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"GOOD FAITH" IN GENERAL CONTRACT LAW AND THE SALES PROVISIONS OF THE UNIFORM COMMERCIAL CODE

Robert S. Summers*

*Men must be able to assume that those with whom they deal in the general intercourse of society will act in good faith.*¹

I. INTRODUCTION

THAT persons should behave in good faith is a minimal standard rather than a high ideal; yet, judging from the facts of litigated cases, contractual bad faith, in its many and varied forms, is a continuing problem. The law's solutions to the problem will be the concern of this Article. The topic is timely, for there is growing interest in devising legal standards of contractual morality—interest generated in part by enactment of the Uniform Commercial Code's express obligations of good faith.²

The doctrine of good faith purchase will not be considered;³ rather,

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¹ R. POUND, AN INTRODUCTION TO THE PHILOSOPHY OF LAW 188 (1922). Some judges have noted that businessmen generally do assume good faith. "Business men habitually . . . trust to luck or the good faith of the opposite party . . ." *Phoenix Ins. Co. v. DeMonchy*, 141 L.T.R. (n.s.) 439, 445 (H.L. 1929) (Lord Atkin). It seems all the more probable that most nonbusinessmen similarly trust to luck or good faith.

² In particular, § 1-203, which provides: "Every contract or duty within this Act imposes a duty of good faith in its performance or enforcement." UNIFORM COMMERCIAL CODE § 1-203 [hereinafter cited as UCC]. In addition, the Code utilizes good faith terminology in 60 of its 400 sections. Thirteen of these sections appear in article 2 on sales: §§ 2-305(2), 2-306(1), 2-311(1), 2-323(2)(b), 2-328(4), 2-402(2), 2-403(1), 2-506(2), 2-603(3), 2-615(a), 2-702(3), 2-706(1), (5), 2-712(1). The Code has now been enacted in all states but Louisiana.

³ A classic study is Gilmore, *The Commercial Doctrine of Good Faith Purchase*,

this Article will deal with other requirements of good faith recognized in contract case law and in Code provisions on sales, a much neglected area of study.⁴ The focus will be on three questions. First, what meaning have the courts and the Code draftsmen given to the phrase "good faith"? It will be argued that good faith, as used in the case law, is best understood as an "excluder"⁵—it is a phrase which has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of bad faith. It will also be suggested that if the Code draftsmen had perceived this, they would not have given the term the general, invariant meaning: "honesty in fact in the conduct or transaction concerned."⁶

The second question is: In what circumstances do case law and the Code provisions on sales impose obligations of good faith? Although it has not been possible to do a comprehensive survey of the cases,⁷ it

63 YALE L.J. 1057-1122 (1954). On good faith purchase of negotiable instruments under the Code, see Littlefield, *Good Faith Purchase of Consumer Paper: The Failure of the Subjective Test*, 39 SO. CALIF. L. REV. 48 (1966).

⁴ Only three general studies on these other requirements have been discovered. Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963); Kessler & Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964); Powell, *Good Faith in Contracts*, 9 CURRENT LEGAL PROBLEMS 16 (1956). As the latter two articles make clear, there are numerous studies of contractual good faith in other legal systems which have recognized legal obligations of contractual good faith more fully than Anglo-American legal systems have.

⁵ For a discussion of excluders generally, see Hall, *Excluders*, 20 ANALYSIS 1 (1959).

⁶ UCC § 1-201(19).

⁷ First of all, in the standard treatises and research tools, relevant good faith pigeonholes are sparse. It has, therefore, been necessary to resort to some hit-or-miss techniques. The cases expressly dealing with good faith which appear in three leading contracts casebooks were sorted out and shepardized. The most useful of these sources was JONES, FARNSWORTH & YOUNG, *CASES AND MATERIALS ON CONTRACTS* (1965). Another valuable source of cases was the late Professor Patterson's brief study in 1955 N.Y. LAW REVISION COMM'N REP. 310-315. Then there were articles and notes which dealt, in part, with good faith as it figured in the formulation of the particular legal doctrines under study. E.g., Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465, 495-505; Havighurst & Berman, *Requirement and Output Contracts*, 27 ILL. L. REV. 1 (1932).

Second, even if the usual research tools had been more helpful, it would not have been possible to do a comprehensive study without staying at the job for several years. For, as this Article shows, good faith is at least potentially relevant in a substantial percentage of the total accumulated contract cases to date. Though the study presented here is merely an Article, the following comment applies *mutatis mutandis*:

The time has long since passed when it was possible for any treatise which deals with a broad field of law to pretend that it is exhaustive. A decorative

can be seen from the ones reviewed here that the duties judges have imposed in the name of contractual good faith are more varied and numerous than anyone has yet recognized in print. On the other hand, it will be seen that the Code's explicit requirements of good faith in sales transactions are less extensive than some scholars would have us believe.⁸ It will also be suggested that extra-Code law on good faith—via section 1-103, which states that "general principles" are to supplement the Code's specific provisions⁹—will prove a more fertile source of Code requirements of good faith than will the Code sections which use these very words.¹⁰

The theories on which courts have afforded relief against contractual bad faith include contract, tort and quasi-contract. And the forms of such relief are highly varied, ranging from denial of any recovery to the award of punitive damages. Our final question is: What adjustments might be made in these theories and forms to provide more adequate relief? Several modest proposals will be set forth, not as final solutions, but as suggestions worthy of further consideration. Among other things, it will be argued that courts should resort to tort law more often than they have to combat bad faith.

Before taking up the first question, it is appropriate to explain in some detail why the imposition and refinement of legal standards of good faith are of potentially great significance in contractual contexts, commercial and noncommercial. First of all, in these contexts good faith has pervasive and distinctive relevance. It is natural for two

feature of the treatises of a half century ago was the collections of cases from all the jurisdictions from Alabama to Wyoming. No such collections will be found here.

1 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* (1965).

⁸ In particular, the requirements appear less extensive than indicated in Mentschikoff, *Highlights of the Uniform Commercial Code*, 27 MOD. L. REV. 167, 168-70 (1964), and in Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of our New Commercial Law*, 11 VILL. L. REV. 213, 247-53 (1966).

⁹ UCC § 1-103 provides:

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

As the extra-Code case law on good faith grows, it can be fed into the Code via this section. What the section invites is not limited to law which exists as of the date of particular enactments of the Code.

¹⁰ For a perceptive account of the various ways in which "general principles" can be relevant under the Code, see Young, Book Review, 66 COLUM. L. REV. 1571 (1966).

parties to assume that each will act in good faith toward the other throughout the course of their contractual dealings.¹¹ Moreover, morals obligate them to act this way.¹² Yet, in one sense their interests will remain essentially antagonistic, for each will be expecting to get something from the other on advantageous terms. And, in a given case, misunderstandings may arise, unforeseen events occur, expected gains disappear or dislikes develop which may motivate one party to act in bad faith. If, however, such a party is legally as well as morally obligated to act in good faith, he will be significantly less likely to break faith.

Good faith is not only peculiarly and pervasively relevant in contractual matters, it is also part of a family of general legal doctrines, including implied promise, custom and usage, fraud, negligence and estoppel, which perform significant functions in this field.¹³ These doctrines supplement, limit and qualify specific legal rules¹⁴ and contract terms, and some of them also serve as substantive bases of liability independent of contract. The functions they perform further the most fundamental policy objectives of any legal system—justice, and justice according to law. By invoking good faith, implying a promise or working an estoppel it may be possible for a judge to do justice *and* do it according to law. Without legal resources of this general nature he might, in a particular case, be unable to do justice at all, or he might be able to do it only at the cost of fictionalizing existing legal concepts and rules, thereby snarling up the law for future cases. In begetting snarl, fiction may introduce inequity, unclarity or unpredictability.¹⁵

¹¹ See note 1 *supra*. It is probable that this assumption is most often tacit rather than either implicit or explicit. On the role of tacit assumptions in contractual contexts, see L. FULLER & R. BRAUCHER, *BASIC CONTRACT LAW* 554-59 (1964).

¹² At least, there is a general moral obligation not to act in bad faith toward those with whom one deals. This is not, of course, to say that moral good faith and legal good faith are identical. Moral good faith is, in one important respect, narrower. See pp. 204-06 *infra*.

¹³ See generally Kessler & Fine, *supra* note 4.

¹⁴ One important relationship of good faith to specific legal rules was aptly formulated as follows: "[Good faith is an] honest intention to abstain from taking any unconscientious advantage of another, even through the forms and technicalities of law" *Warfield Natural Gas Co. v. Allen*, 248 Ky. 646, 655, 59 S.W.2d 534, 538 (1933).

¹⁵ All of which led Bentham to vent his critical wrath in inimitable invective: "Fiction of use to justice? Exactly as swindling is to trade The most pertinacious and basest sort of lying It affords presumptive and conclusive evidence of moral turpitude" *Quoted in* L. FULLER, *LEGAL FICTIONS* 3 (1967).

In addition, fiction can divert analytical focus¹⁶ or even cast aspersions on an innocent party.¹⁷

It should be emphasized that in the foregoing family of general doctrines, good faith has its own distinctive potential. For example, a judge may resort to it as an independent theory of liability for misconduct which is neither fraudulent nor negligent.¹⁸ He may rely on it to enforce the unspecified "inner logic" of a deal when custom and usage are silent and when the true basis for implying a promise is that good faith requires as much.¹⁹ He can also invoke it to help prevent the abuse of powers conferred by contract when the elements of estoppel are absent.²⁰ Thus good faith is both a pervasively relevant and an independently significant doctrine in the fields of contracts and sales.

II. NATURE OF ACTING IN GOOD FAITH

If the potential of the good faith requirement is to be realized in practice, judges and legislators must give meaning to the phrase and must impose specific duties of good faith. What good faith means in contract case law and in the Code provisions on sales will be considered in this section; when it is required, will be considered in the next.

A. *Meaning of Good Faith in Contract Case Law*

What is the best way to determine a judge's meaning when he uses the phrase "good faith"? In the case law taken as a whole, does the term have a single general meaning of its own, or perhaps several such meanings?²¹ (The answers to these questions are closely linked.) Sometimes what a judge means by good faith will be instantly obvious, but

¹⁶ See the discussion in Patterson, *An Apology for Consideration*, 58 COLUM. L. REV. 929, 936-38 (1958).

¹⁷ *Anthony P. Miller, Inc. v. Wilmington Housing Authority*, 179 F. Supp. 199, 204 (D. Del. 1959).

¹⁸ *Hoffman v. Red Owl Stores, Inc.*, 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

¹⁹ E.g., *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 188 N.E. 163 (1933). It is not uncommonly recognized that good faith is often behind a finding of an implied promise. "[I]ts significance . . . [is] in implying terms in the agreement" Farnsworth, *supra* note 4, at 670.

