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A New Tort for Texas: Breach of the Duty of Good Faith and Fair Dealing.

Evelyn T. Ailts

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COMMENTS

A New Tort for Texas: Breach of the Duty of Good Faith and Fair Dealing

Evelyn T. Ailts

I.	Introduction	1296
II.	The Role of Implied Contractual Covenants in Texas	1299
	A. Texas Courts' Traditional Disfavor of Implied Contractual Covenants	1299
	B. Statutory and Common Law Good Faith Duties	1300
	C. The <i>Scharrenbeck</i> Implied Tort Duty.....	1302
III.	The Implied Contractual Covenant of Good Faith and Fair Dealing In Other Jurisdictions	1304
	A. The Implied Contractual Covenant of Good Faith and Fair Dealing as a Derivative Contract Principle.....	1304
	B. The New Tort: Bad Faith Breach of the Duty of Good Faith and Fair Dealing	1306
IV.	The <i>English v. Fischer</i> Decision	1311
	A. The Texas Supreme Court's Interpretation and Rejection of the Implied Contractual Covenant of Good Faith and Fair Dealing	1311
	B. Implied Contractual Covenants Surviving <i>English v.</i> <i>Fischer</i>	1313
	C. Special Relationships As Determinative of the Tort Duty of Good Faith and Fair Dealing	1314
V.	The Insurer-Insured Relationship: Recognition and Evolution of the Tort Duty of Good Faith and Fair Dealing	1317
	A. The Tort Duty of Good Faith and Fair Dealing After <i>English v. Fischer</i>	1317
	B. The New Tort for Texas: Breach of the Duty of Good Faith and Fair Dealing	1319

VI. Texas' Rejection of the Implied Contractual Covenant of Good Faith and Fair Dealing	1323
VII. Conclusion	1326

I. INTRODUCTION

The last half of the twentieth century has seen the expansion of a new principle of contract law—the implied covenant of good faith and fair dealing.¹ As a derivative contract principle,² the good faith covenant has been adopted as implied in every contract by the Uniform Commercial Code,³ the Restatement (Second) of Contracts,⁴ and a strong majority of jurisdictions.⁵

1. See, e.g., *Fernandez v. Vasquez*, 397 So. 2d 1171, 1174 (Fla. Dist. Ct. App. 1981) (good faith and cooperation implied condition precedent to contract performance); *Carrico v. Delp*, 490 N.E.2d 972, 976 (Ill. App. Ct. 1986) (every contract implies good faith and fair dealing between parties); *Metropolitan Park Dist. v. Griffith*, 723 P.2d 1093, 1100 (Wash. 1986) (implied covenant of good faith and fair dealing obligates contracting parties to cooperate). See generally *Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 369 (1980) (duty to perform contracts in good faith now recognized as general contract law principle).

2. See, e.g., *Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1289 (N.D. Ill. 1983) (performance in good faith is derivative principle and does not create independent cause of action); *State v. De Anza Corp.*, 416 So. 2d 1173, 1176 (Fla. Dist. Ct. App.) (under Uniform Commercial Code good faith obligations are derivative), *review denied*, 424 So. 2d 763 (Fla. 1982); *Murphy v. American Home Prods. Corp.*, 448 N.E.2d 86, 91 (N.Y. 1983) (implied good faith obligations used solely as construction aid in determining parties' intent). The contractual covenant of good faith and fair dealing should be distinguished from the tort action for breach of good faith and fair dealing. The bad-faith tort, as it is generally recognized, redresses bad faith in contractual performance in a judicially-deemed "special relationship." See, e.g., *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1141 (Colo. 1984) (en banc) (basis for tort liability for insurer's breach of good faith grounded upon special nature of insurance contract and relationship between parties). Conversely, the contractual good faith covenant is applied typically in arm's length transactions. See generally *Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 383 (1980). As a derivative contract principle, the remedy accorded a breach of the good faith and fair dealing covenant is the same awarded for any breach of contract. See, e.g., *Fortune v. National Cash Register Co.*, 364 N.E.2d 1251, 1256 (Mass. 1977) (breach of good faith and fair dealing is breach of contract).

3. See U.C.C. § 1-203 (1977) ("every contract or duty imposes obligation of good faith in its performance or enforcement"). Good faith is defined as "honesty in fact in the conduct or transaction concerned." See U.C.C. § 1-201(19) (1977). This has generally been held to be a subjective standard. See, e.g., *La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 563 (Tex. 1984) (test for good faith under U.C.C. is party's actual belief not reasonableness thereof). Only under article 2 is good faith defined to encompass a duty of fair dealing. See U.C.C. § 2-103(1)(b) (1977) (imposing standard of good faith entailing honesty in fact and observance of reasonable commercial standards of fair dealing in trade).

4. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"). The official comment to § 205 notes that the good faith requirement varies with the particular

Conceptually, the covenant is quite simple. It requires that neither party to a contract impair the right of the other party to receive the benefits of the agreement.⁶ Within the simplicity of the covenant of good faith and fair

context, but emphasizes "faithfulness to an agreed common purpose and consistency with the justified expectations of the other party." See *id.* comment a. For an overview of the adoption of § 205 as incorporated in the second edition of the RESTATEMENT OF CONTRACTS, see Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810 (1982).

5. See, e.g., *Earle R. Hanson & Assoc. v. Farmers Coop. Creamery Co.*, 403 F.2d 65, 69 (8th Cir. 1968) (interpreting Minnesota Law); *Hoffmaster v. Guiffida*, 630 F. Supp. 1289, 1290 (S.D. W. Va. 1986); *Morgan v. American Family Life Assurance Co.*, 559 F. Supp. 477, 482-83 (W.D. Va. 1983); *Chavers v. National Sec. Fire & Casualty Co.*, 405 So. 2d 1, 4 (Ala. 1981); *Guin v. Ha*, 591 P.2d 1281, 1291 (Alaska 1979); *Beaugureau v. Beaugureau*, 463 P.2d 540, 542 (Ariz. Ct. App. 1970); *Nelson v. Abraham*, 177 P.2d 931, 934 (Cal. 1947) (en banc); *Blish v. Thompson Automatics Arms Corp.*, 64 A.2d 581, 597 (Del. 1948); *Fernandez v. Vasquez*, 397 So. 2d 1171, 1174 (Fla. Dist. Ct. App. 1981); *Leader Nat'l Ins. Co. v. Smith*, 339 S.E.2d 321, 328 (Ga. Ct. App. 1985); *Martindell v. Lake Shore Nat'l Bank*, 154 N.E.2d 683, 690 (Ill. 1958); *Midwest Management Corp. v. Stephens*, 291 N.W.2d 896, 913 (Iowa 1980); *National Safe Corp. v. Benedict & Myrick, Inc.*, 371 So. 2d 792, 795 (La. 1979); *Food Fair Stores, Inc. v. Blumberg*, 200 A.2d 166, 174 (Md. 1964); *Fortune v. National Cash Register Co.*, 364 N.E.2d 1251, 1256 (Mass. 1977); *Faust & Forden, Inc. v. Greenbaum*, 421 S.W.2d 809, 813 (Mo. Ct. App. 1967); *Seaward Constr. Co. v. City of Rochester*, 383 A.2d 707, 708 (N.H. 1978); *Onderdonk v. Presbyterian Homes*, 425 A.2d 1057, 1062 (N.J. 1981); *Rowe v. Great Atl. & Pac. Tea Co.*, 385 N.E.2d 566, 569 (N.Y. 1978); *Weyerhaeuser Co. v. Godwin Bldg. Supply Co.*, 253 S.E.2d 625, 627 (N.C. Ct. App. 1979); *Miles v. N.J. Motors, Inc.*, 338 N.E.2d 784, 787 (Ohio Ct. App. 1975); *Western Natural Gas Co. v. Cities Serv. Gas. Co.*, 507 P.2d 1236, 1241 (Okla.), *cert. denied*, 409 U.S. 1052 (1972); *Comini v. Union Oil Co.*, 562 P.2d 175, 176 (Or. 1977); *Diamon v. Penn Mut. Fire Ins. Co.*, 372 A.2d 1218, 1226-27 (Penn. 1977); *Commercial Credit Corp. v. Nelson Motors, Inc.*, 147 S.E.2d 481, 484 (S.C. 1966); *Resource Management Co. v. Weston Ranch & Livestock Co.*, 706 P.2d 1028, 1037 (Utah 1985); *H.P. Hood & Sons v. Heins*, 205 A.2d 561, 566 (Vt. 1964); *Metropolitan Park Dist. v. Griffith*, 723 P.2d 1093, 1100 (Wash. 1986) (en banc); *In re Estate of Chayka v. Santini*, 176 N.W.2d 561, 564 (Wisc. 1970). Some jurisdictions, although not explicitly recognizing contractual good faith duties, have implied duties of cooperation on contracting parties. See, e.g., *Bolmer v. Kocet*, 507 A.2d 129, 136 (Conn. Ct. App. 1986) (implied contractual obligations of cooperation imposed upon parties); *Odem Realty Co. v. Dyer*, 45 S.W.2d 838, 840 (Ky. Ct. App. 1932) (contractual obligations imposed only as not to prevent performance). Other states recognize the covenant of good faith and fair dealing only in limited contexts. See, e.g., *Pittman v. Larson Distrib. Co.*, 724 P.2d 1379, 1385 (Colo. App. 1986) (refusing to extend contractual good faith covenant recognized under Colorado U.C.C. to employment contracts). Montana and Texas, conversely, recognize the common law good faith doctrine as a tort principle, refusing to imply good faith duties as obligations arising under a contract. See *Nicholson v. United Pac. Ins. Co.*, 710 P.2d 1342, 1348 (Mont. 1985) (good faith covenant not a duty arising under contract); *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983) (no contractual duties of good faith and fair dealing recognized).

6. See, e.g., *Beaugureau v. Beaugureau*, 463 P.2d 540, 542 (Ariz. Ct. App. 1970) (implied obligation of cooperation so each contracting party may receive full benefit of performance); *Carrico v. Delp*, 490 N.E.2d 972, 976 (Ill. Ct. App. 1986) (good faith covenant requires party vested with contractual discretion to exercise it reasonably).

dealing, however, lies its importance. The good faith duty provides the courts with increased flexibility to find a breach of contract in egregious contractual performance not synonymous with a traditional express contract breach.⁷ Courts, armed with the ability to interpret, expand, and supplement contract terms with implied good faith duties, are thus able to inject equity into the resolution of contract disputes not previously actionable under traditional contract breach theory.⁸ With the almost universal acceptance of the contractual good faith and fair dealing doctrine, it is seemingly inevitable that the covenant will evolve into a general principle of American contract law.

In 1983, the Texas Supreme Court in *English v. Fischer*⁹ addressed the issue of whether there exists contractual obligations of good faith and fair dealing, tersely answering in the negative.¹⁰ In the same opinion, however, the court tacitly recognized that a duty of good faith and fair dealing does exist in some contracts.¹¹ The seemingly inimical attitude toward the good faith covenant, coupled with a tacit recognition of limited contractual good faith and fair dealing duties, has resulted in much confusion as to the survival and status of the good faith and fair dealing doctrine in Texas. Only recently has the Texas Supreme Court defined the role of good faith and fair dealing.¹² Rather than adopting the derivative contractual covenant of good faith as universally recognized, Texas now recognizes a new tort—breach of the duty of good faith and fair dealing.¹³

7. See generally Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 811-12 (1982). Professor Summers notes that the good faith tool has permitted courts to remedy previously irredressable bad faith contract performance. See *id.* at 812. The types of bad faith performances redressable by the good faith duties include evasion of the spirit of the contract, lack of diligence in performance, and interference or failure to cooperate in the other party's performance. See *id.* at 813.

8. See, e.g., *Fernandez v. Vasquez*, 397 So. 2d 1171, 1174 (Fla. Dist. Ct. App. 1981) (unlimited power to withhold consent in lease assignment must be exercised in good faith or breach of contract results); *Davis v. Professional Business Servs.*, 712 P.2d 511, 515 (Idaho 1985) (duty of good faith imposed to require cooperation in termination of contractual relationship); *Midwest Management Corp. v. Stephens*, 291 N.W.2d 896, 913 (Iowa 1980) (reservation of absolute right to terminate subscription agreement must be exercised in good faith).

9. 660 S.W.2d 521 (Tex. 1983).

10. See *id.* at 522. The Texas Supreme Court noted that to adopt the laudatory-sounding theory of good faith and fair dealing would be contrary to the long-established adversary system which has ably served Texas for over 150 years. See *id.*

11. Cf. *id.* (stating only that there is not an obligation of good faith and fair dealing in every contract).

12. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (recognizing breach of good faith and fair dealing duty as independent tort in first-party insurance context).

13. See *id.* (damages recoverable for breach of good faith and fair dealing duty owed by insurer to insured in handling claim same as in any other breach of duty).

This comment will assert that the Texas Supreme Court's recognition of this new tort is both a dangerously expansive precedent and a misinterpretation of the merits of the contractual covenant of good faith as it is generally recognized. This comment will first trace the evolving role and status of implied contractual covenants in Texas. Next, it will discuss other jurisdictions' utilization of the good faith and fair dealing covenant, and the rise of the bad-faith breach of contract tort doctrine. Finally, an overview of the Texas courts' interpretation of surviving good faith duties after *English v. Fischer*¹⁴ will be presented, culminating with the Texas Supreme Court's recent recognition of the tort cause of action for breach of duty of good faith and fair dealing.

