Articles

Looking for Law in All the Wrong Places: Problems in Applying the Implied Covenant of Good Faith Performance

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Over the past one hundred years, the implied contractual covenant of good faith performance1 has made its way from a little known...
principle of contract interpretation to a significant doctrine with widespread applications.\(^2\) Where the law’s formalistic approach once limited contracting parties to the express terms of the contract, principles akin to those found in equity now allow a degree of flexibility in contract interpretation that was previously shunned.\(^3\)

Unfortunately, discussions of good faith in general and the implied covenant of good faith performance in particular are often laced with inconsistencies and failures to use sufficiently specific terms. While “good faith” can mean many things and impose different obligations depending on the particular strain of good faith involved, such subtle distinctions are often overlooked. The consequence of these lapses and lack of attention to detail is considerable confusion as to the nature of the covenant of good faith, when the covenant is implicated, and how claims arising from a breach of the covenant are enforced.\(^4\)

This turmoil can be seen in Pennsylvania. There, these misunderstandings and missteps have created a body of case law that is both internally inconsistent and often out of step with the case law of other jurisdictions.\(^5\) Imprecise language in court decisions, incorrect readings of the law, and decisions of other jurisdictions, especially California, have snowballed to such an extent that it is difficult to gauge how the covenant of good faith is viewed.

Pennsylvania’s experience is by no means exceptional. Nationally, judicial decisions and commentators alike have repeatedly lamented courts’ misinterpretation and misapplication of contractual good faith as leading to irreconcilable decisions.\(^6\) Often, courts have handed

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R. Griffin, *Good Faith and Fair Dealing in Commercial Lending Transactions: From Covenant to Duty and Beyond*, 49 Ohio St. L.J. 1237, 1238 (1989) (distinguishing between the “covenant of good faith” and the “duty of good faith” and noting that courts’ tendency to use the terms interchangeably has contributed to the confusion over the terms’ meanings and implications). However, for the reasons set forth infra, the term “covenant” will be used wherever possible. See infra note 143.

2. See infra text accompanying notes 9–77.
5. See infra text accompanying notes 99–195.
6. See, e.g., Wapensky v. John Hancock Mut. Life Ins. Co., 774 F. Supp. 1119, 1130 (N.D. Ill. 1991) (noting that the defendant’s proposed “leap of logic confuses the kind of good faith that is required in every contract and the fiduciary duty that is found only in certain circumstances”); Glenn v. Fleming, 799 P.2d 79, 90 (Kan. 1990) (discussing “the confusion arising from our efforts to describe the duty of good faith and to identify the situations involving bad faith/negligent duty to settle and to defend”); Hauer v. Union State Bank of Wautoma, 532 N.W.2d 456, 463 (Wis. Ct. App. 1995) (attributing confusion of lower court, which called its own proceedings a “disaster,” to “the parties’ intermingling
down broad pronouncements on the subject and subsequently reversed or scaled back their own decisions, or have seen their conclusions overturned by statute. This has made the law on the subject in numerous jurisdictions unstable, obscure, and perplexing in ways almost identical to Pennsylvania law.

This article begins by tracing the history of the implied covenant of good faith and moves to an examination of two problems that have
arisen nationally in confronting the covenant: whether the covenant is implicated in every contractual relationship or only some contractual relationships, and whether a breach of the covenant of good faith gives rise to an independent cause of action or is merely a tool of contract interpretation. Although the focus of this article is on Pennsylvania law and the involvement of Pennsylvania courts with these issues, the topics discussed are sufficiently general and the problems confronted in Pennsylvania are sufficiently common that this article should be of assistance to courts, scholars, and practitioners in other jurisdictions.\(^8\) Perhaps more importantly, this article draws attention to the hidden pitfalls that threaten a person engaging in any discussion on the implied covenant of good faith, and will help any such speaker to choose her words more carefully.

I. Origins and History of the Implied Covenant of Good Faith

A. Early Modern Developments

Although the concept of contractual good faith has origins stretching back to ancient times through eighteenth century England,\(^9\) the current form of the doctrine did not emerge until the late nineteenth and early twentieth century. Many early modern cases center on output and requirements contracts and address terms that are left to a contracting party’s discretion, including one party’s satisfaction with another party’s performance.\(^10\) Eventually, decisions es-

\(^8\) Similarly, articles addressing the implied covenant of good faith as applied in other jurisdictions may be of use to an out-of-state practitioner or scholar. See, e.g., Theresa Viani Agee, Breach of an Insurer’s Good Faith Duty to Its Insured: Tort or Contract?, 1988 UT\(A\)H L. Rev. 135; Erb, supra note 6, at 35; Mark Gergen, A Cautionary Tale About Contractual Good Faith in Texas, 72 Tex. L. Rev. 1235 (1994); John Reid Montgomery, Bid Imperfections in California Public Contracting: Carving Out a Good Faith Exception to the Void Contract Rule, 38 Santa Clara L. Rev. 205 (1997); James A. Webster, A Pound of Flesh: The Oregon Supreme Court Virtually Eliminates the Duty to Perform and Enforce Contracts in Good Faith, 75 Or. L. Rev. 493, 497-509 (1996).


\(^10\) See Burton & Andersen, supra note 1, § 2.2.1.2; John C. Weistart, Requirements and Output Contracts: Quantity Variations Under the UCC, 599 Duke L.J. 1973; see also, e.g., Loudenback Fertilizer Co. v. Tennessee Phosphate Co., 121 F. 298, 302-03 (6th Cir. 1903) (finding that fluctuations in purchases under option contract were permissible “if the result of the carrying on of the business with good faith in view of the obligations of the plaintiff to the defendant”); Baltimore & Ohio R.R. Co. v. Brydon, 3 A. 306, 309 (Md.
pousing the implied covenant of good faith reached a critical mass in New York. By 1903, the doctrine had enough support that the New York Court of Appeals could state the following with regard to a plaintiff's purchase obligations under a requirements contract:

[W]e do not mean to assert that the plaintiff had the right, under the contract, to order goods to any amount. Both parties in such a contract are bound to carry it out in a reasonable way. The obligation of good faith and fair dealing towards each other is implied in every contract of this character. The plaintiff could not use the contract for the purpose of speculation in a rising market, since that would be a plain abuse of the rights conferred, and something like a fraud upon the seller.11

Two watershed New York Court of Appeals cases are regarded as the source of the modern United States incarnation of the doctrine of contractual good faith and provide a decisive break with prior formalist thinking.12 The first of these, Wood v. Lucy, Lady Duff-Gordon,13 is a

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No one can be made by contract the final judge of his own acts, for the law writes ‘good faith’ into such agreements. No covenant of immunity can be drawn that will protect a person who acts in bad faith, because such a stipulation is against public policy, and the courts will not enforce it. Indus. & Gen. Trust v. Tod, 73 N.E. 7, 9 (N.Y. 1905); see also Genet v. President of Del. & Hudson Canal Co., 32 N.E. 1078, 1082 (N.Y. 1893) (“Good faith, honest dealing, business candor and fairness require that this contract should be enforced in the sense and with the meaning which was in the mind of both parties at the time of its execution.”).


staple of many first-year law school contracts classes. In *Wood*, the defendant had given the plaintiff the exclusive right to market her line of clothing in exchange for half of all profits.\(^{14}\) When the defendant began using other distributors, the plaintiff brought suit against her for breach of contract. In response, the defendant argued that her agreement with the plaintiff had imposed no obligations on him and was unenforceable due to a lack of consideration.

On appeal, the Court of Appeals affirmed the trial court’s denial of the defendant’s motion for judgment on the pleadings. In doing so, the court specifically rejected the defendant’s argument that her agreement with the plaintiff did not constitute a contract:

> [The defendant] says that the plaintiff does not bind himself to anything. It is true that he does not promise in so many words that he will use reasonable efforts to place the defendant’s indorsements and market her designs. We think, however, that such a promise is fairly to be implied. The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be “instinct with an obligation,” imperfectly expressed. If that is so, there is a contract. The implication of a promise here finds support in many circumstances. The defendant gave an exclusive privilege. She was to have no right for at least a year to place her own indorsements or market her own designs except through the agency of the plaintiff. The acceptance of the exclusive agency was an assumption of its duties. We are not to suppose that one party was to be placed at the mercy of the other.\(^ {15}\)

Over a decade later, the Court of Appeals revisited the obligations arising from the covenant of good faith in *Kirke La Shelle Co. v. Paul Armstrong Co.*\(^ {16}\) There, the parties had entered into a contract giving the plaintiff a one-half financial interest in and a right to approve “all contracts, sales, licenses, or other arrangements to be made in the future affecting the title to the dramatic rights (exclusive of motion picture rights)” of certain plays.\(^ {17}\) At the time the contract was entered into, talking motion pictures, known as “talkies,” had not yet been invented.\(^ {18}\) When the defendant sold “talkie” movie rights to a producer several years later, the plaintiff brought suit for one-half of the profits.\(^ {19}\)

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15. *Id.* at 214. (citations omitted).
16. 188 N.E. 163 (N.Y. 1933).
17. *Id.* at 165.
18. *See Burton & Andersen, supra* note 1 § 2.2.2.2.
19. 188 N.E. at 164.
The *Kirk La Shelle Co.* court held that "talkies" were not contemplated by the parties at the time the contract was entered into and were therefore not encompassed by the definition of contracts requiring plaintiff approval or the exception of motion picture rights that the defendant was free to pursue independently. Nevertheless, the court held that the contract implied that the plaintiff generally was entitled to a portion of profits generated by the use of the show's dramatic rights. By failing to secure the plaintiff's approval and share talkie profits, the defendant breached its good faith obligations, which the court articulated as follows:

In every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.

The ongoing legitimacy of *Kirk La Shelle Co.*'s good faith holding is open to debate. In the first place, the primary basis for the court's ruling was a fiduciary duty argument, making the good faith discussion little more than dictum. In addition, later holdings restricted the potential application of the case's practical effect. In spite of these failings, the fact that numerous courts have embraced this decision and have relied on its definition and discussion of the implied covenant of good faith when applying New York law or otherwise testifies to its continuing worth.

B. Mainstream Acceptance of Good Faith

The implied covenant of good faith began to achieve wider acceptance when the Uniform Commercial Code ("UCC") was promulgated in 1951. Section 1-203 of the UCC states, simply, that "[c]very contract or duty within this Act imposes an obligation of good faith in

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20. See id. at 166.
21. Id. at 167.
24. The delay between the earlier cases and the widespread acceptance of the implied covenant of good faith has been attributed not to a change in legal sentiment, but to
its performance or enforcement.”25 This “obligation of good faith” is defined as “honesty in fact in the conduct or transaction concerned.”26 The breadth of this obligation is remarkable:

This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act such as the option to accelerate at will (Section 1-208), the right to cure a defective delivery of goods (Section 2-508), the duty of a merchant buyer who has rejected goods to effect salvage operations (Section 2-603), substituted performance (Section 2-614), and failure of presupposed conditions (Section 2-615). The concept, however, is broader than any of these illustrations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1-205 on course of dealing and usage of trade.27

Nevertheless, those drafting the UCC and incorporating the obligation to act in good faith did not believe themselves to be doing anything more than setting forth the current state of United States mercantile law and obligations existing at common law.28

Around this time, commentators initiated an academic discussion on the implied covenant of good faith and how good faith could be defined. In 1963, E. Allan Farnsworth set forth his definition of good faith as requiring “cooperation on the part of one party to the contract so that another party will not be deprived of his reasonable

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26. Id. § 1-201 (2001).
27. Id. § 1-203, cmt. (2001). The obligation of good faith was subsequently broadened for specific articles of the UCC. See Denise R. Boklach, Comment, Commercial Transactions: U.C.C. Section 1-201(19) Good Faith—Is Now the Time to Abandon the Pure Heart/Empty Head Test?, 45 OKLA. L. REV. 647, 666-67 (1992) (discussing modifications to UCC articles 3, 4, and 4A).
pectations." Five years later, Robert S. Summers offered what became known as "excluder analysis" to hone the definition of good faith:

In contract law, taken as a whole, good faith is an "excluder." It is a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith. In a particular context the phrase takes on a specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out.

Scholars expanded on this analysis and offered rationales for the doctrine, and a substantial and diverse body of academic work on the implied covenant of good faith, both in favor and against, quickly developed.

Segments of this discussion were a primary influence on the 1973 adoption of Section 205 of the Restatement (Second) of Contracts.
which was subsequently adopted by a sizeable number of jurisdictions, including Pennsylvania. As with the UCC, the Restatement provision was succinct, stating that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." The Restatement went on to tie in the UCC definition of good faith and to elaborate:

Good faith is defined in Uniform Commercial Code § 1-201(19) as "honesty in fact in the conduct or transaction concerned." "In the case of a merchant" Uniform Commercial Code § 2-103(1)(b) provides that good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." The phrase "good faith" is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for a breach of the duty of good faith also varies with the circumstances.

Given the similarities between the two provisions, it is perhaps not surprising that courts applying the UCC, Restatement, and common law principles of good faith often fail to differentiate between the good faith obligations imposed under each or rely on one to flesh out the other.

By 1980, a majority of United States jurisdictions recognized "the duty to perform a contract in good faith as a general principle of con-

33. Restatement (Second) of Contracts § 205 (1979); see also Summers, supra note 31, at 810–25 (discussing drafting of Section 205 of the Restatement (Second) of Contracts).


35. Restatement (Second) of Contracts § 205 (1979).

36. Id. at cmt. a.

Nevertheless, discussions aimed at finding a precise definition for good faith continue and can be summarized as follows:

[L]egal commentators have differed with regard to the manner in which good faith and fair dealing should be defined. Accordingly, the doctrine of good faith and fair dealing has been defined variously as requiring reasonableness or fair conduct, reasonable standards of fair dealing, decency as well as fairness and reasonableness, fairness, and community standards of fairness, decency and reasonableness.

As a majority of commentators seem to recognize, however, it is probably better that the definition of good faith and fair dealing remains amorphous so that the doctrine can be applied on a case-by-case basis. Nonetheless, some commentators have criticized expansive definitions of good faith and fair dealing as being too vague. Although the concept of good faith and fair dealing will require additional exposition when applied to negotiations, such imprecision in its definition is not unworkable and is common in the law.