²⁰ E.g., *Chrysler Corp. v. Quimby*, 51 Del. 264, 283-84, 144 A.2d 123, 134 (1958).

²¹ Apparently judges and others frequently assume that good faith has one general meaning of its own. E.g., *Peden Iron & Steel Co. v. Jenkins*, 203 S.W. 180, 188 (Tex. Civ. App. 1918). When this does not turn out to be true it is natural to think that the phrase must, therefore, be an ambiguous one—one which has two or more general meanings of its own. See Farnsworth, *supra* note 4.

frequently it will not be. When not, it may be that he is using the phrase loosely. But even if he is using it with care, there may still be unclarity. He might indicate only that, in a given context, parties are to act in good faith²² or that a party did or did not act in good faith,²³ without elaborating at all. Or he might elaborate without communicating in any specific way—for example, by laying down some very general definition of good faith, such as acting “honestly”²⁴ or “being faithful to one’s duty or obligation.”²⁵ The analyst of such an opinion is likely to inquire: What is the meaning of good faith itself? He seems to assume that the phrase has some general meaning or meanings, one of which the judge presumably intends.

One of the principal theses of this Article is that in cases of doubt, a lawyer will determine more accurately what the judge means by using the phrase “good faith” if he does not ask what good faith itself means,²⁶ but rather asks: What, in the actual or hypothetical situation, does the judge intend to rule out by his use of this phrase? Once the relevant form of bad faith is thus identified,²⁷ the lawyer can, if he wishes, assign a specific meaning to good faith by formulating an “opposite”²⁸ for the species of bad faith being ruled out.²⁹ For example, a judge may say: “A public authority must act in good faith in letting bids.” And from the facts or the language of the opinion it may appear that the judge is, in effect, saying: “The defendant acted in bad faith because he let bids only as a pretense to conceal his purpose to award the contract to a favored bidder.” It can then be said that “acting in good faith” here

²² E.g., *Frigaliment Importing Co. v. B.N.S. Int’l Sales Corp.*, 190 F. Supp. 116, 117 (S.D.N.Y. 1960).

²³ E.g., *Dickey v. Philadelphia Minit-Man Corp.*, 377 Pa. 549, 556, 105 A.2d 580, 583 (1954).

²⁴ *Peden Iron & Steel Co. v. Jenkins*, 203 S.W. 180, 188 (Tex. Civ. App. 1918).

²⁵ *Hilker v. Western Auto Ins. Co.*, 204 Wis. 1, 235 N.W. 413, 414 (1931).

²⁶ This also is the approach of nearly all the commentators. E.g., Farnsworth, *supra* note 4.

²⁷ Throughout this Article the phrase “form of bad faith” is used. A more awkward substitute would be “form of breaking faith.” For purposes of composition, the less awkward phrase inevitably wins out and is here used to cover many varieties of conduct, including some which do not involve bad motives. See 204-06 *infra*. It is recognized that some readers will resist this. For them, it would, therefore, be better to use the phrase “form of breaking faith,” at least when referring to conduct which is not in good faith but which, nonetheless, does not involve a bad motive.

²⁸ The word “opposite” is not being used here in any of the formal logician’s technical senses of the word.

²⁹ For purposes of communication, however, this additional step will seldom be necessary.

simply means: letting bids without a preconceived design to award the contract to a favored bidder.³⁰

If good faith had a general meaning or meanings of its own—that is, if it were either univocal or ambiguous—there would seldom be occasion to derive a meaning for it from an opposite; its specific uses would almost always be readily and immediately understood. But good faith is not that kind of doctrine. In contract law, taken as a whole, good faith is an "excluder."³¹ 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.³² In a particular context the phrase takes on specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out. Aristotle was one of the first to recognize that the function of some words and phrases is not to convey general, "extractable" meanings of their own, but rather is to exclude one or more of a variety of things. He thought "voluntary" was such a word.³³ And the late Professor J. L. Austin

³⁰ This example is based on *Heyer Prods. Co. v. United States*, 140 F. Supp. 409 (Ct. Cl. 1956).

³¹ In describing "excluders," Hall states: "Adjectives that have these features, i.e. (1) are attributive as opposed to predicative, (2) serve to rule out something without themselves adding anything, and (3) ambiguously rule out different things according to context, I call 'excluders.'" Hall, *Excluders*, 20 *ANALYSIS* 1 (1959). But it may be unwise to think of good faith as an adjective. It is true that within sentences good faith appears as if it were just another modifier like "ponderous" or "intentional," terms which themselves name, respectively, a positively definable property and a positively definable mental state. True, some have said that good faith in law is merely a state of mind. E.g., *Dallas Waste Mills v. Texas Cane & Linter Co.*, 204 S.W. 868, 869 (Tex. Civ. App. 1918). *Accord*, *Honnold, Buyer's Right of Rejection*, 97 U. PA. L. REV. 457, 475-76 (1949). But see Farnsworth, *supra* note 4, at 672. As this Article will show, good faith is not generally a phrase which names a particular property or state, as such. Rather, if it generally names anything, it names a whole dimension of appraisal. Cf. J. AUSTIN, *PHILOSOPHICAL PAPERS* 128 (1961). Lawyers too must fight against the bewitchment of their intelligence by means of language. That grammar and syntax can subtly mislead philosophers is well known. See L. WITTGENSTEIN, *PHILOSOPHICAL INVESTIGATIONS* 47e (1958); Ryle, *Systematically Misleading Expressions*, in *LOGIC AND LANGUAGE* 11 (1st ser., Flew ed. 1951).

³² At least three different clues initially suggested the appropriateness of classifying good faith as an "excluder." (1) Judges sometimes write of lack of bad faith or absence of bad faith, as if it were the nonexistence of something else that constitutes good faith. (2) When a judge uses the phrase good faith, one is frequently unable to attach a definite meaning to it without knowing what, in context, the judge means to exclude and. (3) Even a cursory study of judicial usage reveals that the phrase is used to rule out a wide range of heterogeneous forms of conduct.

³³ 3 ARISTOTLE, *NICOMACHEAN ETHICS* (W. Ross transl. 1925). Hart also maintains that "the word 'voluntary' in fact serves to exclude a heterogeneous range of cases

of Oxford made much of "excluders." His discussion of the term "real" is instructive:

That is, a definite sense attaches to the assertion that something is real, a real such-and-such, only in the light of a specific way in which it might be, or might have been, *not* real. "A real duck" differs from the simple "a duck" only in that it is used to exclude various ways of being not a real duck—but a dummy, a toy, a picture, a decoy, &c.; and moreover I don't know *just* how to take the assertion that it's a real duck unless I know *just* what, on that particular occasion, the speaker has it in mind to exclude. This, of course, is why the attempt to find a characteristic common to all things that are or could be called "real" is doomed to failure; the function of "real" is not to contribute positively to the characterization of anything, but to exclude possible ways of being *not* real—and these ways are both numerous for particular kinds of things, and liable to be quite different for things of different kinds. It is this identity of general function combined with immense diversity in specific applications which gives to the word "real" the, at first sight, baffling feature of having neither one single "meaning", nor yet ambiguity, a number of different meanings.³⁴

But it is not only because good faith is an "excluder" that the case analyst will be wise to focus on what the phrase rules out, rather than on what it means. It is also because the typical judge who uses this phrase is primarily concerned with ruling out specific conduct, and only secondarily, or not at all, with formulating the positive content of a standard.

Good faith, then, takes on specific and variant meanings by way of contrast with the specific and variant forms of bad faith which judges decide to prohibit. From the cases it would be possible to compile a list of forms of bad faith, with an opposite for each listed as the corresponding specific meaning of good faith. The beginnings of such a list might look like this:

such as physical compulsion, coercion by threats, accidents, mistakes, etc., and not to designate a mental element or state" Hart, *The Ascription of Responsibility and Rights*, 49 PROCEEDINGS OF THE ARISTOTELIAN Soc'Y 171, 180 (1949).

³⁴ J. AUSTIN, *SENSE AND SENSIBILIA* 70-71 (Warnock ed. 1962). If good faith is an "excluder," the author of one recent study has done with the phrase just what Austin says is incorrect. Farnsworth says good faith is ambiguous and sets out to name two different general meanings: "good faith purchase" and "good faith performance." Farnsworth, *supra* note 4. His analysis prompts one to ask: What of "good faith interpretation"? "Settlement"? "Enforcement"? "Termination"? Are all of those separate meanings, too? Surely something has gone awry.

<i>Form of Bad Faith Conduct</i>	<i>Meaning of Good Faith</i>
1. seller concealing a defect in what he is selling ³⁵	fully disclosing material facts
2. builder willfully failing to perform in full, though otherwise substantially performing ³⁶	substantially performing without knowingly deviating from specifications
3. contractor openly abusing bargaining power to coerce an increase in the contract price ³⁷	refraining from abuse of bargaining power
4. hiring a broker and then deliberately preventing him from consummating the deal ³⁸	acting cooperatively
5. conscious lack of diligence in mitigating the other party's damages ³⁹	acting diligently
6. arbitrarily and capriciously exercising a power to terminate a contract ⁴⁰	acting with some reason
7. adopting an overreaching interpretation of contract language ⁴¹	interpreting contract language fairly
8. harassing the other party for repeated assurances of performance ⁴²	accepting adequate assurances

This list could run on and on, but it is unnecessary to extend it for present purposes. As it stands, it shows how specific meanings for good

³⁵ *Stewart v. Wyoming Cattle Ranch Co.*, 128 U.S. 383, 388 (1888).

³⁶ *Dodge v. Kimball*, 203 Mass. 364, 89 N.E. 542, 543 (1909).

³⁷ *Lingenfelder v. Wainwright Brewery Co.*, 103 Mo. 578, 595, 15 S.W. 844, 848 (1891) (only bad faith used).

³⁸ *Carns v. Bassick*, 187 App. Div. 280, 284-85, 175 N.Y. Supp. 670, 673 (1st Dep't 1919).

³⁹ *Obrecht v. Crawford*, 175 Md. 385, 395, 2 A.2d 1, 6 (1938).

⁴⁰ *J.R. Watkins Co. v. Rich*, 254 Mich. 82, 85, 235 N.W. 845, 846 (1931).

⁴¹ *Sylvan Crest Sand & Gravel Co. v. United States*, 150 F.2d 642, 643-44 (1945).

