter only clear violations of societal norms.

As in bad faith insurance cases, punitive damages are permitted in employment cases provided the appropriate standard of malice or oppression is met. Since the precise definition of the terms remain unclear, punitive damages should be confined to cases where the employer's misconduct is deemed outrageous with regard to an important public or private interest.[335]

Even though the utilization of the bad faith tort theory in the employment context suffers from defects in clarity and predictability, the doctrine certainly does supply a highly flexible standard that can facilitate employee expectations and punish and deter employer misconduct.

C. *Banking Cases*

The insurance rationales supporting the bad faith tort have invited the courts to expand the tort remedy for breach of the implied covenant to other special relationships. Consequently, the tort of bad faith breach emerges not only in employment contracts but also in banking contracts.[336]

---

334. Kornblau, *supra* note 294, at 691, 695 (discussion of whether "public policy" exception or implied covenant is preferable vehicle to provide job security); Mallor, *supra* note 294, at 468.

335. Mallor, *supra* note 294, at 494.

336. *See* Commercial Cotton Co. v. United Cal. Bank, 209 Cal. Rptr. 551, 554 (Cal. Ct. App. 1985) ("stonewalling effort" preventing depositor from recovering monies entrusted to bank and subsequently lost due to bank's negligence found tortious breach of the covenant for which punitive damages recoverable); *see also* Tribby v. Northwestern Bank, 704 P.2d 409, 419 (Mont. 1985); First Nat'l Bank v. Twombluy, 689 P.2d 1226, 1230 (Mont. 1984) (bank committed tortious breach of implied covenant by: 1) unjustifiably accelerating maturity date of promissory note, 2) offsetting the amount owed against the funds remaining in plaintiffs' account, and 3) causing plaintiffs' checks to "bounce"); *cf.* Wagner v. Benson, 161 Cal. Rptr. 516, 521-22 (Cal. Ct. App. 1980) (court assumed but did not decide that bad faith cause of

In expanding the bad faith tort to banking contracts, courts ordinarily stress the similarities between the banking and insurance industries. For example, courts underscore the "quasi-fiduciary" nature of the banker-customer relationship, the customer's heavy dependence on and trust in the bank,[337] the substantial inequality of bargaining power,[338] and the fact that the customer seeks security in utilizing the bank's services.[339] The court also focuses on the high degree of statutory regulation of a vital public service,[340] and an objective of punishing and thereby deterring a bank's abuse of its superior bargaining position.[341]

Other courts, however, refuse to recognize the tort of bad faith breach in the banking context.[342] To support their stand they cite the primacy of article 4 of the U.C.C. in governing the relation between a bank and its customers,[343] and express the fear that to allow tort lia-

---

action may arise from borrower-lender relationship); Eglin Fed. Credit Union v. Curfman, 386 So. 2d 860, 862 (Fla. Dist. Ct. App. 1980) (conversion by credit union and lack of U.C.C. good faith supported punitive damage award); Ford, *Unconventional Theories of Lender Liability in Florida*, FLA. B.J., July-Aug. 1985, 46, 46-47 (fertile area for growth in lender liability law is in requirements of good faith dealing in U.C.C. and F.S.A.).

337. Commercial Cotton Co. v. United Cal. Bank, 209 Cal. Rptr. 551, 554 (Cal. Ct. App. 1985) (banker-depositor relationship "quasi-fiduciary" because of depositor's heavy dependence and trust in bank). *But see* Aaron Ferer & Sons v. Chase Manhattan Bank, 731 F.2d 112, 122-23 (2d Cir. 1984).

338. *See Commercial Cotton Co.*, 209 Cal. Rptr. at 554; *see also Tribby*, 704 P.2d at 419 (bank has superior bargaining power over its customer); First Nat'l Bank v. Twombluy, 689 P.2d 1226, 1230 (Mont. 1984) (because of bank's relationship to its debtor, finding of "reckless disregard" for debtor's rights would warrant punitive damages).

339. *Commercial Cotton Co.*, 209 Cal. Rptr. at 554.

340. *Id.*

341. *See* Tribby v. Northwestern Bank, 704 P.2d 409, 419 (Mont. 1985) (court remanded but indicated approval of award of punitive damages); *see also First Nat'l Bank*, 689 P.2d at 1230 (approval of punitive damages indicated even though remanded); *Commercial Cotton Co.*, 209 Cal. Rptr. at 554-55 (court affirmed punitive damage award, but reversed damage award for mental anguish).

342. *See* Reid v. Key Bank, 821 F.2d 9, 12-13, 16 (1st Cir. 1987) (applying Maine law) (bank exhibited bad faith by precipitously and without warning halting further advances on which it knew commercial borrower's business depended, but no punitive damages because bad faith tort not recognized and no other independent torts found); *see also* Brown-Marx Assocs., Ltd. v. Emigrant Sav. Bank, 527 F. Supp. 277, 283 (N.D. Ala. 1981), *aff'd*, 703 F.2d 1361 (11th Cir. 1983) (applying Alabama law) (tort of bad faith limited to insurance context); Carrico v. Delp, 490 N.E.2d 972, 977 (Ill. App. Ct. 1986), *cert. denied.*, 141 Ill. App. 3d 684 (1986); Rigby Corp. v. Boatmen's Bank and Trust Co., 713 S.W.2d 517, 536-37 (Mo. Ct. App. 1986); International Bank v. Morales, 736 S.W.2d 622, 624 (Tex. 1987) (breach of implied "covenant gives rise to cause of action sounding in contract"); Texas Nat'l Bank v. Karnes, 717 S.W.2d 901, 903 (Tex. 1986).

343. *Rigby Corp.*, 713 S.W.2d at 536. "The obligation of good faith appertains to the

bility for bad faith breach of the covenant might spawn punitive damage liability for every purposeful breach of contract.[344]

D. *Commercial Contract Cases*

Although courts readily accept the bad faith tort doctrine in the insurance context, and recognize its applicability to the employment and banking areas, courts confronted with the problem of the doctrine's applicability to general commercial contracts consistently disallow its availability.

The California Supreme Court, however, in *Seaman's Direct Buying Services, Inc. v. Standard Oil*,[345] intimated that tort remedies may be appropriate in commercial contract cases. The court professed to reserve the issue of the tortious character of the implied covenant's breach in a commercial contract setting;[346] yet the court's recognition of a tort of bad faith denial of contract engendered a theoretically limited but a practically expansive construction of a bad faith tort in the commercial context.[347] Pursuant to the new tort created by the *Seaman's* court, tort damages are allowed when a party fails to perform a contract, and then, "in bad faith and without probable case" denies that the contract ever existed at all.[348] While apparently acknowledging the tort of bad faith breach of contract, the court did not specify when the tort should extend to non-insurance cases. The court suggested that courts should extend tort liability to cases involving relationships with "similar characteristics" to those found in insurance contracts.[349] The court's language, however, indicated that deterrence of wrongful conduct was also a substantial factor in supporting the extension of tort damages to ordinary commercial con-

---

performance or enforcement of every contract duty under the Code. The remedy for breach of the obligation of good faith under the Code . . ., accordingly, is a contract, and not a tort remedy." *Id.*

344. *Carrico*, 490 N.E.2d at 977. "To sanction punitive damages on a bad faith theory would allow punitive damages whenever the breach was intentional. Thus, the exception would swallow up the general rule denying punitive damages for breach of contract." *Id.*

345. 686 P.2d 1158 (Cal. 1984).

346. *Id.* at 1167.

347. *Id.*; *see also* Sebert, *supra* note 64, at 1640-41 (criticizing *Seaman's* as an "unhappy compromise," reached by court trying to avoid implications of broad holding and "troubling because it creates another meaningless distinction in the law and diverts attention from the fundamental policy question").

348. Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 686 P.2d 1158, 1167 (Cal. 1984).

349. *Id.* at 1166.

tracts. The court stressed that taking the "stonewall" approach of saying "see you in court" without probable cause or belief in the existence of a defense outraces a mere breach of contract,[350] as "[i]t offends accepted notions of business ethics."[351]

Although the *Seaman's* court did not explicitly recognize the tortious breach of the implied covenant in commercial cases, the court did very little to deny its applicability. The court's failure, however, to differentiate its new tort from a tortious breach of the implied covenant, and its concomitant failure to precisely express its rationale, therefore, only exacerbated the confusion in this complex area of the law. Instead of circumventing the issue, the court should have accepted or rejected the tort of bad faith breach of the implied covenant in the commercial context, as the *Foley* court appeared to do in the employment context.

Decisions by the California courts after *Seaman's*, however, have refused to impose tort remedies unless the contractual setting revealed a "special relationship."[352] In other jurisdictions there is some limited authority supporting the extension of tort remedies to the breach of the implied covenant in a commercial setting.[353] Montana's extension of tort remedies for breach of the covenant is particularly significant because its supreme court underscored the moral justification for imposing a remedy in tort.[354]

Most jurisdictions, however, have refused to apply the bad faith tort to a commercial case.[355] Their denials were largely based on the

---

350. *Id.* at 1167.

351. *Id.*

352. *See, e.g.*, Landsbery v. Scrabble Crossword Game Players, Inc., 802 F.2d 1193, 1199 (9th Cir. 1986) (punitive damages awarded to author for expropriation of work by publisher); Okun v. Morton, 250 Cal. Rptr. 220, 233-34 (Cal. Ct. App. 1988) (sophisticated investor, represented by counsel, and motivated by profit, not in unequal bargaining position); Quigley v. Pet Inc., 208 Cal. Rptr. 394, 401-2 (Cal. Ct. App. 1984) (denying tort damages for breach of covenant because only ordinary commercial contract and "special relationship" lacking).

353. Dunfee v. Baskin-Robbins, Inc., 720 P.2d 1148, 1155 (Mont. 1986) (evidence sufficient to create jury question as to punitive damages when franchisor unreasonably denied franchisees' request for relocation); *see also* Nicholson v. United Pacific Ins. Co., 710 P.2d 1342, 1348-49 (Mont. 1985) (commercial lessor awarded punitive damages for lessee's breach of covenant); Ainsworth v. Combined Ins. Co. of Am., 763 P.2d 673, 676 n.1 (Nev. 1988) (*dicta*), *aff'd on rehearing*, 774 P.2d 1003 (Nev. 1989); Forty Exch. Co. v. Cohen, 479 N.Y.S.2d 628, 639-40 (N.Y. Civ. Ct. 1984) (recognizing existence of tort for bad faith breach of commercial lease but finding breach in this case privileged).

354. *Dunfee*, 720 P.2d at 1153 (focusing on franchisor's conduct even in absence of breach of express term in contract).