II. THE ROLE OF IMPLIED CONTRACTUAL COVENANTS IN TEXAS

A. Texas Courts' Traditional Disfavor of Implied Contractual Covenants

Enforcement of implied contractual covenants has traditionally been disfavored by Texas courts.¹⁵ When confronted with an alleged breach of contract, the courts generally will not entertain arguments of implied duties which attempt to interpret or vary express contract terms.¹⁶ Rather, the focus of Texas courts has been to narrowly enforce contractual obligations expressed by the parties.¹⁷ As enunciated by the Texas Supreme Court in *Danciger Oil & Refining Co. v. Powell*,¹⁸ "It is not enough to say that an implied covenant is necessary in order to make the contract fair, or that without such a covenant it would be improvident or unwise, or that the con-

14. 660 S.W.2d 521 (Tex. 1983).

15. See, e.g., *Emmer v. Phillips Petroleum Co.*, 668 S.W.2d 487, 490 (Tex. App.—Amarillo 1984, no writ) (if parties have expressly stated contract terms, they are bound to exclusion of conflicting implied terms); *Lone Star Steel Co. v. Wahl*, 636 S.W.2d 217, 220 (Tex. App.—Texarkana 1982, no writ) (provisions implied only if necessary to effectuate intentions of parties); *Calvin V. Koltermann, Inc. v. Underream Piling Co.*, 563 S.W.2d 950, 957 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.) (court cannot make contract for parties by implying covenants unnecessary to give effect to contract as whole).

16. See *Exxon Corp. v. Atlantic Richfield Co.*, 678 S.W.2d 944, 947 (Tex. 1984) (where parties expressly provided terms whereby contracts could be terminated, courts will imply no covenant varying written terms).

17. See *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408, 410 (Tex. App.—San Antonio 1986, writ requested) (express contract right to foreclosure by bank upheld despite repeated offers of full payment by mortgagor after default); *Cook Consultants, Inc. v. Larson*, 677 S.W.2d 718, 720 (Tex. App.—Dallas 1984) (where title policy held unambiguous effect given to intent of parties as expressed in instrument), *rev'd in part on other grounds*, 690 S.W.2d 567 (Tex. 1985).

18. 137 Tex. 484, 154 S.W.2d 632 (1941). In *Danciger*, the plaintiff, as vendor, alleged that under a mineral conveyance to the defendant there existed an implied covenant to develop the property for oil and gas mining purposes. See *id.* at 486, 154 S.W.2d at 633. The Texas Supreme Court held that no implied covenant existed as it was not necessary to effect the intent of the parties. See *id.* at 490, 154 S.W.2d at 636.

tract would operate unjustly."¹⁹ Rather, the implied covenant must be necessary to give effect to the purposes of the contract or be so clearly within the parties' contemplation that its inclusion is deemed unnecessary.²⁰ The sanctity accorded the right of parties to arm's length transactions to contract as they please, has been consistently reaffirmed by the Texas courts.²¹ In adhering to enforcement of express contract terms, Texas courts maintain a reluctance to imply contractual covenants not clearly intended by the parties.

B. *Statutory And Common Law Good Faith Duties*

The Texas courts' traditional reluctance to recognize implied good faith duties has been modified by various statutory enactments.²² Most notably, the Texas Uniform Commercial Code has required implied covenants of good faith in all transactions involving the sale of goods.²³ Under the Uniform Commercial Code, the legislature has recognized that good faith duties play a derivative, yet viable, role in the resolution of contract disputes.²⁴

19. *See id.* at 490, 154 S.W.2d at 635.

20. *See id.* at 490, 154 S.W.2d at 635; *see also* *Kutka v. Temporaries, Inc.*, 568 F. Supp. 1527, 1535 (S.D. Tex. 1983) (additional implied provisions must be indispensable to effect parties' intent); *Calvin V. Koltermann, Inc. v. Underream Piling Co.*, 563 S.W.2d 950, 957 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.) (covenant will be implied only if evident from express terms that parties intended it or such covenant is necessary to effectuate purpose of contract).

21. *See Exxon Corp. v. Atlantic Richfield Co.*, 678 S.W.2d 944, 947 (Tex. 1984) (express contract terms cannot be varied by implied covenants); *English v. Fischer*, 660 S.W.2d 521, 523 (Tex. 1983) (no implied conditions may vary express agreement in deed of trust regarding disbursement of insurance proceeds).

22. *See, e.g.*, TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968) (good faith duties imposed upon all transactions under Code); *id.* § 17.50(c) (Vernon Supp. 1987) (under Deceptive Trade Practices Act, suit brought in bad faith entitles defendant to attorneys' fees and court costs); TEX. INS. CODE ANN. art. 21.21, § 16(c) (Vernon Supp. 1987) (suit brought under this section in bad faith entitles defendant to attorneys' fees and court costs); *id.* art. 21.21-2, § 2(d) (Vernon 1981) (insurers must attempt in good faith to effectuate fair and equitable settlements with their insureds).

23. *See* TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968) (every contract or duty within Act imposes obligation of good faith in performance or enforcement). Good faith requirements are explicitly required throughout the Code. *See, e.g., id.* § 2-305(b) (price to be fixed by seller or buyer means price set in good faith); *id.* § 2-306(1) (output of seller or requirement of buyer means such output or requirement as may occur in good faith); *id.* § 2-311(a) (particulars of performance specified by party to contract must be made in good faith); *id.* § 3.302(a)(2) (requirements for holder in due course include taking instrument in good faith).

24. *See, e.g., La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 563 (Tex. 1984) (bank's failure to act in good faith under depository contract is breach of contract under Texas Uniform Commercial Code); *Printing Center v. Supermind Publishing Co.*, 669 S.W.2d 779, 784 (Tex. App.—Houston [14th Dist.] 1984, no writ) (proof that buyer rejected goods in bad

Further, although not based in contract law, the Texas Deceptive Trade Practices Act and the Texas Insurance Code incorporate statutory good faith requirements.²⁵ A suit brought in bad faith under either the Texas Deceptive Trade Practices Act or article 21.21 of the Texas Insurance Code entitles the defendant to recovery of his attorney's fees and court costs.²⁶ Thus, the legislature has again recognized the viability of the good faith concept.

In addition to statutory good faith duties, obligations of good faith and fair dealing have traditionally been recognized in certain relationships entailing duties of trust and faith between the parties.²⁷ Conceptually, these good faith duties are recognized as arising out of the relationship itself and not the

faith under article 2 of Texas Uniform Commercial Code would support action for breach of contract).

25. See TEX. BUS. & COM. CODE ANN. § 17.50(c) (Vernon Supp. 1987) (suit brought under article 21.21 in bad faith subject to sanctions); see also TEX. INS. CODE ANN. art. 21.21, § 16(c) (Vernon Supp. 1987) (suit brought under article 21.21 in bad faith subject to sanctions); *id.* art. 21.21-2 (imposing good faith requirements on insurers in settlement practices). Bad faith has been defined under section 17.50 of the Texas Deceptive Trade Practices Act as conduct motivated by malicious or discriminatory purposes. See TEX. BUS. & COM. CODE ANN. § 17.50(c) (Vernon Supp. 1987); see also *Group Hosp. Servs., v. One & Two Brookover Center*, 704 S.W.2d 886, 891 (Tex. App.—Dallas 1986, no writ) (requiring knowledge of falsity of claim or malicious intent by claimant); *Glasgow v. Hall*, 668 S.W.2d 863, 865 (Tex. App.—Austin 1984, writ ref'd n.r.e.) (party must know his actions are wrong and with such knowledge act with intentional disregard for others' rights). See generally Lynn, *Of White Knights And Black Knights: An Analysis of the 1979 Amendments to the Deceptive Trade Practices Act*, 33 Sw. L.J. 941, 988 (1979) (consumer's claim must be motivated by discriminatory or malicious purpose).

26. See TEX. BUS. & COM. CODE ANN. § 17.50(c) (Vernon Supp. 1987) (reasonable and necessary attorneys' fees and court costs recoverable); TEX. INS. CODE ANN. art. 21.21 § 16(c) (Vernon Supp. 1987) (reasonable and necessary attorneys' fees and court costs recoverable).

27. See, e.g., *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (owner of executive rights owes duty of utmost good faith to mineral estate); *Amoco Prod. Co. v. First Baptist Church*, 611 S.W.2d 610, 610 (Tex. 1980) (per curiam) (working interest owner in gas lease owes duty of good faith in marketing gas for royalty owners); *Johnson v. Peckham*, 132 Tex. 148, 151-52, 120 S.W.2d 786, 787 (1938) (partners owe each other duties of good faith); *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929, holding approved) (insurer owes insured duty of ordinary care and prudence in matter of settlement); *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ) (fiduciary relationship between principal and agent requires loyalty, good faith and integrity of strictest kind); *Comanche Land & Cattle Co. v. Adams*, 688 S.W.2d 914, 915-16 (Tex. App.—Eastland 1985, no writ) (owner of leasing rights owes non-participating royalty interest owners utmost good faith); *Swift v. Priest*, 650 S.W.2d 894, 903 (Tex. App.—San Antonio 1983, writ ref'd n.r.e.) (persons engaged in joint venture owe each other utmost good faith and scrupulous honesty). Recently, the Texas Supreme Court has recognized the insurer-insured relationship as entailing good faith duties. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (insurer owes insured duty of good faith and fair dealing in settlement and resolution of claims).

contract.²⁸ Although the contract may create good faith obligations, it is only those relationships which necessitate utmost trust or arise from an imbalance of bargaining power that give rise to judicially imposed good faith duties.²⁹ This conceptualization permits the Texas courts to impose good faith requirements in special relationships while rejecting obligations of good faith as applicable to general arm's length transactions.³⁰

C. *The Scharrenbeck Implied Tort Duty*

The sanctity of parties' rights to contract as they desire, coupled with Texas' traditional disfavor of implied covenants, does not mean that a contracting party owes no duty to perform *express* contractual promises without care and diligence.³¹ In the 1946 case of *Montgomery Ward & Co. v. Scharrenbeck*,³² the Texas Supreme court laid down the general rule that "accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of contract."³³

It is well established under the *Scharrenbeck* holding that contractual relationships create both contractual obligations and concomitant tort duties.³⁴ A cause of action in tort may be found absent a breach of contract³⁵

28. See, e.g., *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984). The Texas Supreme Court stated that the duty of utmost good faith an executive owes his mineral co-owners arises solely from their relationship. The duty is not expressly or impliedly created by the contract although the contract or deed itself may create the relationship. See *id.*

29. See *English v. Fischer*, 660 S.W.2d 521, 524 (Tex. 1983) (Spears, J., concurring). Justice Spears stated that Texas has traditionally recognized good faith duties in special relationships. The special relationship arises from the element of trust required to accomplish the goals of the transaction or an imbalance of bargaining power. See *id.* Justice Spears' concurrence in *English* has been cited with approval in the recent Texas Supreme Court opinion in *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987).

30. Compare *Manges v. Guerra*, 673 S.W.2d 180, 183-84 (Tex. 1984) (relationship between executive and mineral owners requires imposition of utmost good faith between parties) with *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408, 409-10 (Tex. App.—San Antonio 1986, writ requested) (no implied covenant of good faith in arm's length commercial transaction).

31. See, e.g., *Zidell v. Bird*, 692 S.W.2d 550, 553 (Tex. App.—Austin 1985, no writ) (party owes common law duty to perform contractual obligations with skill and faithfulness).

32. 146 Tex. 153, 204 S.W.2d 508 (1947).

33. *Id.* at 157, 204 S.W.2d at 510. In the *Scharrenbeck* case, the plaintiff sued Montgomery Ward and one of its employees for damages, alleging that the negligence of the employee in repairing and adjusting a hot water heater caused a fire destroying the plaintiff's home. See *id.* at 156, 204 S.W.2d at 509. The defendants argued that the plaintiff failed to state any fact upon which a cause of action for negligence could be stated. The court held that the contract created the relationship, out of which grew a duty to use due care. See *id.* at 157, 204 S.W.2d at 510.

34. See, e.g., *Zidell v. Bird*, 692 S.W.2d 550, 553 (Tex. App.—Austin 1985, no writ) (negligent failure to perform contractual obligation may constitute tort); *UMC, Inc. v. Coon-*

or contemporaneously with such a breach.³⁶ Since punitive damages are not recoverable for a breach of contract,³⁷ the recognition of a tort remedy is important insofar as it may redress egregious contract breaches with punitive damages.³⁸ The *Scharrenbeck* tort remedy has provided the traditional answer in Texas to remedying "bad faith" conduct in arm's length contract performance not entailing a breach.³⁹

rod Elec. Co., 667 S.W.2d 549, 558 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.) (breach of contractual duty may give rise to tort); *Archer v. Bill Pearl Drilling Co.*, 655 S.W.2d 338, 344 (Tex. App.—San Antonio 1983, writ dismiss'd) (negligent performance or negligent non-performance of contractual obligation may constitute tort).

35. See, e.g., *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986) (acts of contracting parties may create tort liability even if acts do not constitute contract breach).

36. See, e.g., *Texas Power & Light Co. v. Barnhill*, 639 S.W.2d 331, 334 (Tex. App.—Texarkana 1982, writ ref'd n.r.e.) (breach of contract and tort may arise out of same transaction); *Hyatt Creek Builders-Eng'rs Co. v. Board of Regents of the Univ. of Tex. Sys.*, 607 S.W.2d 258, 263 (Tex. Civ. App.—Texarkana 1980, writ dismiss'd) (negligent performance of contractual obligation may be tort as well as breach of contract).