⁴² *James B. Berry's Sons v. Monark Gasoline & Oil Co.*, 32 F.2d 74 (1929). (Although the court does not talk of good or bad faith, see UCC § 2-609, Comment 4.)

faith can be derived and shows that this phrase rules out radically heterogeneous forms of bad faith.⁴³

Given the specific meanings of good faith in the foregoing right-hand column, it may seem all the more natural to suppose, contrary to our "excluder" analysis, that there must be some single word or concise phrase which faithfully unifies all such specific meanings into one general meaning of the term.⁴⁴ What about "honesty"? Is not acting in good faith equivalent to acting honestly? Numerous judges appear to have thought so, but this is wrong unless, of course, the definition of honesty is stretched beyond recognition. Honesty only rules out dishonesty in its various forms.⁴⁵ But good faith, as used by many judges, excludes numerous forms of contractual bad faith besides dishonesty. For one thing, dishonesty is necessarily immoral, but in the eyes of many judges contractual bad faith is not necessarily immoral at all. A party may, for example, abuse his bargaining power, undercut the other party's efforts to perform, or act capriciously without having the "guilty mind" that would make his actions immoral—indeed, a party might even think this conduct is in the other party's own best interest. And despite this purity of mind, many judges could be counted on to say that such conduct conflicts with requirements of contractual good faith. As one judge stated, "Good faith in law . . . is not to be measured always by a man's own standard of right, but by that which it has adopted and prescribed as a standard for the observance of all men in their dealings with each other."⁴⁶

⁴³ It should be noted that the distinction between "general positive meaning" and "excluder" is not the same as the distinction between affirmative and negative. Good faith may exclude not only affirmative action as such, it may also exclude refraining from affirmative action. That is, it may require affirmative action as well as forbearance. Duties of disclosure and of diligence are examples.

⁴⁴ Philosophers, legal and nonlegal, have not uncommonly erred in seeking such unity when it was not to be found. See generally Summers, *The New Analytical Jurists*, 41 N.Y.U.L. Rev. 861, 882-85 (1966). Judges seem to have fallen into the error of assuming that the instances to which the same term (e.g., good faith) is applied must have some quality (e.g., honesty) in common. Some judges have even spoken of good faith as a quality, as if it inhered in all conduct in good faith in the way that the quality of redness inheres in all things red (if it does). See, e.g., *Krone v. Snapout Forms Co.*, 360 Mo. 821, 827, 230 S.W.2d 865, 869 (1950).

⁴⁵ It might be argued that honesty not only rules out dishonesty, but also all that is not honest. But this is a mistake. Otherwise, honest and not honest must encompass everything. It would be very odd to say that a requirement of honesty rules out such conduct as abusing one's bargaining power. Rather, in such instances it is better to say that the issue of honesty versus dishonesty simply does not arise.

⁴⁶ *First Nat. Bank v. F.C. Trebein Co.*, 59 Ohio St. 316, 324-25, 52 N.E. 834, 837

Even if it were conceded that conduct must be subjectively immoral before it can constitute bad faith, it still would not follow that dishonesty is the only form of contractual bad faith. Thus when a man openly and straightforwardly gives another a "raw deal," he does not necessarily act dishonestly. That is, he does not undertake to mislead or deceive.⁴⁷ Consider, for example, the conduct of a buyer who openly seizes upon trivial defects to justify his rejection of goods under a rule requiring perfect tender,⁴⁸ admitting all along that he is rejecting the

(1898). It must be conceded that some judges use the phrase good faith restrictively to rule out only immoral action. It seems that this usage comports with usage in moral discourse. But for the law's purposes it is often necessary, as many judges have done in the case of good faith, to depart from lay usage. The intentional torts are analogous. It will not do, for example, for a party to defend against a claim for damages for battery by saying that he meant no harm, and that he socked the plaintiff because he honestly believed this would, on balance, do the plaintiff more good than harm. Yet, in a sense, the defendant did not act immorally—at least he had no evil intent. As one commentator has put it, "It is now more or less generally recognized that the 'fault' upon which [tort] liability may rest is social fault, which may but does not necessarily coincide with personal immorality." W. PROSSER, TORTS 17 (3d ed. 1954). The strong tendency of some judges and lawyers to think of contractual bad faith as necessarily immoral is easy to explain: (1) this is its connotation in moral discourse, and the pull of ordinary language is always powerful, even in legal contexts, and (2) in the one legal context in which the phrase bad faith is used to the knowledge of almost all judges and lawyers, namely the purchase setting, it is commonly applied to a purchaser acquiring with actual notice of third party rights—a situation where the purchaser is trying to get away with something and thus is acting immorally.

⁴⁷ It is not suggested that "undertaking to mislead or deceive" is a comprehensive explication of acting dishonestly. But this account does serve to differentiate acting dishonestly from many other forms of acting in bad faith, and, for present purposes, this is the only relevant realm of contrast. Nor is it suggested that everyone in fact uses "acting dishonestly" synonymously with "undertaking to mislead or deceive." But it is interesting to note that *Webster's Third New International Dictionary*, which in 1961 purported to be *au courant*, listed numerous other accounts of dishonest as obsolete, with "misleading, lying, cheating, untruthfulness, defrauding" then coming to the fore instead. By 1966, the *New Random House Dictionary of the English Language* did not even list other accounts of dishonest. Its story goes like this: "not honest; disposed to lie, cheat or steal; not worthy of trust or belief; a dishonest person . . . proceeding from or exhibiting lack of honesty; fraudulent." It is not suggested that judges always look to lay usage to decide law cases. Often they do not and should not, even when there is a relevant lay use of the term or phrase. But often they do, too. And it is believed that with moral notions such as dishonesty, both the tendency to look to lay usage, and the pull of lay usage, are strong. One addendum: "Acting dishonestly" is not a "success" phrase. Thus, one can act dishonestly without succeeding at deceiving another. Hence the use of "undertaking" in the foregoing formulation. It is not suggested that this is exactly the right word, but it seems the best available.

⁴⁸ Pre-Code law on the sale of goods generally required perfect tender. See, e.g.,

goods because the price has gone down and he wishes to buy more cheaply elsewhere. Such conduct is not dishonest. But it may well be thought immoral, and it is certainly commercial bad faith. In truth, good faith cannot be defined in terms of honesty. As numerous judges use the phrase, it excludes many forms of bad faith which a requirement of honesty alone does not.⁴⁹

It is submitted that any but the most vacuous general definition of good faith will similarly fail to cover all the many and varied specific meanings that it is possible to assign to the phrase in light of the many and varied forms of bad faith recognized in the cases. Of course, a particular judge might declare that for him good faith does have a general, invariant meaning which he always intends when he uses the phrase. But if such a judge should have to pass on very many of the different forms of bad faith, it is most unlikely that he could stand by his definition for long.

To summarize, general definitions of good faith either spiral into the Charybdis of vacuous generality or collide with the Scylla of restrictive specificity. Moreover, the analyst who puts general definitions aside and tries to focus on the form of bad faith which a given judge intends to exclude by his use of the term is likely to get closer to that judge's meaning, for good faith functions as an "excluder," and judges are more interested in what they are proscribing than in characterizing what is generally allowed.

No effort has been made here to identify the criteria which judges ought to use in deciding whether particular conduct is in bad faith, although enough has been said to show that these criteria must vary from context to context. Nor has there been any attempt to catalog all the varieties of contractual bad faith, were this possible.⁵⁰ Instead, the aim has been to show that good faith is best conceptualized as an excluder, and that the lawyer should, therefore, focus on what judges rule out in using this phrase. What has been said may prove of value not just to lawyers, but to judges as well, and thus may also contribute to the accumulation of a viable body of case law on good faith. A judge who appreciates the implications of the excluder analysis should, in working with precedents, refuse to adopt restrictive definitions of good

Mitsubishi Goshi Kaisha v. J. Aron & Co., 16 F.2d 185, 186 (2d Cir. 1926) ("there is no room in commercial contracts for the doctrine of substantial performance").

⁴⁹ Additional forms of bad faith which are not dishonest will be identified in Part III of this Article.

⁵⁰ See note 7 *supra*.

faith; rather, he should focus on the forms of bad faith ruled out in previous opinions and work from these opinions either directly or by way of analogy. Likewise, the judge who sees that good faith functions as an excluder should not waste effort formulating his own reductionist definitions. Instead, he should characterize with care the particular forms of bad faith he chooses to rule out; bad faith rather than good wears the pants in this dichotomy.

B. Good Faith as Conceptualized in Uniform Commercial Code Provisions on Sales

The Code imposes express obligations of good faith on parties to sales transactions via section 1-203, which provides that "[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement," and via thirteen sections in article 2, which expressly require good faith in sales transactions. Section 1-201 (19) defines good faith as used in all these sections to mean, at the least, "honesty in fact in the conduct or transaction concerned." How this narrow definition came to be adopted and the respects in which it is narrow will now be considered.

We may begin with the background of section 1-201 (19). Its predecessor in the 1949 draft of the Code read:

unless otherwise agreed, in this Act: . . . 'Good faith' means honesty in fact in the conduct or transaction concerned. Good faith includes good faith toward all prior parties and observance by a person of the reasonable commercial standards of any business or trade in which he is engaged.⁵¹

It is evident that the Code draftsmen were not, in 1949, thinking of good faith as an "excluder." Rather, they viewed it as a positive concept, with a general, definable meaning of its own. However, in defining the term they did not substantially restrict it, at least as it applied to businessmen, for under the definition businessmen were required to observe their own "reasonable commercial standards," a seemingly far-reaching phrase. Almost any other synonym would have had a significant limiting effect, given the numerous and diverse forms of bad faith that a full-blown obligation of good faith can exclude.⁵²

⁵¹ UCC § 1-201(18) (May 1949 Draft).

⁵² As it was, the 1949 definition did place some limits on the requirement. For example, its reasonableness test applied only to businessmen.

It is evident, too, that the foregoing definition of good faith must have been influenced by formulations of good faith in purchase contexts,⁵³ and especially in contexts involving the purchase of negotiable instruments. Every ex-law student knows that a person cannot be a holder in due course of a negotiable instrument if he does not purchase it in good faith.⁵⁴ But what must he prove to establish his good faith? For decades controversy has raged over whether (1) the purchaser needs only to show that, at the time of purchase, he was in fact ignorant of third party rights in or defenses to the instrument, or (2) he must show not only his ignorance, but also that he had no reason to know of any such rights or defenses. The first standard is frequently formulated in terms of "honesty in fact" and referred to as a subjective test of good faith. The second is often formulated in terms of "reasonableness" and referred to as an objective test.⁵⁵ Instead of choosing between these, as judges have commonly done in negotiable instruments cases, the Code draftsmen, in the 1949 draft of section 1-201(19), required at least "honesty in fact" and, of businessmen, compliance also with reasonable commercial standards of their businesses. Of course, the draftsmen doubtless recognized that this definition controlled the meaning of good faith not only in sections of article 3 on holders in due course,⁵⁶ but also in section 1-203, imposing a general Code obligation of good faith, and in other specific sections of article 2 using these words. But what will suffice in the purchase context should suffice in others as well. Good faith is good faith, or so the draftsmen seem to have thought.