355. *See, e.g.*, Nifty Foods Corp. v. Great Atl. & Pac. Tea Co., 614 F.2d 832, 837-38 (2d

lack of the "special relationship" found in the insurance cases[356] and a fear of unacceptably blurring the line between tort and contract.[357] Nonetheless, several commentators have attempted to propose precise standards and enunciate clear rationales for the covenant's application.[358]

VIII. PUNITIVE DAMAGES FOR A MALICIOUS OR OPPRESSIVE BREACH OF CONTRACT

A. *Insurance Cases*

Several courts have taken a more direct approach to the problem of outrageous breaching conduct and have permitted punitive damages in insurance cases for a malicious or oppressive breach of contract separate from the independent tort or implied covenant of good faith doctrines.

The leading case in this field is *Vernon Fire and Casualty Insurance v. Sharp*,[359] where the Indiana Supreme Court held that punitive damages may be imposed in a contract case when "a serious wrong, tortious in nature, has been committed . . . [even though] the wrong does not conveniently fit the confines of an independent tort,"[360] if it appears that "the public interest will be served by the deterrent effect punitive damages will have upon future conduct of the wrongdoer and

---

Cir. 1980) (applying New York law); Kennedy Elec. Co., Inc. v. Moore-Handley, Inc., 437 So. 2d 76, 81 (Ala. 1983); Aluevich v. Harrah's, 660 P.2d 986, 987 (Nev. 1983), *cert. denied*, 465 U.S. 1006 (1984); Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 571 (Tex. 1981).

356. *See* Delta Rice Mill, Inc. v. General Foods Corp., 583 F. Supp. 564, 566 (E.D. Ark. 1984), *aff'd*, 763 F.2d 1001 (8th Cir. 1985) (relationship was commercial transaction where parties were bargaining at arms length, not relatonship imposing trust or confidence in one party because of its superior position); *see also Kennedy Elec. Co.*, 437 So. 2d at 81 (court expressly isolated special duty implied by law as distinguishing insurance contracts from other contracts); *Aluevich*, 660 P.2d at 987 (contract did not involve "a special element of reliance such as that found in partnership, insurance, and franchise agreements").

357. *See* Battista v. Lebanon Trotting Ass'n, 538 F.2d 111, 118 (6th Cir. 1976) (applying Ohio law) (to make extension would "allow parties" to convert contract actions into tort actions); *see also* Iron Mountain Sec. Storage Corp. v. American Specialty Foods, Inc., 457 F. Supp. 1158, 1165 (E.D. Pa. 1978) (if tort of bad faith applicable to any commercial contract, then most parties breaching contracts would be subject to tort liability since violation of most contracts involves breach of faith).

358. *See, e.g.*, Louderback & Jurika, *supra* note 2, at 227· Comment, *supra* note 288, at 1305 (among other elements, conduct "that obstructs the injured party's ability to receive the substitutionary value of the agreement"). The Comment's author is correct to focus on the obstruction of remedies as an essential analytical feature. *Id.* at 1302.

359. 349 N.E.2d 173 (Ind. 1976).

360. *Id.* at 180.

parties similarly situated."[361] The significance of the decision is that, since the breach was accompanied by intentional, and malicious or oppressive conduct, punitive damages will be awarded for the breach of a contract *per se*, without the necessity of proving an independent tort.[362]

Other courts have followed the lead of the Indiana court and have imposed punitive damages against insurance companies for their malicious or oppressive breaches of contract.[363] These courts have found that malice "denotes the intentional doing of a harmful act without just cause or excuse or an intentional act done in utter disregard of the consequences, . . . and does not necessarily mean actual malice or ill will . . . ."[364] Constructive or implied malice, therefore, "exists where the act or conduct is performed in such a reckless or wanton manner that the law will imply malice from the nature of the conduct and the actor's heedless disregard of the consequences and the rights of others."[365] Oppression is "[a]n act of cruelty, severity, unlawful exaction, or excessive use of authority."[366] The misconduct is ". . . similar to that usually found in the commission of crimes or torts done intentionally or with reckless indifference to the rights of the other party . . . or with an evil motive (e.g. to vex, harass, annoy, injure, or oppress) in conscious disregard of the rights of the injured person."[367]

One court, in reviewing the numerous legal descriptions characterizing flagrant misconduct in breaching a contract, noted:

---

361. *Id.* at 180-81.

362. *Id.* at 180-81, 184 (insurer, without reasonable explanation or offer to settle, refused, despite "so clear" policy provision, to pay insured's legitimate claim for business fire loss, even though insured repeatedly informed insurer of desperate need of proceeds to satisfy pressing financial matters); *see also* Travelers Indem. Co. v. Armstrong, 442 N.E.2d 349, 362-63 (Ind. 1982).

363. *See, e.g.*, Oliver B. Cannon & Son, Inc. v. Fidelity & Casualty Co. of N.Y., 484 F. Supp. 1375, 1388 (D. Del. 1980) (malice or wanton disregard); Casson v. Nationwide Ins. Co., 455 A.2d 361, 368 (Del. Super. Ct. 1982) (willful, wanton, or malicious conduct); Linscott v. Rainier Nat. Life Ins. Co., 606 P.2d 958, 965 (Idaho 1980) (element of outrage); Greenspan v. Commercial Ins. Co. of Newark, 395 N.Y.S.2d 519, 520-21 (N.Y. App. Div. 1977) (willful, malicious, or fraudulent breach and "public fraud" requirement not essential in insurance setting); Hayseeds, Inc. v. State Farm Fire & Casualty Co., 352 S.E.2d 73, 80-81 (W. Va. 1986) (malicious intent to injure or defraud).

364. Curtis v. Aetna Life Ins. Co., 560 P.2d 169, 172 (N.M. Ct. App. 1976), *cert. denied*, 615 P.2d 992 (N.M. 1980).

365. First Fed. Sav. & Loan Ass'n v. Mudgett, 397 N.E.2d 1002, 1008 (Ind. Ct. App. 1979).

366. Vernon Fire & Casualty Ins. Co. v. Sharp, 349 N.E.2d 173, 184 (Ind. 1976).

367. Linscott v. Rainier Nat. Life Ins. Co., 606 P.2d 958, 965 (Idaho 1980).

> at the core of these descriptions is a consideration of the quality of the actor's conduct that characterizes it as reprehensible. It embodies a consciousness of intended or probable effect calculated to unlawfully injure the personal safety or property rights of others. In some instances it may consist of the conscious desire to maximize rather than mitigate the amount of injury suffered.[368]

Courts have stated three major reasons for awarding punitive damages against insurance companies for their malicious or oppressive breaches of contract. First, an expansive recovery rule in an insurance setting serves a consumer protection function.[369] Courts are aware of the considerable economic power possessed by insurance companies and stress the gross disparity of bargaining power between the parties to the insurance contract.[370] Second, the fiduciary aspect of the insurance relationship is emphasized by some courts, which hold that the breach of the insurance contract "approximates" a tort.[371] Other courts, finally, see the prevention of such malicious conduct on the part of insurers as an overriding issue of public policy and, thus, feel that it is a useful and appropriate sanction to punish insurance companies for their malicious or oppressive conduct in the marketplace.[372]

Numerous situations arise when the breach of an insurance contract is an extreme departure from standards of reasonable conduct, and, when done with knowledge of the breach's probable effects, should be grounds for an award of punitive damages. Accordingly, courts have awarded punitive damages for the breach when the malice standard, or the functional equivalent thereof, has been met. Thus, intentionally denying a claim with knowledge that the policyholder's claim was proper is grounds for punitive damages,[373] as is intention-

---

368. *First Fed. Sav. & Loan Ass'n*, 397 N.E.2d at 1008.

369. *Linscott*, 606 P.2d at 963-64.

370. H. H. Henderson v. U.S.F. & G. Co., 620 F.2d 530, 536 (5th Cir. 1980) (applying Mississippi law), *cert. denied*, 449 U.S. 1034 (1980); *Linscott*, 606 P.2d at 965-66; *see also* Guy v. Commonwealth Life Ins. Co., 698 F. Supp. 1305, 1315 (N.D. Miss. 1988).

371. *See* Hamed v. General Accident Ins. Co., 842 F.2d 170, 172 (7th Cir. 1988) (applying Indiana law); *see also* Oliver B. Cannon & Son, Inc. v. Fidelity & Casualty Co. of N.Y., 484 F. Supp. 1375, 1387 (D. Del. 1980); Linscott v. Rainier Nat. Life Ins. Co., 606 P.2d 958, 965 (Idaho 1980) ("like a tort, many such breaches may be impossible to insure against").

372. *See Guy*, 698 F. Supp. at 1315; *see also Linscott*, 606 P.2d at 965; Frizzy Hairstylists, Inc. v. Eagle Star Ins. Co., 392 N.Y.S.2d 554, 557 (N.Y. Civ. Ct. 1977).

373. Hayseeds, Inc. v. State Farm Fire & Casualty Co., 352 S.E.2d 73, 80 (W. Va. 1986).

ally refusing to pay a claim without probable cause,[374] or without just cause.[375] Punitive damages are also proper when the reason for denying payment was contrary to an express term in the policy.[376] Further examples that may merit punitive damage claims are: 1) a delay in paying the claim, either due to a policy of paying the whole claim as opposed to separate parts thereof, despite the insured's dire financial straits,[377] 2) a policy of "delaying payment of just claims through barraging the policyholder with mindless paperwork,"[378] and 3) a policy of "low-balling" claims.[379]

The requisite malice standard is not met, and punitive damages denied, if the insurer's conduct was merely the result of negligence, mistake, lack of judgment, over-zealousness, incompetence, or bureaucratic confusion.[380] Accordingly, punitive damages are denied when the insurance company has a legitimate or arguable reason for not paying the claim,[381] when it honestly contests the amount of damage,[382] or when it contests coverage because the insured has failed to comply with a condition in the policy.[383]

---

374. *Oliver B. Cannon & Son, Inc.*, 484 F. Supp. at 1388.

375. *See* Guy v. Commonwealth Life Ins. Co., 698 F. Supp. 1305, 1313-14 (N.D. Miss. 1988); Ainsworth v. Combined Ins. Co. of Am., 763 P.2d 673, 676 (Nev. 1988); *see also* Curtis v. Aetna Life Ins. Co., 560 P.2d 169, 172 (N.M. Ct. App. 1976), *cert. denied*, 615 P.2d 992 (N.M. 1980) (without "just cause or excuse"); Greenspan v. Commercial Ins. Co., 395 N.Y.S.2d 519, 520 (N.Y. App. Div. 1977) (without "justification").

376. *Ainsworth*, 763 P.2d at 676; *see also* Hamed v. General Accident Ins. Co., 842 F.2d 170, 173-74 (7th Cir. 1988); Henderson v. U.S.F. & G. Co., 620 F.2d 530, 536 (5th Cir. 1980).