37. See, e.g., *Manges v. Guerra*, 673 S.W.2d 180, 184 (Tex. 1984) (suit for breach of contract will not support exemplary damages even if breach malicious or capricious); *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 571 (Tex. 1981) (exemplary damages not allowed even if contract breach intentional); *A.L. Carter Lumber Co. v. Saide*, 140 Tex. 523, 526, 168 S.W.2d 629, 631 (1943) (exemplary damages not recoverable for simple breach of contract). The objective of Texas courts in awarding contract damages is to place the injured party in as good a position as if the contract had been fully performed. See *Stewart v. Basey*, 150 Tex. 666, 670, 245 S.W.2d 484, 486 (1952) (measure for breach of contract is compensation for loss or damage actually sustained); *North Am. Corp. v. Allen*, 636 S.W.2d 797, 799 (Tex. App.—Corpus Christi 1982, no writ) (only loss or damage compensated); *Chrysler Corp. v. Schuenemann*, 618 S.W.2d 799, 805 (Tex. Civ. App.—Houston [1st Dist.] 1981, writ ref'd n.r.e.) (complaining party entitled to recover amount necessary to be put in as good a position as if contract performed); *Cretien v. Kincaid*, 84 S.W.2d 1094, 1097 (Tex. Civ. App.—San Antonio 1935) (injured party should be put as nearly as possible in stance he would have been in had other party performed contract), *aff'd*, 130 Tex. 513, 111 S.W.2d 1098 (1938); see also TEX. BUS. & COM. CODE ANN. § 1.106 (Tex. UCC) (Vernon 1968) (remedies provided by Act to ensure that "aggrieved party may be put in as good a position as if other party had fully performed").

38. See *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986) (distinct tort with actual damages must be proved before exemplary damages awarded); *City Prods. Corp. v. Berman*, 610 S.W.2d 446, 450 (Tex. 1980) (if distinct tort proved in connection with contract breach, punitive damages may be awarded); *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ) (rule precluding punitive damages for breach of contract limited to instances where contract breach did not also constitute willful tort). The state of mind necessary to permit recovery of punitive damages is one of ill will, spite, evil motive, or purposely causing injury to another. See *Clements v. Withers*, 437 S.W.2d 818, 822 (Tex. 1969).

39. See *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986) (under *Scharrenbeck* duty, breach of contractual obligations may constitute tort regardless of presence or absence of breach of contract). The injured party must plead and prove an independently recognized tort cause of action. Without the recognition of such a tort, the focus of the court is on whether a breach of contract occurred. See *id.* Subjective motives of the breaching party

III. THE IMPLIED CONTRACTUAL COVENANT OF GOOD FAITH AND FAIR DEALING IN OTHER JURISDICTIONS

A. *The Implied Contractual Covenant of Good Faith and Fair Dealing as a Derivative Contract Principle*

In the vast majority of jurisdictions which recognize the implied contractual covenant of good faith and fair dealing, conduct traditionally not considered a breach of contract may be considered a breach of the covenant of good faith and fair dealing.⁴⁰ The good faith covenant is an expansive doctrine implemented by courts to impose equity into often stark contract disputes.⁴¹ The implied duty of good faith does not override express contractual obligations;⁴² rather, it has been utilized to supplement and interpret unclear contract obligations⁴³ or to require a degree of good faith performance in effecting express contractual promises.⁴⁴ The good faith

are irrelevant. *See Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 571 (Tex. 1981) (absent proof of independent tort, question centers on contract breach wherein motives of breaching party irrelevant).

40. *See, e.g., Sylvan Crest Sand & Gravel Co. v. United States*, 150 F.2d 642, 644 (2nd Cir. 1945) (concept of good faith implied to construe "cancellation at any time" to mean "reasonable time"); *Midwest Management Corp. v. Stephens*, 291 N.W.2d 896, 913 (Iowa 1980) (absolute right to terminate subscription agreement must be exercised in good faith); *National Safe Corp. v. Benedict & Myrick, Inc.*, 371 So. 2d 792, 795 (La. 1979) (regardless of fact no contractual provision prohibited solicitation of defendant's employees, defendant could claim breach of contract based upon breach of good faith duties).

41. *See generally* Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 370-71 (1980) (concept of good faith is license for judicial intervention to protect reasonable expectations of parties); Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 812 (1982) (good faith concept is tool to redress bad faith not remedied under traditional contract theory).

42. *See, e.g., Murphy v. American Home Prods. Corp.*, 448 N.E.2d 86, 91 (N.Y. 1983) (no good faith obligation may be imposed which is inconsistent with other contract terms).

43. *See, e.g., Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1289 (N.D. Ill. 1983) (good faith duties come into play in defining and modifying express contract duties); *Davis v. Professional Business Servs., Inc.*, 712 P.2d 511, 515 (Idaho 1985) (duties upon contract termination supplemented with good faith duties to cooperate in smooth transition); *National Safe Corp. v. Benedict & Myrick, Inc.*, 371 So. 2d 792, 795 (La. 1979) (contract terms supplemented with good faith duties prohibiting solicitation of defendant's employees by plaintiff). Under transactions governed by the U.C.C., the good faith requirements have likewise been utilized to interpret and enforce contractual obligations. *See, e.g., Management Assistance, Inc. v. Computer Dimensions, Inc.*, 546 F. Supp. 666, 677 (N.D. Ga. 1982) (good faith duty in Georgia Uniform Commercial Code transaction is derivative tool in interpretation of contract obligations). *See generally* Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497, 502 (1984) (good faith duties necessary to supplement omissions in contractual agreements and interpret vague obligations).

44. *See, e.g., Fernandez v. Vasquez*, 397 So. 2d 1171, 1174 (Fla. Dist. Ct. App. 1981) (express right to withhold consent in lease assignment interpreted to mean good faith withholding of consent); *Midwest Management Corp. v. Stephens*, 291 N.W.2d 896, 913 (Iowa

doctrine augments the courts' power to hold a party's bad faith conduct to be a breach of contract even though a party's conduct may be within the letter of the agreement.⁴⁵

Although an operational definition of what constitutes good faith or bad faith has not been clearly articulated,⁴⁶ it is certain that contract terms alone are not sufficient to determine a party's good faith performance.⁴⁷ In *Onderdonk v. Presbyterian Homes*,⁴⁸ the New Jersey Supreme Court utilized the good faith doctrine to impose duties on the parties despite the absence of an express contractual agreement.⁴⁹ In *Onderdonk*, the residents of a retirement community sued the corporation managing the residence, alleging that the corporation was misappropriating their monthly fees by subsidizing activities unrelated to the operation of the residence.⁵⁰ The residents alleged the corporation's failure to submit to adequate periodic accountings was a breach of contract.⁵¹ Although accountings were not expressly required under the contracts, the court cited the duty of good faith and fair dealing as determinative.⁵² The New Jersey Supreme Court reasoned that the duty to account was not only necessary to give efficacy to the contracts as written,

1980) (express right to terminate subscription agreement interpreted to mean good faith exercise of termination).

45. See, e.g., *National Safe Corp. v. Benedict & Myrick, Inc.*, 371 So. 2d 792, 795 (La. 1979) (breach of good faith duty is breach of contract); *Fortune v. National Cash Register Co.*, 364 N.E.2d 1251, 1256-57 (Mass. 1977) (termination of employment without good faith constitutes breach of contract). See generally *Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 373-74 & n.21 (1980) (remedies awarded for bad faith performance parallel those awarded for standard breach of contract).

46. See, e.g., *Egan v. Mutual of Omaha Ins. Co.*, 620 P.2d 141, 145 (Cal. 1979) (en banc) (nature and extent of good faith duties depends on contractual purposes); *Davis v. Professional Business Servs., Inc.*, 712 P.2d 511, 514 (Idaho 1985) (good faith duties defined from specific circumstances under which particular contract made). See generally RESTATEMENT (SECOND) OF CONTRACTS § 205 comment a (1981) (meaning of good faith varies with context).

47. See, e.g., *Rigby Corp. v. Boatmen's Bank & Trust Co.*, 713 S.W.2d 517, 533 (Mo. Ct. App. 1986) (in performance of contract one who "evades the spirit of the deal" and hinders performance acts in bad faith). See generally *Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 371 (1980). Professor Burton states that where a party is given discretion in future decision-making, or the contract omits or is vague on the contractual obligations, the good faith covenant acts as a gap filler to interpret and enforce contractual obligations. See *id.* at 380.

48. 425 A.2d 1057 (N.J. 1981).

49. See *id.* at 1062.

50. See *id.* at 1060.

51. See *id.* at 1062. The residents alleged that an implied covenant existed under the contract requiring the corporation to submit meaningful financial statements. The lower appellate court in *Onderdonk* rejected this argument, holding that, inasmuch as there was no overreaching in the negotiation of the contracts, no implied obligation should be used to write in a provision the parties themselves had omitted. See *id.*

52. See *id.* The New Jersey Supreme Court stated that the duty of good faith imposed upon the corporation an obligation to account. The corporation was precluded from acting in

but was also a duty encompassed by the good faith covenant.⁵³ As illustrated in *Onderdonk*, discretion is given to the fact finder to determine if a party acted in bad faith.⁵⁴ This discretion provides increased flexibility and power to a court to inject a "modicum of morality" into the obligations owed under a contract.⁵⁵

B. *The New Tort: Bad Faith Breach of the Duty of Good Faith and Fair Dealing*

The trend toward compensating parties injured by bad faith breaches of contract has led courts in certain contexts to elevate the implied covenant of good faith and fair dealing to the status of an independent tort.⁵⁶ The bad faith tort doctrine imposes, as a matter of law,⁵⁷ duties of good faith and fair dealing in judicially recognized "special relationships."⁵⁸ A breach of the bad faith tort doctrine occurs when one party impairs the right of the other party to receive the fruits of the agreement.⁵⁹ Upon a finding of a breach,

any manner which would injure the rights of the residents to receive the fruits of the agreement. *See id.*

53. *See id.* The duty to account was implied from the express contract terms and was also a condition imposed on grounds of fairness and justice. *See id.* at 1062, 1065-66.

54. *See id.*; see also *Dorsey Bros. v. Anderson*, 287 A.2d 270, 273 (Md. 1972) (presence of bad faith is question of fact); *Pernet v. Peabody Eng'g Corp.*, 248 N.Y.S.2d 132, 135 (App. Div. 1964) (whether acts constituted bad faith will depend on facts presented).

55. *See Onderdonk v. Presbyterian Homes*, 425 A.2d 1057, 1062 (N.J. 1982) (condition imposed by good faith duties serves fairness and justice). *See generally* Comment, *Tort Remedies for Breach of Contract: The Expansion of Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing into the Commercial Realm*, 86 COLUM. L. REV. 377, 380 (1986) (good faith and fair dealing covenant has introduced a modicum of morality into contract law).

56. *See, e.g., Seaman's Direct Buying Serv. v. Standard Oil Co.*, 686 P.2d 1158, 1166-67 (Cal. 1984) (en banc) (extending tort liability to commercial context where party breaches contract and in bad faith denies existence of contract); *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1037 (Cal. 1973) (en banc) (tort liability imposed on insurer for bad faith refusal to pay an insured's claim); *Gates v. Life of Mont. Ins. Co.*, 668 P.2d 213, 215 (Mont. 1983) (bad faith tort recognized in employment context).

57. *See, e.g., Noble v. National Am. Life Ins. Co.*, 624 P.2d 866, 869 (Ariz. 1981) (en banc) (good faith duties are implied in contract by law); *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1037 (Cal. 1973) (en banc) (duty of good faith and fair dealing nonconsensual); *First Sec. Bank v. Goddard*, 593 P.2d 1040, 1047 (Mont. 1979) (good faith duties imposed independent of contract); *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315, 1320 (Ohio 1983) (good faith duties are legal duties imposed by law).

58. *See, e.g., Commercial Cotton Co. v. United Cal. Bank*, 209 Cal. Rptr. 551, 554 (Ct. App. 1985) (bank depositor relationship is "at least quasi-fiduciary" entailing good faith duties); *Gates v. Life of Mont. Ins. Co.*, 668 P.2d 213, 214 (Mont. 1983) (employment relationship parallels insurance relationship requiring implied tort duties of good faith and fair dealing); *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315, 1319 (Ohio 1983) (the special nature of the relationship existing between the insurer and its insured necessitates good faith requirements).

59. *See, e.g., Continental Casualty Co. v. United States Fidelity & Guar. Co.*, 516 F.

jurisdictions now recognizing the bad faith tort may award punitive damages to the injured party.⁶⁰

The tort cause of action for breach of the implied good faith covenant originated in insurance cases attempting to redress bad faith practices in third-party settlement cases.⁶¹ Under this theory tort liability was imposed on an insurer who in bad faith refused to settle a claim, thereby subjecting the insured to personal liability for any amounts over the policy limit.⁶² Under traditional contract theory, the insurer, even if acting in bad faith, would only be liable up to the amount represented in the insurance policy.⁶³ With the imposition of the bad-faith tort, the insured could recover the full amount of any judgment against him upon a finding that the insurer acted in bad faith.⁶⁴ The often-cited reasoning for imposing tort liability for a bad

Supp. 384, 387 (N.D. Cal. 1981) (good faith duty precludes injuring rights of other contracting party to receive benefits of agreement); *Egan v. Mutual of Omaha Ins. Co.*, 620 P.2d 141, 145 (Cal. 1979) (en banc) (question of breach focuses on whether actions injured promisee's expected benefits of agreement), *cert. denied*, 445 U.S. 912 (1980).