Regardless of any ambiguities as to its definition, the concept of the implied covenant of good faith has become firmly entrenched in principles of United States contract law.

C. Expansion Toward Tort: Bad Faith

Even as the implied covenant of good faith gained wider acceptance, a line of cases emerged, first in California and then elsewhere, in which courts recognized a separate cause of action, usually based at least in part in tort, arising from a party's failure to adhere to its implied covenant of good faith. For the purposes of this article and for the sake of simplicity, this cause of action will be referred to as "bad faith." Although the expansion of bad faith claims has halted and been reversed, the claim itself marks a significant development that often colors how the term "good faith" is heard and used.

The benchmark case in which the California Supreme Court held that a breach of the implied covenant of good faith could give rise to a tort action is Comunale v. Traders & General Insurance Co.40 In Comunale, the plaintiff had been seriously injured when he was struck by a vehicle driven by Percy Sloan.41 At the time, Sloan was insured by the defendant under a policy that had a limit of $10,000 per injured person and $20,000 per accident and that gave the defendant the right to approve any settlement.42 Although the plaintiff made an offer to settle the claim well within the policy limits, Sloan did not have the financial wherewithal to do so, and the defendant refused to defend Sloan or to provide the funds necessary for settlement.43 At trial, the jury returned a verdict of $25,000 for the plaintiff.44 Sloan subsequently assigned his rights against the defendant to the plaintiff, who brought suit to recover the amount of the verdict in excess of the policy.45 On appeal, the California Supreme Court examined whether Sloan, and thus the plaintiff, had a sustainable cause of action against

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41. See id. at 200.
42. See id.
43. See id.
44. See id. The jury also returned a verdict of $1,250 for the plaintiff's wife, who was also injured in the accident.
the defendant for the amount of the original judgment in excess of
the policy limit of $10,000.46

The Comunale court first noted that "[t]here is an implied cove-
nant of good faith and fair dealing in every contract that neither party
will do anything which will injure the right of the other to receive the
benefits of the agreement."47 The court further held that "the implied
obligation of good faith and fair dealing requires the insurer to settle
in an appropriate case although the express terms of the policy do not
impose such a duty."48 An insurer could act in breach of this obliga-
tion when determining whether or not to accept an offer of
settlement:

We do not agree with the cases that hold there is no liability in
excess of the policy limits where the insurer, believing there is no
coverage, wrongfully refuses to defend and without justification ref-
uses to settle the claim. An insurer who denies coverage does so at
its own risk, and, although its position may not have been entirely
groundless, if the denial is found to be wrongful it is liable for the
full amount which will compensate the insured for all the detri-
ment caused by the insurer’s breach of the express and implied
obligations of the contract.

Certainly an insurer who not only rejected a reasonable offer of
settlement but also wrongfully refused to defend should be in no
better position than if it had assumed the defense and then de-
clined to settle. The insurer should not be permitted to profit by its
own wrong. A breach which prevents the making of an advanta-
geous settlement when there is a great risk of liability in excess of
the policy limits will, in the ordinary course of things, result in a
judgment against the insured in excess of those limits. . . .

. . . The question is what would Sloan have gained from the full
performance of the policy contract with Traders. If Traders had
performed its contract, it would have settled the action against
Sloan, thereby protecting him from all liability. The allowance of a
recovery in excess of the policy limits will not give the insured any
additional advantage but merely place him in the same position as
if the contract had been performed.

It follows from what we have said that an insurer, who wrongfully
denies to defend and who refuses to accept a reasonable settle-
ment within the policy limits in violation of its duty to consider in
good faith the interest of the insured in the settlement, is liable for

46. 328 P.2d at 200. The court also considered whether Sloan’s cause of action against
the defendant was assignable and whether the cause of action was barred by the statute of
limitations.

47. Id.

48. Id. at 201.
the entire judgment against the insured even if it exceeds the policy limits.\textsuperscript{49}

The court further hinted that the action arising from an insurer’s failure to settle arose part in contract and part in tort,\textsuperscript{50} although the decision focused primarily on the contract aspects of the plaintiff’s claim.\textsuperscript{51}

By its own terms, \textit{Comunale} extended this tort-contract hybrid claim only to situations where an insurer failed to settle a claim within the limits of the relevant policy:

The decisive factor in fixing the extent of Traders’ liability is not the refusal to defend; it is the refusal to accept an offer of settlement within the policy limits. Where there is no opportunity to compromise the claim and the only wrongful act of the insurer is the refusal to defend, the liability of the insurer is ordinarily limited to the amount of the policy plus attorneys’ fees and costs. In such a case it is reasoned that, if the insured has employed competent counsel to represent him, there is no ground for concluding that the judgment would have been for a lesser sum had the defense been conducted by insurer’s counsel, and therefore it cannot be said that the detriment suffered by the insured as the result of a judgment in excess of the policy limits was proximately caused by the insurer’s refusal to defend. This reasoning, however, does not apply where the insurer wrongfully refuses to accept a reasonable settlement within the policy limits.\textsuperscript{52}

However, California cases immediately following \textit{Comunale} expanded on the doctrine in both scope and concomitant rights. In \textit{Crisci v. Security Insurance Co.},\textsuperscript{53} the California Supreme Court confirmed that a suit for an insurer’s breach of the implied covenant of

\textsuperscript{49} \textit{Id.} at 201–02 (citations omitted).


\textsuperscript{51} \textit{See} 328 P.2d at 203.

\textsuperscript{52} \textit{Id.} at 201 (citation omitted).

\textsuperscript{53} 426 P.2d 173 (Cal. 1967).
good faith sounded in tort as well as contract, entitling the plaintiff to compensation for mental distress, a remedy not permitted in contract claims. Six years later, the same court held that a bad faith claim was available to first-party insurers proceeding against an excess carrier, and the following year found that punitive damages were available under this new contract-tort.

At the same time, courts in jurisdictions across the United States adopted the reasoning of *Comunale* and began permitting claims and extra-contractual damages for an insurer’s breach of the covenant of good faith. While courts often differed as to whether a bad faith claim sounded in tort, contract or both, many, though not all,

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54. See id. at 178–79.
found the logic in favor of the right to a bad faith claim against an insurer in some capacity sufficiently convincing.

However, California courts did not stop with insurance claims. In 1980, the California Court of Appeal held that a breach of the covenant of good faith inherent in an employment contract gave rise to a contract-tort bad faith claim. Soon after, the California Supreme Court issued a decision in *Seaman's Direct Buying Service Inc. v. Standard Oil Co.* that indicated a willingness to go even further:

While the proposition that the law implies a covenant of good faith and fair dealing in all contracts is well established, the proposition advanced by Seaman's—that breach of the covenant always gives rise to an action in tort—is not so clear. In holding that a tort action is available for breach of the covenant in an insurance contract, we have emphasized the "special relationship" between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility. No doubt there are other relationships with similar characteristics and deserving of similar legal treatment.

The concept of the "special relationship" was explained further in *Wallis v. Superior Court*, where the court found that the "special relationship" between the plaintiff and his former employer allowed him to proceed on his bad faith claim for breach of the covenant implied in his employment contract:

For purposes of serving as a predicate to tort liability, we find that the following "similar characteristics" must be present in a contract: (1) the contract must be such that the parties are in inherently unequal bargaining positions; (2) the motivation for entering the contract must be a non-profit motivation, *i.e.*, to secure peace of mind, security, future protection; (3) ordinary contract damages are not adequate because (a) they do not require the party in the superior position to account for its actions, and (b) they do not make the inferior party "whole;" (4) one party is especially vulnera-

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64. *Id*. at 1166 (citation omitted).

65. See 207 Cal. Rptr. 123 (Ct. App. 1984). It is this "special relationship" requirement that some Pennsylvania courts have fixed on and misapplied; see *infra* text accompanying notes 99–160.
ble because of the type of harm it may suffer and of necessity places trust in the other party to perform; and (5) the other party is aware of this vulnerability.

These criteria having been met, the party in the stronger position has a heightened duty not to act unreasonably in breaching the contract, and to consider the interest of the other party as tantamount to its own.66

While California courts and a handful of others embraced an independent contract-tort claim for breach of the covenant of good faith beyond an insurance context,67 most other jurisdictions steadfastly refused to create a new cause of action separate from a contract claim outside of an insurance context.68 Even in California, Seaman’s sowed the seeds of confusion and led to numerous conflicting decisions.69 Seaman’s also faced harsh criticism from scholars who felt that the decision “represent[ed] a potentially disastrous expansion of the bad faith tort into the commercial realm.”70

66. Id. at 129 (citation omitted).
67. See, e.g., Dare v. Mont. Petroleum Mktg. Co., 687 P.2d 1015, 1020 (Mont. 1984) (holding that tort liability may be imposed for breach of an employment contract’s implied covenant of good faith and fair dealing); K Mart Corp. v. Ponsock, 732 P.2d 1364 (Nev. 1987) (finding that tort damages were available for breach of the covenant of good faith in an employment context); Wilder v. Cody Country Chamber of Commerce, 868 P.2d 211, 221 (Wyo. 1994) (“[R]ecovery of damages is permitted for tortious conduct which arises out of a contractural relationship of employment in breach of the implied covenant of good faith and fair dealing.”). It has been stated that some decisions embrace tort liability for a breach of good faith obligations even outside of the expanded “special relationship” context. See Susan D. Gresham, “Bad Faith Breach”: A New and Growing Concern for Financial Institutions, 42 Vand. L. Rev. 891, 904–13 (1989) (reviewing cases applying tort duty of good faith to contracts without a finding of a special relationship). In particular, it has been stated that Montana courts took positions even more extreme than those embraced by their California counterparts. See Kerry L. Macintosh, Gilmore Spoke Too Soon: Contract Rises from the Ashes of the Bad Faith Tort, 27 Loy. L.A. L. Rev. 483, 497 (1994).
68. See, e.g., Kennedy Elec. Co., v. Moore-Handley, Inc., 437 So. 2d 76, 81 (Ala. 1983) (“We are not prepared to extend the tort of bad faith beyond the area of insurance policy cases at this time.”); Oldenburger v. Del E. Webb Dev. Co., 765 P.2d 531 (Ariz. Ct. App. 1988) (refusing to extend tort of bad faith to real estate contract); Aluevich v. Harrah’s, 660 P.2d 986, 987 (Nev. 1983) (refusing to extend tort of bad faith to commercial leasing contract); Rodgers v. Tecumseh Bank, 756 P.2d 1223, 1226 (Okla. 1988) (refusing to extend tort of bad faith to commercial lending contract); see also E. Allan Farnsworth, Contract is Not Dead, 77 Cornell L. Rev. 1034, 1037 (1992) (“The Seaman’s case has not been widely followed elsewhere.”).
70. Mark Snyderman, What’s So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending, 55 U. Chi. L. Rev. 1335, 1363 (1988); see also Sandra
The golden age of the ever-expanding contract-tort claim for breach of the implied covenant of good faith began its decline in *Foley v. Interactive Data Corp.*71 There, the California Supreme Court distinguished an employment relationship from an insurance relationship and found that a contract-tort bad faith claim could not arise in a typical employment relationship.72 After *Foley*, California courts essentially limited contract-tort claims to insurance cases.73 In 1995, the California Supreme Court even overruled *Seaman's* itself:

As previously indicated, the *Seaman's* decision has generated uniform confusion and uncertainty regarding its scope and application, and widespread doubt about the necessity or desirability of its

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71. 765 P.2d 373 (Cal. 1988). The decline of contract-tort bad faith claims in California appears to have been a side effect of a political debate over the California Supreme Court's distaste for capital punishment. See Macintosh, supra note 67, at 497-98.

72. 765 P.2d at 396; see also Guz v. Bechtel Nat'l Inc., 100 Cal. Rptr. 2d 352 (2000) (reaffirming principles set forth in *Foley*).

holding. These doubts and criticisms, express or implied, in decisions from this state and from other state and federal courts, echoed by the generally adverse scholarly comment cited above, convince us that Seaman's should be overruled in favor of a general rule precluding tort recovery for noninsurance contract breach, at least in the absence of violation of "an independent duty arising from principles of tort law" other than the bad faith denial of the existence of, or liability under, the breached contract. As set forth above, the critics stress, among other factors favoring Seaman's abrogation, the confusion and uncertainty accompanying the decision, the need for stability and predictability in commercial affairs, the potential for excessive tort damages, and the preference for legislative rather than judicial action in this area. Even if we were unimpressed by the nearly unanimous criticism leveled at Seaman's, on reconsideration the analytical defects in the opinion have become apparent. It seems anomalous to characterize as "tortious" the bad faith denial of the existence of a contract, while treating as "contractual" the bad faith denial of liability or responsibility under an acknowledged contract. In both cases, the breaching party has acted in bad faith and, accordingly, has presumably committed acts offensive to "accepted notions of business ethics." Yet to include bad faith denials of liability within Seaman's scope could potentially convert every contract breach into a tort. Nor would limiting Seaman's tort to incidents involving "stonewalling" adequately narrow its potential scope. Such conduct by the breaching party, essentially telling the promisee, "See you in court," could incidentally accompany every breach of contract. For all the foregoing reasons, we conclude that Seaman's should be overruled. We emphasize that nothing in this opinion should be read as affecting the existing precedent governing enforcement of the implied covenant in insurance cases. Further, nothing we say here would prevent the Legislature from creating additional civil remedies for noninsurance contract breach, including such measures as providing litigation costs and attorney fees in certain aggravated cases, or assessing increased compensatory damages covering lost profits and other losses attributable to the breach, as well as restoration of the Seaman's holding if the Legislature deems that course appropriate. Thus far, however, the Legislature has not manifested an intent either to expand contract breach recovery or to provide tort damages for ordinary contract breach.74

Other jurisdictions that had followed California's lead in broadening contract-tort claims retreated in California's wake by limiting claims to insurance relationships.75 To this day, the majority of states

still recognize a separate contract, tort, or hybrid bad faith cause of action for breach of the implied covenant of good faith arising from an insurance contract that allows for damages beyond those permitted in a simple breach of contract action. However, this claim has been largely confined to dealings between an insured and its insurer, and generally is not implicated by breaches between parties having any other "special relationship."  