377. *Henderson*, 620 F.2d at 536; Travelers Indem. Co. v. Wetherbee, 368 So. 2d 829, 835 (Miss. 1979); *Ainsworth*, 763 P.2d at 676.

378. L.F. Pace & Sons, Inc. v. Travelers Indem. Co., 514 A.2d 766, 776-77 (Conn. App. Ct. 1986) (evidence of economic duress by defendant's manager), *certif. for appeal denied*, 516 A.2d 886 (Conn. 1986); *see also* Hayseeds Inc. v. State Farm Fire & Casualty Co., 352 S.E.2d 73, 81, n.2 (W. Va. 1986).

379. Frizzy Hairstylists, Inc. v. Eagle Star Ins. Co., 392 N.Y.S.2d 554, 557 (N.Y. Civ. Ct. 1977).

380. *See Hayseeds, Inc.*, 352 S.E.2d at 80-81 (some evidence that company began investigation with preconceived disposition to deny claim does not "rise to the level of malice" in settlement process); *see also* Travelers Indemnity Co. v. Armstrong, 442 N.E.2d 349, 362 (Ind. 1982); Kocse v. Liberty Mut. Ins. Co., 377 A.2d 1234, 1238 (N.J. Super Ct. Law Div. 1977) (lack of immediate investigation and taking incriminating statements from insured without informing of right to counsel not sufficiently "aggravated situation" for punitive damages); Olbrich v. Shelby Mut. Ins. Co., 469 N.E.2d 892, 895 (Ohio Ct. App. 1983) (extreme caution not malicious).

381. H.H. Henderson v. U.S.F. & G. Co., 620 F.2d 530, 536 (5th Cir. 1980); Standard Life Ins. Co. v. Veal, 354 So. 2d 239, 248 (Miss. 1978).

382. *Henderson*, 620 F.2d at 536.

383. Casson v. Nationwide Ins. Co., 455 A.2d 361, 368-69 (Del. Super. Ct. 1982).

Still other courts, utilizing the *Vernon* approach, treat the breaches considered malicious as similar in substance to those constituting a breach of the implied covenant of good faith and fair dealing in the insurance context.[384]

B. *Non-Insurance Cases*

The *Vernon* approach has also been utilized in breach of contract cases outside of the insurance context. Thus, some courts elect the most straightforward option, proclaiming unambiguously that punitive damages are permissible for any sufficiently malicious,[385] oppressive,[386] or the equivalent,[387] breach of contract.[388]

---

384. *See, e.g.*, Ainsworth v. Combined Ins. Co. of Am., 763 P.2d 673, 676 (Nev. 1988); Upthegrove Hardware, Inc. v. Pennsylvania Lumbermans Mut. Ins. Co., 431 N.W.2d 689, 695 (Wis. Ct. App. 1988) (insurer's investigators knowingly destroyed potentially exonerating evidence and lied about what they found gave rise to punitive damages for malicious, bad-faith handling of insured's fire claim).

385. *See* Robison v. Katz, 610 P.2d 201, 208 (N.M. App. 1980), *cert. denied*, 615 P.2d 992 (N.M. 1980) (malice is the "intentional doing of a wrongful act").

386. *See* Davis v. Gage, 682 P.2d 1282, 1286 (Idaho Ct. App. 1984). "This means there must be an 'intersection' of a bad act (an extreme deviation from reasonable standards of conduct) and a bad state of mind (for example, malice)." *Id.*

387. *See* Alaska N. Dev., Inc. v. Alyeska Pipeline Serv. Co., 666 P.2d 33, 41 (Alaska 1983) ("outrageous" means act committed with bad motives, malice or reckless indifference).

388. *See, e.g*, Unifoil Corp. v. Cheque Printers & Encoders Ltd., 622 F. Supp. 268, 272 (D.N.J. 1985) (sufficiently aggravated circumstances found where breach of implied warranty of merchantability may lead to punitive damages); L.F. Pace & Sons, Inc. v. Travelers Indem. Co, 514 A.2d 776, 776 (Conn. App. Ct. 1986), *certif. for appeal denied*, 516 A.2d 886 (Conn. 1986) (tort elements such as wanton or malicious injury or reckless indifference to interests of others gives tortious overtones to breach of contract action thereby justifying award of punitive damages); Boise Dodge, Inc. v. Clark, 453 P.2d 551, 556 (Idaho 1969) (if "fraud, malice, oppression or other sufficient reason" found, punitive damages may be assessed in contract actions); Young v. Scott, 700 P.2d 128, 133 (Idaho Ct. App. 1985) (breach of lease by landlord and delay in remodeling, leaving tenant with no income during usual busy period, sufficient misconduct for punitive damages); Art Hill Ford, Inc. v. Callender, 423 N.E.2d 601, 602 (Ind. 1981) (punitive damages recoverable "whenever the elements of fraud, gross negligence, or oppression mingle . . . and it can be shown that the public interest will be served by the deterrent effect of punitive damages"); Hibschman Pontiac, Inc. v. Batchelor, 362 N.E.2d 845, 847-48 (Ind. 1977) (automobile dealer's failure to make repairs supported finding of elements of tort—fraud, malice, gross negligence, or oppression—"mingled into" claim of breach of warranty to justify award of punitive damages); A.B.C. Home & Real Estate Inspection, Inc. v. Plummer, 500 N.E.2d 1257, 1263 (Ind. Ct. App. 1986) (standard of reckless disregard and contravention of public interest); Southern School Bldgs., Inc. v. Loew Elec., Inc., 407 N.E.2d 240, 253-54 (Ind. Ct. App. 1980) (malice); Peterson v. Culver Educ. Found., 402 N.E.2d 448, 453-54 (Ind. Ct. App. 1980) (elements of fraud, malice, gross negligence, or oppression combined with breach of contractual promises may support award of punitive damages); Robinson v. Katz, 610 P.2d 201, 208 (N.M. App. 1980), *cert. denied*, 615 P.2d 992 (N.M. 1980) (stan-

These courts stress the consumer protection function as the rationale for their award. Punitive damages are viewed as particularly appropriate in punishing and deterring flagrant misconduct in a

---

dard of malice or reckless or wanton conduct as breach of contract with material misrepresentations made in reckless disregard of the truth); Hilder v. St. Peter, 478 A.2d 202, 210 (Vt. 1984) (to recover punitive damages, "willful or wanton or fraudulent breach of contract may be shown by conduct manifesting personal ill will, or carried out under circumstances of insult or oppression, or even by conduct manifesting . . . a reckless or wanton disregard of [one's] rights"). *But see* Mortgage Finance, Inc. v. Podleski, 742 P.2d 900, 902-03 (Colo. 1987) (overturning long line of appellate decisions awarding punitive damages for breach of contract since statute required "tortious conduct" for punitive damages).

In *L.F. Pace*, defendant's manager refused to review plaintiff's current financial statements before refusing to issue payment and performance bonds in violation of implied contract after issuing bid bond for project. *L.F. Pace*, 514 A.2d at 776. In *Boise Dodge*, a car dealer turned back the odometer on a demonstrator car before selling it as a new car. *Boise Dodge*, 453 P.2d at 556. In *Art Hill Ford*, an automobile dealer took six months to complete repairs on a new truck, falsely informed the plaintiff that he needed parts that were unavailable, and accused the plaintiff of causing the trouble. *Art Hill Ford, Inc.*, 423 N.E.2d at 604. In *Plummer*, a home inspector misrepresented to home purchasers that the roof on a house was in good condition. *Plummer*, 500 N.E.2d at 1263. In *Southern School Bldgs., Inc.*, a building contractor maliciously withheld monies due to an electrical contractor for purposes of injuring his business. *Southern School Bldgs., Inc.*, 407 N.E.2d at 253-54. In *Hilder*, tenants sued their landlord for breach of the implied warranty of habitability and requested punitive damages for the landlord's failure to repair, after notice of defect, and his failure to provide a facility essential to the health and safety of the tenant. *Hilder*, 478 A.2d at 210.

Several courts have adhered to the rule permitting punitive damages for breach of contract but have denied punitive damages on the facts therein. *See, e.g.*, Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 750-51 (7th Cir. 1988) (applying Indiana law requiring clear and convincing evidentiary standard for punitive damages); Lull v. Wick Const. Co., 614 P.2d 321, 325-26 (Alaska 1980) (breach of contract not sufficiently tortious or malicious); Curtis v. Partain, 614 S.W.2d 671, 673 (Ark. 1981) ("willful or malicious act in connection with contract" were insufficient allegations in breach of construction contract by diversion of funds paid on contract); Quedding v. Arisumi Bros., Inc., 661 P.2d 706, 710 (Haw. 1983) (breach of construction contract by failure to insert reinforcing steel bars in wall as per requirements not wanton, oppressive, or malicious); Dunn v. Ward, 670 P.2d 59, 62 (Idaho Ct. App. 1983) (insufficient evidence of defendant's outrageous or willful action in breaching noncompetition clause contained in sale of business); New Mexico Hosp. Ass'n v. A.T. & S.F. Memorial Hosps., Inc., 734 P.2d 748, 753 (N.M. 1987) (refusal to award punitive damages for group account member's intentionally misleading behavior and breach of contract with representative of unemployment compensation group account was not abuse of discretion); Hood v. Fulkerson, 699 P.2d 608, 611 (N.M. 1985) (no evidence of malice or fraudulent contract when sub-contractor breached plumbing installation warranty by improperly and negligently installing water lines in attics of townhouses); Ranchers Exploration and Dev. Corp. v. Miles, 696 P.2d 475, 478-79 (N.M. 1985) (premature termination of contract due to inability to obtain processing for raw materials not sufficiently malicious); O'Coin v. Woonsocket Inst. Trust Co., 535 A.2d 1263, 1266-67 (R.I. 1988) ("egregious" standard used when bank employee, without subpoena, disclosed embarrassing information regarding payment of debtor's loan to auditor general's office, not "egregious" as a matter of law since same disclosures later compelled in open court).

consumer contract setting.[389] Courts recognize that the consumer may be in an inferior bargaining position,[390] and be forced to sign an adhesion contract or do without the desired product or service.[391] Courts also rely on the rationale that the public interest is served by the deterrent effect of punitive damages for a flagrant breach of contract.[392]

Consequently, if the breach involves a commercial contract,[393] an "arms-length business deal,"[394] or a transaction involving "two presumably sophisticated parties, not one experienced party attempting to deceive or defraud a neophyte,"[395] punitive damages are not con-

---

389. *See, e.g.*, Delta Rice Mill, Inc. v. General Foods Corp., 583 F. Supp. 564, 566-67 (E.D. Ark 1984), *aff'd*, 763 F.2d 1001 (8th Cir. 1985) (punitive damages not awarded because "the existing relationship . . . was a commercial relationship where both parties were bargaining at arms length as opposed to a relationship imposing some degree of trust and confidence in one party because of its superior position"); Bank of N.Y. v. Bright, 494 N.E.2d 970, 977 (Ind. Ct. App. 1986) (not only plaintiff's account improperly liquidated by bank and investment company but small investor's concerns treated with "utter indifference over a substantial period of time."); Jones v. Abriani, 350 N.E.2d 635, 650-51 (Ind. Ct. App. 1976) (punitive damages awarded against mobile home dealer who: (1) sold mobile home with major defects in its construction to young, married couple, (2) failed to repair it despite continued assurances, (3) refused to refund the down payment upon rejection, and (4) concealed limited warranty until warranty period ran out.); Hilder v. St. Peter, 478 A.2d 202, 210 (Vt. 1984) (landlord, after receiving notice of defect, failed to make repairs essential to health and safety of tenant).