60. *See, e.g.*, *Chavers v. National Sec. Fire & Casualty Co.*, 405 So. 2d 1, 7 (Ala. 1981) (insurer's bad faith refusal to settle may include tort damages for mental distress and economic loss); *Noble v. National Am. Life Ins. Co.*, 624 P.2d 866, 868 (Ariz. 1981) (en banc) (breach of good faith duties permits remedy in tort); *Bender v. Time Ins. Co.*, 286 N.W.2d 489, 493 (N.D. 1979) (breach of good faith and fair dealing duty entitled insured to all damages proximately caused thereby). Courts have generally required a showing of malice to justify an award of punitive damages. *See, e.g.*, *Silberg v. California Life Ins. Co.*, 521 P.2d 1103, 1110 (Cal. 1974) (en banc) (recovery of exemplary damages must be based upon intent to injure or conscious disregard of insured's rights); *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315, 1321 (Ohio 1983) (to justify exemplary damages defendant must have acted with actual malice). *But see* *First Sec. Bank v. Goddard*, 593 P.2d 1040, 1048-49 (Mont. 1979) (fraud or malice may be implied by law if defendant's conduct unjustifiable).

61. *See* *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 201-02 (Cal. 1958) (en banc). Originating in California, the bad faith tort doctrine was utilized to permit an insured to recover the total amount of a judgment sustained against him if the insurer refused a settlement offer while defending the insured. *See id.* at 200-01. The wrongful refusal to settle permitted recovery by the insured for the entire amount of the judgment against the insured, including any amount in excess of the policy limit. *See id.* at 202; *see also* *Crisci v. Security Ins. Co.*, 426 P.2d 173, 176-77 (Cal. 1967) (en banc) (exposing insured to risk of substantial recovery over policy limits by refusal to reasonably settle constitutes independent tort).

62. *See, e.g.*, *Crisci v. Security Ins. Co.*, 426 P.2d 173, 176 (Cal. 1967) (en banc). In *Crisci*, the insurer refused a \$10,000 settlement offer within the policy limits of its contract with the insured. *See id.* at 175. A judgment was entered against the insured for \$91,000 leaving the insured personally liable for the amounts over \$10,000. *See id.* at 176. The California Supreme Court, in finding that the insurer breached the tort of good faith and fair dealing, awarded the insured the full amount of the judgment against him, including mental anguish damages. *See id.* at 178.

63. *See* *Spencer v. Aetna Life & Casualty Ins. Co.*, 611 P.2d 149, 151 (Kan. 1980) (insured's recovery limited to contract remedy of policy's face amount plus interest); *see also* Comment, *The Emerging Fiduciary Obligations and Strict Liability Insurance Law*, 14 CAL. W.L. REV. 358, 358 (1978).

64. *See, e.g.*, *Continental Casualty Co. v. United States Fidelity & Guar. Co.*, 516 F.

faith breach on the part of the insurer is the quasi-fiduciary and adhesive nature of the insurance contract.⁶⁵ Further, as contrasted to a typical commercial contract generally entered into for pecuniary gain, the insured seeks security and peace of mind in the purchase of insurance.⁶⁶ In the third-party insurance context,⁶⁷ the bad faith tort has received almost universal acceptance.⁶⁸

Recent years have witnessed increased judicial willingness to expand tort liability arising from good faith duties beyond the third-party settlement context. Most commonly, the bad faith tort has been expanded to incorporate good faith duties on the part of the insurer in the first-party insurance context.⁶⁹ Again, the premise of imposing tort liability is the quasi-fiduciary

Supp. 384, 387 (N.D. Cal. 1981) (insurer acting in bad faith will be liable for total judgment against insured regardless if over policy limit); *Guin v. Ha*, 591 P.2d 1281, 1291 (Alaska 1979) (breach of good faith and fair dealing by insurer entitled insured to recovery of any judgment against him).

65. *See, e.g.*, *Egan v. Mutual of Omaha Ins. Co.*, 620 P.2d 141, 146 (Cal. 1979) (en banc) (bargaining power in insurance relationship unequal because of its adhesive nature), *cert. denied*, 445 U.S. 912 (1980); *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315, 1319 (Ohio 1983). The Ohio Supreme Court depicted the insurer-insured relationship as an adhesive relationship. The disparity of economic situations, and the absence of bargaining power by the insured, are cited as determinative of the special relationship. *See id.* The fiduciary nature of the relationship rests on the reservation of the insurer's exclusive right to negotiate the claim brought against the insured. *See Duncan v. Andrew County Mut. Ins. Co.*, 665 S.W.2d 13, 19 (Mo. Ct. App. 1983) (fiduciary relationship arises from insurer withholding from its insured any right to settle without insurer's consent).

66. *See, e.g.*, *Eckenrode v. Life of Am. Ins. Co.*, 470 F.2d 1, 5 (7th Cir. 1972) (purpose in buying insurance is to ensure economic and mental welfare); *D'Ambrosio v. Pennsylvania Nat'l Mut. Casualty Ins. Co.*, 396 A.2d 780, 786 (Pa. Super. Ct. 1978) (insurance contract is purchased for peace of mind, not commercial advantage). Other reasons have been offered by the courts as requiring good faith tort duties. *See Grand Sheet Metal Prods. Co. v. Protection Mut. Ins. Co.*, 375 A.2d 428, 430 (Conn. 1977) (economic effect on insured could be disastrous upon an insurer's bad faith refusal to pay).

67. *See, e.g.* *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 198 (Cal. 1958) (en banc) (insured filed suit against his insurer for failure to accept settlement offer of third-party). A third-party action should be distinguished from a first-party action, where the insured sues his insurer for failure to settle a claim the insured himself asserts. *See, e.g.*, *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1037 (Cal. 1973) (en banc) (suit for wrongful refusal to pay and settle an insured's claim).

68. *See, e.g.*, *Spencer v. Aetna Life & Casualty Ins. Co.*, 611 P.2d 149, 155 (Kan. 1980) (duties of good faith in third-party context well established). Some jurisdictions, however, impose tort liability on insurers premised on general negligence principles rather than on breach of good faith tort duties. *See State Farm Mut. Ins. Co. v. Brewer*, 406 F.2d 610, 612 (9th Cir. 1968) (insurer's duty under Oregon law in settlement practices is one of due diligence and good faith); *Ranger County Mut. Ins. Co. v. Guin*, 30 Tex. Sup. Ct. J. 159, 160 (Jan. 21, 1987) (insurer owes duty to use reasonable care in settlement of third-party claims, including investigation and preparation of lawsuit).

69. *See, e.g.*, *Guin v. Ha*, 591 P.2d 1281, 1291 (Alaska 1979) (undue delay in settlement of insured's claim is breach of bad faith tort); *Noble v. National Am. Life Ins. Co.*, 624 P.2d

or "special" nature of the relationship.⁷⁰ Some jurisdictions have expansively applied the good faith covenant to impose tort liability in employment,⁷¹ banking,⁷² and commercial contexts.⁷³ By the judicial recognition of a "special" relationship, an injured party may forego the traditional breach of contract cause of action and sue in tort for a breach of the covenant of good faith and fair dealing.⁷⁴

The central criticism of the judicial expansion of the bad faith tort doctrine is its infusion of tort ideology and liability into resolution of disputes

866, 868 (Ariz. 1981) (en banc) (refusal or failure to pay valid claim without justification is breach of bad faith tort); Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1037 (Cal. 1973) (en banc) (refusal, without cause, to compensate insured under claim may give rise to tort cause of action); Hoskins v. Aetna Life Ins. Co., 452 N.E. 2d 1315, 1319 (Ohio 1983) (expanding good faith duties owed in third-party claim to include first-party context). *But see* Spencer v. Aetna Life & Casualty Ins. Co., 611 P.2d 149, 157-58 (Kan. 1980) (refusing to extend bad faith tort to first-party insurance context). The court in *Spencer* found the first-party relationship distinguishable from the third-party relationship. In the first-party context, there is no possibility of exposing the insured to judgments in excess of his policy limits. The insurer does not maintain the exclusive control of the defense which gives rise to fiduciary obligations. Rather, in the first-party relationship, the relationship is adversarial not fiduciary. *See id.* at 155. Further, as the legislature has provided a remedy for an insurer's bad faith settlement practices, the insured has redress under statute. *See id.* at 158; *see also* Duncan v. Andrew County Mut. Ins. Co., 665 S.W.2d 13, 19-20 (Mo. Ct. App. 1983) (refusing extension of bad faith tort to pay first-party claims in view of statutory remedy and absence of fiduciary relationship); A.A.A. Pool Serv. & Supply, Inc. v. Aetna Casualty & Sur. Co., 395 A.2d 724, 726 (R.I. 1978) (legislative remedies exclusive for insurer's failure to settle in good faith).

70. *See, e.g.,* Christian v. American Home Assurance Co., 577 P.2d 899, 904 (Okla. 1978) (extending rationale of special relationship in third-party to first-party insurance context); Anderson v. Continental Ins. Co., 271 N.W.2d 368, 375 (Wis. 1978) (fiduciary nature of insurance relationships requires good faith and fair dealing in settlement practices).

71. *See, e.g.,* Wallis v. Superior Court, 207 Cal. Rptr. 123, 129 (Ct. App. 1984) (good faith tort duties imposed in employment context because of gross disparity in bargaining power); Gates v. Life of Mont. Ins. Co., 668 P.2d 213, 214 (Mont. 1983) (employer has duty much like insurer's duty to act in good faith in discharging contractual obligations).

72. *See* Commercial Cotton, Inc. v. United Cal. Bank, 209 Cal. Rptr. 551, 554 (Ct. App. 1985). The court in *Commercial Cotton* held good faith duties are imposed upon banks because depositors are dependent on their banks and seek security in using the banks' services. The relationship between the bank and depositor is "at least quasi-fiduciary." *Id.*

73. *See* Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 686 P.2d 1158, 1167 (Cal. 1984) (en banc). In *Seaman*, the California Supreme Court applied the bad faith tort to a general commercial contract by departing from the theory requiring a "special relationship" between the parties. *See id.* at 1166-67. The court in *Seaman* held that, absent a special relationship, tort liability would only be imposed if, in addition to breaching the contract the party "seeks to shield itself from liability by denying, in bad faith and without probable cause that the contract exists." *See id.* at 1167. *See generally* Note, *Extending the Bad Faith Tort Doctrine to General Commercial Contracts*, 65 B.U.L. REV. 355 (1985) (extensively discussing *Seaman* and its effect in extending tort liability into general commercial realm).

74. *See, e.g.,* Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315, 1320 (Ohio 1983) (special insurer-insured relationship gives rise to independent tort cause of action for bad faith breach).

historically addressed and remedied by contract theory.⁷⁵ Tort law is directed at compensating the injured party and punishing the tortfeasor if his conduct was willful.⁷⁶ Conversely, under contract theory the goal is to return the injured party to the position he would have been in had the breaching party performed.⁷⁷ Punishment, regardless of the breaching party's motives, has not been a contract theory concern.⁷⁸ The bad faith tort blurs this distinction. The tort cause of action indicates judicial dissatisfaction with existing contract remedies and a willingness to both redress injury and punish the wrongdoer.⁷⁹ Under this view, the necessity of punishing bad faith contractual performance outweighs the preservation of the traditional distinctions between contract and tort law. The majority of jurisdictions have refused to expand the bad faith breach as a cognizable tort outside the limited insurance context.⁸⁰ These same jurisdictions, however, do recognize the contractual duty of good faith and fair dealing as a derivative con-

75. See Snow, *Excess Liability—Crisci and Lysick*, 36 INS. COUNS. J. 51, 54 (1969) (use of the bad faith tort doctrine to subject contracting parties to tort liability renders meaningless traditional distinctions between contract and tort liability).

76. See W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON TORTS 5-6 (5th ed. 1984). The function of tort law is directed toward compensation of individuals for losses suffered within the scope of legally recognized interests. Where a tortfeasor's wrongdoing is intentional and deliberate, punitive damages may be awarded to punish the defendant and deter others from following the defendant's example. See *id.*

77. See 5 A. CORBIN, CONTRACTS § 1076 (1964) (damages for breach of contract restricted to compensation for pecuniary harm). Under the universally accepted rule of *Hadley v. Baxendale*, contract recovery is limited to those damages reasonably foreseeable at the time the contract is entered and those damages which are unforeseeable, if the breaching party had actual notice of such damages at the time of contracting. See *Hadley v. Baxendale*, 156 Eng. Rep. 145, 147 (Ex. Ch. 1854). See generally RESTATEMENT (SECOND) OF CONTRACTS § 351 (1979).

78. See generally 5 A. CORBIN, CONTRACTS § 1077 (1964) (punitive damages not recoverable for breach of contract).

79. See *Spencer v. Aetna Life & Casualty Ins. Co.*, 611 P.2d 149, 151 (Kan. 1980) (recognition of bad faith tort is judicial response to quest to provide for "every wrong a remedy"); see also Note, *The Availability of Excess Damages for Wrongful Refusal to Honor First Party Insurance Claims—An Emerging Trend*, 45 FORDHAM L. REV. 164, 166 (1976) (without the recognition of such tort, insurance company can deny coverage or delay payment with no more penalty than interest on amount owed). See generally Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 111 (1981) (discussing inadequacies of traditional contract remedies).