II. Development of the Implied Covenant of Good Faith in Pennsylvania

Interestingly, the origins of the implied covenant of good faith in Pennsylvania date back to times significantly before the articulation of the modern doctrine in New York and elsewhere. In *Singerly v. Thayer*, the Pennsylvania Supreme Court considered a contract in which the defendant warranted that the installation of a hydraulic hoist would be "satisfactory in every respect." The plaintiff found the hoist to be unsatisfactory and demanded that it be removed.

The court held that the plaintiff's demand was proper. As an initial matter, it held that the satisfaction required in the contract was the satisfaction of the plaintiff. However, the discretion accorded the plaintiff was not without limit:

To justify a refusal to accept the elevator on the ground that it is not satisfactory, the objection should be made in good faith. It must not be merely capricious. It is declared in 1 Pars. Cont. 542, if A. agrees to make something for B., to meet the approval of B., or with any similar language, B. may reject it for any objection which is made in good faith, and is not merely capricious. *Andrews v. Bel-


77. See Macintosh, *supra* note 67, at 500 ("By the 1990s, the only area in which the bad faith tort retained any vitality was insurance."). *But see* Ennes v. H & R Block E. Tax Serv., Inc., Civ. A. No. 3:01CV-447-H, 2002 WL 226345, at *2 (W.D. Ky. Jan. 11, 2002) (noting that "in contracts involving 'special relationships' not found in ordinary commercial settings . . . courts find a tort duty of good faith"); Little v. UNUMProvident Corp., 196 F. Supp. 2d. 659, 670 (S.D. Ohio 2002) ("Ohio courts have defined the tort of bad faith in broad enough terms to permit its extension to other forms of special relationships beyond that of insurer and insured.").

78. 2 A. 230 (Pa. 1885).
79. Id. at 232.
80. See id.
81. See id.
field is cited to support this view. That case arose on a written agreement to build a carriage in a manner which should meet the approval of the person for whom it was to be made, not only on the score of workmanship, but also that of convenience and taste. It was held that his rejection made in good faith was conclusive.82

Applying this principle, the court found that the hoist’s failure to function properly supported the conclusion that the plaintiff’s dissatisfaction was justified, and that the defendant was required to remove the hoist as requested.83 Numerous subsequent Pennsylvania decisions relied on this language to require that a party’s determination as to satisfaction be made in good faith.84

Pennsylvania’s implied covenant of good faith was expanded significantly beyond a party’s satisfaction in two decisions in the middle of the last century. In Gray v. Nationwide Mutual Insurance Co.,85 the plaintiff obtained a judgment against Robert B. MacLatchie based on injuries the plaintiff had sustained in a car accident.86 Because the defendant, MacLatchie’s insurer, refused to pay the portion of the judgment in excess of the policy limits, MacLatchie assigned his claims to the plaintiff, who proceeded against the defendant in contract for its breach of the covenant of good faith it owed to MacLatchie.87 In determining if MacLatchie could assign his claim against the defendant to the plaintiff, the court reviewed relevant Pennsylvania case law, as well as Comunale, and touched on the nature of the action against the defendant:

Our task is to determine whether MacLatchie, the insured, has a cause of action in assumpsit or in tort against the insurer for its wrongful refusal to settle. . . . We believe that this recent case law,

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82. Id. at 233 (citation omitted).
83. See id. at 234–35.
85. 223 A.2d 8 (1966). At least one trial court opinion between Singerly and Gray addresses the implied covenant of good faith in other manners.
86. See 223 A.2d at 8–9.
87. See id. at 9.
employing contractual terms for the obligation of the insurer to represent in good faith the rights of the insured, indicates that a breach of such an obligation constitutes a breach of the insurance contract for which an action in assumpsit will lie.

Similar language has been employed by the Supreme Court of California:

When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim. Its unwarranted refusal to do so constitutes [a] breach of the implied covenant of good faith and fair dealing.88

88. Id. at 11–12 (footnote omitted) (citing Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 201 (Cal. 1958)). On the surface, Perkoski v. Wilson appears to be another case where the Pennsylvania Supreme Court addressed the implied covenant of good faith, but to accept this analysis blindly is unwise. In Perkoski, a jury awarded the plaintiffs an amount in excess of the defendant's insurance policy. See 92 A.2d 189, 190–91 (Pa. 1952). When the trial court granted the request of the defendant's insurer to limit recovery under the defendant's insurance policy to the policy limit, the defendant appealed, contending that his insurer was responsible for that portion of the judgment in excess of the limit. See id. at 191. In endorsing the defendant's arguments, the court relied on the insurance company's obligation to act in good faith toward the defendant:

When the company voluntarily undertook the defense of Wilson, in pursuance of its privilege under the policy, it assumed a position of trust and confidence which called for an exercise of the utmost good faith, particularly in view of the possible conflict of interest between the insurer and the insured such as later developed. It was accordingly incumbent upon the company to inform its policy-holder of its prospective adverse interest with respect to the extent of its liability under the terms of the policy. Instead of so doing, however, the company carried on Wilson's defense until final judgments were entered against him. Then, for the first time, it made known to him that it denied liability for a substantial portion of the one judgment, not because either or both of the judgments exceeded the specified money limits of the policy but because of the insurer's contention favorable to itself and detrimental to the interest of its insured. Good conscience and fair dealing required that the company pursue a course that was not advantageous to itself while disadvantageous to its policyholder, and, not having so acted, the company was estopped thereafter to the extent of its liability to the insured on account of the judgment against him in favor of the husband-plaintiff.

Id. While there is little doubt that the Perkoski court made use of the insurer's obligation to act in good faith, it is unclear whether this obligation of good faith arose from the unusual, fiduciary-like nature of the insurer-insured relationship, from the implied covenant of good faith as read into the insurance contract, or both. Cf. Birth Ctr. v. St. Paul Cos., Inc., 787 A.2d 376, 390 (Pa. 2001) (Nigro, J., concurring) (citing Perkoski as "first recognizing assumpsit action for bad faith"). Indeed, in Malley v. Am. Indem. Corp. the primary case relied on in Perkoski, the court concentrated primarily on the insurer's superior position vis à vis the insured, not on the obligations arising out of or implied in the insurance contract. See 146 A. 571 (Pa. 1929); see also Cowden v. Aetna Cas. & Sur. Co., 134 A.2d 223 (Pa. 1957) (discussing both "bad faith on the part of the insurer in the discharge of its contractual duty" and the fact that an insurance contract "operates . . . to create an agency relationship"). As noted, these two varieties of good faith are, in fact, quite different and should not be confused or substituted for each other. See infra text accompanying notes 149–47.
The Pennsylvania Supreme Court addressed the implied covenant of good faith outside of an insurance context in *Daniel B. Van Campen Corp. v. Building & Construction Trades Council.* There, the plaintiff general contractor brought suit against the city of Philadelphia for costs associated with a secondary boycott of its general contractor who used a subcontractor whose employees were not unionized. The city's failure to intervene to halt or to mitigate the effects of the boycott led the plaintiff to argue that the city breached its implied obligations under the contract to cooperate with the plaintiff.

Although the court found that the contract imposed no such obligation on the city, the court, in interpreting the contract between the parties, refused to limit itself to the express terms of the parties' contract.

The law is clear that "[i]n the absence of an express provision, the law will imply an agreement by the parties to a contract to do and perform those things that according to reason and justice they should do in order to carry out the purpose for which the contract was made and to refrain from doing anything that would destroy or injure the other party's right to receive the fruits of the contract. Accordingly, a promise to do an act necessary to carry out the contract must be implied." 90

*Daniel B. Van Campen Corp.* was followed by Pennsylvania's adoption of the UCC and Restatement provisions on the obligation of good faith. UCC Section 1-203 was enacted by the Pennsylvania legislature and became effective on January 1, 1980. 91 The Pennsylvania Superior Court gave its first unqualified and clear endorsement of

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90. 195 A.2d at 136–37 (citing 8 P.L.E., Contracts, § 140). This principle ultimately evolved into Pennsylvania's doctrine of necessary implication. See Frickert v. Deiter Bros. Fuel Co., Inc., 347 A.2d 701, 705 (Pa. 1975) (Pomeroy, J., concurring) (making the first reference to this principle as the doctrine of necessary implication); Slater v. Pearle Vision Ctr., Inc., 546 A.2d 676, 679 (Pa. Super. Ct. 1988) (setting forth the doctrine of necessary implication); see also W & G Seaford Assocs., L.P. v. E. Shore Mkt., Inc., 714 F. Supp. 1336, 1346 (D. Del. 1989) ("Under the doctrine of necessary implication, a promise can be read into a contract in order to carry out the purpose for which the contract was made."). Although Pennsylvania's doctrine of necessary implication is related to principles of contractual good faith, it is separate and distinct. See Murphy v. Duquesne Univ. of the Holy Ghost, 777 A.2d 418 (Pa. 2001) (noting that the obligation of good faith "is akin to the contract doctrine of necessary implication"); Somers v. Somers, 615 A.2d 1211, 1214 (Pa. Super. Ct. 1992) ("A similar requirement of good faith has been imposed under a contract doctrine developed in Pennsylvania case law called the 'doctrine of necessary implication.'"). However, the portion of *Daniel B. Van Campen Corp.* quoted above is cited in a number of other jurisdictions as embodying the implied covenant of good faith. See, e.g., Boddie-Noell Prop., Inc. v. 42 Magnolia P'ship, 544 S.E.2d 279, 284 (S.C. Ct. App. 2000).
Restatement Second Section 205 in 1985, while at the same time harkening back to one of the early modern New York cases on the covenant of good faith: “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.”

As Justice Cardozo once wrote: “The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be ‘instinct with an obligation,’ imperfectly expressed.”

The Pennsylvania Supreme Court gave its backing to this principle the same year. This adoption was reinforced in Baker v. Lafayette College, where the Pennsylvania Superior Court applied Section 205 to an employment contract, albeit with no substantive discussion as to what obligations evolved from the covenant of good faith.

Even as Pennsylvania courts made it clear that a covenant of good faith was implied in all contracts, it was equally apparent that a breach of this covenant did not give rise to an independent cause of action. In Engstrom v. John Nuveen & Co., for example, the court examined an employment contract and found that a breach of the covenant of good faith was, in essence, a breach of the contract:

There is no claim under Pennsylvania law for breach of a duty of good faith and fair dealing where the employment relationship is at-will. There may be an express or implied covenant of good faith and fair dealing in any contract between the parties, but if so, its breach is a breach of contract rather than an independent breach of a duty of good faith and fair dealing.

94. See Bethlehem Steel Corp. v. Litton Indus., Inc., 488 A.2d 581 (Pa. 1985). It may be that the provision currently set forth in Section 205 was adopted by the Pennsylvania Supreme Court as early as 1978. In Atl. Richfield Co. v. Razumic, 390 A.2d 736 (Pa. 1978), the court held that a franchisor had an obligation to deal with its franchisee in good faith and cited both the UCC and a tentative draft of what later became Section 205. See id. at 738 n.7a. Several years later, in Bethlehem Steel Corp., the Pennsylvania Supreme Court cited Atl. Richfield as having “accepted as the law of this Commonwealth the principle stated in Restatement (Second) of Contracts § 205 that ‘[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.’” 488 A.2d at 600. This leaves room for the argument that the adoption of Section 205 predates the Section’s promulgation, even though later cases point to Germantown Mfg. as the decision adopting Section 205. See Creeger Brick & Bldg. Supply Inc. v. Mid-State Bank & Trust Co., 560 A.2d 151, 153 (Pa. Super. Ct. 1989).
97. Id. at 958 (citations omitted).
Instead, the covenant of good faith was treated as a principle of contract interpretation whereby courts could gain flexibility in light of the parties' conduct after the contract in question had been consummated. By logical extension, a claim arising from a breach of the implied covenant of good faith sounds solely in contract, not in tort.98

Thus, two principles of Pennsylvania law on the implied covenant of good faith are clear from these cases. First, the covenant is implied in every contract, regardless of the relationship of the parties, and second, this covenant is used to interpret the contract and generally does not give rise to a separate cause of action, either in tort or contract. As indicated by the citations provided in each case, these principles are squarely in line with the approach taken by the UCC, the Restatement (Second) of Contracts, numerous commentators, and most jurisdictions across the United States.

III. Difficulties in Application

After such unequivocal approval for the application of an implied covenant of good faith to all contracts, it is perhaps puzzling that later cases would attempt to divide contracts into those that include a covenant of good faith and those that do not implicate such a covenant. Similarly, it may come as a surprise that a breach of the implied covenant of good faith could sustain a contract-based cause of action independent of a claim for breach of contract, given the covenant is nothing more than an implied term of the contract. Nevertheless, courts in Pennsylvania and elsewhere have struggled recently with these two questions and have often reached conclusions that are at odds with the dictates of prior case law.

A. Application to All or a Limited Subset of Contracts?

One of the primary disputes in Pennsylvania courts is over which types of relationships between contracting parties give rise to an implied covenant of good faith. More specifically, courts have struggled with the question of whether the covenant is implied in every contract or only in a limited subset of contracts evidencing a "special relationship." The result has been a body of contradictory case law that effectively leaves the matter unresolved.

1. Limited Applications: The Requirement of a Special Relationship

Much of the confusion surrounding this dispute has its origins in *Creeger Brick & Building Supply Inc. v. Mid-State Bank and Trust Co.*, where a borrower brought an action against its bank for tortious breach of the covenant of good faith. This claim arose from certain actions undertaken by the bank that had an adverse affect on the borrower’s business. The *Creeger Brick* court first noted that both the Restatement (Second) of Contracts and the UCC state that an obligation to act in good faith arises in every contract, and that this obligation is contractual in nature, not tort-based. However, the court went on to reject the borrower’s claim, making a number of pronouncements regarding Pennsylvania law in the process:

In this Commonwealth the duty of good faith has been recognized in limited situations. Most notably, a duty of good faith has been imposed upon franchisors in their dealings with franchisees. It has also been imposed upon the relationship between insurer and insured. In *Germantown Manufacturing Co. v. Rawlinson*, the Superior Court implied that there may also be a duty of good faith in connection with an employer’s attempt to recoup theft losses from the wife of an employee who was responsible for the thefts. Conversely, the Supreme Court of Pennsylvania has refused to impose a duty of good faith which would modify or defeat the legal rights of a creditor. Other courts have also refused to apply a duty of good faith to alter or defeat the rights of a creditor which have been granted by law or contract. . . .