390. *See, e.g.*, *Bright*, 494 N.E.2d at 976-77; *see also Jones*, 350 N.E.2d at 650.

391. *See, e.g.*, *Jones*, 350 N.E.2d at 650.

392. *See, e.g.*, First Fed. Sav. & Loan Ass'n of Indianapolis v. Mudgett, 397 N.E.2d 1002, 1005 (Ind. Ct. App. 1979); *see also* Hilder v. St. Peter, 478 A.2d 202, 210 (Vt. 1984) (public benefit in "display of ethical indignation").

393. *See, e.g.*, J. Yanan & Assocs., Inc. v. Integrity Ins. Co., 771 F.2d 1025, 1033-34 (7th Cir. 1985) (applying Indiana law) (some evidence of harassment in suit between two insurance companies but not rising to level of "economic duress"); Reliable Tire Distrib., Inc. v. Kelly Springfield Tire Co., 607 F. Supp. 361, 374 (D. Pa. 1985) (punitive damages not awarded against tire manufacturer who manufactured tires in violation of agreement with plaintiff-distributor and who disposed of excess inventory to competing distributor). "Where a cause of action is limited to a breach of a commercial contract, punitive damages are not appropriate regardless of the nature of the conduct constituting the breach . . . ." *Id.*

394. *See, e.g.*, J. Yanan & Assocs., Inc. v. Integrity Ins. Co., 771 F.2d 1025, 1033-34 (7th Cir. 1985); *Reliable Tire Distrib.*, 607 F. Supp. at 374 (parties who contract at arms length obtain mutual rights and obligations arising under the contract"); Delta Rice Mill, Inc. v. General Foods Corp., 583 F. Supp. 564, 566 (E.D. Ark. 1984), *aff'd*, 763 F.2d 1001 (8th Cir. 1985) ("both parties bargaining at arms length"); Alaska N. Dev. Inc. v. Alyeska Pipeline Serv. Co., 666 P.2d 33, 41 (Alaska 1983) ("arms length business deal").

395. Canada Dry Corp. v. Nehi Beverage Co., Inc., 723 F.2d 512, 525 (7th Cir. 1983) (neither exploitation of the consumer nor infliction of economic duress present in breach of franchise agreement by franchisor); *see also* Art Janpol Volkswagon, Inc. v. Fiat Motors, 767

sidered appropriate regardless of the nature of the misconduct constituting the breach.

The courts that stress the consumer protection rationale do not perceive any essential differences which would prompt punitive damages to be more proper against an unreasonable insurance company than against a car dealer,[396] for example. In either case, a consumer is provided with a significant, supplemental, common law safeguard against flagrant misconduct by an entity possessing a stronger negotiating position.

A breach sufficiently malicious to award punitive damages emerges as an "extreme deviation from reasonable standards of conduct" and " [was] performed by the defendant with understanding of [his] conduct and . . . with understanding of or disregard for the consequences."[397] Accordingly, a breach "without just cause or excuse,"[398] a breach resulting from a blatant violation well within a layperson's understanding,[399] or a "distorted or fanciful contract term interpretation"[400] will warrant punitive damages. Moreover, breaches, involving "predatory practices,"[401] "economic duress,"[402] or aiming towards "unjust enrichment"[403] also meet the punitive damage

---

F.2d 690, 696 (10th Cir. 1985) (applying New Mexico law) (no finding of malice in breach of dealership contract by auto distributor).

396. *See* Hibschman Pontiac Inc. v. Batchelor, 362 N.E.2d 845, 847 (Ind. 1977).

397. *See* Cheney v. Palos Verdes Inv. Corp., 665 P.2d 661, 667-69 (Idaho 1983) (owner of cattle deprived bailees of their possessory lien on cattle in order to be unjustly enriched by bailee's labor); Yacht Club Sales & Servs., Inc. v. First Nat'l Bank, 623 P.2d 464, 475-76 (Idaho 1980) (payor bank wrongfully dishonored checks by placing "hold" on bank account without prior consultation with an attorney and without inquiry or notice to payee); Young v. Scott, 700 P.2d 128, 133 (Idaho Ct. App. 1985) ("extreme deviation from standards of reasonable conduct" found in landlord's delays in completing promised remodeling, evidence that landlord disturbed plaintiff's personal property, and statement made by landlord that he wanted to terminate lease and board up plaintiff's restaurant).

398. Budget Rent-A-Car, Inc. v. B & G Rent-A-Car, Inc., 619 S.W.2d 832, 837-38 (Mo. Ct. App. 1981) (franchisees' breach of noncompetition covenant in franchise agreement was willful and without just cause or excuse and franchisees sought to conceal breach).

399. Davis v. Gage, 712 P.2d 730, 731 (Idaho Ct. App. 1985).

400. Storck v. Cities Serv. Gas Co., 634 P.2d 1319, 1323-24 (Okla. Ct. App. 1981) (contract interpreted as without malice or intent to deliberately injure).

401. Photovest Corp. v. Fotomat Corp., 606 F.2d 704, 729-30 (7th Cir. 1979) (applying Indiana law) (predatory, monopolizing practices by franchisor against franchisee), *cert. denied*, 445 U.S. 917 (1980).

402. J. Yanan & Assocs., Inc. v. Integrity Ins. Co., 771 F.2d 1025, 1033-34 (7th Cir. 1985) (some evidence of harassment in contract dispute between two insurance companies but insufficient evidence of "economic duress").

403. Cheney v. Palos Verdes Inv. Corp., 665 P.2d 661, 669 (Idaho 1983).

standard.

If the breach is part of the adjudication of a "good faith" or "honest" dispute as to what the contract requires of a party, punitive damages are not proper.[404] Consequently, if the breach involves an honest error of judgment,[405] "poor judgment,"[406] neglect or negligence,[407] forgetfulness,[408] mistake of law or fact,[409] "extremely poor workmanship,"[410] incompetence,[411] overzealousness,[412] or technical infractions,[413] punitive damages will not be awarded. However, courts will refuse to find malice even if the breach involves harassment,[414] or if the purpose of the breach is to take business directly from a competi-

---

404. First Fed. Sav. & Loan Ass'n v. Mudgett, 397 N.E.2d 1002, 1006 (Ind. Ct. App. 1979) (cause of action by purchasers of home against vendor alleging that vendor breached real estate purchase agreement by failing to make specified repairs). In *First Fed. Sav. & Loan Ass'n*, the court denied punitive damages, reasoning that "the evidence of events reflects casual discussion of defects, imperfectly remembered conversations, questions of judgment as to the extent of damages to be repaired, varying degrees of expertise necessary to satisfy plaintiffs, forgotten details, an ambiguous memorandum hastily drawn, bad tempers and delays." *Id.*

405. Tolliver v. Mathas, 538 N.E.2d 971, 977 (Ind. Ct. App. 1989); *see also* Kruszewski v. Kwasneski, 539 N.E.2d 965, 967 (Ind. Ct. App. 1989); Bank of N. Y. v. Bright, 494 N.E.2d 970, 976 (Ind. Ct. App. 1986); *First Fed. Sav. & Loan Ass'n*, 397 N.E.2d at 1006.

406. Delta Rice Mill Inc. v. General Foods Corp., 583 F. Supp. 564, 567 (E.D. Ark. 1984), *aff'd*, 763 F.2d 1001 (8th Cir. 1985) ("neglect and exercise of poor judgment" in commercial transaction "falls far short of constituting willfulness, wantonness, malice or conscious indifference").

407. *See, e.g.*, Hood v. Fulkerson, 699 P.2d 608, 611 (N.M. 1985) (negligent installation of water lines breached plumbing installation warranty but no punitive damages); Dotlich v. Dotlich, 475 N.E.2d 331, 345-46 (Ind. Ct. App. 1985); *Tolliver*, 538 N.E.2d at 977; Orkin Exterminating Co., Inc. v. Traina, 461 N.E.2d 693, 698 (Ind. Ct. App. 1984) (failure to supervise or fire employee amounted to willful and wanton misconduct warranting punitive damages), *rev'd*, 486 N.E.2d 1019, 1025 (Ind. 1986) (evidence insufficient to support award of punitive damages).

408. *First Fed. Sav. & Loan Ass'n*, 397 N.E.2d at 1006.

409. *See, e.g.*, Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 751 (7th Cir. 1988) (ambiguous description of territory in truck stop franchise agreement resulting in "honest mistake"); Hatfield v. Max Rouse & Sons Northwest, 606 P.2d 944, 956 (Idaho 1980) (auctioneer mistakenly sold equipment at less than minimum price); *Kruszewski*, 539 N.E.2d at 967; *Tolliver*, 538 N.E.2d at 977; *Bright*, 494 N.E.2d at 977; *Dotlich*, 475 N.E.2d at 345-46.

410. Harper v. Goodin, 409 N.E.2d 1129, 1133 (Ind. Ct. App. 1980).

411. *Id.*

412. Tolliver v. Mathas, 538 N.E.2d 971, 977 (Ind. Ct. App. 1989); Kruszewski v. Kwasneski, 539 N.E.2d 965, 967 (Ind. Ct. Ap. 1989); Dotlich v. Dotlich, 475 N.E.2d 331, 345-46 (Ind. Ct. App. 1985).