80. See, e.g., *Battista v. Lebanon Trotting Ass'n*, 538 F.2d 111, 118 (6th Cir. 1976) (under Ohio law, special considerations in insurer-insured relationship do not apply to ordinary commercial transaction); *Iron Mountain Sec. Storage Corp. v. American Specialty Foods, Inc.*, 457 F. Supp. 1158, 1166 (E.D. Pa. 1978) (refusing to extend bad faith tort cause of action outside insurance arena into general commercial realm); *Aluevich v. Harrah's*, 660 P.2d 986, 987 (Nev. 1983) (refusing to recognize bad faith tort outside insurance context), *cert. denied*, 465 U.S. 1006 (1984).

cept in the resolution of contract disputes.⁸¹

IV. THE *ENGLISH V. FISCHER* DECISION

A. *The Texas Supreme Court's Interpretation and Rejection of the Implied Contractual Covenant of Good Faith and Fair Dealing*

In *English v. Fischer*,⁸² a homeowner sued his mortgagee alleging that the mortgagee breached the duty of good faith and fair dealing owed to the homeowner in failing to turn over fire insurance proceeds to assist the homeowner in rebuilding following a fire.⁸³ The mortgagee initially agreed to turn over the insurance proceeds; however, she instead applied the proceeds to the promissory note as expressly authorized under the deed of trust.⁸⁴ Repairs were delayed for a year, resulting in an increased cost of repair.⁸⁵ The district court awarded the plaintiff damages on the theory of breach of the covenant of good faith and fair dealing.⁸⁶ The Corpus Christi Court of Appeals affirmed this award.⁸⁷ The Texas Supreme Court reversed, noting that the deed of trust expressly provided that disbursement of the insurance proceeds would be paid to the mortgagee.⁸⁸ The court refused to override the

81. Compare *Iron Mountain Sec. Storage Corp. v. American Specialty Foods, Inc.*, 457 F. Supp. 1158, 1166-67 (E.D. Pa. 1978) (bad faith tort only applicable in special insurer-insured relationship) with *Comini v. Union Oil Co.*, 562 P.2d 175, 176 (Or. 1977) (contractual covenant of good faith and fair dealing implied in every contract).

82. 660 S.W.2d 521 (Tex. 1983).

83. See *id.* at 522. The Fischers, as purchasers, were required to carry fire insurance on the property in favor of the lienholder, Mrs. English. See *English v. Fischer*, 649 S.W.2d 83, 85 (Tex. App.—Corpus Christi 1982), *rev'd*, 660 S.W.2d 521 (Tex. 1983).

84. See *English v. Fischer*, 649 S.W.2d 83, 86 (Tex. App.—Corpus Christi 1982), *rev'd*, 660 S.W.2d 521 (Tex. 1983). Mrs. English verbally agreed to turn over the proceeds but, after conferring with her ex-husband, who was an attorney, she decided not to. Because of escalating interest rates and the language of the deed of trust, he advised her to insist that the unpaid note balance be paid off in full. See *id.*

85. See *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983). Fischer alleged that the delay in repair was due to his inability to obtain a loan for repairs without the insurance proceeds. See *id.*

86. See *English v. Fischer*, 649 S.W.2d 83, 88 (Tex. App.—Corpus Christi 1982), *rev'd*, 660 S.W.2d 521 (Tex. 1983). The special issue submitted to the jury was whether English breached an implied warranty of good faith and fair dealing. Such a warranty required the mortgagee to cooperate with the mortgagor so that the insurance proceeds would be used in the best interests of both parties. See *id.* As the jury found a breach of the good faith warranty, damages were recoverable in an amount equalling the difference between the cost of repair when the funds should have been paid and such cost when actually incurred by the homeowners. See *id.* at 91.

87. See *id.* at 90-91.

88. See *English v. Fischer*, 660 S.W.2d 521, 523 (Tex. 1983). The deed of trust provided that the insurance monies "shall be" payable to English. The Corpus Christi Court of Appeals, although acknowledging that the deed of trust provided that payments were to be made to the mortgagee, focused on the purpose of maintaining insurance on the property. The court

express contractual provisions and place the mortgagee under a "threat of treble damages" through a good faith and fair dealing argument.⁸⁹ The Texas Supreme Court could have recognized that the duty of good faith and fair dealing was inapplicable to the facts of the case; however, the court held a contractual duty of good faith and fair dealing is not implied in every contract, thus departing from the strong majority view.⁹⁰

The *English* opinion reaffirms the Texas Supreme Court's traditional commitment to enforcing express contract terms as written.⁹¹ Yet, the court erroneously assumed that a breach of the covenant of good faith and fair dealing necessarily entails an award of treble damages.⁹² A breach of the contractual covenant of good faith and fair dealing entailing traditional contract liability must be distinguished from the bad faith breach of contract tort.⁹³ Only under limited circumstances have jurisdictions elevated a breach of the covenant of good faith and fair dealing to the status of an independent tort.⁹⁴ Rather, the majority of jurisdictions utilize the good

found that the intent in obtaining the insurance was to provide the Fischers with a fund to repair and the mortgagee with additional security to the extent of the debt. *See English v. Fischer*, 649 S.W.2d 83, 87-88 (Tex. App.—Corpus Christi 1982), *rev'd*, 660 S.W.2d 521 (Tex. 1983). Since the mortgagee's security was not impaired and the mortgagor was not in default, the court held that there existed a good faith duty to turn over the insurance proceeds to the homeowners to permit repair. *See id.* at 89.

89. *See English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983). The court stated that to "adopt the laudatory sounding theory of 'good faith and fair dealing' would place a party under the onerous threat of treble damages should he seek to compel his adversary to perform according to the contract terms as agreed upon by the parties." *Id.*

90. *Compare* Great Atl. & Pac. Tea Co., 385 N.E.2d 566, 569 (N.Y. 1978) (duty of good faith in performance imposed in all contracts) *with English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983) (covenant of good faith and fair dealing not implied in every contract).

91. *See English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983) (focusing on agreement as made by the parties and embodied in contract itself).

92. *See id.* (*English* court refused to award treble damages under laudatory sounding theory of breach of good faith and fair dealing). Most jurisdictions hold that a breach of the good faith covenant entitles the injured party solely to a remedy in contract. *See, e.g., Rigby Corp. v. Boatmen's Bank & Trust Co.*, 713 S.W.2d 517, 536 (Mo. Ct. App. 1986) (breach of contractual duty of good faith and fair dealing under Missouri U.C.C. gives rise to action in contract only). *See generally* Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 374 & n.21 (1980) (remedies awarded in bad faith performance cases same as those awarded "for any garden variety breach of contract").

93. *See Carrico v. Delp*, 490 N.E.2d 972, 977 (Ill. Ct. App. 1986) (finding that party breached covenant of good faith and fair dealing is not synonymous with breach of good faith duty entailing remedy in tort). Without a finding of a special relationship, the remedy accorded a breach of good faith obligations sounds in contract. *Compare* Fortune v. National Cash Register Co., 364 N.E.2d 1251, 1256 (Mass. 1977) (remedy in contract accorded breach of contractual duty of good faith imposed in all contracts) *with Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315, 1320 (Ohio 1983) (premise of tort liability for breach of good faith duties due solely to special relationship between insurer and insured).

94. *See, e.g., Kennedy Elec. Co. v. Moore-Handley, Inc.*, 437 So. 2d 76, 81 (Ala. 1983)

faith covenant as an equitable and derivative tool in resolving contract disputes.⁹⁵ Without recognizing good faith and fair dealing as a derivative contract principle, the Texas Supreme Court rejected the concept. After *English*, questions remained concerning the survival of the good faith argument in Texas.

B. *Implied Contractual Covenants Surviving English v. Fischer*

It is interesting to note that none of the *English* opinions—majority, concurring or dissenting—mentioned the *Scharrenbeck* duties, thus posing a question as to their vitality.⁹⁶ However, in 1986, the Texas Supreme Court reaffirmed its approval of the implied *Scharrenbeck* tort duty in *Jim Walter Homes, Inc. v. Reed*,⁹⁷ stating that a contractual relationship may create duties under contract and tort law.⁹⁸ With the *Scharrenbeck* implied tort duty intact after *English*, a distinction should be noted between the contractual obligation of good faith and fair dealing rejected by the supreme court and the imposed *Scharrenbeck* duty which the court has reaffirmed as a vital contractual concern. The *Scharrenbeck* tort doctrine requires a separate tort, independent and apart from a breach of contract to be pled and proven before tort liability will arise.⁹⁹ Without an independent allegation of a rec-

(although every contract imposes good faith obligations, tort remedy for breach thereof will not be extended outside area of insurance cases); *Aluevich v. Harrah's*, 660 P.2d 986, 987 (Nev. 1983) (while recognizing applicability of bad faith tort in insurance context, refusing to extend tort to general commercial situation), *cert. denied*, 465 U.S. 1006 (1984).

95. *See, e.g., Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1289 (N.D. Ill. 1983) (good faith obligations used derivatively to define and modify express contract terms).

96. *See generally Fleuriot, Alternate Causes of Action: Supplementing your DTPA Case*, in *SUING AND DEFENDING UNDER THE DECEPTIVE TRADE PRACTICES ACT F-19* (State Bar of Texas 1985). The author notes that the *Scharrenbeck* duties requiring faithfulness and care in performance of contractual obligations seem to conflict with the *English* court's proscription of good faith contractual duties. *See id.*

97. 711 S.W.2d 617 (Tex. 1986). In *Reed*, the plaintiff homeowner sued his builder alleging, in part, gross negligence in the builder's performance of the contractual obligation to construct the plaintiff's home. *See id.* at 617. The Corpus Christi Court of Appeals affirmed the trial court's award of exemplary damages but increased the amount of remittitur ordered by the trial court. *See Jim Walter Homes, Inc. v. Reed*, 703 S.W.2d 701, 707 (Tex. App.—Corpus Christi 1985), *rev'd*, 711 S.W.2d 617 (Tex. 1986).

98. *See Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986). The Texas Supreme Court, delineating what constitutes a breach of the implied *Scharrenbeck* tort duty, focused on the nature of the injury as being determinative. When the only injury is the "economic loss to the subject of a contract itself, the action sounds in contract alone." As the only injury alleged was that the house promised was not the house received, the court reversed the jury award of exemplary damages. *See id.*

99. *See id.* (to recover punitive damages plaintiff must prove distinct tort injury with actual damages); *see also Texas Power & Light Co. v. Barnhill*, 639 S.W.2d 331, 334 (Tex. App.—Texarkana 1982, writ ref'd n.r.e.) (separate tort must be pleaded and proven to recover exemplary damages arising out of contractual duties).

ognized tort, the issue in an arm's length contract dispute will center simply on whether a breach of contract occurred, regardless of ill-motives or bad faith on the part of the breaching party.¹⁰⁰ After *English*, a party to a contract still owes the *Scharrenbeck* duty to perform express contractual obligations with care and diligence.¹⁰¹ Theoretically, that same party owes no duty to cooperate with the other party to ensure he receives expected benefits from the agreement.¹⁰²

C. *Special Relationships As Determinative of the Tort Duty of Good Faith and Fair Dealing*

The vague directive of the court in *English* that a covenant of good faith and fair dealing is not to be found in every contract¹⁰³ left subsequent courts with the task of discerning what implied good faith duties remained.¹⁰⁴ It is clear that obligations of good faith have survived.¹⁰⁵ What is not clear is the status of the contractual covenant of good faith and fair dealing.¹⁰⁶ Subse-

100. See e.g., *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408, 409-10 (Tex. App.—San Antonio 1986, writ requested) (whether breach occurred in arm's length contract determined from contract terms, regardless of good or bad faith motives of contracting parties).

101. See, e.g., *Zidell v. Bird*, 692 S.W.2d 550, 553 (Tex. App.—Austin 1985, no writ) (party owes *Scharrenbeck* duty to perform contractual obligations with reasonable care and skill).

102. See, e.g., *Cook Consultants, Inc. v. Larson*, 677 S.W.2d 718, 720-21 (Tex. App.—Dallas 1984) (no implied duties of good faith and fair dealing between mortgagor and title policy issuer), *rev'd in part on other grounds*, 690 S.W.2d 567 (Tex. 1985). See generally Fleuriot, *Alternate Causes of Action: Supplementing your DTPA Case*, in SUING AND DEFENDING UNDER THE DECEPTIVE TRADE PRACTICES ACT F-19 (State Bar of Texas 1985) (implied contractual covenant of good faith, rejected under *English*, must be distinguished from *Scharrenbeck* concept of inherent contractual duties imposed as tort concept).

103. See *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983).

104. See *id.* at 524 (Spears, J., concurring). Justice Spears agreed that implied good faith duties should not be used to override express contract terms. However, this Justice stated that Texas courts have found implied good faith and fair dealing duties in many contractually based transactions where a specific relationship is involved. See *id.* Similar good faith duties are implied under all contracts governed by the Texas Uniform Commercial Code. See *id.* at 525. Justice Spears further noted that in situations which recognized good faith duties, public policy would require that they could not be disclaimed. See *id.* The majority in *Fischer*, however, failed to address these traditionally imposed good faith and fair dealing obligations. Courts, subsequent to *English*, distinguished a contractual covenant of good faith rejected in *English* from a duty of good faith traditionally recognized in certain relationships. See, e.g., *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (good faith duties arise from relationships, not from contractual obligation); *Aetna Casualty & Sur. Co. v. Marshall*, 699 S.W.2d 896, 901 (Tex. App.—Houston [1st Dist.] 1985) (*English* did not abolish good faith duties found previously in recognized special relationships), *aff'd*, 30 Tex. Sup. Ct. J. 155 (Jan. 21, 1987).