In September 1950, the Committee on the Proposed Commercial Code

⁵³ In the early drafts, Karl N. Llewellyn, the chief draftsman of the Code, had the purchase context very much at the forefront of his mind in drafting good faith definitions. See, e.g., UCC § 10, Comment (1948 Draft). No doubt many other scholars of commercial law were, at this time, thinking in the same vein. For example, one author stated: "In its customary setting in problems of *bona fide* purchase, a concept such as 'good faith' is necessary, and reasonably workable." Honnold, *Buyer's Right of Rejection*, 97 U. PA. L. REV. 457, 475 (1949).

⁵⁴ I fear that I speak only of every law student who graduated prior to the recent onset of the so-called elective curriculum. This development can only hasten the end of courses in bills and notes. One hesitates to imagine similarly catastrophic consequences of electivism.

⁵⁵ For discussion of the "objective-subjective" controversy, see W. BRITTON, *HANDBOOK ON THE LAW OF BILLS AND NOTES* 246 (2d ed. 1961); W. HAWKLAND, *CASES AND MATERIALS ON COMMERCIAL PAPER AND BANK DEPOSITS AND COLLECTIONS* 196-200 (1967); Rightmire, *The Doctrine of Bad Faith in the Law of Negotiable Instruments*, 18 MICH. L. REV. 355 (1920).

⁵⁶ See, in particular, UCC § 3-302(1) (c).

of the Section on Corporation, Banking and Business Law of the American Bar Association recommended that the general Code definition of good faith be

limited either to honesty in fact or at most this plus "commercial decency" or something akin to this concept. A possible definition would be:

"(18) 'Good faith' means honesty in fact in the conduct or transaction concerned and the absence of trickery, deceit or improper purpose."⁵⁷

The Committee gave three reasons for its recommendation:

[(1)] Although we recognize that there are some court decisions that have added to "honesty in fact" in the meaning of "good faith" the requirement to observe some commercial standards of conduct, nevertheless we believe that to the average person and the average lawyer, "good faith" signifies primarily "honesty." [(2)] Assuming, however, that within the term there should be added to "honesty" some meaning of "commercial decency" the phrase "observance of reasonable commercial standards" carries with it the implication of usages, customs or practices. If this is true there immediately arises the very difficult problem of *what* usages, customs and practices are those intended to be included in the standard. Any lawyer who has ever attempted to prove what a usage or custom is will immediately recognize how litigious such a standard could grow to be. [(3)] More serious still is the possibility that "reasonable commercial standards" could mean usage, customs or practices existing at any particular time. This could have the very bad effect of freezing customs and practices into particular molds and thereby destroy the flexibility absolutely essential to the gradual evolution of commercial practices—a result which the Code draftsmen certainly would never desire.⁵⁸

While the Code draftsmen did not adopt the ABA's recommended definition, they did delete all but the "honesty in fact" half of their 1949 definition of good faith,⁵⁹ so that in the 1952 final Official Draft section 1-201(19) read: "'Good faith' means honesty in fact in the

⁵⁷ Malcolm, *The Proposed Commercial Code*, 6 BUS. LAW. 113, 128 (1951).

⁵⁸ *Id.*

⁵⁹ Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 812 (1958).

conduct or transaction concerned"⁶⁰—today's definition. At the same time, the sponsors also inserted an objective test of good faith in several other provisions of the Code.⁶¹

With the objective half of the generally applicable section 1-201 definition of good faith lopped off, the remaining "honesty in fact" half took on more significance. In assessing the effect of the deletion, it is useful to distinguish the following classes of cases:

- (1) cases in which a purchaser, payor or the like feigns ignorance of third party rights or defenses, pretends belief in their absence or willfully refrains from investigating;
- (2) cases in which a purchaser, payor or the like negligently fails to ascertain the existence of third party rights or defenses;
- (3) cases other than (1) in which a party feigns ignorance of or pretends belief in facts;
- (4) other forms of dishonesty such as cheating, trickery, deviousness or the like, including fraud;
- (5) cases other than (2) in which a party negligently fails to ascertain the existence of facts—for example, he negligently fails to discover a breach of warranty;
- (6) other forms of negligent behavior unrelated to the ascertainment of facts at the moment of purchase—for example, the negligent failure to give timely notice;
- (7) forms of bad faith that do not involve dishonesty, let alone negligence—for example, openly abusing the power to break off negotiations, openly taking unfair advantage of bargaining power, openly acting capriciously or openly undercutting another's performance.

Readers familiar with negotiable instruments law will immediately recognize cases in categories (1) and (2) as the ones which the subjective-objective controversy was largely all about. The subjective test of good faith only ruled out conduct that came within category (1),

⁶⁰ UCC § 1-201(19) (1952 Draft with 1953 changes) [hereinafter cited as 1952 Draft].

⁶¹ UCC §§ 2-103(1)(b), 3-302(1)(b), 3-406, 3-419(3), 7-404, 7-501(4), 8-318. But there was precedent for defining "good faith" primarily in terms of honesty. Prior uniform acts had so defined it. *See, e.g.*, UNIFORM SALES ACT § 76(2); UNIFORM WAREHOUSE RECEIPTS ACT § 58(2); UNIFORM BILLS OF LADING ACT § 53(2), all drafted by Professor Samuel Williston of the Harvard Law School. It is important to note that these prior uniform acts expected much less from definitions of good faith than the Code draftsmen. Hence, but little strain could have been thrown on them.

while the objective test ruled out conduct within both (1) and (2). It would have been natural for negotiable instruments-minded lawyers working on the Code in its early stages to think that the sole effect of the two-pronged definition of good faith in section 1-201(18) of the 1949 draft was merely to rule out cases in categories (1) and (2). A few of them may have perceived that the 1949 draft would also rule out cases in categories (3) and (5), and possibly those in (4) and (6). However, it seems likely that cases in category (7), forming, as we shall see, a large class, escaped the notice of nearly everyone. However, in ruling out unreasonableness, as well as dishonesty, the 1949 draft proscribed not only what negotiable instruments-minded men were aiming at—namely, cases in categories (1) and (2)—but also virtually all of the other remaining types of cases listed, including those in category (7).

But this blunderbuss effect was lost in 1952, when good faith was finally defined merely as "honesty in fact in the conduct or transaction concerned." Even then, negotiable instruments-minded lawyers could be expected to assume that the sole effect of lopping off the reasonableness half of the 1949 definition was merely to "make negligence irrelevant to good faith." Consider, for example, the following comment of Professor Braucher:

Section 1-201(19) defines "good faith" as "honesty in fact," and thus follows a number of the uniform commercial acts in making negligence irrelevant to good faith. The adoption of this "subjective" test, sometimes known as the rule of "the pure heart and the empty head," dates back more than a hundred years in the law of negotiable instruments, to the abandonment of the "objective" standard announced in *Gill v. Cubitt*. In the Code the definition of "good faith" is also made applicable in the rather different context of section 1-203: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."⁶²

However, this deletion appears to have had a much more significant effect than merely that of "making negligence irrelevant to good faith." According to one observer, it left the Code's general obligation of good faith in section 1-203 "enfeebled";⁶³ good faith, as defined now in section 1-201(19), expressly rules out only cases in categories (1), (3) and (4).

⁶² Braucher, *supra* note 59, at 812.

⁶³ Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 674 (1963).

What of cases in categories (2), (5), (6) and (7)? They appear to be left untouched by the express language of section 1-201(19). And since categories (2), (5) and (6) only include acts of negligence—conduct which is not, as such, a form of bad faith—they may be set to one side. This leaves the large class of cases which fall within category (7): forms of bad faith that do not, as such, involve dishonesty or negligence. Regardless of how bad such conduct may be, it is far from certain that judges will consider it dishonest and, therefore, in bad faith within the meaning of section 1-201(19).⁶⁴

Should it be concluded, then, that the Code definitions of good faith, *in their entirety*, do not rule out conduct within category (7) when it occurs in sale-of-goods transactions? Not without two general qualifications.

First, there is a special definition of good faith applicable within article 2. Section 2-103(1)(b) provides:

In this Article, unless the context otherwise requires . . . good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

This definition obviously excludes far more than the section 1-201(19) “honesty” definition. But the Code seems to give this broader definition a rather limited scope. It appears to apply by its terms only when a specific provision in article 2 uses the phrase, “good faith.” On this reading, its scope would be strikingly narrow since only thirteen of the 104 provisions of article 2 use these words. Code Comments⁶⁵ suggest, however, that this definition applies throughout the gamut of circumstances governed by article 2, as if it reached back into article 1 and defined good faith in section 1-203 for purposes of that section’s general application to sales between merchants. But there is little justification in the text for this interpretation, and several of the relevant Comments

⁶⁴ Of course, judges could give the “honesty” definition a rubbery texture. But this, again, would be to indulge in fiction. See pp. 198-99 *supra*. Furthermore, this would be inconsistent with the legislative history of § 1-201(19), which is restrictive, not expansive. Indeed, the honesty definition of good faith, given its origins, could be read only to rule out very special forms of “undertaking to mislead or deceive,” namely, “feigning ignorance of third party rights or defenses, or pretending belief in their absence.” Of course, it is not suggested that the definition ought to be read this way. At least, it rules out all forms of undertaking to mislead or deceive. See the discussion in note 47 *supra*.

⁶⁵ UCC §§ 1-201(19), Comment 19; 1-203, Comment 1; 2-209, Comment 2; 2-609, Comment 6; 2-612, Comments 3, 7.

can be explained away as addressed to earlier versions of the Code in which good faith in section 1-201(19) was broadly defined both for purposes of section 1-203 and for specific provisions throughout the Code.⁶⁶ In the Code's evolution, Comments have not always kept pace with changes in the text.⁶⁷

Another limiting feature of the special definition of good faith in article 2 is that it applies only "in the case of a merchant." Section 2-104(1) defines a merchant as

a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

Furthermore, the article 2 definition of good faith presumably can operate only insofar as there are commercial standards of fair dealing in a given trade which are reasonable. It may be hard to determine what a trade is, and a given trade may not have any standards at all; it may be a jungle. In that event, the only forms of dealing ruled out under the article 2 definition would be those excluded by its "honesty" language—language which is already applicable to article 2 transactions via sections 1-203 and 1-201(19).