It seems reasonably clear from the decided cases that a lending institution does not violate a separate duty of good faith by adhering to its agreement with the borrower or by enforcing its legal and contractual rights as a creditor. The duty of good faith imposed upon contracting parties does not compel a lender to surrender rights which it has been given by statute or by the terms of its contract. Similarly, it cannot be said that a lender has violated a duty of good faith merely because it has negotiated terms of a loan which are favorable to itself. As such, a lender generally is not liable for harm caused to a borrower by refusing to advance additional funds, release collateral, or assist in obtaining additional loans from third persons. A lending institution also is not required to delay attempts to recover from a guarantor after the principal debtor has defaulted. Finally, if the bank in this case falsely represented appellants' financial circumstances to other creditors for the purpose of damaging appellants' ability to continue doing business, appellants may have causes of action in tort for slander, misrepresentation, or interference with existing or prospective

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100. *See id.* at 153.
contractual relations. There is no need in such cases to create a separate tort for breach of a duty of good faith.101

Because so many later cases misconstrue this decision, it is worth taking a moment to parse the analysis undertaken by the Creeger Brick court. Creeger Brick cannot be read as holding that the covenant of good faith is not a part of every contract. While the court noted that the circumstances recognized as giving rise to an implied covenant of good faith in Pennsylvania are "limited," the Pennsylvania cases cited for this limitation address situations where a borrower attempted to invoke the covenant to prevent a creditor from exercising rights to which it was entitled under the relevant contract.102 The primary focus of the Creeger Brick decision was not on whether the bank owed the borrower an obligation of good faith, but rather whether the specific obligations arising from that obligation trumped the bank’s rights and whether the bank’s actions breached those obligations.

Also significant is the Creeger Brick court’s distinction between tort and contract law. At the outset, the court noted that “[w]here a duty of good faith arises, it arises under the law of contracts, not under the law of torts.”103 In addition, in concluding its analysis, the court reasoned that there was “no need ... to create a separate tort for breach of a duty of good faith” because of the other remedies available to the borrower.104 This supports the inference that the court was deciding not whether the contract between the borrower and the bank gave rise to an obligation of good faith, but rather whether the borrower could bring a claim arising from a breach of that obligation in tort.

In the years immediately following Creeger, Pennsylvania courts upheld the line of thinking espoused in the Restatement and the

101. Id. at 153–55 (citation omitted).
102. See Wagner v. Benson, 161 Cal. Rptr. 516 (Ct. App. 1980); Layne v. Fort Carson Nat’l Bank, 655 F.2d 856 (Colo. Ct. App. 1982); Heights v. Citizens Nat’l Bank, 342 A.2d 738 (Pa. 1975); Schaller v. Marine Nat’l Bank of Neenah, 388 N.W.2d 645 (Wis. Ct. App. 1986). Indeed, the Creeger Brick court went on to cite a number of cases that gave an expansive interpretation to the implied covenant of good faith: but see K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (lender had good faith duty to give borrower notice before refusing to advance further funds under financing agreement where established maximum credit limit had not been reached); Skeels v. Universal C.I.T. Credit Corp., 335 F.2d 846 (3d Cir. 1964) (lender violated duty of good faith by repossessing automobiles despite repeated acquiescences in late payments and assurances of additional financing); First Nat’l Bank in Libby v. Twombly, 689 F.2d 1226 (Mont. 1984) (lender breached duty of good faith by accelerating due date of borrower’s loan and exercising offset against borrower’s checking account). Creeger, 560 A.2d at 154.
103. Id. at 153 (citing AM/PM Franchise Ass’n v. Atl. Richfield Co., 542 A.2d 90, 94 (Pa. 1988)).
104. Id. at 154–55.
UCC. In *Liazis v. Kosta, Inc.*, the court examined a trial court's denial of a petition to open or strike judgment and noted that "[f]undamentally, every contract imposes upon the parties a duty of good faith and fair dealing in the performance and enforcement of the contract." Because the creditor allegedly had failed to act in good faith by providing an accounting for the petitioner, the creditor had breached its obligations, and the petition raised a meritorious defense.

The covenant of good faith arose in a slightly different context in *Somers v. Somers.* There, the plaintiff brought suit against his former employer for breach of an employment contract. Essentially, the plaintiff was entitled to half of all profits from a specific project the employer had undertaken. When the employer allegedly failed to negotiate with a third party in good faith regarding the project, the plaintiff brought suit for breach of the contract, even though the contract did not include a provision governing the employer's conduct in negotiations with third parties. On appeal, the Superior Court sided with the plaintiff:

The general duty of good faith and fair dealing in the performance of a contract as found in The RESTATEMENT (SECOND) OF CONTRACTS § 205, has been adopted in this Commonwealth in *Creeger Brick & Building Supply Inc. v. Mid-State Bank & Trust Co.* and *Baker v. Lafayette College.* A similar requirement has been imposed upon contracts within the Uniform Commercial Code by 13 PA. CONS. STAT. § 1203. The duty of "good faith" has been defined as "[h]onesty in fact in the conduct or transaction concerned." The obligation to act in good faith in the performance of contractual duties varies somewhat with the context, and a complete catalogue of types of bad faith is impossible, but it is possible to recognize certain strains of bad faith which include: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.

The duty to perform contractual obligations in good faith does not evaporate merely because the contract is an employment contract, and the employee has been held to be an employee at will. The court went on to hold that the allegations in the plaintiff's complaint supported the conclusion that the employer had violated the covenant of good faith implied in the employment contract.

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108. *Id.* at 1213 (citation omitted).
As can be seen from both Liazis and Somers, Pennsylvania courts acting immediately after Creeger Brick considered the implied covenant of good faith to be an inseparable part of every contract. The question for any court was not whether the covenant existed, but what specific obligations the covenant imposed in a given situation. This position was in line with Pennsylvania case law stretching back through Baker and Daniel B. Van Campen Corp. to Singerly.

This thinking was boldly contradicted and called into question by the Commonwealth Court in Commonwealth, Department of Transportation v. E-Z Parks, Inc.\footnote{620 A.2d 712 (Pa. Commw. Ct. 1993).} The E-Z Parks court faced a situation where the Department of Transportation ("DOT") leased E-Z Parks a parking lot under a lease agreement that gave DOT the right to terminate if any portion of the premises was required for the transportation construction purposes.\footnote{Id. at 714–15.} After DOT determined that it would use a portion of the leased premises for a staging area for construction of a highway, it entered into a lease with a third party for a portion of the premises and subsequently terminated the lease. E-Z Parks brought suit, arguing in part that DOT's failure to notify it of its negotiations with the third party constituted a violation of DOT's implied covenant of good faith. The Board of Claims found in favor of E-Z Parks, whereupon DOT appealed to the Commonwealth Court.

On appeal, the Commonwealth Court reversed the Board's decision:

DOT argues that the Board erred in holding that DOT breached the termination clause because it had a duty of good faith toward E-Z Parks. However, Pennsylvania courts have recognized a separate duty of good faith performance of contracts only in limited circumstances. This duty of good faith is limited to situations where there is some special relationship between the parties, such as a confidential or fiduciary relationship. A confidential relationship exists when "one person has reposed a special confidence in another to the extent that the parties do not deal with each other on equal terms, either because of an overmastering dominance on one side, or weakness, dependence or justifiable trust, on the other." A business association may be the basis of a confidential relationship "only if one party surrenders substantial control over some portion of his affairs to the other."

E-Z Parks did not claim nor did the Board of Claims find a confidential relationship between E-Z Parks and DOT. However, the Board imposed a heightened duty upon DOT because it failed to apprise E-Z Parks of DOT's negotiations with PPA. Without a finding that a confidential relationship exists, the Board could not im-
pose a good faith duty upon DOT. Rather, we hold that the parties had a typical landlord-tenant relationship. There is no special duty of good faith imposed by the Landlord and Tenant Act of 1951. The termination clause was a negotiated provision, bargained for between counsel of E-Z Parks and DOT in an arms-length transaction, the terms of which cannot be ignored.111

The court went on to state that "actions of government officials are presumed to have been done in good faith," and that "the challenger has a heavy burden to prove otherwise."112 Thus, E-Z Parks was not entitled to recover based on DOT's alleged breach of its implied covenant of good faith.

At the onset, it is clear that E-Z Parks shatters the uniform front established by prior Pennsylvania decisions on the implied covenant of good faith. In one ruling, the Commonwealth Court contradicted over 100 years of case law and set the stage for a conflict over which contracts include a covenant of good faith.

What makes E-Z Parks even more confounding is its lack of supporting citations. First, as discussed below, Creeger Brick does not stand for the proposition that the implied covenant of good faith is limited only to certain contracts. Moreover, there is no citation for the statement that the implied covenant of good faith arises only when there is a "special relationship" between the parties. These defects make E-Z Parks a flawed decision, at best.

If E-Z Parks were the sole decision restricting the application of the covenant of good faith, it would, perhaps, be easy to distinguish and would serve as nothing more than a glitch in an otherwise perfect lattice of integrated and mutually supporting cases. However, E-Z Parks was followed by a decision of the Third Circuit in Parkway Garage, Inc. v. City of Philadelphia,113 which ascribed the same interpretation to Creeger Brick as the E-Z Parks court and precluded the plaintiff from invoking the implied covenant of good faith. Although the Third Circuit initially noted the standards set forth in both the Restatement and the Pennsylvania Supreme Court's decision in Daniel B. Van Campen Corp., it then isolated Creeger Brick's use of the word "limited":

Thus, under Pennsylvania law, every contract does not imply a duty of good faith. In Creeger, the court held that, because other causes of action existed where the plaintiff could seek relief, "[t]here is no

111. Id. at 717; Act of April 6, 1951, P.L. 69, 68 P.S. §§ 250-101-250-602 (citation omitted).
113. 5 F.3d 685 (3d Cir. 1993).
need in such cases to create a separate tort for breach of a duty of
good faith." Similarly, in the case sub judice, Parkway’s allegations
concerning the closing of the garage in bad faith are identical to its
allegations under § 1983. Therefore, like the plaintiff in Creeger,
Parkway could seek relief under an established cause of action, and
there is thus no reason to imply a separate tort for breach of a duty
of good faith.\footnote{Id. at 701–02 (footnote omitted); see also D'Ambrosio v. Pa. Nat'l Mut. Cas. Ins.
Co., 431 A.2d 966, 970 (Pa. 1981) (the court refused to recognize separate cause of action
for breach of good faith where adequate remedy was provided under Unfair Insurance
Practices Act); Standard Pipeline Coating Co. v. Solomon & Teslovich, Inc., 496 A.2d 840,
843 (Pa. 1985) (the court would not create a tort remedy where there was an adequate
remedy to address the claims in existing tort and contract law).}

The Parkway Garage decision is remarkable for three reasons.
First, the Third Circuit treated the implied covenant of good faith as
intertwined with a tort claim and did not consider the possibility that
the covenant could give rise to a contract claim or that it could be
used as a rule of contract interpretation. Second, the Parkway Garage
court followed the path set down in E-Z Parks by finding that the im-
plied covenant of good faith was not found in all contracts under
Pennsylvania law. Third, Parkway Garage appeared to impose the addi-
tional restriction that a plaintiff has a valid claim arising from a breach
of the covenant of good faith only when the allegations of a breach
differ from the allegations supporting the plaintiff’s other claims and
foreclosed the possibility of pleading in the alternative.

These concepts were part of an attempted integration in Chrysler
Credit Corp. v. B.J.M., Jr., Inc.,\footnote{834 F. Supp. 815 (E.D. Pa. 1993).} where the court gave one of the most
articulate and concise pronunciations of the perceived constraints on
the covenant of good faith:

The courts of Pennsylvania . . . have recognized a separate, com-
mon-law duty of good faith performance of contracts only in lim-
ited situations where there is some special relationship between the
parties, such as a confidential or fiduciary relationship. It should
be noted that where a good faith duty has been found to exist, it
arises under the law of contracts, not under the law of torts.\footnote{Id. at 841–42.}

When read together, E-Z Parks, Parkway Garage, and Chrysler Credit
reveal several interesting issues. First, through these three cases, the
idea that the implied covenant of good faith is not implicated in every
contract gained a solid foothold in Pennsylvania case law. Courts that
espouse this position adhere to the belief that the covenant to per-
form a contract in good faith arises only when a “special relationship”
exists between the parties. This thinking is in direct conflict with the
earlier Pennsylvania position, which finds a covenant of good faith in every contract.

More puzzling is the way these courts addressed the nature of a claim arising from a breach of the covenant of good faith. Each of the E-Z Parks, Parkway Garage, and Chrysler Credit decisions recognize that a breach of the covenant of good faith gives rise to a right in contract, not in tort. However, in Parkway Garage, as in Creeger Brick, the court concluded by stating that there was “no reason to imply a separate tort for breach of a covenant of good faith.” These seemingly contradictory conclusions hint at a more fluid treatment of the implied covenant of good faith than one might expect.

Instead of marking a readily accepted change in Pennsylvania law, E-Z Parks, Parkway Garage, and Chrysler merely set the stage for a debate over the implied covenant of good faith. In Kedra v. Nazareth Hospital, for example, the court held that “Pennsylvania law imposes a duty of good faith and fair dealing in the performance of every contract.” In doing so, the Kedra court failed to distinguish and completely ignored E-Z Parks, Parkway Garage, and Chrysler Credit. Other decisions in this period that reached the same conclusion as that reached in Kedra also did so without so much as a footnote on the three conflicting cases.