105. See *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (fiduciary relationships imposing utmost good faith duties on parties upheld).

106. Compare *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408, 409-10 (Tex. App.—San Antonio 1986, writ requested) (right to foreclose under deed of trust upon default upheld

quent Texas courts, including the Texas Supreme Court, have distinguished *English* by recognizing a good faith duty as arising out of the relationship of the contracting parties rather than being inherent in the contract itself.¹⁰⁷ A contract may, however, create the requisite relationship.¹⁰⁸ Those relationships traditionally recognized as requiring high duties of faith and trust between the parties have been reaffirmed as surviving with good faith requirements.¹⁰⁹ Subsequent to *English*, courts have uniformly rejected arguments of imposed duties of good faith and fair dealing involving parties to general arm's length transactions.¹¹⁰

regardless of good or bad faith motives of lender) *with* State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661, 685 (Tex. App.—El Paso 1984, writ dismissed by agr.) (lender cannot in bad faith use threat of foreclosure under deed of trust to obtain economic advantage). In *Cluck*, the debtor defaulted on a promissory note and the bank instituted foreclosure proceedings. *See Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408, 409 (Tex. App.—San Antonio 1986, writ requested). Despite the debtor's repeated offers of full payment of the deficiency, the bank refused his tender and accelerated the note. *See id.* The San Antonio Court of Appeals refused to vary the contract terms by finding implied good faith covenants, and held that the bank had an express right to refuse the debtor's tender after default. *See id.* at 410. Conversely, in *Farah*, the debtor corporation was not in default on the note. *See State Nat'l Bank v. Farah Mfg. Co.*, 678 S.W.2d 661, 686 (Tex. App.—El Paso 1984, writ dismissed by agr.). The right to foreclose, however, was premised not only upon default, but also on any unauthorized change in the management of the corporate debtor. Although the management clause was violated by the debtor, invoking a legitimate right to foreclosure, the El Paso Court of Appeals held that the manner in which foreclosure threats were made constituted actionable economic duress. *See id.* Under the recognized tort theory of duress, the court in *Farah* was able to redress deemed "bad faith" practices on the part of a lender in exercising foreclosure rights. *See id.* The *Cluck* and *Farah* opinions indicate a judicial willingness to redress bad faith conduct in general commercial transactions only upon a showing of a concomitant breach of a recognized tort duty.

107. *See Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (duty of good faith and fair dealing owed by insurer to insured arises out of special relationship and is not contractual covenant); *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (good faith duties do not arise from express or implied terms of contract but from relationship); *Comanche Land & Cattle Co. v. Adams*, 688 S.W.2d 914, 916 (Tex. App.—Eastland 1985, no writ) (duty of utmost good faith owed by executive of mineral estate arises solely from relationship).

108. *See, e.g., Aetna Casualty & Sur. Co. v. Marshall*, 699 S.W.2d 896, 901 (Tex. App.—Houston [1st Dist.] 1985) (contract may create special relationship between parties including duty of good faith and fair dealing), *aff'd*, 30 Tex. Sup. Ct. J. 155 (Jan. 21, 1987).

109. *See, e.g., Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (executive owes good faith duties to mineral estate); *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ) (fiduciaries owe strictest loyalty and good faith in contractual obligations); *Texas Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24, 29 (Tex. App.—Texarkana 1984, writ granted) (lessee owes highest good faith toward lessors). The Texas courts' recognition of traditional good faith duties in relationships entailing trust and faith have followed Justice Spears' concurring opinion in *English*, recognizing special relationships. *See English v. Fischer*, 660 S.W.2d 521, 524 (Tex. 1983) (Spears, J. concurring).

110. *See, e.g., Exxon Corp. v. Atlantic Richfield Co.*, 678 S.W.2d 944, 947 (Tex. 1984)

A cumulative analysis of Texas case law subsequent to *English* indicates that the "special relationship" has been the core of a successful breach of the good faith duty argument.¹¹¹ Nevertheless, since Texas recognizes the breach of a fiduciary obligation as an independent tort, many suits are often not brought under a cause of action for breach of implied duties of good faith and fair dealing;¹¹² rather, the cause of action arises solely out of a recognized tort cause of action—breach of a fiduciary duty.¹¹³ Courts construing *English* have been inconsistent in finding a direct cause of action based purely on a breach of duties of good faith and fair dealing.¹¹⁴ The

(commercial contract expressly providing terms by which contracts could be terminated will not be varied by good faith arguments); *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408, 410 (Tex. App.—San Antonio 1986, writ requested) (right to accelerate under deed of trust cannot be varied by implied good faith covenant); *Cook Consultants, Inc. v. Larson*, 677 S.W.2d 718, 720-21 (Tex. App.—Dallas 1984) (title policy does not imply good faith duties on contracting parties), *rev'd in part on other grounds*, 690 S.W.2d 567 (Tex. 1985).

111. Compare *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (special nature of insurance relationship necessitates good faith tort duties); *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (utmost good faith owed by mineral executive arises from relationship); *Cantu v. Western Fire & Casualty Ins. Co.*, 716 S.W.2d 737, 739 (Tex. App.—Corpus Christi 1986) (refusing to recognize good faith tort duties in first-party insurance relationship), *writ ref'd n.r.e. per curiam*, 30 Tex. Sup. Ct. J. 216, 217 (Feb. 11, 1987) (noting no approval of court of appeals holding regarding duty of good faith and fair dealing); *Christensen v. Integrity Ins. Co.*, 709 S.W.2d 724, 729 (Tex. App.—Houston [14th Dist.]) (*English* did not abolish previously existing special relationships entailing good faith duties such as in insurance context), *rev'd on other grounds*, 719 S.W.2d 161 (Tex. 1986); *Aetna Casualty & Sur. Co.*, 699 S.W.2d 896, 901 (Tex. App.—Houston [1st Dist.] 1985) (insurance contracts create special relationships entailing good faith duties), *aff'd*, 30 Tex. Sup. Ct. J. 155 (Jan. 21, 1987); *Comanche Land & Cattle Co. v. Adams*, 688 S.W.2d 914, 915 (Tex. App.—Eastland 1985, no writ) (good faith duties owed by executive to mineral estate arise from relationship) *with Exxon Corp. v. Atlantic Richfield Co.*, 678 S.W.2d 944, 947 (Tex. 1984) (no good faith duties implied in commercial contract); *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408, 409 (Tex. App.—San Antonio 1986, writ granted) (no implied good faith obligations in commercial contract to vary express terms); *Cook Consultants, Inc. v. Larson*, 677 S.W.2d 718, 720-21 (Tex. App.—Dallas 1984) (no good faith and fair dealing duty between mortgagor and title company under issuance of title policy), *rev'd on other grounds*, 690 S.W.2d 567 (Tex. 1985); *Chitsey v. National Lloyd's Ins. Co.*, 698 S.W.2d 766, 771 (Tex. App.—Austin 1985, writ granted) (no good faith duties imposed upon insurer in ascertaining amount due under insured's claim).

112. See *Manges v. Guerra*, 673 S.W.2d 180, 184 (Tex. 1984) (breach of fiduciary duty entailing good faith duties provides injured party remedy in tort); see also *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ). The court in *Douglas* characterized an alleged and conclusively proved breach of fiduciary duty as a tort. Breach of a fiduciary duty as a cause of action is recognized if a party breaches the good faith duties imposed by the relationship. Analytically, these good faith duties are elements of the cause of action for breach of a fiduciary duty and not the basis of a separate cause of action. See *id.*

113. See *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ).

114. Compare *Comanche Land & Cattle Co. v. Adams*, 688 S.W.2d 914, 915-16 (Tex.

trend of the Texas courts after *English* has been to reaffirm existing good faith duties arising out of relationships entailing fiduciary obligations.¹¹⁵

V. THE INSURER-INSURED RELATIONSHIP: RECOGNITION AND
EVOLUTION OF THE TORT DUTY OF GOOD FAITH
AND FAIR DEALING

A. *The Tort Duty of Good Faith and Fair Dealing After
English v. Fischer*

After *English v. Fischer*, the most litigated and inconsistent application of good faith obligations revolved around the role of good faith and fair dealing in the first-party insurance context. In the third-party context, Texas has redressed bad faith settlement practices under the well-established *Stowers Doctrine*,¹¹⁶ providing an insured a private cause of action sounding in negligence.¹¹⁷ In the first-party context, bad faith settlement practices have traditionally been governed under article 21.21-2 of the Texas Insurance Code, interpreted by courts as precluding any private cause of action.¹¹⁸ After

App.—Eastland 1985, no writ) (breach of utmost duty of good faith entitles injured party to damages) *with* Douglas v. Aztec Petroleum Corp., 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ) (breach of fiduciary duty entailing good faith requirements entitles injured party to exemplary damages).

115. *See, e.g.*, Manges v. Guerra, 673 S.W.2d 180, 183 (Tex. 1984) (executive owes fiduciary duties to mineral estate owners); Douglas v. Aztec Petroleum Corp., 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ) (fiduciaries owe each other utmost good faith); Comanche Land & Cattle Co. v. Adams, 688 S.W.2d 914, 916 (Tex. App.—Eastland 1985, no writ) (executive of mineral estate owes utmost good faith to royalty owners); Heritage Resources, Inc. v. Anschutz Corp., 689 S.W.2d 952, 956 (Tex. App.—El Paso 1985, writ ref'd n.r.e.) (joint venturers owe each other duty of utmost good faith and fair dealing).

116. *See* G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929, holding approved). In this widely cited case, the Texas Commission of Appeals recognized that an insurer owes its insured in settlement matters that degree of "care and diligence which a man of ordinary care and prudence would exercise in the management of his own business." *Id.* Under *Stowers*, lack of good faith or fraudulent conduct may support a tort cause of action for negligence by the insured. *See id.* at 547, 548. The *Stowers* doctrine has recently been reaffirmed and expanded in Ranger County Mut. Ins. Co. v. Guin, 30 Tex. Sup. Ct. J. 159 (Jan. 21, 1987). The Texas Supreme Court held that a *Stowers* doctrine suit incorporates all aspects of the agency relationship between the insurer and its insured. A *Stowers* cause of action may redress not only an insurer's failure to settle in response to an unconditional offer to settle within the policy limits, but further compensates the plaintiff for "investigation, preparation for defense of the lawsuit, trial of the case and reasonable attempts to settle." *Id.* at 160. The narrow question of an insurer's bad faith refusal to settle, recognized under *Stowers*, now incorporates a broader question—simply whether an insurer acted in bad faith in its handling of the claim.

117. *See, e.g.*, Ranger County Mut. Ins. Co. v. Guin, 30 Tex. Sup. Ct. J. 159, 160 (Jan. 21, 1987) (insurer owes insured reasonable care and prudence in third-party settlement practices).

118. *See* TEX. INS. CODE ANN. art. 21.21-2 (Vernon 1981). Unfair claim settlement

English v. Fischer, however, some appellate courts, by denoting the insurance relationship as "special", have acknowledged a private cause of action by an insured for breach of good faith duties in the first-party insurance context.¹¹⁹ Other courts, construing *English* broadly, have refused to impose any previously unrecognized good faith obligations upon insurers.¹²⁰ The determinative factor in discerning if an insurer owed a duty of good faith and fair dealing to its insured was simply the particular jurisdiction where the suit was filed.

practices are defined as an insurer's failure to attempt "in good faith to effectuate prompt, fair, and equitable settlements of claims submitted in which liability has become reasonably clear." *Id.* § 2(d). The penalties imposed upon an insurer for bad faith settlement practices are governed by the State Board of Insurance. If the State Board of Insurance finds a violation, it will issue a cease and desist order to stop such unlawful practices. The Board further has the power to revoke or suspend the insurer's certificate of authority. *See id.* § 6(a). Article 21.21-2 of the Texas Insurance Code has consistently been interpreted as the exclusive remedy for redressing bad faith settlement practices in the first-party context. *See McKnight v. Ideal Mut. Ins. Co.*, 534 F. Supp. 362, 364-65 (N.D. Tex. 1982) (no private cause of action accorded under article 21.21-2); *Texas Farm Bureau Mut. Ins. Co. v. Vail*, 695 S.W.2d 692, 694 (Tex. App.—Dallas 1985, no writ) (legislature intended to seal off unfair claim settlements with article 21.21-2 from expansive language of Texas Deceptive Trade Practices Act and Texas Insurance Code); *Hi-Line Elec. Co. v. Travelers Ins. Co.*, 587 S.W.2d 488, 490 (Tex. Civ. App.—Dallas 1979, writ ref'd n.r.e.) (article 21.21-2 confers no private cause of action); *Lone Star Life Ins. Co. v. Griffin*, 574 S.W.2d 576, 580 (Tex. Civ. App.—Beaumont 1978, writ ref'd n.r.e.) (legislature intended that article 21.21-2 remedies be exclusive).