The second qualification—and the second avenue for retrieving ground lost because of the narrow definition in section 1-201(19)—involves use of the "unless the context otherwise requires" language prefacing this definition. This language allows a judge to apply section 1-203, the Code's general good faith provision, to rule out forms of contractual bad faith other than dishonesty. There is evidence that Karl Llewellyn, the Code's chief draftsman, was cognizant of forms of bad faith be-

⁶⁶ It must be admitted that UCC § 1-201(19), Comment 19 and the Comment to UCC § 1-203, cannot be explained away in this way. A quote from the Code's chief draftsman may be more appropriate here:

I am ashamed of it in some ways; there are so many pieces that I could make a little better; there are so many beautiful ideas I tried to get in that would have been good for the law, but I was voted down. . . . When we weren't allowed to put in where we wanted to go . . . , we at least got the thing set up so that we are allowed to state in accompanying comments where the particular sections are trying to go.

Llewellyn, *Why a Commercial Code?*, 22 TENN. L. REV. 779, 784, 782 (1953).

⁶⁷ Skilton, *Some Comments on the Comments to the Uniform Commercial Code*, 1966 WIS. L. REV. 597.

sides dishonesty, and that he intended the Code's obligations of good faith to exclude conduct of this nature.⁶⁸ A judge bent on raising standards of contractual morality may implement Llewellyn's purpose via the "unless the context otherwise requires" language. But for good reasons other judges may refuse to take this route. The force of these reasons ought to lead the Code's Permanent Editorial Board to rework its treatment of good faith. First of all, a judge may think that the deletion of the reasonableness half of the 1949 definition, which left good faith defined solely in terms of honesty, manifested an intent to leave nondishonest bad faith untouched except insofar as other specific Code provisions deal with it.⁶⁹ Second, Professor Patterson plainly pointed out the narrowness of the honesty definition during the New York Law Revision Commission's review of the Code: "The purposes of Section 1-203 seem to go beyond the requirement of 'honesty in fact'" ⁷⁰ Despite this, the Code sponsors did not revise the definition of good faith when they subsequently overhauled the Code in light of the Commission's work. This, a judge might conclude, shows that the Code sponsors have given up on more expansive doctrines of good faith. Third, under the foregoing approach, the instances in which it would be necessary to invoke the prefatory language of 1-201(19) might well outnumber the instances in which the honesty definition itself would be invoked, given the many and varied forms of nondishonest bad faith. Thus a judge tempted to adopt this approach might feel he would have to accept the paradoxical consequence that the "unless otherwise required" language of 1-201(19) is to do an even bigger job than the honesty definition itself. Understandably, he might not be willing to accept an interpretation which would have this effect. After all, such language is ordinarily inserted ahead of a definition only to

⁶⁸ See especially UCC § 10, Comment, and § 26 Comment (1948 Draft). In the 1962 Official Text, *see, e.g.*, the Comment to § 1-203; the Comment to § 2-209 on good faith in modifying a contract; Comment 4 to § 2-210 on good faith in exercising rights to specify requirements; Comment 3 to § 2-612 on good faith interpretation; Comment 5 to § 2-504 on good faith duties of co-operation; Comment 2 to § 2-601 on good faith in disposing of rejected goods; Comment 5 to § 2-607 on good faith duties to give notice of breach; Comment 7 to § 2-612 on negotiation in good faith; Comment 11 to § 2-615 on good faith in not discriminating between buyers.

⁶⁹ This intent is reinforced by the fact that the draftsmen have made an "objective" test applicable for some sections of the Code. See note 61 *supra*. When read along side such sections as 2-103(1)(b), there is at least a negative implication that § 1-201(19) deals only with dishonesty.

⁷⁰ 1955 N.Y. LAW REVISION COMM'N REP. 310, 311.

deal with exceptional situations, and not to perform functions of the magnitude that the definition itself is to perform.

In sum, the Code's definitions restrictively distort the doctrine of good faith. A variety of factors account for this, including the draftsmen's failure to view good faith as an excluder, their urge to guide through definitions,⁷¹ the influence of the subjective-objective controversy in the law of negotiable instruments, the precedent of prior uniform acts and an apparently compromising attitude toward an American Bar Association committee. The Code's Permanent Editorial Board should amend the Official Text to confine its definitions of good faith to purchase contexts alone,⁷² leaving good faith otherwise wholly undefined, both for the purposes of the section 1-203 general requirement of good faith and for purposes of the various specific provisions which use these words in nonpurchase contexts. The Board should also amend section 1-203 to rule out all relevant forms of contractual bad faith, examples of which should be given.⁷³

If an obligation of good faith is to do its job, it must be open-ended rather than sealed off in a definition. Courts should be left free, under the aegis of a statutory green light, to deal with any and all significant forms of contractual bad faith, familiar and unfamiliar. The legislature should grant only power; it should not try to guide through definitions—a fact Code draftsmen have recognized in other, analogous contexts.⁷⁴ Courts should determine the scope of the good faith requirement, partly because it is an unusually "circumstance-bound" doctrine and excludes highly varied forms of bad faith, many of which become identifiable only in the context of circumstantial detail of a kind that defies comprehensive statutory formulation. In addition, the requirement of good faith often functions as a kind of "safety valve" which may be turned to fill gaps and qualify or limit rights and duties arising under contracts

⁷¹ Definitions are frequently inspired by the desire to give specific guidance.

⁷² An argument can be made that the definitions are not even adequate in purchase contexts. But that controversy is beyond the scope of this study.

⁷³ A possible substitute for § 1-203 might read:

Section 1-203. Obligation of Good Faith

(1) From the negotiation to discharge of contracts or duties this Act governs, parties shall act in good faith.

(2) For purposes of subsection (1), "good faith" rules out all relevant breaches of faith, e.g., abusing the privilege to withdraw an offer, taking unfair advantage, evading the spirit of a contract, conjuring up a dispute to force a favorable modification, abusing a power to terminate a contractual relation.

⁷⁴ In UCC § 2-302 the draftsmen did not undertake to define "unconscionability." Nor did they, in article 9, define "possession."

or rules of law. Judges, situated as they are in the midst of the relevant circumstantial detail, are in the best position to know when to turn this valve.

To treat the nature of good faith as conceptualized in the Code is inevitably to tell a significant part of the story of the scope of good faith obligations under article 2 of the Code. But there is still more to the story.

III. SCOPE OF OBLIGATIONS TO ACT IN GOOD FAITH

Cases have been discovered which, if taken as a whole rather than by states, require good faith at every stage of the contractual process, from preliminary negotiation through performance to discharge, and in nearly all kinds of contracts. This is not to say that all cases agree as to when a duty of good faith should be imposed, for they do not. Nor, of course, is it to say that the jurisdictions are more or less uniform in the extent to which they require good faith. On some questions there is a fair sprinkling of decisions from different states, but on others—for example, whether contract negotiations must be conducted in good faith—case law is scant. Further research would probably turn up more cases, but it has not been possible to do a comprehensive survey of all the cases in which good faith could have figured.⁷⁵

The cases discovered reveal that good faith is a highly versatile doctrine. Procedurally, it may figure in plaintiff's *prima facie* case for relief,⁷⁶ or it may be asserted as an affirmative defense.⁷⁷ Substantively, it may be invoked to rule out a wide variety of forms of bad faith, including negotiating without serious intent to contract, abusing the privilege to break off negotiations, entering a transaction without intending to perform or in reckless disregard of prospective inability to perform, nondisclosure of known defects in the subject of a sale, abusing superior bargaining power, evading the spirit of a transaction, lack of diligence, willfully rendering only substantial performance, and abusing the power to specify terms or to determine compliance. Other forms of

⁷⁵ See note 7 *supra*. It should be added that no effort has been made to collect statutes which require good faith. See, e.g., GA. CIV. CODE, § 56-1206 (1960), allowing damages against an insurer for bad faith refusal to pay a loss; CAL. CIV. CODE § 3306 (1954), allowing enhanced damages against a vendor of realty who refuses to convey in bad faith, and; the Automobile Dealers' Day in Court Act, under which a dealer may recover damages from a manufacturer who terminates a franchise not in good faith, § 2, 15 U.S.C. § 1222 (1964).

⁷⁶ E.g., *Ralston v. Mathew*, 173 Kan. 550, 250 P.2d 841 (1952).

⁷⁷ E.g., *Doll v. Noble*, 116 N.Y. 230, 22 N.E. 406 (1889).

bad faith which have been ruled out by the doctrine include interfering with or failing to cooperate in the other party's performance, pretending to dispute or arbitrarily disputing, adopting overreaching or "weaseling" interpretations or constructions of contract language, taking advantage of the other party's weaknesses to get a favorable readjustment or settlement of a dispute, abusing the right to adequate assurances of performance, refusing for ulterior reasons to accept the other party's slightly defective performance, willfully failing to mitigate the other party's damages, and abusing a privilege to terminate contractual relations.⁷⁸ Courts have not always ruled out the foregoing forms of bad faith solely in the name of good faith; some have been proscribed more commonly in the name of other doctrines—for example, deceit,⁷⁹ failure of constructive conditions of cooperation⁸⁰ and breach of implied promises.⁸¹

Code sources of specific duties of good faith are numerous and varied, although relevant Code case law to date is scant. First, the parties are free to include contract clauses requiring good faith.⁸² Second, section 1-103 authorizes a judge to apply extra-Code case law on good faith if it rises to the status of a "supplemental general principle of law or equity."⁸³ What is such a principle? Must a jurisdiction's highest court state explicitly that good faith is generally required in matters contractual, or is it enough if that court recognizes explicitly several specific duties of good faith from which it could be generalized that good faith is a "general principle"? Only a few courts, notably those of New York⁸⁴ and California,⁸⁵ have said that good faith is generally required. It would seem that recognition of several specific duties is

⁷⁸ Each of these forms of bad faith will be treated subsequently. In the course of this study, numerous other forms of contractual bad faith have been encountered. But for purposes of this Article, it is not necessary to discuss them.

⁷⁹ For example, see the "false promise" cases at 227-28 *infra*.

⁸⁰ See, e.g., the "hindering of performance" cases at 241-42 *infra*.

⁸¹ See, e.g., the "evasion of the spirit of the deal" cases at 234-35 *infra*, and the discussion of "implied promise" at 233 *infra*.

⁸² But the parties are not free to vary explicit Code duties of good faith. UCC § 1-102(3).

⁸³ On the countervailing tendency in our law to view principles as less law than specific rules, see Dworkin, *The Case for Law—A Critique*, 1 VALPARAISO L. REV. 215-17 (1967). This factor presumably has impeded recognition of general obligations of good faith in our law.

⁸⁴ *Wigand v. Bachmann-Bechtel Brewing Co.*, 222 N.Y. 272, 277, 118 N.E. 618, 619 (1918).

⁸⁵ *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 771, 128 P.2d 665, 677 (1942).

enough, but perhaps even this should not be necessary if the specific duty in question is one which several other states impose.