413. Davis v. Gage, 712 P.2d 730, 731 (Idaho Ct. App. 1985).

414. J. Yanan & Assocs., Inc. v. Integrity Ins. Co., 771 F.2d 1025, 1033-34 (7th Cir. 1985).

tor or to redirect business to oneself.[415]

C. *Conclusion*

The *Vernon*-based decisions clearly and markedly emerge as concise and unequivocal pronouncements by some courts that a breach of contract alone will support the recovery of punitive damages without resorting to either the bad faith or independent tort doctrines, or by taking refuge in any of the traditional "exceptions" to the general rule. This method definitely possesses the benefits of avoiding the rigidities of orthodox doctrine and the complexities of legal inventions necessitated by the other approaches. Moreover, this method serves as a strong punishment and deterrent. As a result the author's proposed principle is based on this prescript.[416]

IX. PROBLEMS IN PROPOSING A JUST PRINCIPLE

A. *Vague Standards*

The nebulous nature of the standards for awarding punitive damages for breach of contract emerges as a particularly serious concern in the current controversy as to the availability of such damages. Adherents to the orthodox rule raise the issue of vague standards to advance arguments in favor of maintaining the present rule prohibiting the recovery of punitive damages in contract actions.[417]

The imposition of potentially large liability in the absence of precise standards, although obviously fulfilling a compensatory function, may produce great uncertainty for all contracting parties. Moreover, the interjection of uncertainty into the breaching party's calculation of the costs attendant to the breach serves to diminish the deterrence aspect of punitive damages.

The efficient allocation of societal resources might also be impaired. Punishing conduct not clearly denoted as contrary to law impedes the

---

415. *Id.*; *see also* Reliable Tire Distrib., Inc. v. Kelly Springfield Tire Co., 607 F. Supp. 361, 373-74 (D. Pa. 1985).

416. *See* Patton v. Mid-Continent Sys., Inc., 841 F.2d 742, 751 (7th Cir. 1988) (underscoring "opportunistic breach" as the "common element in most of the Indiana cases that have allowed punitive damages").

417. *See, e.g.*, McCormick, *supra* note 18, § 81, at 289-91; Ellis, *supra* note 54, at 39-40; Farnsworth, *supra* note 59, at 1146-47. *But see*, Sebert, *supra* note 64, at 1661. "The 'chilling effect' of punitive damage liability in contract actions is likely to be much less significant than is feared by the critics of punitive damages." *Id.*

predictability of risks and, therefore, affects an essential aspect of the efficient operation of commercial transactions. If the prospective contract parties are disinclined to enter into an agreement which ultimately may result in unlimited liability, the parties may be deterred from entering into contractual relations.

In addition to the potentially chilling effect punitive damages might produce for commercial transactions, vague or non-existent standards that fail to specify the conduct subject to civil punishment diminish the fairness value of punitive damages. To compel a contract party to guess what behavior a jury would find sufficiently egregious to warrant punitive damages certainly raises the social costs for their imposition.

Admittedly, standards for awards of punitive damages are inherently difficult to elucidate, particularly in breach of contract actions. Case law in general manifests a lack of precision as to the standards the courts are applying. The current standards merely present a confusing and partial picture. In many cases, the distinguishing features among "bad faith," "malicious," and "oppressive" conduct are more theoretical than practical, and are frequently misconstrued, misapplied, or just ignored by the courts. To permit the recovery of punitive damages for breach of contract actions in a functional and fair manner, it is imperative that the courts promulgate precise standards for their recovery.

B. *Substance Over Form*

Some courts, although ritually incanting the traditional maxims, treat the cases in such a fashion as to indicate the orthodox doctrine is no longer taken seriously. In some jurisdictions, the alleged general rule has become so perforated with exceptions as to contradict either the influence of the traditional theories or the honesty of their usage.[418] Examination of these decisions indicates that some courts are trying to make punitive damage law governing breach of contract

418. *See* Linscott v. Ranier Nat. Life Ins. Co., 606 P.2d 958, 963 (Idaho 1980); *see also* Sebert, *supra* note 64, at 1649-50 (bad faith insurance cases primarily responsible for helping to obliterate classical tort-contract distinction). "The general rule has never really been the inpenetrable barrier it has appeared to be. Many of the so-called established exceptions to the general rule simply have afforded traditional courts more latitude in escaping the strictures of the rule without seeming to violate it. In some jurisdictions, the so-called exceptions have been construed broadly enough to raise doubts as to the continuing viability of the rule." *Linscott*, 606 P.2d at 963.

similar to the law governing the commission of a tort. As the traditional bases supporting the orthodox rule are further rejected by courts, the general rule in those jurisdictions will continue to dissolve by the introduction of new exceptions and the liberal construction and application of old ones.

The continuing use, however, of the standard "general rule exceptions" format poses problems. Perplexity perforce ensues from utilizing a harsh general rule and then for exemplary reasons adopting and construing exceptions which render the orthodox doctrine altogether meaningless. The extensive employment of exceptions to obviate the general rule makes anticipation and logical analysis of these cases extremely onerous. Finally, this traditional format sows the seeds of lamentable rulings. A court in a static and rigid jurisdiction may utilize the general rule and only narrowly apply the standard exceptions, resulting in frequent miscarriages of justice.

The origin of the orthodox rule is apparently mixed up with the old canard distinguishing actions in tort from actions in contract. Since drawing a rigid line between contract and tort actions is a hazardous undertaking at best, an award of punitive damages should not hang upon so slender a thread as to whether a case sounds in contract or tort. Moreover, a cause of action may inextricably combine tort and contract elements.[419] As the two areas of law are often intermixed, if not inseparable, defending the traditional differentiations drawn in punitive damage awards emerges as an increasingly difficult and intricate task. The major reason given for distinguishing between actions in tort and actions in contract, when deliberating on punitive damages, is the adherence to the hoary tort-contract dichotomy.[420]

In modern cases authorizing the award of punitive damages for breach of contract, the court does not seem overly concerned with whether the plaintiff's cause of action sounds in tort or contract. The law manifestly should sanction the recovery of punitive damages where the behavior of the breaching party signifies outrageous con-

419. *See, e.g.*, CORBIN, *supra* note 3, § 1077, at 439; PROSSER & KEETON, *supra* note 1, § 92, at 655-67.

420. *See* Morrow v. L.A. Goldschmidt Assocs. Inc., 492 N.E.2d 181, 187 (Ill. 1986) (Goldenhersh, J., dissenting) (artificial distinction needs to be acknowledge and excised from law of Illinois); Kennedy & Duncan, *Distributive and Paternalistic Motives in Contract and Tort Law*, 41 MD. L. REV. 563, 591 (1982) (differences between tort and contract "mere anachronisms, relics of an earlier form of false legal consciousness" that should not effect outcome).

duct, regardless of whether the claim is based in tort or contract. This prefered solution directly addresses the problem of an outrageous breach of contract by placing substance ahead of legal form.

C. *The Tort of Bad Faith*

Although several jurisdictions utilize the tort of bad faith breach of contract as the solution to the problems of undercompensation and of punishing and deterring reprehensible conduct in a contract setting, serious practical and theoretical problems ensue from the imposition of this type of tort liability for breach of contract.

Primarily, the bad faith tort doctrine fails to differentiate between the contractual breach of the implied convenant of good faith and fair dealing and a bad faith breach of contract rising to the level of a tort. Since every breach of contract contravenes the right of another party to receive the benefits of the bargain, theoretically, every breach of contract would also constitute a breach of the implied convenant of good faith and fair dealing. On one hand, if courts uniformly construe any and all willful breaches of contract to equate to breaches of the implied convenant, then every intentional breach must be regarded as tortious. Such a doctrine would seriously erode the fundamental bases of contract law and could totally supplant traditional breach of contract law. On the other hand, courts cannot, on principled grounds, mandate tort liability for some breaches of the implied convenant while merely imposing contract liability for others. Formulating rational restricting prescripts emerges as an arduous task since the convenant is implied in all contracts.

The difficulty in formulating precise standards is further exacerbated by the inherent ambiguity accompanying the particular nature of the implied duty of good faith. The expression "good faith" not only lacks a precise definition, but the generally accepted definition that the implied duty of good faith means to do nothing to harm is necessarily vague.

Regardless of the theoretical inconsistency and the vagueness of the terminology, the courts struggle, on a case by case basis, to effect the bad faith tort determinations. Conduct rising to the level of a bad faith tort, however, may manifest itself in a myriad number of forms, yet the courts have not devised a precise set of standards which must be met in order for tort liability to ensue. The unfortunate result is that the bad faith tort has been employed with so little explanation of

its essential elements that one is unable to derive an inclusive, functional definition from the caselaw.

Presuming a court has surmounted the theoretical and practical obstacles and has branded particular breach of contract conduct to be in such bad faith so as to trigger tort liability, the court next would confront the punitive damage issue. That is, is the conduct that has been found sufficiently unreasonable for the tort of bad faith so reprehensible so as to make punitive damages the appropriate remedy for the breach? Courts appear to have difficulty in grasping the distinctions between bad faith conduct breaching the contract covenant, unreasonable bad faith conduct giving rise to tort liability, and bad faith conduct that is such a departure from the norm that punitive damages are appropriate.[421]

The covenant of good faith and fair dealing does require that a contract party not do anything to deprive the other party of the benefit of the bargain. Yet, it is not likely that the mere breach of this covenant, even intentionally, will be sufficient bad faith to trigger tort liability without an additional showing of unreasonableness, such as an intentional breach by a party with knowledge that it is asserting a dubious claim. For punitive damage recovery, however, this bad faith, unreasonable, and thus tortious breach, must also exhibit an actual showing of some of the traditional indicia for punitive damages. Otherwise, if a tortious bad faith breach is not, for example, also malicious, punitive damages are too harsh a sanction.

Many courts, however, fail to undertake the rigorous analytical re-

421. *See, e.g.*, United Am. Ins. Co. v. Brumley, 542 So. 2d 1231, 1238-39 (Ala. 1989) (bad faith tort present but no punitive damage standard mentioned when court awarded punitive damages against Medicare supplemental benefits carrier for intentionally failing to determine whether there was lawful basis for paying claim); Insurance Co. of N. Am. v. Smith, 375 S.E.2d 866, 870-871 (Ga. Ct. App. 1988) (punitive damages awarded for bad faith conduct but no mention as to bad faith as a tort); Independent Life & Accident Ins. Co. v. Peavy, 528 So. 2d 1112, 1115-16 (Miss. 1988) (punitive damages awarded but difficult to discern basis thereof); Blue Cross & Blue Shield, Inc. v. Mass., 516 So. 2d 495 (Miss. 1987) (punitive damages awarded but unable to discern whether based on bad faith breach, malicious breach, bad faith tort, bad faith aggravated tort, or gross negligence); Staff Builders, Inc. v. Armstrong, 525 N.E.2d 783, 788-90 (Ohio 1988) (instructions confused bad faith and punitive damage standards), *reh'g denied*, 533 N.E.2d 788 (Ohio 1988); Olbrich v. Shelby Mut. Ins. Co., 469 N.E.2d 892 (Ohio Ct. App. 1983) (punitive damages for bad faith but bad faith standard equated with traditional punitive damage standard); Chitsey v. National Lloyds Ins. Co., 738 S.W.2d 641, 643-44 (Tex. 1987) ("gross negligence" standard but not clear if gross negligence the standard for initial breach of the tort duty of good faith or the punitive damage standard for aggravated breach).

sponsibility of precisely defining the breaching conduct in relationship to the proper standard of recovery: bad faith breach of the contract covenant, bad faith tortious breach, or bad faith-tortious-punitive breach. Absent such an explicit analysis, punitive damage recovery might unfairly chill legitimate conduct by imposing punishment disproportionate to the degree of culpability and might give the party asserting the breach of the covenant a disproportionate economic weapon to wield over the party avoiding or denying the obligation.[422]

Applying an amorphous bad faith doctrine, as well as stretching established independent torts, begets judicial decision-making that fictionalizes the law and spawns uncertainty and instability. The integration of the bad faith tort doctrine into contract law, however, does indicate that courts are increasingly discontented with traditional contract remedies and are actively searching for routes by which to escape the traditional restrictions on recovery in contract. A reasoned approach to the problem, therefore, is to formulate precise criteria that recognize the recovery of punitive damages, premised on the contract, for particularly outrageous breaches of contract. If the appropriateness of punitive damages, founded on the contract, is forthrightly recognized, and firm criteria framed for their application, the courts will not be compelled to resort to amorphous doctrines or strained constructions to fit the facts of a particular case.