Although it failed to reach a decisive conclusion, the federal court for the Eastern District of Pennsylvania attempted to harmonize these decisions in Fremont v. E.I. Dupont DeNemours & Co., where the plaintiff alleged that his former employer’s failure to provide him with a bonus violated the employer’s obligation to act in good faith in fulfilling its obligations under his employment contract. In resolving a

117. 5 F.3d at 702.
121. Id. at 873.
conflict of laws question, the *Fremont* court noted that Delaware law holds that “the duty of good faith and fair dealing clearly attaches to all contracts,” and then turned to Pennsylvania law:

The precise extent to which Pennsylvania law extends the duty of good faith and fair dealing, however, is the subject of a degree of uncertainty. In support of the proposition that the duty applies in this case, plaintiff argues that the duty inheres in every contract, citing a diversity case from this district with language to that effect. As the Pennsylvania Supreme Court has not spoken on the issue, this court’s predictive inquiry must be informed by an examination of the relevant intermediate appellate decisions. It is true that the Pennsylvania Superior Court has on several occasions stated that the duty of good faith and fair dealing inheres in every contract. The Superior Court, however, has not been entirely univocal on this issue. In *Creager Brick & Bldg. Supply Inc. v. Mid-State Bank & Trust Co.*, the court, in holding that the duty of good faith could not defeat express contractual rights, stated that “the duty of good faith has been recognized in limited situations.” Although the *Creager* court’s statement might well be considered, in the parlance of the statistician, an “outlier,” it may not be wholly disregarded. The Third Circuit, in *Parkway Garage, Inc. v. City of Philadelphia*, read *Creager* for the proposition that “under Pennsylvania law, every contract does not imply a duty of good faith” and held that there is no implied duty of good faith where a plaintiff has recourse to an independent cause of action to vindicate the same rights with respect to which the plaintiff invokes the duty of good faith.

Thus according to the Third Circuit, whose predictions of state law this court is bound to follow, there are some contracts to which the duty does not attach.

At the same time, *Fremont* appeared to call into question the legitimacy of the Third Circuit’s ultimate determination on this subject:

The *Somers* court cited *Creager* as supporting recognition of a general duty of good faith and fair dealing, but the *Creager* opinion may be read as not in full harmony with the *Somers* reading. In *Seal v. Riverside Federal Savings Bank*, this court noted this apparent anomaly but read *Creager* as standing for the unremarkable proposition that “the implied duty of good faith cannot defeat express...
contractual rights by imposing upon that party specific obligations that it is entitled, by express agreement, to resist." Accordingly, this court ruled that the duty inhered in a contract in which a joint venture partner promised to procure funding for a development project where plaintiff alleged that the partner instead undermined the project by withholding critical information. In making this prediction of Pennsylvania law, this court noted that the duty of good faith and fair dealing "has been embraced with increased vigor by the Pennsylvania Superior Court in recent years." In light of this clarification, and the Superior Court's post-Creeger affirmation, in Somers, of a general duty of good faith, caution should be exercised before giving broad application to the Creeger court's suggestion that the reach of the duty of good faith is limited.\textsuperscript{129}

While this discussion in Fremont provides insight into how the conflicting Pennsylvania decisions might be reconciled, it is little more than dicta. In examining the specific contract at issue, the court concluded that, regardless of whether one followed those decisions limiting the covenant of good faith to certain contracts or those applying the covenant broadly, the covenant was implied in the plaintiff's contract with his former employer:

It is... readily apparent that the agreement at issue in this case is the type of contract to which, under the pertinent Superior Court decisions, the duty would attach. Unlike the situation before the court in Parkway Garage, this is not a case in which the plaintiff has an independent cause of action that he can invoke to vindicate the interests he asserts here. Furthermore, the plaintiff in this case is not, as was the plaintiff in Creeger, seeking to defeat express terms of a contract by means of the duty of good faith. Thus under both Delaware and Pennsylvania law, the duty of good faith applies to this contract, requiring reasonableness in DuPont's exercise of discretion to conduct the litigation and determine whether Fremont would receive a bonus.\textsuperscript{130}

Accordingly, Fremont is educational, but not necessarily of considerable weight.

A less extensive attempt at coordination was made in Northview Motors, Inc. v. Chrysler Motors Corp.\textsuperscript{131} There, the Third Circuit stated that "every contract has an implied term that the parties will perform their duties in good faith," but that "[i]n practice... the courts have recognized an independent cause of action for breach of a duty of good faith and fair dealing only in very limited circumstances."\textsuperscript{132}

\begin{footnotes}
\item[129] Id. at 874 n.1 (citations omitted).
\item[130] Id. at 875 (footnote omitted).
\item[131] 227 F.3d 78 (3d Cir. 2000).
\item[132] Id. at 91 (citations omitted). Northview Motors' comment that the breach of the implied covenant of good faith gives rise to an independent cause of action is discussed below. See infra text accompanying notes 167–68.
\end{footnotes}
However, the court went on to sidestep the question as to whether a covenant was implied, as it concluded that the plaintiff's good faith claim was duplicative of its other causes of action and was therefore barred.\textsuperscript{133}

Pennsylvania state courts have largely ignored these attempts at harmonization and instead typically stake out extreme positions. Recently, in \textit{Agrecycle, Inc. v. City of Pittsburgh},\textsuperscript{134} the Commonwealth Court summarized the more limited approach:

In Pennsylvania, the courts have recognized the duty of good faith only in limited situations. More specifically, the duty of good faith may not be implied where (1) a plaintiff has an independent cause of action to vindicate the same rights with respect to which the plaintiff invokes the duty of good faith; (2) such implied duty would result in defeating a party's express contractual rights specifically covered in the written contract by imposing obligations that the party contracted to avoid; or (3) there is no confidential or fiduciary relationship between the parties.\textsuperscript{135}

Only months earlier, however, the Superior Court applied the broad approach and held that "[e]very contract in Pennsylvania imposes on each party a duty of good faith and fair dealing in its performance and its enforcement."\textsuperscript{136} Thus, this conflict remains unresolved.\textsuperscript{137}

\begin{itemize}
  \item[133.] See id. at 92.
  \item[135.] Id. at 867 (citations omitted); see also Chester Perfetto Agency, Inc. v. Chubb & Son, No. Civ. A. 99-3492, 1999 WL 972010, at *4 (E.D. Pa. Oct. 21, 1999) ("[W]here a plaintiff has an independent cause of action that he can invoke to vindicate his interests, no duty of good faith attaches to the contract.").
  \item[137.] Courts in other jurisdictions have struggled with this issue as well, with equally confounding results. For example, Indiana courts have repeatedly addressed this question, often with conflicting decisions, and most recently engaged in unusual semantic acrobatics to find an implied covenant of good faith in the context of an agency relationship:

  Indiana law recognizes an implied duty of good faith in all insurance contracts requiring that an insurer will act in good faith with its insured. This duty results from the unique nature of the insured/insurer relationship, which may be at varying times arm's-length, fiduciary, and/or adversarial. But Indiana does not imply such a covenant in every contract. We nevertheless think these agency agreements, though by professionals, are in the category of agreements that carry some
2. Unsound Foundations of the Limited Application

To confront this issue properly, it is necessary to look at the rationale for *E-Z Parks* and its progeny’s break with prior Pennsylvania holdings, which find the covenant of good faith present in all contracts, and its imposition of the “special relationship” requirement. This break appears to stem from one of three sources: a tort-related claim for breach of the covenant of good faith, the distinct duty of good faith found in fiduciary relationships, and the confusion of a breach with the existence of the implied covenant of good faith. Regardless of the origin, this break is an incorrect interpretation of Pennsylvania law and, potentially, that of other jurisdictions.

a. Contract-Tort Claim

The “special relationship” element’s most likely source is from the separate contract-tort claim of bad faith. As seen earlier, bad faith began in California as a hybrid claim available when insurance companies failed to settle a third-party claim within the limits of the relevant insurance policy. As part of its now repudiated expansion of contract-tort bad faith actions, California briefly permitted such actions where the parties had a “special relationship” beyond an insurance relationship.

Pennsylvania’s adoption from California law of a “special relationship” requirement for finding that a covenant of good faith exists in a contract would be incorrect for several reasons. In the first place, in 1981, the Pennsylvania Supreme Court entirely rejected the common law claim for bad faith propounded by California courts. In re--

implied covenants. Agency relationships generally carry with them the obligation of the principal to exercise reasonable care to avoid placing the agent in harm’s way in the course of carrying out the agency.


sponse, the Pennsylvania General Assembly enacted a statute that authorized an insured to bring an action against its insurer for bad faith in a similar fashion to the bad faith claims permitted in California, thus avoiding the case law ambiguities that forced California courts to look for a "special relationship" between the parties.\textsuperscript{139} It remains unclear if this action sounds in tort, contract, both, or neither,\textsuperscript{140} but it is certain, that it is distinct from a claim based on a breach of the covenant of good faith and that a Pennsylvania bad faith claim has an origin quite different from that of its distant California relative. Accordingly, it is improper to allow the "special relationship" requirement imposed on bad faith claims in California to bleed into either

Practices Act and found both that "the Unfair Insurance Practices Act serves adequately to deter bad faith conduct" and that "the count in trespass for alleged bad faith conduct of an insurer, which seeks both punitive damages and damages for emotional distress, must be rejected." \textit{Id. at 970}. \textit{D'Ambrosio} appears to have left intact Pennsylvania case law holding that an insured may bring a contract-based action against an insurer for breach of the covenant of good faith. See supra text accompanying notes 85–88.

\textsuperscript{139} See 42 PA. CONS. STAT. § 8371 (2001). In its entirety, Section 8271 reads as follows:

In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:

(1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.

(2) Award punitive damages against the insurer.

(3) Assess court costs and attorney fees against the insurer.

\textit{Id.} Pennsylvania courts and commentators agree that this provision was enacted as a response to \textit{D'Ambrosio}. See, e.g., Polselli v. Nationwide Mut. Fire Ins. Co., 23 F.3d 747, 750 (3d Cir. 1994) ("In \textit{D'Ambrosio} . . . the Supreme Court of Pennsylvania held that there is no common law remedy under Pennsylvania law for bad faith on the part of insurers. In response, the Pennsylvania legislature enacted 42 Pa.C.S.A. § 8371 which creates a statutory remedy for bad faith conduct."); Tina M. Oberdorf, \textit{Bad Faith Insurance Litigation in Pennsylvania: Reoccurring Issues Under Section 8371}, 33 DUQ. L. REV. 451, 452–53 (1995) ("Because the Pennsylvania Supreme Court in \textit{D'Ambrosio} refused to recognize the bad faith tort cause of action already adopted by numerous other jurisdictions, the Pennsylvania legislature created a statutory cause of action for bad faith conduct on the part of insurers on February 7, 1990.").

Pennsylvania claims arising from a breach of the implied covenant of good faith or Pennsylvania bad faith claims.

Even if California bad faith law could be viewed as a source for Pennsylvania claims, imposing a "special relationship" on purely contract-based claims finds no basis in California law. At no point did California ever require a "special relationship" to support the existence of an implied covenant of good faith. Indeed, California courts have steadfastly adhered to the principle that every contract includes a covenant of good faith and that a breach of that covenant in any context inheres in every contract and may give rise to a contract-based claim. The "special relationship" concept was used only in California's brief venture in expanding contract-tort bad faith claims.

If Pennsylvania courts have confused claims for breach of the implied covenant of good faith with contract-tort bad faith claims, it is understandable why Pennsylvania courts would be reticent to find this

141. See, e.g., Guz v. Bechtel Nat'l, Inc., 100 Cal. Rptr. 2d 352 (2000) (stating that "the covenant of good faith and fair dealing [is] implied by law in every contract"); [T]here is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement. . . . Because the covenant is a contract term, in most cases compensation for its breach is limited to contract rather than tort remedies.

Kransco v. Am. Empire Surplus Lines Ins. Co., 97 Cal. Rptr. 2d 151 (2000); see e.g., Cates Constr., Inc. v. Talbot Partners, 86 Cal. Rptr. 2d 855, 864 (1999) ("By now it is well established that a covenant of good faith and fair dealing is implicit in every contract"); see also Wells Fargo Bank v. Ariz. Laborers, Teamsters & Cement Masons Local No. 395 Pension Trust Fund, 38 P.3d 12 (Ariz. 2002) ("When the remedy for breach of the covenant sounds in contract, it is not necessary for the complaining party to establish a special relationship."); Folk v. Larrabee, 17 P.3d 247 (Idaho 2000) (affirming jury verdict that employer had breached duty of good faith implied into implied employment contract); cf. Seidenberg v. Summit Bank, 791 A.2d 1068, 1075 (N.J. Super. Ct. App. Div. 2002) ("[W]hile disparate strength may sometimes be a prominent feature, it is not the sine qua non of an action arising from a breach of the duty of good faith."); Cook v. Zions First Nat'l Bank, 919 P.2d 56, 60-61 (Utah Ct. App. 1996) (implying covenant of good faith in employment contract as a tool of contractual analysis); Wilder v. Cody Country Chamber of Commerce, 868 P.2d 211, 222 (Wyo. 1994) ("When a special relationship of trust and reliance is demonstrated, a breach of the implied covenant is actionable as a tort."). Even Pennsylvania courts examining California law have recognized this. See Lindenbaum v. Mel Bernie & Co., Civ. A. No. 87-8000, 1989 WL 38676, at *4-5 (E.D. Pa. Apr. 18, 1989) (noting that the California Supreme Court held in Foley that tort remedies are not available for breach of the implied covenant of good faith and fair dealing in employment cases, but that Foley "did not abrogate contractual remedies for breach of the implied covenant of good faith and fair dealing in at-will employment").

142. See also Vickery, supra note 1, at 96 ("In California, tort liability hinges on a finding of a special relationship."); cf. Cent. Sav. & Loan Ass'n v. Stemmons N.W. Bank, N.A., 848 S.W.2d 232 (Tex. Ct. App. 1992) (noting that breach of a covenant of good faith giving rise to a tort-based claim "can exist at common law where a 'special relationship' exists between the parties to a contract.").
covenant in all contracts, given the additional tort remedies awardable for such a claim and the contraction of bad faith claims in California.\textsuperscript{143} Indeed, it is remarkable that Pennsylvania courts imposing a

\textsuperscript{143} Moreover, it is not difficult to see how such confusion could arise. As noted supra, the terms "duty" and "covenant" are often used interchangeably when referring to good faith obligations implied in a contract. See supra note 1. However, "duty" is a term that is frequently associated and interwoven with actions in tort, not in contract. See, e.g., Brooks v. Hill, 717 So.2d 759, 765 (Ala. 1998) (quoting Jefferson County v. Reach, 368 So.2d 250, 252 (Ala. 1978)),

Where the wrong results from a breach of a promise, the claim is ex contractu. However, if the wrong springs from a breach of a duty, either growing out of the relationship of the parties, or imposed by law, the claim is ex delicto. Further, where the parties have entered into a contract, if the cause of action arises from a breach of duty arising out of the contract, rather than from a breach of a promise of the contract itself, the claim is ex delicto.