A third source is section 1-203, which provides: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." Some writers would have us believe that this provision imposes a pervasive obligation of good faith in sales transactions.⁸⁶ Its reach is broad, but far from all-inclusive. As we have seen, the "honesty" definition of good faith appears to limit it significantly. And, by its terms, it does not rule out bad faith in the negotiation and formation of contracts, a fertile field for untoward conduct. The Code's Permanent Editorial Board should change this.⁸⁷

A fourth source of duties of good faith under the Code is section 1-205(3), which provides:

A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

This section will, in some cases, operate to require good faith, and one commentator has argued that it establishes a general duty of "commercial" good faith in sales transactions.⁸⁸ Yet when there is no prior course of dealing between the parties, an obligation of good faith cannot arise from this source. And when there is a prior course of dealing, it is far from clear that section 1-205 automatically holds the parties to a general obligation of good faith in their subsequent dealings. Subsection 1-205(1) says only that a course of dealing is

a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

That parties have dealt with each other does not necessarily mean that they have "a common basis of understanding" to deal in good faith. Turning to "usage of trade" under subsection 1-205(2), in a particular

⁸⁶ Mentschikoff, *Highlights of the Uniform Commercial Code*, 27 MOD. L. REV. 167, 168-70 (1964).

⁸⁷ See the proposed revision of § 1-203, note 73 *supra*.

⁸⁸ Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of our New Commercial Law*, 11 VILL. L. REV. 213, 247-53 (1966).

trade, dealing in good faith may have "such regularity of observance . . . as to justify an expectation that it will be observed with respect to the transaction in question."⁸⁹ But, even conceding as much, it does not follow that the Code thus imposes a general obligation of good faith in all trades.

A fifth source consists of specific provisions in article 2. Thirteen sections in the article expressly require good faith. Several more do not use these exact words, but clearly incorporate good faith requirements—for example, section 2-302 on unconscionability, section 2-206(1) (b) on the "unilateral contract trick,"⁹⁰ section 2-311(3) on hindering the other party's performance and section 2-309 on abuse of termination powers.

A final source of Code obligations of good faith consists of the Official Comments for each section. The Comments are not law, but judges give them some weight. Numerous Comments in article 2 expressly require good faith,⁹¹ include cross-references to section 1-203⁹² or do both. Moreover, the lead Comment to section 1-102 expressly invites judges to apply Code sections by analogy when they are inapplicable by their terms.⁹³ Some judges will accept this invitation and will apply by analogy article 2 sections which explicitly or implicitly require good faith.

⁸⁹ UCC § 1-205(2).

⁹⁰ The unilateral contract trick has been described by Dean Hawkland:

Suppose B offers to buy 100 units of x goods from S, and his offer clearly prescribes that the mode of acceptance is to be shipment of the goods. S, in response to the offer, ships to B 100 units of x goods. B discovers that the goods are defective and sues S for breach of the sales contract. S defends by asserting that no contract was ever consummated, because his non-conforming shipment did not give the offeror that for which he bargained, and, consequently, did not constitute an acceptance. A number of courts have been receptive to this defense. Subsection 2-206(1)(b) shatters the defense

W. HAWKLAND, *SALES AND BULK SALES* 6 (1958).

⁹¹ Sections in article 2 which do not use the phrase good faith but whose Comments do are as follows: § 2-205, Comment 5; § 2-209, Comment 2; § 2-210, Comment 4; § 2-309, Comments 1, 3, 5, 8; § 2-312, Comments 1, 2, 3; § 2-313, Comments 4, 6; § 2-314, Comment 10; § 2-317, Comment 2; § 2-324, Comments 1, 4; § 2-326, Comment 2; § 2-327, Comment 4; § 2-504, Comments 2, 5; § 2-601, Comments 1, 2; § 2-604, Comment; § 2-607, Comments 4, 5; § 2-608, Comments 3, 5; § 2-609, Comments 2, 3, 4, 6; § 2-610, Comment 4; § 2-612, Comments 3, 5, 7; § 2-715, Comments 2, 3.

⁹² The following sections in article 2 do not use the phrase good faith but have Comments which include a cross reference to § 1-203: §§ 2-209, 2-309, 2-312, 2-314, 2-324, 2-504, 2-609, 2-610, 2-612, 2-715.

⁹³ See Note, *The Uniform Commercial Code as a Premise for Judicial Reasoning*, 65 COLUM. L. REV. 880 (1965).

We may now profitably consider how particular forms of contractual bad faith have fared at the hands of courts, and how they would be likely to fare under relevant Code provisions. The main purposes of the extended, but far from exhaustive survey which follows are to show (1) that, contrary to the facile assumption that good faith is a nebulous doctrine, it is possible to pin down particular duties of good faith which rule out specific, concrete and characterizable forms of bad faith; (2) that these duties are more varied and numerous than has heretofore been recognized; (3) that a substantial body of case law exists on which courts may draw to recognize such duties in new contexts; (4) that section 1-103, which authorizes use of extra-Code law "supplementally," is likely to be the most fertile of the Code's sources of duties of good faith; (5) that the scope of section 1-203, expressly imposing a general Code obligation of good faith, apparently is limited significantly both by its own terms and by Code definitions of good faith; and (6) that other Code resources for combating bad faith can have an important bearing in particular contexts.⁹⁴

A. Bad Faith in the Negotiation and Formation of Contracts

Forms of bad faith at the negotiation and contract formation stage include negotiating without serious intent to contract, abusing the privilege to break off negotiations, entering into a contract without having the intent to perform, entering a deal recklessly disregarding prospective inability to perform, failing to disclose known defects in goods being sold, and taking undue advantage of superior bargaining power to strike an unconscionable bargain. The extent to which courts recognize such forms of bad faith for what they are, and act accordingly, varies widely. For example, except for cases ruling out a bad faith withdrawal of an offer, there is little case law on abuse in the negotiation process. On the other hand, there are many cases, in contract and in tort, on nondisclosure and misrepresentation.

Since section 1-203, which sets forth the general requirement of good faith, applies only to the "performance or enforcement" of a contract, it does not impose a duty of good faith in the negotiation and formation of sales contracts. Thus to the extent that the text of the Code rules out bad faith in the negotiation and formation stages it must be

⁹⁴ The potential bearing of custom and usage and of the "unless the context otherwise requires" language prefacing the honesty definition of good faith will be assumed but not discussed. On the latter, see 213-14 *supra*.

via section 1-103, on supplemental principles of law, or via specific sections in article 2. Like general contract case law, Code sections treat the foregoing forms of bad faith unevenly. For example, they neglect bad faith in the negotiation of sales contracts but invalidate unconscionable sales contracts or clauses.

*Negotiating Without Serious Intent to Contract*⁹⁵

A party who negotiates without serious intent to contract might be trying to tie up the other party in order to stall for time or in order to keep him from competing in another venture or deal. He also might be going through the motions of negotiating merely to comply formally with some rule of law that requires him to shop around for the best deal.⁹⁶

While the law requires parties to collective bargaining transactions to negotiate in good faith,⁹⁷ and while a few cases say that a party who has contracted to negotiate must do so in good faith,⁹⁸ only one case has been discovered in which a court has recognized, in the absence of a statutory or contractual duty to negotiate, that a cause of action exists against a party who negotiates without serious intent to contract. In *Heyer Products Co. v. United States*,⁹⁹ a 1956 decision, the Court of Claims held that a disappointed low bidder on a Government contract is entitled to recover the expenses he has incurred in preparing his bid whenever he can show that "bids were not invited in good faith, but as a pretense to conceal the purpose to let the contract to some favored bidder" ¹⁰⁰ The potential implications of this case are far reaching. If bidders are protected in this way, then why not protect similarly any party who finds that he is the victim of another's ulterior negotiating purposes? A party to negotiations assumes the usual risk that business reasons may prevent consummation of a deal, but he does not assume

⁹⁵ This category and the next (abusing the privilege to withdraw a proposal or an offer) are suggested in the admirable article by Kessler & Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 419 (1964). The article deals with a wide variety of forms of bad faith in the negotiation and formation stage.

⁹⁶ Obviously, there are still other possible reasons for such conduct.

⁹⁷ Cox, *The Duty to Bargain in Good Faith*, 71 HARV. L. REV. 1401 (1958).

⁹⁸ E.g., *Henry G. Meigs, Inc. v. Empire Petroleum Co.*, 171 F. Supp. 888, 892-93 (E.D. Wis. 1959), *aff'd*, 273 F.2d 424 (7th Cir. 1960).

⁹⁹ 140 F. Supp. 409 (Ct. Cl. 1956).

¹⁰⁰ 140 F. Supp. at 414.

the risk that the other party, having no serious intent to contract, will merely lead him on and then drop him.¹⁰¹

The *Heyer* decision does not seem to have had much influence in the ten years since it was handed down, or at least *Heyer*-type plaintiffs have not won any reported cases.¹⁰² There are several possible explanations. No doubt a cause of action such as that in *Heyer* is hard to prove, and lawyers, thinking exclusively in terms of contract, may hastily dismiss the possibility of relief when the parties do not ultimately consummate a contract. Furthermore, courts may fear that by following *Heyer* they will deter parties from entering contract negotiations or will undesirably limit freedom to negotiate. Then, too, *Heyer* may seem easily distinguishable. Even those who would concede the soundness of the decision might try to distinguish it on any of the following grounds: (1) that, far from independently sanctioning a claim for damages flowing from a specific form of bad faith, the case turns on an interpretation of Section 3(b) of the Armed Services Procurement Act of 1947, which provides that unless the public interest requires the rejection of all bids, the one "most advantageous to the United States" shall be accepted;¹⁰³ (2) that bidders on Government contracts need special protections not afforded to other offerors "because of the large cost involved in preparing a bid";¹⁰⁴ or (3) that since federal regulations make Government contract bids irrevocable, considerations of "mutuality" justly "imply a correlative right in the bidder" to have the Government consider his bid in good faith.¹⁰⁵

But none of these distinctions justifies limiting the *Heyer* doctrine. The first is not even a true distinction, for the case could not have turned on an interpretation of Section 3(b) of the Armed Services Procurement Act of 1947; the court recognized an independent cause of

¹⁰¹ The wrong here is aggravated, and becomes worthy of the legal system's concern, whenever a "negotiator" leads the negotiatee on and then refuses both to consummate and to compensate for the out-of-pocket expenses the negotiatee has been induced to incur. The negotiatee might incur even greater losses, as where he passes up other opportunities, reasonably assuming that the negotiations in progress with the negotiator will materialize.

¹⁰² See *Robert F. Simmons & Associates v. United States*, 360 F.2d 962 (Ct. Cl. 1966) and *Edelman v. FHA*, 251 F. Supp. 715 (E.D.N.Y. 1966) for the most recent cases of significance. Although plaintiffs have been unsuccessful in litigation, this does not mean that *Heyer* has had no impact upon the behavior of negotiating parties.