D. *The Special Relationship Requirement*

The "special relationship," "special factors," and consumer protection doctrines, enunciated by courts and commentators as a device to circumscribe punitive damage liability for breach of contract, are subject to several criticisms. On one hand, the doctrines are inherently vague, expansive, and over-inclusive; they could justify tort-like liability for almost any breach of contract. On the other hand, the doctrines are under-inclusive; they too easily can be interposed to avoid the issue of tort-like liability.[423]

The special factors themselves, moreover, may not be particularly meaningful in determining extra-contractual liability. The fact that a contract is an adhesion contract is not relevant to the issue of outra-

422. Comment, *supra* note 293, at 1327-28 (excellent analysis of bad faith conduct as opposed to punitive damage conduct).

423. *Id.* at 1299-1301 (thorough discussion and analysis of criticisms of special relationship doctrine).

geous conduct in the breach of the contract. The fact that an industry is highly regulated is not relevant to the issue of the effect of an outrageous breach on the victim and society. The fiduciary aspect of the relationship should not be dispositive of the issue of extra-contractual recovery, since a relationship of trust, confidence and dependence can arise in any type of contractual relationship. The "special relationship" and "special factor" doctrines are, thus, inadequate to demarcate the boundaries of punitive damage liability.

The failure, furthermore, of contract remedies to sufficiently punish and deter misconduct occurs in every type of contract, not merely those designated as "special," or "consumer." The punitive damage remedy, therefore, should be predicated upon outrageous misconduct that violates moral norms, not upon the existence or nature of a special or consumer relationship.

The often enunciated distinction between commercial and non-commercial contracts, moreover, emerges as a specious one that no longer should dominate the discussion of punitive damage liability. The line between commercial and non-commercial contracts is not clear. Many categories of contracts, for example, employment contracts, possess both commercial and non-commercial characteristics. The desire for profit and the desire for security and peace of mind are often mixed motives. In addition, elements of trust and dependence may arise in a commercial contract setting, especially at the time of performance.

Punitive damages for an outrageous breach of contract cannot be divorced from the commercial contract cases on any principled basis. Punitive damages must be predicated upon the contravention of societal standards of appropriate conduct, rather than upon the presence of a specific type of contractual relationship.

Although the type of contract, relationship, or "factors," may underscore an exigency to punish and deter particular breaches of contract, these contractual aspects should not delimit the boundaries of punitive damage liability. Therefore, the rule to be proposed herein is not limited to the non-commercial, consumer, special relationship, or special factor case. An aggrieved party should not be compelled to prove that the parties to the contract had a particular relationship or contract. The proposed rule is based on principles distinct from any relationship, principally that a promise broken in an outrageous manner is so morally offensive so as to demand punitive damage

liability.[424]

X. Rationales for Punitive Damages for Breach of Contract

A. *Introduction*

A potential avenue of redress that opens up to a victim of an outrageous breach of contract is the availability of punitive damages. The purposes of punitive damages are to punish the wrongdoer and to deter others from engaging in the proscribed behavior. Punitive damages, moreover, serve a compensatory function. These purposes of punitive damages are not incompatible with the purposes of contract law.

B. *Compensation*

Compensation, of course, aims to make the aggrieved party "whole," that is, to compensate the nonbreaching party for consequent losses. Contract law is designed not only to compensate but also to advance the market economy by affording the parties flexibility in the area of breach of contract.

There is wide recognition, however, that traditional contract remedies fail to adequately compensate the nonbreaching party. To correct this problem of undercompensation, many commentators urge that tort principles and tort damages, particularly punitive damages, be expanded in certain circumstances into the arena of contract law.[425]

Punitive damages are enlisted into the service of compensating the nonbreaching party due to the remedial limitations of contract damage law. The contract damages recognized by the common law are a particularly imprecise reflection of the aggrieved party's actual losses. The orthodox *Hadley v. Baxendale*[426] rule prohibits recovery for consequential losses unless the breaching party knew of the particular

---

424. *See* Seaman's Direct Buying Serv. v. Standard Oil, 686 P.2d 1158, 1167 (Cal. 1984). The California Supreme Court, in *Seaman's*, in a commercial setting, justified its holding that "stonewalling" is a type of bad faith tort by proclaiming that the practice "offends accepted notions of business ethics." *Id.*

425. *See, e.g.*, Diamond, *supra* note 2, at 445-46, 448; Speidel, *supra* note 2, at 195; Sebert, *supra* note 64, at 1570, 1648, 1664-65.

426. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

risks at the time the contract was entered into.[427] The expectation measurement of damages serves as a cap on recovery, even when reliance losses exceed expectation.[428] Undercompensation is also exacerbated by the restrictive requirement that the nonbreaching party prove the certainty of damage and the foreseeability of loss.[429]

Punitive damages also may redress the undercompensation that results from other restrictive aspects of traditional contract damages. Damages for mental distress, for example, generally are not recoverable for breach of contract.[430] Transactional expenses may have to be paid out of the damages awarded for actual monetary loss.[431] Thus, legal costs may emerge as a significant cause of the undercompensation of the contract plaintiff. In particular, a plaintiff that incurs substantial legal fees in enforcing contract rights, but receives only ordinary contract damages, is definitely not made "whole."[432] A prohibitively expensive legal system may even deter parties from enforcing their contract rights altogether. To offset expenses, such as legal costs, that are not otherwise recoverable, punitive damages may be awarded.[433] Another example of undercompensation is illustrated by the fact that prejudgment interest generally is not recoverable.[434] Contract remedies, finally, do not compensate the nonbreaching party if the nonbreaching party is wrongfully obstructed by the breacher from utilizing the remedies.

The inadequacy of contract law to fully compensate the nonbreaching party has prompted courts to award damages other than, or

---

427. 9 Ex. at 355, 156 Eng. Rep. at 151; *see* RESTATEMENT (SECOND) OF CONTRACTS § 351, at 135-36 (1981); Farnsworth, *supra* note 59, at 1200-01.

428. *See* RESTATEMENT (SECOND) OF CONTRACTS § 349, at 124 (1981); *see also* FARNSWORTH, *supra* note 27, § 12.16, at 888-90.

429. *See* Sebert, *supra* note 64, at 1662 ("relatively stringent certainty requirements").

430. *See* RESTATEMENT (SECOND) OF CONTRACTS § 353, at 149 (1981).

431. Mallor, *supra* note 294, at 486-87; *see also* Sebert, *supra* note 64, at 1662.

432. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1444-45 (1980); *see also* Sebert, *supra* note 64, at 1662.

433. *See* Erhardt v. Leonard, 657 P.2d 494, 499 (Idaho Ct. App. 1983) (punitive damages may be awarded to compensate plaintiff for necessary and reasonable attorney fees and expenses); *see also* Patton v. Mid-Continent Sys., Inc. , 841 F.2d 742, 751 (7th Cir. 1988); Morrow v. L. P. Goldschmidt, 492 N.E.2d 181, 186 (Ill. 1986)(Goldenhersh, J., dissenting).

434. *See Morrow*, 492 N.E.2d at 185-86 (Goldenhersh, J., dissenting) (discussion of effect if punitive damages not awarded); *see also Patton*, 841 F.2d at 751; Sebert, *supra* note 64, at 1662. "Absent the assessment of punitive damages, a willful violator of a contract incurs no sanction and bears only the costs of performance under the terms of the agreement. In many instances, the sum awarded is not subject to prejudgment interest, and absent a specific provision, the wronged party cannot recover his attorney fees." *Morrow*, 492 N.E.2d at 185-86.

in addition to, ordinary contract damages. In particular, tort remedies, with their more permissive requirements for providing damages, have been employed as a device to fully compensate contract claimants. To the extent, however, that legal costs and fees are recoverable, and that the consequential damage standard is expansively construed by courts,[435] the compensatory rationale is thereby significantly diminished. The compensation factor, therefore, emerges as a rudimentary foundation to support the recovery of punitive damages in a breach of contract cause of action. The strength of compensation as a rationale supporting the recovery of punitive damages hinges on the power of the other two rationales - punishment and deterrence.

C. *Punishment*

Punishment of the wrongdoer is another often stated rationale underpinning awards of punitive damages.[436] In addition to punishing the wrongdoer, punitive damages express society's outrage towards the misconduct of the wrongdoer.[437] In the context of breach of contract, punishment is executed through the exaction of punitive damages. Awards of punitive damages in breach of contract cases also display this feature of societal condemnation.

Clearly, contract disputes can engender outrageous conduct that is particularly appropriate for a punitive damage sanction. Justice, however, demands that punishment be imposed for conduct precisely defined as wrongful.[438] Unfairness ensues when the standards proscribing behavior are vague. Since the punishment rationale functions as a principal pillar underlying the recovery of punitive damages in breach of contract cases, the definitiveness of the standards for awarding punitive damages emerges as a paramount concern.

D. *Deterrence*

The purpose of punitive damages is not only to punish the wrong-

---

435. *See, e.g.*, Lawton v. Great S. W. Fire Ins. Co., 392 A.2d 576, 580-81 (N.H. 1981) (insurer who breaches implied contractual duty of good faith may be liable for reasonably foreseeable consequential damages in excess of policy limits); Beck v. Farmers Ins. Exch., 701 P.2d 795, 801-02 (Utah 1985) (expansive range of recoverable damages in excess of policy limits foreseeable, including mental anguish damages).