Town of Alma v. Azco Constr., Inc., 10 P.3d 1256, 1262 (Colo. 2000),

Tort obligations generally arise from duties imposed by law. Tort law is designed to protect all citizens from the risk of physical harm to their persons or to their property. These duties are imposed by law without regard to any agreement or contract. In contrast, contract obligations arise from promises made between parties.

\textsuperscript{1} Ibid. In contrast, "covenant" is a term associated with contract law. See, e.g., Baty v. ProTech Ins. Agency, 63 S.W.3d 841, 850 n.6 (Tex. Ct. App. 2001) ("The words 'covenant' and 'provision' are terms generally associated with contracts and written instruments, not torts."); Madnick v. Doelling, 713 S.W.2d 799, 800 (Tex. Ct. App. 1986) ("With regard to the word 'covenant', Black’s Law Dictionary, 5th Ed., 1979, says: 'In its broadest usage, means any contract.'"); BLACK’S LAW DICTIONARY 369 (7th ed. 1999) (defining "covenant" as "[a] formal agreement or promise, usu[ally] in a contract"). Hence, referring to the implied covenant of good faith as a "duty" may exacerbate the uncertainty surrounding good faith and may contribute to confusing bad faith claims with claims arising from a
“special relationship” requirement rarely find that such a relationship exists. However, this concern is unwarranted, as a bad faith cause of action is distinct from an action arising from a breach of the covenant of good faith. Thus, the application of a bad faith “special relationship” requirement to contractual good faith claims finds no support in the state where the general principle originated.

As a final reason for disregarding California’s “special relationship” requirement, it is worth noting that California courts themselves have barred bad faith claims other than those brought against insurers. In 1995, the California court specifically curtailed the “special relationship” extension of bad faith claims set forth in Seaman’s and strongly criticized those cases that elaborated on this concept. For these three reasons, to the extent that California is the origin of the “special relationship” requirement found in Pennsylvania law, courts imposing such a requirement have acted in error.

It is also possible that Texas law could be the source of Pennsylvania’s “special relationship” requirement. Under Texas law, the common law implied covenant of good faith “is not imposed in every contract but only in special relationships marked by shared trust or an imbalance in bargaining power.” Once a claim for breach of the covenant of contractual good faith is established, it gives rise to a breach of the implied covenant of good faith outside of an insurance context. See Ebke & Griffin, supra note 1, at 1238 (noting that the confusion over whether a breach of good faith obligations gives rise to a claim in contract or in tort is aggravated by the tendency of courts . . . to use the terms ‘covenant of good faith’ and ‘duty of good faith’ interchangeably).


145. Birth Ctr. v. St. Paul Cos., Inc., 787 A.2d 376, 390 (Pa. 2001) (Nigro, J., concurring) (“I believe that the law in this Commonwealth establishes that there are two separate ‘bad faith’ claims that an insured can bring against an insurer—a contract claim for breach of the implied contractual duty to act in good faith, and a statutory bad faith tort claim sounding in tort under 42 Pa.C.S. § 8371.”).


claim sounding in tort, entitling a plaintiff to punitive and mental anguish damages.148

However similar Texas law may be to *E-Z Parks* and the related cases, it is nevertheless an unlikely and inappropriate source for Pennsylvania’s rule. Only two Pennsylvania decisions have ever cited any Texas decision when considering claims based on the implied covenant of good faith, and those cases involved an interpretation of Texas law and jibed with the result that courts in the majority of states would

there is a special relationship, such as that between an insured and his or her insurance carrier.”); *In re Marriage of Braddock*, 64 S.W.3d 581 (Tex. App. 2001) stating:

[T]he duty of good faith and fair dealing exists only if intentionally created by express language in a contract or unless a special relationship of trust and confidence exists between the parties to the contract. The special relationship necessary to create such a duty of good faith and fair dealing arises either from the element of trust necessary to accomplish the goals of the contract, or has been imposed by the courts because of an imbalance of bargaining power.

*Id.* at 586.


Texas law does not impose a common-law duty of good faith and fair dealing in every contract, recognizing the duty only in special relationships marked by shared trust or imbalance in bargaining power. Once the duty is imposed, however, its breach sounds in tort, allowing recovery of both actual and punitive damages.

Macintosh, *supra* note 67, at 500 n.152. Although Texas case law generally supports this principle, there are a number of decisions that indicate that Texas may face a conflict similar to that of Pennsylvania. See, e.g., *Int’l. Bank, N.A. v. Morales*, 736 S.W.2d 622, 624 (Tex. 1987) (“The duty to dispose of collateral in a commercially reasonable manner is an implied covenant in all contracts under Tex. Bus. & Comm. Code Ann. § 9.504 (Vernon Supp. 1986). Breach of the covenant gives rise to a cause of action in contract for which punitive damages may not be awarded.”);

Every contract or duty governed by the business and commerce code imposes an obligation of good faith in its performance or enforcement. The failure to act in good faith under Section 1.203, however, does not state an independent tort action. ‘A breach of this implied duty under the code gives rise only to a cause of action for breach of contract.’

Bank One, Texas, N.A. v. Stewart, 967 S.W.2d 419, 442 (Tex. App. 1998); Ebke & Griffin, *supra* note 1, at 1241 (“The Texas Supreme Court has repeatedly held that a lender’s breach of the implied covenant of good faith under the Uniform Commercial Code gives rise to a cause of action which sounds in contract.”); see also Gergen, *supra* note 8, at 1235 (discussing good faith confusion under Texas law); Dennis Patterson, *Good Faith in Tort and Contract Law: A Comment*, 72 Tex. L. Rev. 1291, 1292 (1994) (calling Texas law “internally troubled” and stating that Texas’s “refusal to recognize a duty of good faith in contract is strange, if not perverse”).
have reached. These principles remain uncited by other Pennsylvania decisions, and no other Pennsylvania court demonstrates any awareness of the distinct approach taken by Texas. In addition, relying on Texas law would be inconsistent both with earlier Pennsylvania law extending the covenant of good faith to all contracts and with those decisions that treat a breach of the implied covenant of good faith as arising under contract law. Thus, to the extent that the "special relationship" requirement has its roots in the tort or tort-like claim for bad faith, its presence is unwelcome in Pennsylvania.

b. Fiduciary or Confidential Relationship

A second potential source for the special relationship requirement is confusion with the duty of good faith that arises in a fiduciary or confidential relationship with the implied covenant of good faith. As in many other jurisdictions, Pennsylvania holds that a fidu-


151. If this is so, Pennsylvania would not be alone. In Carmichael v. Adirondack Bottled Gas Corp. of Vermont, 635 A.2d 1211 (Vt. 1993), the court addressed an ordinary commercial contract and stated that an action for breach of the covenant of good faith, which is implied in every contract, "is really no different from a tort action, because the duty of good faith is imposed by law and is not a contractual term that the parties are free to bargain in or out as they see fit." Id. at 1216. The court went on to affirm the verdict against the defendant for breach of the covenant and the concomitant award of punitive damages. See id. at 1217–18. In this regard, the Vermont Supreme Court appears to have made the same mistake as the Pennsylvania by confusing the contract-tort claim of bad faith with breach of the implied covenant of good faith, but with the opposite result: instead of transferring the special relationship requirement from bad faith and blocking legitimate contract-based claims, as Pennsylvania courts have done, the Carmichael court took the tort aspects of bad faith, including punitive damages, and allowed it to bleed into commonplace contractual claims for breach of the covenant of good faith.

ciary or confidential relationship brings with it a duty to act in good faith. Although the implied covenant of good faith and the fiduciary duty of good faith have often been confused, commentators have repeatedly noted that the two are distinct:

In general, a fiduciary who is bound by good faith forgoes the opportunity to act in his own interest at all. An insurer who is bound by good faith forgoes that opportunity to act solely in its own interest. An ordinary contract party, by contract, is free to act in its own interest so long as it performs as promised. 154

App. 1997) ("Under either theory of breach of fiduciary duty or the tortious breach of duty of good faith and fair dealing, plaintiff was required to present evidence that a special relationship or a fiduciary-type relationship existed between the parties that was independent of the duties under the Agreement."). aff'd in relevant part, 26 P.3d 785 (Or. 2001); Macintosh, supra note 67, at 501–15 (discussing the "quasi-fiduciary model" used in early bad faith decisions); Rice, supra note 6, at 336–37 (discussing certain state's reference to a "quasi-fiduciary relationship" between an insurer and an insured). Given the language used by some California courts, this confusion would be quite reasonable. See, e.g., Egan v. Mut. of Omaha Ins. Co., 620 P.2d 141, 146 (Cal. 1979) ("The obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary. Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibility consonant with that trust.")

Id. at 146. Moreover, Pennsylvania would hardly be alone in blending these two discrete types of good faith. See, e.g., Beck v. Farmers Ins. Exch., 701 P.2d 795, 799 (Utah 1985) (rejecting a tort approach to bad faith because "the contract itself creates a fiduciary relationship because of the trust and reliance placed in the insurer by its insured").

153. See, e.g., Strassburger v. Phila. Record Co., 6 A.2d 922, 924 (Pa. 1939) (holding that a corporate director's fiduciary duty includes the obligation to act in good faith); McCown v. Fraser, 192 A. 674 (Pa. 1937) (In a confidential relationship, "the party in the superior position is obligated, legally as well as morally, to act with the most scrupulous fairness and good faith . . ."); Bailey v. Jacobs, 189 A. 320, 324 (Pa. 1937) ("Directors and officers occupy toward stockholders what is commonly characterized as a fiduciary relationship. They must act in the utmost good faith . . ."); Bergner v. Bergner, 67 A. 999, 1001 (Pa. 1909) ("[A]gency is a recognized fiduciary relation; its vital principle is good faith, without which the relation could not exist.");

A confidential relationship is any relationship existing between parties to a transaction wherein one of the parties is bound to act with the utmost good faith for the benefit of the other party and can take no advantage to himself from his acts relating to the interest of the other party.

Biddle v. Johnsonbaugh, 664 A.2d 159, 162 (Pa. Super. Ct. 1995); Frederick v. City of Butler, 374 A.2d 768, 770–71 (Pa. Commw. Ct. 1977) ("As a public body, the council of the City of Butler stands in a fiduciary relationship to the public and to taxpayers, and its conduct must always be guided by the rule of good faith, fidelity, and integrity.").

154. BURTON & ANDERSEN, supra note 1, § 9.2.2 n.20; see also Mkt. St. Assocs. Ltd. P'ship v. Frey, 941 F.2d 588, 593–94 (7th Cir. 1991) (discussing differences between contractual good faith and fiduciary good faith and the undesired consequences of confusing them); Int'l Ins. Co. v. Certain Underwriters at Lloyd's London, No. 88 C 9838, 1991 WL 349907, at *19 (N.D. Ill. 1991) (noting the traditional distinction between the general duty of good faith owed between contracting parties dealing at arm's length and the more exacting duty of candor owed by fiduciaries); Burton, supra note 31, at 372 n.17 (noting that the implied covenant of good faith performance is distinct from the fiduciary duty of good faith); Allan W. Vestal, Fundamental Contractarian Error in the Revised Uniform Partnership Act
Similarly, a claim arising from a breach of the contract-based implied covenant is distinct from a tort claim arising from a breach of the fiduciary duty.\textsuperscript{155}

While it is axiomatic that imposing a fiduciary duty of good faith requires a fiduciary relationship between the parties, there is no reason to find that other forms of the obligation to act in good faith, including those arising from a contract, mandate finding a fiduciary or similar relationship. Yet if fiduciary obligations are the source of the "special relationship" requirement, this is exactly what Pennsylvania courts have done.

c. Confusion of Existence of the Covenant with the Breach of Covenant

As a final option, it is possible that Pennsylvania courts have confused the existence of the implied covenant of good faith with a breach of the implied covenant. Needless to say, it is important to distinguish between whether a contract gives rise to a covenant of good faith and whether a party fulfilled its obligations arising from that covenant. Just as finding that parties have entered into a contract does not mandate that the contract was breached, so too would it be peculiar to establish such a causal connection between the covenant of good faith and a breach thereof.

While it is not clear that Pennsylvania courts have made this error, it is interesting to note that each of the decisions reached through the mid-1990s that found an implied covenant of good faith also found that it was breached.\textsuperscript{156} It is not until the end of the 1990s that courts appear to have grasped this distinction and found a covenant without an attendant breach.\textsuperscript{157} If courts have grasped this distinction,

\begin{itemize}
  \item \textsuperscript{155} See, e.g., Hauer v. Union State Bank of Wautoma, 532 N.W.2d 456, 463 (Wis. Ct. App. 1995) ("Where a contract is involved, in order for a claim in tort to exist, a duty must exist independently of the duty to perform under the contract, such as a fiduciary relationship.");
\end{itemize}
perhaps they will feel more comfortable implying a covenant of good faith without fear that a claim will necessarily arise.

Moreover, it is worth noting that the parties to any contract may take it upon themselves to limit or to restrict the application of the implied covenant of good faith. As noted by many courts, this covenant cannot be used to override the express terms of a contract. Thus, contracting parties may draft their agreement in such a way that a reviewing court is constrained as to the obligations the covenant of good faith may impose.

In short, there are several possible sources from which Pennsylvania courts could have adopted the "special relationship" require-

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As to acts and conduct authorized by the express provisions of the contract, no covenant of good faith and fair dealing can be implied which forbids such acts and conduct. And if defendants were given the right to do what they did by the express provisions of the contract there can be no breach.

Id. at 778. Corey R. Chivers, "Contracting Around" the Good Faith Covenant to Avoid Lender Liability, 1991 COLUM. BUS. L. REV. 359, 360 (suggesting that many "many have overlooked . . . the extent to which contracting parties can 'contract around' the implied good faith covenant in order to prevent some of the perceived costs that judicial decisions have imposed"); cf. Murphy v. Duquesne Univ. of the Holy Ghost, 777 A.2d 418, 434 (Pa. 2001) ("[W]hen an employer expressly provides in an employment contract for a comprehensive evaluation and review process, a court may look to the employer's good faith to determine whether the employer has in fact performed those contractual duties.").