119. *See Christensen v. Integrity Ins. Co.*, 709 S.W.2d 724, 729 (Tex. App.—Houston [14th Dist.]), *rev'd on other grounds*, 719 S.W.2d 161 (Tex. 1986); *Aetna Casualty & Sur. Co. v. Marshall*, 699 S.W.2d 896, 906 (Tex. App.—Houston [1st Dist.] 1985), *aff'd*, 30 Tex. Sup. Ct. J. 155 (Jan. 21, 1987). The Houston Court of Appeals for the First District held that an insurer is bound by duties of good faith and fair dealing when handling its insured's claims. *See id.* The court noted that *English* did not abolish good faith duties in previously existing "special relationships." The court reasoned that since the inception of the *Stowers* doctrine, Texas courts have recognized that the insurer-insured relationship is such a "special relationship." By analogy, the court extended the special relationship rationale in the third-party context recognized in *Stowers* to the first-party context. *See id.* On appeal, the Texas Supreme Court declined to address the good faith allegation, affirming on other grounds. *See Aetna Casualty & Sur. Co. v. Marshall*, 30 Tex. Sup. Ct. J. 155, 156-57 (Jan. 21, 1987).

120. *See Thompson v. M & B Constr. Corp.*, 585 F. Supp. 561, 563-64 (N.D. Tex. 1984) (under *English*, no good faith duties may be imposed to state cause of action for an insurer's bad faith in adjusting loss); *Chitsey v. National Lloyd's Ins. Co.*, 698 S.W.2d 766, 771 (Tex. App.—Austin 1985, writ granted) (no covenant of good faith imposed upon insurer for alleged bad faith in settling amount due under policy); *Cantu v. Western Fire & Casualty Ins. Co.*, 716 S.W.2d 737, 739 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.) (no cause of action stated for breach of implied duty of good faith owed by insurer in settlement of claim). In refusing the application for writ of error, the Texas Supreme Court stated, in a per curiam opinion, that its refusal of writ was not to be construed as approving of the language of the Corpus Christi Court of Appeals regarding the duty of good faith and fair dealing. *See Cantu v. Western Fire & Casualty Ins. Co.*, 30 Tex. Sup. Ct. J. 216, 217 (Feb. 11, 1987).

B. *The New Tort for Texas: Breach of the Duty of Good Faith and Fair Dealing*

In the case of *Arnold v. National County Mutual Fire Insurance Co.*,¹²¹ the Texas Supreme Court squarely addressed and adopted the duty of good faith and fair dealing in the first-party insurance context.¹²² In *Arnold*, an insured motorcyclist, after being severely injured in an accident, timely requested his policy payments from his insurer, National County Mutual.¹²³ Despite recommendations from an independent insurance adjusting firm to pay the entire policy limit, the insurer refused to pay.¹²⁴ The insured was forced to sue the other motorist involved, as well as National County Mutual.¹²⁵ Upon judgment in the insured's favor, National County Mutual paid Arnold's claim in full.¹²⁶ The insured subsequently filed suit against National County Mutual alleging that the insurer breached statutory duties¹²⁷ and its common law duty of good faith and fair dealing.¹²⁸ The Houston Court of Appeals for the First District affirmed the trial court's summary judgment in favor of National County Mutual, holding that all causes of action were barred by the statute of limitations.¹²⁹ The Texas Supreme Court, however, reversed the lower courts' holding that Arnold had failed to state a cause of action for breach of the good faith and fair dealing duty.¹³⁰ Under *Arnold*, the Texas Supreme Court recognized a new tort: breach of the duty of good faith and fair dealing owed by an insurer in the first-party insurance

121. 30 Tex. Sup. Ct. J. 177 (Jan. 28, 1987).

122. *See id.* at 178.

123. *See id.* at 177. Arnold was severely injured when he was struck by a car operated by an uninsured motorist. His policy with National County Mutual included uninsured motorist protection with a \$10,000 limit. *See id.*

124. *See id.*

125. *See id.* at 178. Arnold obtained judgments against both defendants. *See id.*

126. *See id.* The evidence in Arnold's motion for summary judgment established that National County Mutual based its decision to deny the claim on the advice of its agent who was the attorney handling the file. Although the uninsured motorist admitted the accident was his fault, National County Mutual refused to settle. The attorney for National County Mutual testified in his deposition that he was inexperienced in insurance matters and based his conclusion to deny payment on his perception that juries would be prejudiced against motorcyclists, and, further, that Arnold was speeding and intoxicated. The defenses were deemed "weak at best" and intoxication was not even pled. National County Mutual failed to investigate any facts supporting its attorney's contentions. *See id.*

127. *See id.* The insured alleged violations of the Texas Deceptive Trade Practices Act and articles 21.21 and 21.21-2 of the Texas Insurance Code. *See id.*

128. *See id.*

129. *See id.* The court of appeals' opinion was not published. *See id.* at 177.

130. *See id.* at 178. The Texas Supreme Court held an insurer has a duty to deal fairly and in good faith with its insureds. *See id.* The statute of limitations begins to run on a good faith and fair dealing claim when the underlying contract claims are ultimately resolved. *See id.* at 179.

context.¹³¹

The Texas Supreme Court in *Arnold* held that the duty of good faith and fair dealing arises from the special relationship found within the insurance context.¹³² The court in *Arnold* recognized that

[a] cause of action for breach of the duty of good faith and fair dealing is stated when it is alleged that there is no reasonable basis for denial of a claim or payment or a failure on the part of the insurer to determine whether there is any reasonable basis for the denial or delay.¹³³

Under this test, the insurer's conduct is measured by a negligence standard.¹³⁴ Damages are recoverable under the same principles as in other tort actions and may include exemplary and mental anguish damages.¹³⁵

The recognition in *Arnold* of a cause of action for a breach of an insurer's duty of good faith and fair dealing in the first-party insurance context has important consequences. First, the Texas Supreme Court expressly recognized that a breach of the duty of good faith and fair dealing is, in and of itself, an independent tort providing a new substantive remedy for an insured faced with bad faith settlement practices.¹³⁶ Although narrowly recognized

131. *See id.* at 178.

132. *See id.* The court viewed as determinative the unequal bargaining power between the parties and the possibility of abuse by insurers in settling claims. The insurer may arbitrarily deny coverage and delay settlement with no more penalty than interest on the amount owed. Further, insurance companies have exclusive control over the "evaluation, processing, and denial of claims." *Id.*

133. *Id.*

134. *See id.* The Texas Supreme Court cited the *Stowers* standard requiring reasonable care and diligence. *See id.*

135. *See id.* at 179.

136. *See id.* at 178. In creating the new bad faith tort, the Texas Supreme Court did not address article 21.21-2 of the Texas Insurance Code which has been interpreted consistently as the exclusive remedy for an insurer's bad faith practices in the first-party settlement context. *See id.*; *see also* General Accident, Fire & Life Assurance Corp. v. Legate, 578 S.W.2d 505, 506 (Tex. Civ. App.—Texarkana 1979, writ ref'd n.r.e.) (article 21.21-2 confers no private cause of action). *See generally* Comment, *An Insurer's Failure to Settle: Standing Under the Stowers Doctrine, Texas Deceptive Trade Practices Act, and Article 21.21 of the Insurance Code*, 34 BAYLOR L. REV. 441, 447 (1982) (Texas legislature did not intend to create private cause of action for unfair claim settlement practices). Courts in other jurisdictions, with legislative statutes paralleling Texas' Insurance Code article 21.21-2 have not been uniform in recognizing the new bad faith tort doctrine in the first-party context. *Compare* Seaman v. Liberty Mut. Ins. Co., 322 N.W.2d 35, 43 (Iowa 1982) (legislative remedy exclusive way to redress bad faith settlement practices) *with* Jenkins v. J. C. Penney Casualty Ins. Co., 280 S.E.2d 252, 258 (W.Va. 1981) (private cause of action implied to redress bad faith settlement practices). The Texas Supreme Court has not yet addressed whether an insured, claiming payments from an insurer governed under the Texas Worker's Compensation Act, likewise has a direct cause of action against his insurer for bad faith settlement practices. *See* Aetna Casualty & Sur. Co. v.

in the first-party insurance context, the framework is laid for expansion of bad faith tort liability outside of insurance disputes.¹³⁷ The bad faith tort must be differentiated from the traditionally recognized breach of fiduciary duty tort.¹³⁸ The two torts are not substantively synonymous.¹³⁹ After *Arnold*, a party to a judicially-deemed special relationship may have two common law tort causes of action—the bad faith tort *and* the breach of fiduciary duty tort.¹⁴⁰ It is arguable that a “special relationship” plaintiff, if unable to establish the recognized fiduciary tort, may be able to establish the newly

Marshall, 30 Tex. Sup. Ct. J. 155, 156-57 (Jan. 21, 1987) (declining to address good faith duties owed by worker's compensation carrier). *But see* *Aranda v. Insurance Co. of N. Am.*, 722 S.W.2d 755, 757-58 (Tex. App.—Houston [14th Dist.] 1986, no writ) (no cause of action stated for breach of good faith duties owed by worker's compensation carrier to its insured).

137. *See Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987). The Texas Supreme Court held that the special relationship existing between the insurer and insured was the basis for implying good faith tort duties. *See id.* In so doing, the court added the insurance relationship to existing judicially-deemed “special relationships.” *See, e.g., Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984) (executive owes mineral estate utmost good faith premised on parties' special relationship); *Heritage Resources, Inc. v. Anschultz Corp.*, 689 S.W.2d 952, 956 (Tex. App.—El Paso 1985, no writ) (parties to joint venture owe each other duty of utmost good faith and fair dealing); *see also English v. Fischer*, 660 S.W.2d 521, 524 (Tex. 1983) (Spears, J., concurring) (noting special relationships traditionally recognized in Texas as owing good faith duties). The *Arnold* court cited *Manges* and Justice Spears' concurring opinion in *English* with approval, intimating these relationships may also provide the basis for a tort cause of action for bad faith breach of the implied duty of good faith and fair dealing. *See Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987).

138. *See Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987). The Texas Supreme Court in *Arnold* did not mention or premise the finding of a special relationship in the insurance context on the fiduciary nature of the relationship. *See id.* This approach is in accord with the general view of those jurisdictions recognizing bad faith tort duties in the first-party insurance context. *See, e.g., Duncan v. Andrew County Mut. Ins. Co.*, 665 S.W.2d 13, 19 (Mo. Ct. App. 1983) (in first-party context, insurer and insured have adversary or creditor-debtor, not fiduciary, relationship; thus good faith requirement inapplicable). Without addressing the necessity of fiduciary obligations as a requirement upon which to premise tort liability, however, it becomes easier to establish a special relationship as defined by the court in *Arnold* since a fiduciary relationship is not required for tort liability to be found. *See Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987). After *Arnold*, the tort for breach of fiduciary duties, traditionally recognized in Texas, should be distinguished from the new tort for breach of good faith and fair dealing, which does not explicitly require a fiduciary relationship. *See id.*

139. *Compare Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (tort cause of action based on breach of good faith and fair dealing imposed on parties in special relationship) *with Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ) (tort of breach of fiduciary duty entails breach of duties of loyalty, good faith and integrity of the strictest kind).

140. *See Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987). It is the absence of any requirement or mention of fiduciary obligations that distinguishes the bad faith tort from the breach of fiduciary duty tort.

recognized breach of the duty of good faith and fair dealing.¹⁴¹

Second, the bad faith tort may provide a powerful tool for Texas courts to impose tort liability on contracting parties by expansive judicial recognition of special relationships.¹⁴² By analogy to *Arnold*, a plaintiff who proves an unequal bargaining position between the contracting parties may establish a special relationship imposing good faith requirements.¹⁴³ Upon judicial recognition of such a special relationship, the confines of traditional contract

141. Compare *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (special relationship arises out of unequal bargaining power, exclusive control over settlement and possibilities of abuse in performance) with *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1962) (fiduciary relationships arise when moral, social, domestic or purely personal relationships exist between parties). In *Thigpen*, the Texas Supreme Court stated that no fiduciary obligations exist between a lender and borrower or between commercial business parties. Thus, a banker-borrower relationship or a general arm's length transaction would preclude a cause of action for breach of fiduciary duties. Other jurisdictions, however, have expansively recognized a tort cause of action for breach of good faith and fair dealing within the same context. See *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 686 P.2d 1158, 1167 (Cal. 1984) (en banc) (breach of commercial contract coupled with bad faith denial of contract's existence gives rise to tort liability); *First Nat'l Bank v. Twombly*, 689 P.2d 1226, 1230 (Mont. 1984) (upholding tort liability for breach of good faith and fair dealing duty in bank's refusal to honor lending commitment).

142. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (special relationship in insurance context is basis for recognition of bad faith tort). Other jurisdictions, under the elements of a special relationship advanced in *Arnold*, have expanded the viability of the bad faith tort doctrine outside the insurance context. See, e.g., *Commercial Cotton Co. v. United Cal. Bank*, 209 Cal. Rptr. 551, 554 (Ct. App. 1985) (imposing tort liability in bank depositor context because depositors totally dependent on bank and seek security in utilizing bank's services); *Rulon-Miller v. International Business Machines Corp.*, 208 Cal. Rptr. 524, 534-35 (Ct. App. 1984) (tort doctrine imposed in employment context due to employee's complete powerlessness to assert rights against employer); *Wallis v. Superior Court*, 207 Cal. Rptr. 123, 129 (Ct. App. 1984) (bad faith tort cause of action imposed in employment context because of special relationship paralleling insurance context including gross disparity in bargaining power); *Gates v. Life of Mont. Ins. Co.*, 668 P.2d 213, 214-15 (Mont. 1983) (tort cause of action applied to employment context because relationship parallels insurance context). Most jurisdictions have yet to expand the tort doctrine to the employment context. The Texas Supreme Court, in 1985, held an employment relationship for an indefinite term may be terminated at will with or without cause. See *Sabine Pilot Serv., Inc. v. Hauck*, 687 S.W.2d 733, 734 (Tex. 1985). The court did, however, grant a narrow exception to the employment at-will doctrine in recognizing a cause of action for an employee who refused to perform an illegal act. See *id.* In the banking context, the current and consequential opinion on writ to the Texas Supreme Court is *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408 (Tex. App.—San Antonio 1986, writ requested). As currently recognized by the San Antonio Court of Appeals, no contractual covenants of good faith and fair dealing are implied in the commercial lender context. See *id.* at 410. The court in *Cluck*, in refusing to vary express contract terms with implied good faith duties, upheld the express right to foreclose upon default, despite the debtor's repeated tender of performance. See *id.* See generally Heiman, *Impact of Common Law Theories on Lender Recovery and Liability* in EMERGING THEORIES OF LENDER LIABILITY 41-42 (1987).