436. *See, e.g.*, DOBBS, *supra* note 19, § 3.9, at 205; MCCORMICK, *supra* note 18, § 77, at 275, § 81, at 286; Ellis, *supra* note 54, at 8-10; Sebert, *supra* note 64, at 1664-65.

437. *See* PROSSER & KEETON, *supra* note 1, § 2, at 11-12.

438. *See* Ellis, *supra* note 54, at 9; Sebert, *supra* note 64, at 1664-65.

doer but also to deter others from repeating the proscribed conduct.[439] Deterrence effects a benefit to society by the reduction of future misbehavior and the enforcement of agreeable social standards. Punitive damages regulate future conduct by increasing the penalties for misconduct.[440]

In breach of contract cases, the threat of punitive liability will deter immoral business practices. The availability of punitive damages serves to constrain a dominant contract party from capitalizing on the weaker party's condition.[441] Discouraging abuse of power is particularly appropriate at the performance stage, where the contract may be essential to the personal or business interests of a party who does in fact become dependent on the other's performance.

Deterrence is an especially convincing rationale when the breaching party engages in a systematic course of misconduct that, even though substantial in its entirety, is too slight in an individual case for the aggrieved party to sue. Deterrence targeted at repeated institutional misconduct that tramples the rights of individuals emerges as a forceful justification for exacting punitive damages.

The availability of punitive damages, finally, creates a strong incentive to perform one's contractual obligation or to admit liability. The additional strong deterrent effect of punitive damages is particularly appropriate in breach of contract cases due to the comparatively limited measure of compensatory damage recovery. The breaching party may calculate in advance the expected liability and may have little incentive not to breach when the expected liability for compensatory damages is less than the actual harm caused by the breach. In such cases, punitive damages can adjust the breaching party's calculation and thereby promote deterrence.[442]

Extremely large punitive damages need not be awarded to achieve the desired deterrent effect. Rather, the awarding of smaller yet more frequent awards might be the most proper method to prevent outrageous breaches of contract.

---

439. *See* MCCORMICK, *supra* note 18, § 77, at 275; PROSSER & KEETON, *supra* note 1, § 2, at 9, 12; Sebert, *supra* note 64, at 1664-65.

440. *See* Ellis, *supra* note 54, at 8, 25, 77.

441. Mallor, *supra* note 294, at 485. The courts "have become more receptive in recent years to the use of punitive damages in cases involving abuse of power in contractual relationships, and this new willingness reflects changing views about the responsibilities of those who wield a high degree of economic power." *Id.*

442. *See id.* at 486-87; *see also* Sebert, *supra* note 64, at 1660-61.

E. *Conclusion*

Punitive damages are appropriate to address willful, tort-like misconduct arising out of a breach of contract. By recognizing punitive damage recovery, the courts will further the goals of compensation, punishment, and deterrence. Compensation, however, does not provide a complete rationale for punitive recovery. Punishment and deterrence emerge as the most appropriate rationales for the imposition of punitive damages. Punitive damages, of course, should not be available for every breach of contract. The appropriateness of punitive damages for an outrageous breach of contract, however, can be justified by the traditional policies underlying punitive damages. No persuasive rationale presents itself for the courts to hold that outrageous misconduct arising out of a breach of contract should not be punished and deterred in the same manner as outrageous misconduct resulting in a tort.

XI. The Proposed Principle for the Recovery of Punitive Damages for Breach of Contract

A. *Introduction*

Since deterrence emerges as the most significant rationale for the recovery of punitive damages in breach of contract cases, the objective in devising standards for such awards should be to strengthen the deterrent purpose. Present standards, however, only provide a partial, and often perplexing, response. It is virtually impossible as well as undesirable to catalogue the multifarious variety of contractual transactions and then attempt to tailor standards to fit categories of cases and categories of defendants. Rather, flexible standards are necessary in order for the law to adapt to new business practices. Therefore, in formulating standards that strengthen deterrence, courts should tailor the standards to fit categories of conduct.

Courts, of course, should treat immoral business practices more severely than legitimate contractual disputes. The type of misconduct to be condemned and punished, although difficult to precisely categorize, should be made comprehensible. The breaching party's behavior should be more than merely distasteful, sharp, or wrong. Rather, the breach, by the nature of the contract, the breacher's state of mind, or method of the breach, should entail outrageous conduct. To be properly imposed, punitive damages must not only be limited to the most outrageous conduct, but also must be limited to situations where the

defendant possesses some precise means to appreciate the wrongfulness of the conduct.

The solution, therefore, requires providing a remedy for a recognizable wrong, and assuring that a breacher is required to pay the higher measure of damages only when the breacher's misconduct justifies the heightened liability. Most importantly, the standard must distinguish between misconduct which merely entails the breach of the contract duty, rendering traditional contract remedies applicable, and outrageous misconduct accompanying the breach which contravenes punitive damage standards, rendering punitive damages applicable.

B. *The Principle - Outrageous Breach*

The principle for imposing punitive damages for breach of contract should call for a finding that the defendant's conduct amounted to a separate and independent tort committed in an aggravated fashion, and was fraudulent, or outrageous.[443] An outrageous breach is an intentional breach where the defendant maliciously or oppressively caused harm to the plaintiff.

C. *Malice and Oppression Defined Under the Outrageous Breach Principle*

The malice requirement is satisfied by a finding of either actual or implied malice. Actual malice is conduct by a defendant which is intended to cause injury to the plaintiff. Actual malice entails the performance of an intentional act, with an evil or rancorous motive, prompted by hate, spite, resentment, or ill will, and for the purpose of deliberately and willfully injuring the plaintiff.[444] Implied malice is conduct done by a defendant with conscious disregard, callous disregard, or in reckless disregard of a person's rights.[445] Reckless disregard involves knowledge of a risk which is substantially greater than that which is necessary to render an actor's conduct negligent.[446] The

---

443. *See* Alaska N. Dev., Inc. v. Alyeska Pipeline Serv. Co., 666 P.2d 33, 41 (Alaska 1983) (employing and defining an "outrage" standard); *see also* Linscott v. Rainier Nat. Life Ins. Co., 606 P.2d 958, 965 (Idaho 1980) (employing and defining an "outrage" standard).

444. *See e.g.*, *Curtis*, 560 P.2d at 172; First Fed. Sav. & Loan Ass'n, 397 N.E.2d at 1006, 1008; PROSSER & KEETON, *supra* note 1, § 2, at 10.

445. *See e.g.*, First Fed. Sav. & Loan Ass'n v. Mudgett, 397 N.E.2d 1002, 1008 (Ind. Ct. App. 1979); PROSSER & KEETON, *supra* note 1, § 2, at 10.

446. *See, e.g., First Fed. Sav. & Loan Ass'n*, 397 N.E.2d at 1006-07; PROSSER & KEETON, *supra* note 1, § 34, at 213-14.

implied malice standard, however, is a lesser standard than actual malice and denotes a slightly lower level of culpability.[447]

Malice, whether actual or implied, is a subjective standard which necessitates an inquiry into the motive of the defendant. The subjectivity aspect of the malice standard renders the malice requirement inherently difficult to meet. The difficulty is particularly present in breach of contract cases, which, unlike tort cases, often lack the physical acts a jury can point to as disclosing the presence of a subjective malicious intent. Wanting such physical manifestations, a jury will be compelled to establish the motive by inference or by surmising the state of mind of the defendant. The task of proving intent is particularly exacerbated in a case involving a breach of contract by an institutional or corporate defendant. The plaintiff will often be unable to pinpoint the precise actor, let alone be able to offer proof of intent, in an institutional or corporate context.

A subjective standard, such as malice, moreover, focuses on the evil intent of the defendant and fails to concentrate on the outrageousness of the defendant's conduct. Consequently, the primary purpose of punitive damages, the deterrence of reprehensible conduct, is not sufficiently promoted by adopting merely a subjective malice standard.

Accordingly, if a breacher's conduct is deemed oppressive, punitive damages also are appropriate under the outrageous breach principle. Oppression is the defendant's subjection of a person to cruel and unjust hardship.[448] Oppression, an objective standard, is more realistic than, and thus preferable to, a subjective malice standard for outrageous breach of contract cases. Oppression, in examining actual abuses of bargaining power and immoral practices, focuses on the acts of the defendant in order to determine whether the plaintiff has been subjected to cruel and unjust hardship. An oppression standard, therefore, offers a practical, objective test to assess the outrageousness of the defendant's conduct by turning the jury's attention from the defendant's motive to the degree the conduct oppressed the plaintiff. Although a malicious motive may not be demonstrated, if the defendant's acts oppress the plaintiff, it is the oppressive character of the defendant's conduct that warrants the punitive damages.[449]

---

447. *See supra* notes 364-368 and accompanying text.

448. *See supra* notes 366-368 and accompanying text.

449. Comment, *supra* note 293, at 1329 (distinguishing bad faith conduct from punitive damage conduct).

The oppression standard provides a more definite standard, not only for the jury but also for reflective defendants, by which to judge the outrageousness of the defendant's conduct. The oppression standard, in addition, permits the more precise standard to be applied to cases that lack malice but still warrant an imposition of punitive damage liability. Oppression, therefore, more efficaciously fulfills the deterrent function of punitive damages and emerges as an essential concomitant to the proposed punitive damage principle.

D. *Malice and Oppression Distinguished from Bad Faith*

Malice and oppression denote, respectively, the presence of an actor's intent to cause harm and the presence of misconduct that causes hardship. Although, admittedly, the precise meaning of these terms is difficult to discern, the malice or oppression standard represents an attempt justifiably to restrict punitive damages to cases exhibiting clearly outrageous behavior.

Bad faith conduct, however, does not involve sufficient culpability to warrant punitive damages. The actor's state of mind or the harm caused under a bad faith standard renders the recovery of punitive damages a disproportionate remedy. The bad faith state of mind does not possess the necessary element of purposefulness or substantial awareness that the victim will suffer severe consequences as a result of the misconduct. Rather, the bad faith state of mind contemplates an actor with an intent or knowledge to avoid liability, evade litigation, or gain an advantage which litigation might not support. The bad faith actor acts unreasonably; yet the actor need not intend to harm the victim, and even may be ignorant of the consequences. Bad faith conduct, although illegitimate and wrong, simply does not rise to the outrageousness level needed for punitive damages.[450]

Since bad faith satisfies neither the state of mind nor conduct requirements, punitive damages are not to be awarded for mere bad faith conduct. Practical and theoretical policy rationales demand the finding of either malice or oppression before punitive damages properly are recovered pursuant to the outrageous breach principle.