¹⁰³ 62 Stat. 22 (1948), *re-enacted*, 10 U.S.C. § 2305(c) (1964).

¹⁰⁴ See *Hawkland, Contracts*, in 1957 ANN. SURV. AM. L. 267, 268 (Collings ed. 1958).

¹⁰⁵ 105 U. PA. L. REV. 756, 760 n.34 (1957).

action on an "implied contract."¹⁰⁶ Moreover, there is little force in the argument that bidders on Government contracts need protection not afforded other offerors; all offerors can, in particular cases, incur significant expenses in preparing proposals. Finally, in this age of asymmetry, considerations of "mutuality" can hardly serve to distinguish cases.

Because of its potential significance,¹⁰⁷ the *Heyer* case has been discussed at some length. How might a party who negotiates for a sales contract without serious intent fare under the Uniform Commercial Code? He could not be held liable under section 1-203, which imposes a general duty of good faith, for that provision does not cover the negotiation and formation of contracts. And article 2's specific provisions are silent on negotiating without serious intent. However, the Code does not preclude a tort recovery, based on general principles of deceit. Section 1-103 states that general principles of law and equity supplement the Code, including principles of "fraud" and "misrepresentation."¹⁰⁸ Moreover, section 2-721 specifically contemplates "remedies for fraud."

Abusing the Privilege to Withdraw a Proposal or an Offer

Traditionally, a negotiating party who has made a proposal, but not an offer, has generally been allowed to break off negotiations with impunity, even when he has "agreed to agree" and has induced the other party to rely to his detriment.¹⁰⁹ But a recent case may foretell different law for the future and thus show the way to an important new legal duty of good faith in the conduct of contract negotiations. In *Hoffman v. Red Owl Stores, Inc.*¹¹⁰ the Wisconsin Supreme Court allowed recovery against a party who walked away from contract negotiations after inducing the other party to rely on the prospect that a contract would materialize. Red Owl had represented to the plaintiff that it

¹⁰⁶ 140 F. Supp. 409, 413 (Ct. Cl. 1956).

¹⁰⁷ "Negotiation" may be taking hold as a law school subject. See, e.g., White, *The Lawyer as Negotiator: An Adventure in Understanding and Teaching the Art of Negotiation*, 19 J. LEG. ED. 337 (1967). If so, it is to be hoped that explicit attention will be given not only to the art of negotiating but also to the legal rights and wrongs of negotiating.

¹⁰⁸ The dissenting judge in *Heyer* maintained that the Court of Claims lacked jurisdiction because the cause of action sounded in tort. 140 F. Supp. at 414. See also *Edelman v. FHA*, 251 F. Supp. 715, 719 n.7 (1966).

¹⁰⁹ See, e.g., *Rosenfield v. United States Trust Co.*, 290 Mass. 210, 217, 195 N.E. 323, 326 (1935). But see *Morris v. Ballard*, 16 F.2d 175 (D.C. Cir. 1926).

¹¹⁰ 26 Wis. 2d 683, 133 N.W. 2d 267 (1965).

would establish him as a franchise operator of a Red Owl grocery store if he would perform certain conditions and contribute 18,000 dollars. The plaintiff met all conditions—that is, he sold his bakery, bought and operated a small grocery store for a time to gain experience, secured an option to buy certain land for the proposed supermarket and rented a home close to the site. But Red Owl then insisted that he invest 34,000 dollars, instead of 18,000 dollars.¹¹¹ The plaintiff refused and brought an action to recover the damages he sustained in relying upon Red Owl's negotiating proposal.

The court granted relief on the theory of promissory estoppel, stating that to sustain this theory it is not necessary for a defendant's representations to

embrace all essential details of a proposed transaction between promisor and promisee so as to be the equivalent of an offer that would result in a binding contract between the parties if the promisee were to accept the same.¹¹²

On the question of damages, the court remarked:

Where damages are awarded in promissory estoppel instead of specifically enforcing the promisor's promise, they should be only such as in the opinion of the court are necessary to prevent injustice. Mechanical or rule of thumb approaches to the damage problem should be avoided.¹¹³

Concluding that recovery should not be allowed for lost profits, the court granted reimbursement only for the expenditures and losses the plaintiff incurred in preparing to take up the Red Owl franchise. This is a welcome departure from decisions which interpret Section 90 of the Restatement of Contracts inflexibly to require the award of full expectancy damages in all cases.¹¹⁴ The potential significance of *Red Owl*

¹¹¹ It may be a common ploy for a party who wishes to break off to introduce a new and highly unreasonable condition into the negotiations, hoping thereby to induce the other to walk away.

¹¹² 26 Wis. 2d at 697, 133 N.W.2d at 274-75. Courts have usually viewed promissory estoppel as a substitute for consideration in cases in which the plaintiff has relied to his detriment on either a gratuitous promise or an offer.

¹¹³ *Id.* at 701, 133 N.W.2d at 276.

¹¹⁴ For cases and discussion, see Shattuck, *Gratuitous Promises—A New Writ?*, 35 MICH. L. REV. 908 (1937).

is substantial.¹¹⁵ If the decision is followed by other courts, it will no longer be possible for one party to scuttle contract negotiations with impunity when the other has been induced to rely to his detriment on the prospect that the negotiations will succeed.

What of the bad faith withdrawal of offers?¹¹⁶ It is important to distinguish between the positions of unilateral and bilateral offerees. While it may once have been that a unilateral offeror could lawfully withdraw his offer at any time before the offeree fully completed the performance constituting his acceptance, this is no longer the general rule. Varying theories now deny the unilateral offeror the right to withdraw his offer after the offeree has begun performance.¹¹⁷ Furthermore, the unilateral offeree who has merely prepared to perform may, according to some cases, recover any reasonably foreseeable expenses which he has incurred.¹¹⁸

When a bilateral offer is withdrawn after the offeree has relied on it to his detriment, without first accepting, the result should depend, in part, on the terms of the offer. Bilateral offers may be divided into three categories: (1) those which clearly call for a return promise from the offeree before reliance would be reasonable, (2) those which contemplate that the offeree will or may rely prior to making a return promise and (3) those which do not clearly specify any sequence of events. In cases of the first type, courts do not appear willing to protect the rely-

¹¹⁵ As one observer put it, the case creates "a new right which looks very much like a cause of action for breach of an implied promise to negotiate in good faith." 51 CORNELL L.Q. 351, 355 (1966). The *Red Owl* court said Red Owl did not act in bad faith. 26 Wis. 2d at 695, 133 N.W.2d at 273. But from the context, it is clear that the court meant only that Red Owl had no fraudulent intent at the time of making its proposals. Under the circumstances of the cases it remains a violation of good faith for Red Owl to refuse both (a) to consummate the deal and (b) to compensate Hoffman for his losses.

¹¹⁶ Some judges have, in so many words, invoked good faith to limit the power to revoke an offer. *E.g.*, *Zwolanek v. Baker Mfg. Co.*, 150 Wis. 517, 525, 137 N.W. 769, 773 (1912). Corbin has objected to this conceptualization, stating: "In general, it is not thought to be bad faith to revoke any offer before it has been accepted, even though the purpose is to avoid contracting with the offeree" 1 A. CORBIN, CONTRACTS § 49, at 193 (1963). The author disagrees with Corbin's assertion, at least insofar as it applies to the withdrawal of an offer which reasonably and foreseeably induces detrimental reliance. An offeror who, without more, acts in this way breaks faith unless he agrees to compensate for such reliance.

¹¹⁷ See *Brackenbury v. Hodgkin*, 116 Me. 399, 102 A. 106 (1917); *Los Angeles Traction Co. v. Wilshire*, 135 Cal. 654, 67 P. 1086 (1902); RESTATEMENT OF CONTRACTS § 45 (1932).

¹¹⁸ 1 A. CORBIN, CONTRACTS § 51 (1963).

ing offeree.¹¹⁹ This is sound, for the offeree who relies on such an offer without first closing the deal assumes the risk that the offeror will withdraw. In cases of the second kind, the doctrine of promissory estoppel is increasingly being invoked to protect the reasonably relying offeree against a withdrawal.¹²⁰ In cases of the third variety, the offeror's right to withdraw should be limited in a proper case.¹²¹ At the least, out-of-pocket costs should be recoverable whenever the requirements of promissory estoppel are met.

Does the Code impose any duties not to abuse the privilege to withdraw? Section 1-203 is, as we have seen, silent with respect to the negotiation and formation stages. However, a court might use section 1-103, concerning supplemental principles of law, to bring any applicable extra-Code case law to bear. With two notable exceptions, specific provisions in article 2 do not require good faith negotiation. The first exception is section 2-205, which limits an offeror's power to withdraw a "firm" offer:

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

This section is narrow in scope and applies only if (1) there has actually been an offer (2) by a merchant (3) in a signed writing (4) which gives assurance that it will be held open and (5) which would, but for lack of consideration, otherwise be irrevocable. A meritorious plaintiff may well hang up on at least one of these requirements.¹²²

¹¹⁹ *E.g.*, *White v. Corlies & Tift*, 46 N.Y. 467 (1871).

¹²⁰ *See, e.g.*, *Reynolds v. Texarkana Constr. Co.*, 237 Ark. 583, 374 S.W.2d 818 (1964); *Drennan v. Star Paving Co.*, 51 Cal. 2d 409, 333 P.2d 757 (1958). The effect of invoking § 90 of the Restatement may be to compensate not merely loss of out-of-pocket expenses, but also, as in these very cases, loss of expected profits.

¹²¹ No cases have been discovered which fit the "proper case" description. It should be noted that because the parties were not close enough together to justify awarding damages for loss of expectancy from the contemplated contract itself, it does not follow that no expectancy damages should ever be awarded in any such case. A meritorious plaintiff might have foregone other opportunities on the reasonable assumption that the deal at hand was "going through."

¹²² There is little case law under this section to date. *See*, *E.A. Coronis Associates v. M. Gordon Constr. Co.*, 90 N.J. Super. 69, 216 A.2d 246 (App. Div. 1966).