143. See *Arnold v. National County Mut. Life Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan.

liability become increasingly meaningless.¹⁴⁴ The Texas Supreme Court's focus on the special relationship as determinative of good faith tort duties opens the door for expansive litigation to define and classify what relationships may be deemed judicially "special."¹⁴⁵

VI. TEXAS' REJECTION OF THE IMPLIED CONTRACTUAL COVENANT OF GOOD FAITH AND FAIR DEALING

The concept of good faith and fair dealing as a general derivative contractual obligation remains unrecognized in Texas.¹⁴⁶ Although *English* provided a negative inference that in some contracts there does indeed exist contractual good faith duties,¹⁴⁷ subsequent courts, including the Texas Supreme Court, have refused to apply a purely contractual obligation of good faith and fair dealing in every case.¹⁴⁸ Instead of applying the duty of good faith as a derivative contract principle, the courts have recognized duties of good faith and fair dealing in special relationships and have remedied the negligent performance of a contract with a recently recognized independent tort cause of action.¹⁴⁹ It is arguable that the Texas courts have miscon-

28, 1987) (duties of good faith and fair dealing may arise out of special relationship created by contract between parties).

144. See, e.g., *Betterton v. First Interstate Bank*, 800 F.2d 732, 736 (8th Cir. 1986) (recognizing tort liability within special relationships while rejecting bad faith tort in general commercial context). See generally Comment, *Extending the Bad Faith Tort Doctrine to General Commercial Contracts*, 65 B.U.L. REV. 355, 373 (1985). In addition to having different damages available, the two theories protect different interests. Tort actions are designed to prevent societal harms while contract actions protect a party's right in having promises performed. See *id.*

145. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987). The court failed to differentiate between the recognized breach of fiduciary duty tort cause of action and the bad faith tort cause of action. See *id.*

146. See *id.* (no contractual covenant of good faith and fair dealing is implied in every contract).

147. See *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983). The Texas Supreme Court only stated that there is not in every contract an implied covenant of good faith and fair dealing. See *id.*

148. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987). In addressing the contractual covenant of good faith and fair dealing, the *Arnold* court, paralleling the *English* opinion, stated its refusal to imply contractual duties in every contract. Again, the Texas Supreme Court has inferred that possible contractual good faith covenants exist. Cf. *id.*; cf. also *Exxon Corp. v. Atlantic Richfield Co.*, 678 S.W.2d 944, 947 (Tex. 1984). In *Exxon*, the Texas Supreme Court, citing *English*, refused to imply a covenant of good faith and fair dealing to vary express contract terms in a commercial arm's length transaction. The court, however, only stated there can be no good faith covenant varying express terms. See *id.* The language of the court in *Exxon* precluding only those good faith covenants which vary express obligations, appears to limit the *English* blanket proscription of imposing any good faith contractual obligations. Cf. *id.*

149. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan.

strued the import of a contractual duty of good faith and fair dealing owed under a contract. Imposing liability under a bad faith tort doctrine is not synonymous with the covenant of good faith and fair dealing, which entails a traditional contract remedy which is universally recognized.¹⁵⁰

The central argument for the adoption of the contractual duty of good faith and fair dealing must focus upon the covenant's flexibility in redressing egregious conduct in contract performance not currently actionable under Texas law.¹⁵¹ The argument must be further premised on the belief that existing remedies under Texas law are insufficient to address contractual inequities.¹⁵² It is axiomatic that a negligent failure or refusal to perform contractual obligations may give rise to a suit for a breach of contract. Additionally, Texas courts have responded to culpable contract performance by recognizing a vast array of tort causes of action available to an injured party.¹⁵³ Even the legislature, under statutes such as the Texas Deceptive

28, 1987) (good faith tort duties arise solely out of relationship, not out of contractual obligations).

150. See *Rigby Corp. v. Boatmen's Bank & Trust Co.*, 713 S.W.2d 517, 536 (Mo. Ct. App. 1986) (recovery for breach of contractual covenant of good faith and fair dealing in commercial context is limited to common law theory of contract damages). The remedies afforded under the bad faith tort and contractual good faith covenant are not synonymous. Compare *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315, 1319 (Ohio 1983) (breach of good faith duties imposed upon parties entitles injured party to remedy in tort) with *Fortune v. National Cash Register Co.*, 364 N.E.2d 1251, 1256 (Mass. 1977) (breach of contractual covenant of good faith accords remedy in contract).

151. Cf. *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983). The Texas Supreme Court, in addressing existing remedies to parties who have a contract dispute, stated that existing and long-established adversary system in Texas has ably served Texas for almost 150 years.

152. See generally Weissman, *Lender Liability: The Obligation to Act in Good Faith and Deal Fairly*, J. COM. BANK LENDING, Dec. 1986, at 5. The author parallels the rejection of contractual good faith and fair dealing duties by *English* to the encompassing role of the contractual covenant of good faith as enunciated in a California case, *Cohen v. Ratinoff*, 195 Cal. Rptr. 84 (Ct. App. 1983). See Weissman, *Lender Liability: The Obligation to Act in Good Faith and Deal Fairly*, J. COM. BANK LENDING, Dec. 1986, at 5. The author, in quoting from the *Cohen* holding, notes that there is in every contract an implied covenant of good faith and fair dealing, requiring the parties to refrain from impairing performance. Moreover, there is the duty to do everything that the contract presupposes that the parties will do to accomplish its goals. The author states California's approach is more in keeping with the trend of authority than the Texas approach. See *id.*

153. See *Montgomery Ward & Co. v. Scharrenbeck*, 146 Tex. 153, 157, 204 S.W.2d 508, 510 (1947) (breach of contractual obligations may result in tort liability). Texas courts have redressed egregious conduct arising out of arm's length contractual obligations by providing the injured party with various tort causes of action. See, e.g., *Trenholm v. Ratcliff*, 646 S.W.2d 927, 930 (Tex. 1983) (fraud); *First City Bank v. Global Auctioneers, Inc.*, 708 S.W.2d 12, 17-18 (Tex. App.—Texarkana 1986, writ ref'd n.r.e.) (misrepresentation); *Douglas v. Aztec Petroleum Corp.*, 695 S.W.2d 312, 319 (Tex. App.—Tyler 1985, no writ) (breach of fiduciary duty); *Zidell v. Bird*, 692 S.W.2d 550, 553 (Tex. App.—Austin 1985, no writ) (negligent per-

Trade Practices Act, has bestowed remedies upon parties injured as a result of culpable contract-based conduct.¹⁵⁴ Where an injured party cannot establish a breach of contract or an independent statutory or tort cause of action, the implied covenant of good faith and fair dealing acts as an umbrella providing the injured party a remedy in contract.

It is arguable that the Texas courts' inimical stance toward a contractual covenant of good faith and fair dealing is unfounded. The good faith doctrine could not be used to override express terms of the contract, thus preserving the traditional sanctity accorded to contracting parties by Texas courts.¹⁵⁵ Further, as the remedy for a breach of the contractual duty of good faith and fair dealing is the same as that awarded for a breach of contract,¹⁵⁶ the imposed duty is in accord with Texas' steadfast reluctance to impose punitive damages for a breach of contract.¹⁵⁷ To recover punitive damages, the plaintiff would still have to look to an independent tort recognized under the *Scharrenbeck* duty,¹⁵⁸ a violation under the Texas Deceptive Trade Practices Act,¹⁵⁹ or the recently recognized bad faith tort premised in

formance of contractual obligations); *State Nat'l Bank v. Farah Mfg. Co.*, 678 S.W.2d 661, 667 (Tex. App.—El Paso 1984, writ *dism'd* by agr.) (fraud, intentional interference with business relations, duress); *Christopher v. General Computer Sys., Inc.*, 560 S.W.2d 698, 707 (Tex. Civ. App.—Dallas 1977, writ *ref'd n.r.e.*) (misappropriation).

154. *See, e.g.*, *Padre Island Inv. Corp. v. Sorbera*, 677 S.W.2d 90, 92 (Tex. App.—San Antonio 1984, no writ) (contract breach damages and DTPA damages not mutually exclusive). A breach of contract alone, however, does not necessarily entail liability under the Deceptive Trade Practices Act (DTPA). *See La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 565 (Tex. 1984); *Ashford Dev., Inc. v. USLife Real Estate Servs. Corp.*, 661 S.W.2d 933, 935 (Tex. 1983).

155. *See, e.g.*, *Gordon v. Matthew Bender & Co.*, 562 F. Supp. 1286, 1289 (N.D. Ill. 1983) (principles of performance in good faith are derivative, in that they define and interpret express contract terms). *See generally* Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497, 499 (1984) (courts do not override express agreement with implied good faith covenant).

156. *See, e.g.*, *Teachers Ins. & Annuity Ass'n v. Butler*, 626 F. Supp. 1229, 1235, 1236 (S.D.N.Y. 1986) (damages for failure to negotiate in good faith over dispute in loan terms are same as those for breach of contract); *Carrico v. Delp*, 490 N.E.2d 972, 976 (Ill. App. Ct. 1986) (breach of good faith is breach of contract); *National Safe Corp. v. Benedict & Myrick, Inc.*, 371 So. 2d 792, 795 (La. 1979) (breach of good faith duty remedied under contract theory).

157. *See Manges v. Guerra*, 673 S.W.2d 180, 184 (Tex. 1984) (exemplary damages not recoverable for breach of contract even if breached intentionally or maliciously).

158. *See Montgomery Ward & Co. v. Scharrenbeck*, 146 Tex. 153, 157-58, 204 S.W.2d 508, 510 (1947) (breach of duties owed under contract may give rise to cause of action in tort). *But see* *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986) (recognized tort must be pled and proven before exemplary damages awarded).

159. *See* TEX. BUS. & COM. CODE §§ 17.45-.63 (Vernon Supp. 1987); *see also* *Padre Island Inv. Corp. v. Sorbera*, 677 S.W.2d 90, 96 (Tex. App.—San Antonio 1984, no writ). *See generally* Fleuriot, *Alternate Causes of Action: Supplementing Your DTPA Case*, in *SUING AND*

a special relationship.¹⁶⁰

The application of the contractual covenant of good faith and fair dealing is narrow. It simply provides a court more equitable power to interpret, expand, or supplement existing contract terms to produce just results out of unjust contractual performance.¹⁶¹ Without judicial recognition of a contractually-based special relationship or a contract involving the sale of goods, contracting parties in Texas today are free of implied good faith duties.¹⁶² These arm's length transactions represent the last vestiges of the traditional sanctity accorded to contracting parties without judicial or legislative imposition of contractually implied good faith duties.

VII. CONCLUSION

The Texas Supreme Court, in recognizing breach of a duty of good faith and fair dealing as a new tort for Texas, has indicated its willingness to redress bad faith performance in contractually-based transactions with a tort remedy.¹⁶³ In so doing, the Texas Supreme Court may have set a dangerously expansive precedent. With the premise of a "special relationship", the recovery of damages under traditional confines of contract law become increasingly blurred.¹⁶⁴ The dangers of the erosion between contract and tort theory necessitate a narrow interpretation of what relationships are "special" and, therefore, entail good faith and fair dealing duties. Without such limitations, the fears expressed in *English v. Fischer* could become reality—treble liability for breaches of good faith and fair dealing in contractual

DEFENDING UNDER THE DECEPTIVE TRADE PRACTICES ACT F-1 (State Bar of Texas 1985) (discussing DTPA as available remedy in contract breach).

160. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (tort remedy for breach of good faith and fair dealing in first-party insurance context).

161. See, e.g., *Rigby Corp. v. Boatmen's Bank & Trust Co.*, 713 S.W.2d 517, 533 (Mo. Ct. App. 1986) (party who evades spirit of deal and denies other party benefit of contract commits breach even if conduct is within letter of agreement); *Murphy v. American Home Prods. Corp.*, 488 N.E.2d 86, 91 (N.Y. 1983) (implied obligations of good faith used only in aid and furtherance of terms). See generally *Burton, More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497, 500 (1984) (covenant of good faith in no manner limits right of contracting parties to agree as they please).

162. See *English v. Fischer*, 660 S.W.2d 521, 524 (Tex. 1983) (Spears, J., concurring) (good faith duties imposed under Texas UCC and within judicially recognized special relationships).

163. See *Arnold v. National County Mut. Fire Ins. Co.*, 30 Tex. Sup. Ct. J. 177, 178 (Jan. 28, 1987) (inequities arising within special insurance relationship necessitates implied tort duties).

164. See, e.g., *Betterton v. First Interstate Bank*, 800 F.2d 732, 736 (8th Cir. 1986) (refusing to extend bad faith tort outside insurance arena to avoid blurring of contract/tort distinction).

1987]

COMMENT

1327

transactions actionable in Texas for over one hundred years under traditional contract theory.