E. *Determining the Presence of Malice or Oppression*

In order to promulgate a fair and workable outrageous breach rule,

---

450. *Id.*

one must attempt to determine the grounds sufficient to support a finding of malice or oppression. The breaching party's possession of a "good" reason for the breach, for example, inability to perform, should not subject the breacher to punitive damage liability. Neither good faith business judgment, even if mistaken, nor the honest, but mistaken, assertion of a right is sufficient. Negligently asserting an invalid position is insufficient, as is the purposeful assertion of a colorable but losing defense.

A mere intentional breach, standing alone, is insufficient to meet the outrageous breach malice or oppression standard. The grounds constituting malice or oppression must require more than merely not fulfilling one's contractual obligation. Something more than a purposeful economic decision not to perform, which is really nothing more than nonfeasance, is mandated under this malice or oppression standard.

Even an intentional breach that entails the avoiding or denying clear rights under the contract is insufficient. A breach committed with the purpose of deriving financial benefits or profits is insufficient. A motive of greed is not enough to trigger the standard. Finally, not even an intentional breach of contract committed out of malevolence towards the other contract party will satisfy the standard. Thus, the question emerges as to just what grounds are contemplated that would satisfy the outrageous breach standard and result in punitive damages.

Punitive damages are warranted when a contract party, who is capable of performing, intentionally breaches the contract with the *intent* of *causing* the victim harm *beyond* the harm usually considered as reasonably foreseeable for breach of contract. This rule coheres with the traditional common law principles because, under the rule, an actor is assigned punitive damage liability only if the actor possesses the intent to injure beyond the extent considered recoverable for breach of contract under the *Hadley v. Baxendale* limitations. The rule also coheres with the malice standard since the rule proposes a subjective test that focuses on the intent of the breaching party. The breaching party also must have the knowledge that he will be causing harm which traditional contract damages will be inadequate to rectify. The breacher need not possess the knowledge at the time the contract is entered into, although such a requirement is a prerequisite for recovery under *Hadley*; rather, knowledge to a substantial certainty need only come about by the time of the breach.

Punitive damages are warranted, in addition, when a contract breacher causes injury beyond that which is considered reasonably foreseeable for breach of contract. This rule also coheres with the traditional common law principles because, under the rule, an actor is assigned punitive damage liability only if his actions go beyond the *Hadley* limits. Such a rule also coheres with an oppression standard since the rule proposes an objective test that focuses on the conduct of the defendant in causing the harm as the key factor in determining liability.

Punitive damages are warranted, finally, when the breaching party purposefully seeks to obstruct, or does obstruct, the victim's ability to pursue the expectation remedies and to receive the subtitutionary value of the contract.[451] Once again, such a rule coheres with the common law limitations as well as with the malice and oppression standards.

F. *The Proposed Principle and the Common Law*

The common law recognizes that a contract party possesses a justifiable expectation that either performance will occur or that a breach will occur for which the nonbreaching party will be able to recover damages incurred as a result of the breach.

Breaching conduct that equates to failure to perform or that impedes or frustrates the aggrieved party's right to performance can normally be remedied by ordinary contract remedies, for example, recovery of expectation damages. Breaching conduct, however, that intends to or does harm the victim beyond the victim's ability to obtain the substitutionary value for the performance, or that intends to or does obstruct the victim's ability to seek the equivalent of performance, warrants the punitive remedy. An intentional breach, for example, by a defendant who is capable of performing, but who attempts to avoid both performance and liability for non-performance for a contractual obligation recognized to be binding, by denying the existence of the contract or asserting an illegitimate defense, for the purpose of attempting to extract an unjustifiable favorable settlement, is a proper case for imposing punitive damage liability under the proposed principle.

The punitive damage standard proposed herein coheres with the

---

451. *Id.* at 1302, 1305.

classical "efficient breach" theory. The traditional view that contract damages should protect the non-breaching party's expectancy interest is reinforced by the rules proposed herein in that punitive damages are only warranted for conduct beyond the expectancy interest or in obstruction of the expectancy interest. Moreover, this proposal is in accord with classical doctrine in recognizing that a breach of contract well may be a routine part of a contractual transaction by proposing a standard that permits punitive damages for a breach only in outrageous situations.

The proposed principle also takes the "special relationship" and consumer cases into account. When the relationship entails a disparity in bargaining power, and an ensuing imbalanced bargaining process, the potential for the dominant party to thwart the weaker party's expectancy is high. Such impediment, of course, would materialize as a key, but not exclusive, factor in determining punitive damage liability under the proposed principle.

A long line of cases pronounces that an intentional breach of contract, even if motivated by ill will, is insufficient for punitive damage liability. The reason, of course, is that while the breacher does in fact want to cause harm to the victim, the harm intended and the harm caused is merely the breach of the contract; thus, the actionable wrong is only the breach of contract for which ordinary breach of contract remedies typically are sufficient. The proposed standard recognizes the orthodox rationale.

The proposed outrageous principle also recognizes that an intentional breach of contract, committed with the purpose of inflicting injury beyond that which is considered reasonably foreseeable under the common law limitations on contract damages, should warrant punitive damage liability. The reason, of course, is that since the actor intends to cause harm beyond the breach of contract damages, the actionable and punitory wrong is the intentional causing of the harm. The breach of contract is merely the *means* by which the harm is inflicted.

The proposed principle, finally, is consistent with those jurisdictions that strictly adhere to the independent tort "exception," because an actor who breaches a contract with the intent to cause harm beyond that recognized by common law contract limitations is not only breaching a private contract duty not to perform, but is also breaching a public tort-like duty not to harm the other party. This principle, therefore, does more than merely protect the contract inter-

est in having promises performed or the substitutionary equivalent paid. The principle also protects the tort interest in being free from harm by imposing punitive liability for harm beyond that ordinarily recoverable for a breach of contract that is intentionally committed.

The proposed outrageous breach principle, finally, coheres with the traditional common law requirement of a finding of moral "fault," in the form of extreme social unreasonableness, as a necessary condition for punitive damage liability. The actor subjected to punitive damage liability under this proposal is either personally blameworthy, because he subjectively knows he is injuring the victim beyond recognized limits, or is objectively at fault because he has departed from acceptable societal standards of conduct. Such "fault" creates the moral responsibility for punitive damages and coheres with the traditional common law view that "fault" consists of a failure to meet an objective societal standard of behavior or of personal blameworthiness.[452]

G. *Conclusion*

A primary purpose of this paper is to devise a fair and functional approach to the awarding of punitive damages in breach of contract cases. The author believes that the outrageous breach principle proposed herein fulfills that purpose. One recalls that important arguments against awarding punitive damages are that such damages will discourage contractual transactions, undermine commercial stability, and impede the free flow of commerce. Considering the precise, clear, and strict guidelines proposed herein, and the rationales therefor, the author feels that these legitimate fears should be allayed. The availability of punitive damages under such a clear and workable principle plainly will put contract parties on notice that extremely immoral business practices will not be tolerated by the law merely because such practices are perpetuated in a contractual setting.

XII. CONCLUSION

This complex and eventful area of law, punitive damages for breach of contract, raises an important and elemental public policy objective: how to solve the problem of outrageous conduct in contract relations, without introducing uncertainty, inflexibility, and inefficiency into the contract arena? Conflict, of course, exists between these objectives

452. *Id.* at 1307 (discussion of moral "fault" in the context of implied covenant).

and a just solution necessarily comprises balancing one goal against another. The seminal issue arises as to which of the principles examined—independent tort based on contract breach, tortious breach of convenant, tortious breach of contract, breach of contract with malice or oppression, or the author's outrageous breach of contract - strikes the proper balance and, thus, best promotes the realization of these policy objectives.

The author believes that the courts will be able to accomplish an important mission by adopting the outrageous breach of contract principle by introducing morality into contract law through the punishment and deterrence of clearly immoral breach of contract conduct. Thus, the principle represents a modification of the neutral attitude of orthodox contract law toward the breach.

In order to avoid uncertainty and inefficiency, a principle must be composed of precise rules. The principle also must provide the courts with a uniform approach to resolving cases. The principle proposed meets both of the previous criteria. Additionally, the principle proposed provides attorneys with a legal framework to analyze a client's breaching behavior and to anticipate the outcome of a punitive damage action based on that conduct.

A jury, of course, will be necessary to make the final determination as to the outrageousness of the conduct. Juries are assigned other duties of rectification and this one does not appear to be any more arduous, particularly since the court will be instructing the jury as to the legal framework upon which to base their conclusion. The jury must be trusted to distinguish an ordinary breach of contract, involving socially tolerable conduct, from a breach involving such outrageous conduct that the societal interest in punishment and deterrence is triggered. A business person, tempted by an opportunity to commit an outrageous breach of contract, surely will reconsider the action if confronted with the possibility of suffering an adverse jury verdict with a punitive element.

When a rule of law permits clearly immoral conduct, the courts must reject it as unjust; when a rule of law no longer mirrors current practices or moral standards, the courts must modify it. The law has outgrown not only the rigid dichotomy between tort and contract in the area of punitive damages for breach of contract, but also the strict adherence to the general rule-orthodox exceptions methodology of resolving recovery issues.

On principle, an outrageous breach of contract must be subject to

punitive damages. Punitive damages must be rooted in the character of a wrongdoer's behavior and not the technical term given to the wrongful act. One contemporary inclination, as manifested by the latest "exception" to the general rule, is forcefully predisposed to discard the difference between tort and contract and to comprehend that a breach of contract, like a tort, is a proper subject for punitive damages. As a matter of public policy, sound morality, and justice, the courts can no longer condone clearly immoral behavior merely because of the contractual context.

Contract law must be based on fundamental fairness and decency. The law cannot provide a contract "cover" for immoral actions. Furthermore, punishment of immoral breach of contract conduct must be a purpose of contract law. Consequently, the courts must update antiquated legal theories by imposing legal responsibilities anchored on a heightened awareness of moral concerns and contemporary moral standards. To do otherwise is to risk the pernicious effects of a commensurate diminution of individual moral responsibility and accountability and a concomitant diminution of respect for law.

The courts must be more receptive to the use of punitive damages in cases involving abuse of power in contractual relations. The concentration of economic and other forms of power today exposes a weaker contract party to outrageous conduct by a stronger contract party. The courts especially must be attuned to the activities of those who possess a great deal of economic power, and, accordingly, must employ tactics to guard against the risks of abuse in economic transactions.

The principle proposed herein emphasizes the value of morality. The principle also seeks to combine efficaciously the value of morality with the values of economic efficiency and individual freedom. The author believes that the principle markedly enhances the clarity and morality of existing doctrine in this area of damage law without impairing commercial transactions or individual initiative. The principle promotes personal morality while punishing and detering abuses of superior power, economic tyranny, and morally outrageous misconduct. Most importantly, the principle serves to make contract law just.