160. However, it is worth noting that the implied covenant of good faith frequently may not be disclaimed entirely. See U.C.C. § 1-102(3) (2002) ("[T]he obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable."); Olympus Hills Shopping Ctr., Ltd. v. Smith's Food & Drug Ctrs., Inc., 889 P.2d 445, 450 n.4 (Utah Ct. App. 1994) ("[T]he obligation of good faith is 'constructive' rather than 'implied' because the obligation is imposed by law and cannot be disclaimed."); Burton, supra note 31, at 371 n.14 ("Although the parties are not free to disclaim the obligation to perform in good faith as such, . . . they are free to determine by agreement what good faith will permit or require of them."); Diamond & Foss, supra note 32, at 625 ("Of the courts that have addressed the issue, most, but not all, have agreed that the covenant cannot be waived."); Van Alstine, supra note 31, at 1226 ("[T]he duty of good faith is 'imposed' in every contract, and cannot be disclaimed, even by express stipulation."). But see MJ & Partners Restaurant Ltd. P'ship v. Zadikoff, 995 F. Supp. 929, 932 (N.D. Ill. 1998) ("Under Illinois law, a covenant of good faith and fair dealing is implied in every contract unless expressly disavowed.").
ment for finding that a specific contract includes an implied covenant of good faith. Nevertheless, imposing such a requirement has no reasonable basis and conflicts with prior Pennsylvania case law. Hence, it is appropriate for Pennsylvania law to recognize that the covenant of good faith is, in fact, implied in every contract, irrespective of the type relationship between the parties.

This conclusion should not lead to an explosion of legitimate claims arising from breaches of the covenant of good faith. The specific obligations arising from the implied covenant of good faith and whether those obligations have been fulfilled are extremely fact sensitive inquiries and must be determined on a case-by-case basis. Under some circumstances, these obligations may be so light that they almost do not exist. However, it would be in error to ignore the covenant entirely.

B. Independent Cause of Action or Rule of Contractual Interpretation?

The second item of confusion in Pennsylvania and elsewhere is whether a breach of the implied covenant of good faith outside of an insurance context gives rise to a contract-based cause of action separate from an ordinary breach of contract action, or merely serves as a vehicle for interpreting the contract. As with the issue of which contracts include a covenant of good faith, much of the uncertainty derives from confusing the contract-tort of bad faith with breaches of the general covenant present in all contracts.

Whether a breach of the implied covenant of good faith amounts to an independent claim or is a rule of contract interpretation has an effect beyond the mechanics of how the claim is pled. In Pennsylvania, as in many states, the interpretation of a contract is a question of law to be resolved by the presiding judge. Other questions, including the intent of the parties and the existence of a breach, are questions of fact that are often addressed by a jury. Thus, how a breach of the


implied covenant of good faith is pled will affect how it is treated by courts as a practical matter.\textsuperscript{163}

1. Treatment as an Independent Cause of Action

The majority of Pennsylvania cases through the 1990s to today respects this approach and have refused to permit independent claims for breach of the covenant of good faith outside of an insurer-insured relationship.\textsuperscript{164} Thus, in general, "a breach of such covenant is a breach of contract action, not an independent action for a breach of a duty of good faith and fair dealing."\textsuperscript{165}

\textsuperscript{163} See also Watson Truck & Supply Co., Inc. v. Males, 801 P.2d 639, 642 (N.M. 1990) ("Application of the covenant of good faith and fair dealing becomes difficult, however, under circumstances where, as here, it may be argued that from the covenant there is to be implied in fact a term or condition necessary to effect the purpose of a contract."); Rice, \textit{supra} note 6, at 335–37 ("[A]mong those tribunals which recognize an independent tort action for bad faith, significant confusion exists over whether an insurer's duty to act responsibly is implied in fact or implied in law."). It follows that, if a breach of the implied covenant is nothing more than a rule of contract interpretation, then it could be a question of law as to what obligations the covenant imposed and a question of fact as to whether that obligations was fulfilled. Cf. Guardian Alarm Co. of Mich. v. May, 24 Fed. Appx. 464, 470 (6th Cir. 2001) ("[T]he question of whether a party has adhered to the duty of good faith is properly decided by the jury. . . ."); Questar Pipeline Co. v. Gryenberg, 201 F.3d 1277, 1291 (10th Cir. 2000) (affirming trial court's role in determining what duties the covenant of good faith imposed because "[t]his was a contractual interpretation issue and a question of law for the court. . . ."); Cotran v. Rollins Hudig Hall Int'l, Inc., 948 P.2d 412, 421 (Cal. 1998) (discussing jury role in covenant of good faith claims); Rogers v. Farmers & Merchants Bank, 545 S.E.2d 51, 53 (Ga. Ct. App. 2001) ("[T]he question of good faith is for the jury."); Schawk, Inc. v. Donruss Trading Cards, Inc., 746 N.E.2d 18, 27 (Ill. App. Ct. 2001) ("[W]hether a party has acted in good faith is generally a question of fact for the jury.").


\textsuperscript{165} \textit{Seiple}, 1998 WL 175593, at *2 (citation omitted).
Yet this is exactly what some courts and numerous practitioners in Pennsylvania have done or appear to have done. For example, in Killian v. McCulloch, the court permitted the plaintiff to proceed on separate claims for breach of contract and breach of the contractual covenant of good faith:

Plaintiffs' breach of contract claim is predicated on Defendants' failure to pay benefits due under the Plan. Plaintiffs' claim for breach of the implied covenant of good faith and fair dealing is predicated on Defendants' failure to ensure funding for the required payments under the Plan. While at first glance the two causes of action may appear to be the same, in reality they are not. Defendants had a written obligation to pay benefits when they became due, however, the duty to ensure adequate funding for the Plan arises because Defendants were obligated by contract to pay the benefits. Although it is not expressly stated in the Plan, such a duty would be implied by the doctrine of necessary implication because it was the parties' intent for certain employees to receive bonuses after a three and a half year period. Therefore, a difference exists between obtaining adequate funding to pay out benefits, and actually paying the benefits when they became due.

In sum, the obligation to ensure funding is not expressly covered by the terms of the Plan, and this Court finds that such an obligation can be implied under the doctrine of necessary implication and section 205 of the Restatement (Second) of Contracts. Defendants have provided us with no other reason why Plaintiffs cannot state a claim for both breach of contract and breach of an implied covenant. Moreover, to assert that Plaintiffs cannot bring a claim for breach of the implied covenant because they have already stated a claim for breach of contract is ludicrous. There is nothing preventing Plaintiffs from stating two separate claims for breach of contract in the complaint; likewise, Plaintiffs are not prevented from stating a claim for breach of contract along with a claim for breach of the implied covenant of good faith and fair dealing. Therefore, plaintiffs have adequately stated a claim for breach of the implied covenant of good faith and fair dealing.

166. In McGrenaghan, for example, the plaintiff asserted a claim for breach of the implied covenant of good faith and fair dealing that was inherent in her employment contract, but did not assert a pure breach of contract claim. Likewise, in Seiple, the plaintiff contended that his former employer had breached the covenant of good faith and fair dealing without asserting a breach of the contract itself. In a twist on this theme, the plaintiff in Drysdale advanced separate claims for breach of contract and breach of the covenant of good faith and fair dealing without asserting a breach of the contract itself. In a twist on this theme, the plaintiff in Drysdale advanced separate claims for breach of contract and breach of the covenant of good faith and fair dealing. 1998 WL 966020, at *1 n.1. See also Solomon v. U.S. Healthcare Sys. of Pa., Inc., 797 A.2d 346 (Pa. Super. Ct. 2002) (noting plaintiff's separate claims for breach of contract and breach of an implied covenant of good faith and fair dealing).


168. Id. at 1251 (citation omitted).
The court spoke more obliquely in *Herbst v. General Accident Insurance Co.*\textsuperscript{169} where it made the following inference:

Pennsylvania law does not recognize a claim for breach of a duty of good faith and fair dealing arising from the termination of an at-will employment relationship. Only in very limited circumstances may a distinct claim for breach of a duty of good faith and fair dealing be maintained independent of an action for breach of an underlying contract.\textsuperscript{170}

While it could be argued in another jurisdiction that this statement was intended to reference bad faith claims, Pennsylvania's refusal to allow bad faith claims outside of an insurance setting removes this from consideration.\textsuperscript{171} Instead, *Herbst* leaves readers with the impression that Pennsylvania permits a separate contract-based action for a breach of the covenant of good faith under certain circumstances.\textsuperscript{172}

Some decisions take a more nuanced approach that still leaves open avenues for uncertainty. In *Northview Motors, Inc. v. Chrysler Motors Corp.*\textsuperscript{173} the Third Circuit prohibited an independent action where a breach of the covenant of good faith was duplicative of a breach of contract claim, but left room for such an action where it was based on separate allegations:

Courts have utilized the good faith duty as an interpretive tool to determine the parties' justifiable expectations in the context of a breach of contract action, but that duty is not divorced from the specific clauses of the contract and cannot be used to override an express contractual term.\textsuperscript{174} Thus, a party is not entitled to main-


\textsuperscript{170} 1999 WL 820194, at *3 (citation omitted).

\textsuperscript{171} Even *Herbst's* characterization of *Creeger Brick* as allowing claims in an insurer-insured relationship cannot be taken as an allusion to insurance bad faith claims, as *Creeger Brick* was decided while *D'Ambrosio*’s ban on insurance bad faith claims was still in effect and a year before Section 8371 was adopted.


\textsuperscript{173} 227 F.3d 78, 92 (3d Cir. 2000).

tain an implied duty of good faith claim where the allegations of bad faith are "identical to" a claim for "relief under an established cause of action."\footnote{Parkway Garage, Inc. v. City of Phila., 5 F.3d at 701-02 (noting that Parkway's allegations concerning the closing of a garage in bad faith were identical to its allegations under 42 U.S.C. § 1983 and, therefore, there was no reason to imply a separate cause of action for breach of a duty of good faith); see also D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co., 494 Pa. 501, 431 A.2d 966, 970 (Pa. 1981) (court refused to recognize separate cause of action for breach of duty of good faith where adequate remedy was provided under Unfair Insurance Practices Act); Creeger Brick v. Mid-State Bank, 560 A.2d at 93-94 (Pa. Super. Ct. 1988), aff'd in part & rev'd on other grounds 526 Pa. 110, 584 A.2d 915 (Pa. 1990); Standard Pipeline Coating Co. v. Solomon & Teslovich, Inc., 344 Pa. Super. 367, 496 A.2d 840, 843 (Pa. Super. Ct. 1985) (court would not create a tort remedy where there was an adequate remedy to address the claims in existing torts and contracts law).}

... \[W\]e believe that if a plaintiff alleging a violation of the implied covenant of good faith also were to file a claim for fraud based on the same set of facts, Pennsylvania courts likely would decline to proceed with the claim alleging bad faith. Instead, Pennsylvania courts would consider the other claims in the plaintiff's complaint. Such an approach limits the use of the bad faith cause of action to those instances where it is essential. The covenant of good faith necessarily is vague and amorphous. Without such judicial limitations in its application, every plaintiff would have an incentive to include bad faith allegations in every contract action. If construed too broadly, the doctrine could become an all-embracing statement of the parties' obligations under contract law, imposing unintended obligations upon parties and destroying the mutual benefits created by legally binding agreements. Therefore, we predict that the Pennsylvania Supreme Court would not extend the limited duty to perform a contract in good faith to a situation such as that presented here in which the parties in great detail set forth their mutual obligations and rights in the [Sales and Service Agreements]. ... Overall, we are satisfied that, in the face of these detailed provisions setting forth both contractually and statutorily the parties' obligations and rights, we should not recognize an independent cause of action for breach of the implied covenant of good faith in this case.\footnote{Northview Motors, 227 F.3d at 91-92 (footnote omitted). See also King of Prussia Equip. Corp. v. Power Curbers, Inc., 158 F. Supp. 2d 463, 466 (E.D. Pa. 2001) (barring independent action where "the inclusion of the proposed claim of breach of a covenant of good faith and fair dealing adds nothing of consequence to the breach of contract claim"); cf. Twentieth Century Fox Film Corp. v. Marvel Enters., Inc., 155 F. Supp. 2d 1, 16 (S.D.N.Y. 2001) (citing California decisions to state that "a claim for breach of the implied covenant may be sufficiently alleged where additional conduct by the defendant, separate and apart from the conduct resulting in the breach, frustrates the plaintiff's right to benefits due under the contract").}

Further muddying the waters is the Pennsylvania Supreme Court's recent decision in \textit{Birth Center v. St. Paul Cos.}\footnote{787 A.2d 376 (Pa. 2001).} There, the
court held that an insurer was liable for compensatory damages resulting from its breach of the implied covenant of good faith and bad faith conduct. In doing so, the court implied that a bad faith claim under 42 Pennsylvania Consolidated Statutes section 8371 automatically gave rise to a contract cause of action for breach of the covenant of good faith, but did not distinguish between a breach of contract action and a potential independent claim for breach of the implied covenant of good faith.178

Of even greater significance is the crossfire between the concurring and dissenting opinions. Justice Steven Zappala dissented essentially based on his belief that "a claim for bad faith refusal to settle sounds in tort, not in contract."179 In doing so, Justice Zappala drew a line between breach of an insurance contract and breach of the covenant of good faith arising from that contract:

It is hornbook law that a breach of either the duty to indemnify or the duty to defend constitutes a breach of a promise set forth in the liability insurance contract and gives rise to a cause of action ex contractu; a breach of the duty to act in good faith arises from a breach of the fiduciary duty growing out of the liability insurance contract and gives rise to a cause of action ex delicto.180

The logical inference to be drawn from this statement is that a breach of the covenant of good faith cannot give rise to a contract action at all. If a contract-based claim does not accrue as a result of a breach of the covenant in an insurance context, there is little chance that such a claim can be found under other circumstances.

In his concurrence, Justice Russell Nigro confronted Justice Zappala's arguments and articulated a distinction between tort-based bad faith claims and contract-based bad faith claims:

I... write separately to assert my view that, unlike Justice Zappalla [sic], I believe that the law in this Commonwealth establishes that there are two separate "bad faith" claims that an insured can bring against an insurer—a contract claim for breach of the implied con-


179. 787 A.2d at 391.

180. Id. at 391–92 (citation omitted).
tractual duty to act in good faith, and a statutory bad faith tort claim sounding in tort under 42 Pa.C.S. § 8371. Pursuant to the contract claim, an insured may recover traditional contract damages, including uncompensatories. Pursuant to the statutory claim, however, the insured may recover only those damages specifically set forth in 42 Pa.C.S. § 8371, i.e., punitive damages, attorney fees, court costs and interest.

Although historically the case law in this Commonwealth has been less than clear as to the nature of the common law “bad faith” claim against an insurer, i.e., whether it sounds in tort or contract, I believe that any ambiguity in that regard was settled by D’Ambrosio, which explicitly stated that there is no common law bad faith tort claim. D’Ambrosio, however, did not address the viability of the bad faith contract claim, which has its roots in the 1952 case of Perkoski v. Wilson, and was reaffirmed by this Court in Gray. Accordingly, D’Ambrosio left the long-recognized contractual bad faith claim undisturbed.

By subsequently enacting 42 Pa.C.S. § 8371, the General Assembly filled the gap that we had identified in D’Ambrosio with a statutory cause of action in tort for bad faith. By virtue of § 8371, insureds may now supplement the breach of contract damages that they can obtain through their bad faith contract action by also bringing a claim under § 8371 for the specific damages authorized in that statute.

Thus, Justice Nigro’s opinion can be read as endorsing the idea that a contract “bad faith” claim is possible and that this claim is independent of a breach of contract claim.

Although these opinions focus primarily on insurance bad faith claims, they are nonetheless instructive. Thus, Birth Center in its entirety presents three approaches. The first is the Birth Center majority approach, where an insurance bad faith claim encapsulates a breach of contract claim. The second, articulated by Justice Zappala, holds that breach of the covenant of good faith in an insurance context is a tort, a breach of a contract’s term gives rise to a contract action, and, presumably, breach of the covenant of good faith in any other context.

181. 92 A.2d 189 (Pa. 1952) (first recognizing assumpsit action for bad faith).
IMPLIED COVENANT OF GOOD FAITH

is of no import. Third is Justice Nigro's implied belief that a breach of the covenant of good faith may be brought as a tort claim in an insurance context and as a contract claim, potentially independently, in other contexts. This conflict is especially confusing when viewed in light of earlier decisions that open the question as to whether a breach of the implied covenant of good faith should be prosecuted separately from a breach of contract action or should be presented as one facet of a breach of contract claim.

2. Good Faith as a Rule of Contract Interpretation

Again, much of the confusion stems from a failure to distinguish between tort-contract bad faith claims accruing against insurers under 42 Pennsylvania Consolidated Statutes section 8371 and claims arising from a breach of the implied covenant of good faith in other settings. It is essential that each of these claims be examined separately.

A synthesis of the opinions of Justices Nigro and Zappala in *Birth Center* reveals that insurance bad faith claims brought under Pennsylvania statute are entitled to treatment as actions independent of a breach of contract claim. The punitive damages permitted under the bad faith statute make it impossible to consider a claim brought thereunder as nothing more than one part of a breach of contract claim, as punitive damages are not permitted in a breach of contract action.\(^{183}\)

This conclusion has the support of other jurisdictions where similar actions are treated as independent causes of action.\(^{184}\) Of particu-


*P*arties to an insurance contract are expected to deal with each other in good faith and must abstain from any conduct which impairs the right of the other to receive the benefits of the agreement. A breach of this duty may give rise to an independent tort action for bad faith.

*I*d. at 635. *Best Place, Inc. v. Penn Am. Ins. Co.*, 920 P.2d 334, 346 (Haw. 1996) ("T*here is a legal duty, implied in a first-and third-party insurance contract, that the insurer must act in good faith in dealing with its insured, and a breach of that duty of good faith gives rise to an independent tort cause of action.");

*A*n insured who believes an insurance claim has been wrongly denied may have available two distinct legal theories, one for breach of the insurance contract and one in tort for breach of the duty of good faith and fair dealing; the two theories have separate, though often overlapping, elements, defenses and recoveries.

lar interest is how Missouri courts have addressed this issue, as Missouri, like Pennsylvania, permits bad faith claims by statute, not case law.\textsuperscript{185}

Bad faith liability is a separate cause of action from failure to defend. If an insurer is obligated to provide a defense, but fails to do so, the insured has a cause of action for breach of contract. Where the insurer has an opportunity to settle a claim against its insured within the policy limits, but fails to do so, the insured may have an action for "bad faith" refusal to settle.\textsuperscript{186}

Thus, Pennsylvania statutory bad faith claims may be treated as independent of other breaches of the implied covenant of good faith.

The law becomes more opaque when considering the treatment of breaches of the implied covenant of good faith in a non-insurance context. While a number of recent cases have, to some extent, recognized a separate contract-based obligation or hinted that they would do so, Pennsylvania case law militates against adopting this position. Earlier decisions speak to "implying an agreement" that would fill in the gaps of existing contract provisions,\textsuperscript{187} while Engstrom\textsuperscript{v. John Nuveen & Co.}\textsuperscript{188} makes it clear that there is no separate action of any kind for breach of the covenant of good faith in an employment context.\textsuperscript{189} As has already been noted, an employment relationship was among the first affiliations outside of an insurance relationship that could give rise to an independent claim in tort.\textsuperscript{190} If a breach of the covenant of good faith in an employment contract does not give rise to a separate cause of action, it is logical to conclude that breaches in other types of contracts are similarly limited. Recent cases that reach

\textsuperscript{334-35} (Tex. Ct. App. 2001) ("[A] breach of the duty of good faith and fair dealing gives rise to a cause of action in tort that is separate from any cause of action for breach of the underlying insurance contract."); cf. A.A.A. Pool Serv. & Supply, Inc. v. Aetna Cas. & Sur. Co., 395 A.2d 724, 725–26 (R.I. 1978) ("[P]arties to a contract have an implied obligation to deal fairly with one another. However, we do not agree with plaintiff's assertion that the unfair denial of its claim entitles it to sue its insurer in tort.").

\textsuperscript{185} Mo. ANN. STAT. § 375.420 (West 2001).


\textsuperscript{188} 668 F. Supp. 953 (E.D. Pa. 1987).

\textsuperscript{189} \textit{See id.} at 958.

\textsuperscript{190} \textit{See supra} note 62.
this end and use the covenant of good faith as a tool of contractual interpretation are better reasoned than their counterpart decisions that hold otherwise.\textsuperscript{191}

Moreover, the basis for courts finding a separate contract claim for breach of the covenant of good faith is faulty. Most of these courts appear to have examined \textit{Engstrom} and \textit{Creeger Brick}'s rejection of a separate \textit{tort} claim for breach of the covenant of good faith in most circumstances and construed this rejection as an opening for separate \textit{contract} claims in certain contexts, including situations where the allegations giving rise to the separate claim are distinct from those giving rise to another action.\textsuperscript{192} This failure to discriminate between bad faith claims and contract-based claims is, once again, the source of flawed decisions.

Outside of Pennsylvania, courts considering this issue have almost uniformly held that a breach of the implied covenant of good faith under such circumstances amounts to nothing more than a breach of contract claim.\textsuperscript{193} This supports the conclusion that Pennsylvania courts have historically been correct in their interpretations of the law


\textsuperscript{192}. \textit{Cf} ATI Ctrs., Inc., 1999 WL 562243, at *3 (addressing a commercial contract and concluding that "Pennsylvania does not recognize a cause of action in tort for breach of a duty of good faith separate and apart from a breach of contract claim").

\textsuperscript{193}. \textit{See} Thomasville Furniture Indus., Inc. v. JGR, Inc., 3 Fed. Appx. 467, 471 (6th Cir. 2001) ("[T]he implied covenant of good faith and fair dealing . . . is not an independent basis for a cause of action."); Echo, Inc. v. Whitson Co., 121 F.3d 1099, 1106 (7th Cir. 1997) ("The obligation of good faith, therefore, creates neither a cause of action sounding in tort nor its own \textit{sui generis} cause of action."); Baxter Healthcare Corp. v. O.R. Concepts, Inc. 69 F.3d 785, 792 (7th Cir. 1995) ("[T]he covenant of good faith and fair dealing is not an independent source of duties for the parties to a contract. Instead, the covenant merely 'guides the construction of the explicit terms in the agreement.'"); Medtronic, Inc. v. ConvACare, Inc., 17 F.3d 252, 256 (8th Cir. 1994) ("Minnesota law does not recognize a cause of action for breach of the implied covenant of good faith and fair dealing separate from the underlying breach of contract claim."); Swedish Civil Aviation Admin. v. Project Mgmt. Enters., Inc., 190 F. Supp. 2d 785, 794 (D. Md. 2002) ("The implied duty of good faith . . . is merely part of an action for breach of contract."); Designers N. Carpet, Inc. v. Mohawk Indus., Inc., 153 F. Supp. 2d 198, 197 (E.D.N.Y. 2001) ("A claim for breach of an implied covenant of good faith and fair dealing does not provide a cause of action that is separate and different from a breach of contract claim. Rather, breach of that duty is merely a breach of the underlying contract.");
and that any recent aberrations may be overlooked. This approach was neatly summarized in a recent federal court decision:

This court finds that Pennsylvania law would not recognize a claim for breach of covenant of good faith and fair dealing as an independent cause of action separate from the breach of contract claim since the actions forming the basis of the breach of contract claim are essentially the same as the actions forming the basis of the bad faith claim. Plaintiffs cite Somers v. Somers,194 in support of the claim for breach of implied covenant of good faith and fair dealing. However, the majority in Somers only stated that the general duty of good faith and fair dealing in the performance of a contract has been adopted in this Commonwealth, and that a party may bring a claim for breach of contract. A breach of such cove-

reason, a cause of action for breach of the doctrine of good faith and fair dealing will not stand without breach of an explicit contract provision.

Gibbs Props. Corp. v. CIGNA Corp., 196 F.R.D. 430, 441 (M.D. Fla. 2000); Clark Bros. Sales Co. v. Dana Corp., 77 F. Supp. 2d 837, 852 (E.D. Mich. 1999) ("Under Michigan law, this implied covenant does not override the express terms of the parties' contract, and cannot form the basis for a claim independent of that contract."); Fleet Nat. Bank v. Liuzzo, 766 F. Supp. 61, 67 (D.R.I. 1991) ("[A] breach of the duty of good faith gives rise only to a breach of contract claim, not to an independent cause of action in tort."); Stewart Enters. Int'l, Inc. v. Peykan, Inc., 555 S.E.2d 881, 884 (Ga. Ct. App. 2001); Cramer v. Ins. Exch. Agency, 675 N.E.2d 897, 903 (Ill. 1996) ("The implied covenant of good faith modifies, and becomes part of, the provisions of the contract itself. As such, the covenant is not independent of the contract."); Hauer v. Union State Bank of Wautoma, 532 N.W.2d 456, 464 (Wis. Ct. App. 1995) (Section 1-203 of the UCC "does not support an independent cause of action for failure to act in good faith under a contract."); cf. McKie v. Huntley, 620 N.W.2d 599, 602 (S.D. 2000) ("[S]ettled law precludes an independent tort action for breach of good faith and fair dealing arising from a contract." (quoting High Plains Genetics Research, Inc. v. J K Mill-Iron Ranch, 535 N.W.2d 839, 843 (S.D. 1995)); Charles E. Brauer Co., Inc. v. NationsBank of Va., N.A., 466 S.E.2d 382, 385 (Va. 1996) ("The breach of the implied duty under the U.C.C. gives rise only to a cause of action for breach of contract."); UCC § 1-203 comment (2002) ("[T]he doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached."). It appears that California may be an exception to this rule. See Twentieth Century Fox Film Corp. v. Marvel Enters., Inc., 155 F. Supp. 2d 1, 16 (S.D.N.Y. 2001) (interpreting California law to hold that a claim for breach of the implied covenant of good faith "must be dismissed as duplicative where it merely restates the contract claim," but that it "may be sufficiently alleged where additional conduct by the defendant, separate and apart from the conduct resulting in the breach, frustrates the plaintiff's right to benefits due under the contract"); cf. White v. Ransmeier & Spellman, 950 F. Supp. 39, 42 (D.N.H. 1996) (holding that employee's conduct was divorced from her contractual obligations to such an extent that it could not give rise to a breach of the covenant of good faith implied in the contract); Idaho First Nat'l Bank v. Bliss Valley Foods, Inc., 824 P.2d 841, 864 (Idaho 1991) ("A violation of the implied covenant is a breach of the contract. It does not result in a cause of action separate from the breach of contract claims, nor does it result in separate contract damages unless such damages specifically relate to the breach of the good faith covenant.").

nient is a breach of contract action, not an independent action for breach of a duty of good faith and fair dealing.195

Conclusion

As demonstrated, the implied covenant of good faith is an essential tool of modern contractual interpretation. From the New York of one hundred years ago to middle twentieth century California to present-day Pennsylvania, courts and scholars have sculpted this flexible technique to maintain a delicate balance between tort and contract law and to ensure that terms omitted from any contract's express provisions yet indispensable to performance as envisioned by the contract are taken into account.

While the implied covenant of good faith is fundamental to and inherent in every contract, it is important to recognize the covenant's limitations. With the exception of insurance contexts, the covenant cannot be given status independent of the underlying contract and cannot serve as the basis for its own separate claim. Courts elevating the covenant of good faith in this manner do so in error and in contravention of the history of the covenant and the prevailing sentiment in the overwhelming majority of jurisdictions.

In addition to establishing these principles, this article has provided two examples of how a failure to stay aware of the subtle distinctions that exist in principles of contractual good faith can wreak havoc with the law and lead to decisions that are both contradictory and confusing. Even a small misstep, such as overlooking the differences in how good faith is treated in an insurance contract, an employment contract, and a commercial contract, can lead to disastrous results that later courts may build upon to create an erroneous body of law.

Given that the doctrine's breadth and frequent use require heightened attention, it is necessary that courts, commentators, and practitioners, whether in Pennsylvania or elsewhere, keep these distinctions in mind when engaging in discussions on good faith. Any actions that fail to live up to this standard have the potential to return to perplex us in the future.