Section 2-207, the other notable exception, prohibits an offeror from abusing the privilege to break off by seizing upon an insignificant variance in a purported acceptance to establish that no contract was formed.¹²³ Thus under the Code contracts can be formed which, under general contract law, would fail because of conflict with the requirement that an acceptance match up perfectly¹²⁴ with an offer.¹²⁵

Entering A Deal Not Intending to Perform or Recklessly Disregarding Prospective Inability to Perform

According to one authority, in the majority of states a party who promises without intending to perform will be liable in tort for deceit.¹²⁶ The purchase of goods without intent to pay is illustrative.¹²⁷ Let us suppose, though, that instead of making a false promise, the party makes a promise in reckless disregard of a substantial likelihood that he will be unable to perform when the time comes. Of course, if he ultimately fails to perform, he will usually be liable for breach of contract. But, for present purposes, the significant point is that the courts give special effect to the party's bad faith in recklessly disregarding substantial prospective inability to perform. For example, there is authority that a vendor of realty who ultimately is unable to convey good title must compensate the aggrieved party for the loss of his bargain if, when entering the contract, the vendor knew or had good reason to know of his substantial prospective inability to perform.¹²⁸ Otherwise, the

¹²³ This section also purports to limit the power to withdraw in the face of a significant variance. See *Roto-Lith, Ltd. v. F.P. Bartlett & Co.*, 297 F.2d 497 (1st Cir. 1962). See also UCC §§ 2-206(1)(a), (b), § 2-204(1), § 2-208, each of which can operate to prevent bad faith withdrawal.

¹²⁴ *Poel v. Brunswick-Balke-Collender Co.*, 216 N.Y. 310, 110 N.E. 619 (1915).

¹²⁵ A form of bad faith cognate to those discussed in this section consists in backing out of a deal that is, in law, imperfectly formed. See the discussion at 259 *infra*. A deal may fail in law for a variety of reasons, including noncompliance with the statute of frauds or indefiniteness. Many courts refuse to require the party backing out to pay either expectancy damages or damages for detrimental reliance. However, quasi-contractual recovery has been allowed in some cases. Note, *Quasi Contractual Recovery for Part Performance of a Contract*, 44 HARV. L. REV. 623 (1931). Article 2 of the Code seeks to reduce the occasions on which this form of bad faith can occur in the first place. Its statute of frauds provisions are less stringent than earlier ones. UCC § 2-201. And it tolerates much indefiniteness in valid contracts of sale. See UCC § 2-204(3) and the numerous "gap filler" provisions in article 2.

¹²⁶ W. PROSSER, *SELECTED TOPICS ON THE LAW OF TORTS* 380, 401 (1954).

¹²⁷ *E.g.*, *Donovan v. Clifford*, 225 Mass. 435, 114 N.E. 681 (1917).

¹²⁸ See, *e.g.*, *Arentson v. Moreland*, 122 Wis. 167, 99 N.W. 790 (1904).

vendor would be liable only for the amount necessary to restore the vendee to the status quo. To cite a second example, under pre-Code law a seller could, in some circumstances, reclaim goods sold on credit to an insolvent who bought without a reasonable expectation that he would be able to pay for them;¹²⁹ this relief was available in lieu of the usual remedy of money damages.

A party to a sales transaction under the Code who makes a false promise will be liable therefor in tort either independently or via section 1-103 on supplemental general principles. This same section might also be used to draw in extra-Code law giving special effect to the reckless disregard of prospective inability to perform. Among the specific sections of article 2 which may be relevant, section 2-702(2) should be singled out. It provides:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

Seller's Nondisclosure of Known Infirmities in Goods

Caveat emptor was supposed to have been the prevailing rule at one time, notwithstanding that it can conflict with elementary requirements of good faith. But there is evidence that the courts are putting this doctrine to rest in some fields.¹³⁰ What of the sales field? Suppose a seller remains silent with respect to a known infirmity in his product under circumstances in which he knows his purchaser probably would not buy at all or would buy only at a lower price if he knew of the infirmity. Presumably, many would agree that the seller has acted in bad faith, but under the oft-stated general rule of pre-Code case law, he has incurred no liability in tort or in contract.¹³¹ Of course, if the seller actively conceals the truth, he is liable in tort for the damage he

¹²⁹ *California Conserving Co. v. D'Avanzo*, 62 F.2d 528 (2d Cir. 1933).

¹³⁰ See Kessler & Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 441-44 (1964).

¹³¹ See W. PROSSER, TORTS 710-11 (1964).

causes,¹³² but such is not the case when no more than passive nondisclosure is involved.

If the infirmity in question goes to title or to quality, the Code's warranty provisions may afford significant relief against a nondisclosing seller, especially when the buyer does not examine the goods before entering into the contract.¹³³ Of potentially greatest significance here is section 2-314, which defines the seller's obligation to sell "merchantable goods":

(1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

- (a) pass without objection in the trade under the contract description; and
- (b) in the case of fungible goods, are of fair average quality within the description; and
- (c) are fit for the ordinary purposes for which such goods are used; and
- (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
- (e) are adequately contained, packaged, and labeled as the agreement may require; and
- (f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.

Many cases of bad faith nondisclosure will generate valid claims for breach of the foregoing implied warranty of merchantability,¹³⁴ but

¹³² *Id.* at 711.

¹³³ UCC § 2-316(3) (b) states:

when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him

¹³⁴ See also UCC § 2-315 on the related implied warranty of fitness.

this section will not afford relief for all meritorious claimants. Thus goods might be "merchantable" within the foregoing definition and yet have known infirmities which, if disclosed to the buyer, would at least have led him to insist on a lower price; section 2-314 does not necessarily afford relief under these circumstances. Furthermore, a seller has broad power under article 2 to disclaim warranties or to limit drastically remedies for their breach.¹³⁵ A nondisclosing seller who follows either or both of these tacks may leave the buyer without significant rights under the Code's warranty provisions.

Had the Code sponsors drafted section 1-203 to apply to the negotiation and formation of contracts, courts could have invoked it against the nondisclosing seller acting in bad faith.¹³⁶ But, as Professor Patterson pointed out to the Code draftsmen at the New York hearings in 1955:

Good faith in the making of a commercial contract is not required by section 1-203 and . . . therefore . . . one party to such a contract is not required to disclose to the other a material fact relating to the prudence or value of the bargain, even though the one who knows this fact also is aware that the other party does not know it, and would not make the contract if he did.¹³⁷

Taking Advantage of Another in Driving a Bargain

There are many ways, short of fraud, by which one party can take advantage of another in driving a bargain. For example, one may take advantage of another's lack of real alternatives,¹³⁸ his disinclination to read a printed form,¹³⁹ his inferior negotiating skill,¹⁴⁰ his lack of knowledge,¹⁴¹ or his emotional state.¹⁴² At the least, if a person con-

¹³⁵ UCC §§ 2-316, 2-718, 2-719.

¹³⁶ The section could have been invoked not only for undisclosed defects in quality but also, presumably, for failure to bring disclaimers and the like to the attention of the buyer. On what might be called a duty of good faith to disclose "defects in legal rights," see K. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 370-71 (1960), and Kessler & Fine, *supra* note 128, at 442 n.173.

¹³⁷ 1955 N.Y. LAW REVISION COMM'N REP. 315.

¹³⁸ See, e.g., *Henningson v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960).

¹³⁹ E.g., *Klar v. H. & M. Parcel Room, Inc.*, 270 App. Div. 538, 61 N.Y.S.2d 285 (1st Dep't 1946), *aff'd*, 296 N.Y. 1044, 73 N.E.2d 912 (1947).

¹⁴⁰ See cases cited and discussed in Collins, *Contracts*, in 1962 ANN. SURVEY OF AM L. 451, 459-62 (1963).

¹⁴¹ E.g., *Kellogg v. Iowa State Traveling Men's Ass'n*, 239 Iowa 196, 211-12, 29 N.W.2d 559, 568 (1947).

¹⁴² See, e.g., *Newman & Snell's State Bank v. Hunter*, 243 Mich. 331, 220 N.W. 665 (1928).

sciously takes advantage of such weaknesses, he acts in bad faith. When in this manner he not only strikes a bargain, but also strikes one that is unconscionable, his action becomes all the more the law's concern.

Some courts at times refuse to enforce some unconscionable contracts or contract clauses. But, except in a relatively few areas,¹⁴³ they seldom do this openly. Rather than invalidate openly in the name of public policy, fairness or good faith, they more often resort to back door techniques—for example, they base their decisions on contract interpretation or construction,¹⁴⁴ on specific rules of offer and acceptance,¹⁴⁵ on want of "mutuality,"¹⁴⁶ on lack of consideration,¹⁴⁷ or on mutual mistake.¹⁴⁸ This is all a notoriously open secret.¹⁴⁹ At the same time, it cannot be said that, in general, unconscionable contracts or contract clauses are, as such, invalid. The courts, as a whole, are not yet willing to go so far, and they certainly are not ready to go so far openly.

Under the Code relevant extra-Code law can be brought to bear via section 1-103 to afford relief to victims of unconscionable sales contracts. And section 1-203, though not applicable by its terms to the negotiation and formation of contracts, applies to prevent enforcement of unconscionable deals, at least when they are dishonest. Admittedly, this will be rare.¹⁵⁰ Some specific Code provisions may protect parties from binding themselves unwittingly to overreaching clauses.¹⁵¹ More im-

¹⁴³ *Henningson v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960), is perhaps the most important recent example. In some fields, such as creditor-debtor relations, courts have long been willing openly to invalidate contract clauses. See, e.g., *Seasongood, Drastic Pledge Agreements*, 29 HARV. L. REV. 277 (1916).

¹⁴⁴ See, e.g., *Hardy v. General Motors Acceptance Corp.*, 38 Ga. App. 463, 144 S.E. 327 (1928).

¹⁴⁵ See, e.g., *Cutler Corp. v. Latshaw*, 374 Pa. 1, 97 A.2d 234 (1953).

¹⁴⁶ See, e.g., *Weil v. Chicago Pneumatic Tool Co.*, 138 Ark. 534, 212 S.W. 313 (1919).

¹⁴⁷ See cases cited and discussed in Note, *Species of Inadequacy of Consideration Which Have Induced Judicial Refusal to Attach Obligation to Promises*, 27 COLUM. L. REV. 178 (1927).

¹⁴⁸ See, e.g., *Dansby v. Buck*, 92 Ariz. 1, 373 P.2d 1 (1962).

¹⁴⁹ See *Siegelman v. Cunard White Star, Ltd.*, 221 F.2d 189, 206 (2d Cir. 1955); Llewellyn, Book Review, 52 HARV. L. REV. 700, 702 (1959).

¹⁵⁰ While preparing this Article, the author spent a day at the University of Chicago School of Law perusing the Karl Llewellyn Papers. Among other things, he came across evidence that the Code's chief draftsman perceived the possible relevance of § 1-203 to problems of unconscionability. On what is presumably his copy of the 1949 Draft of the Code, the following question is hand-written opposite § 1-203: "Is an unfair bargain prohibited"? In the 1949 Draft the relevance of this section would have been even more obvious, for good faith was then defined to rule out much more than dishonesty. See also UCC § 1-205, Comment 6.

¹⁵¹ See, e.g., UCC §§ 2-316(2), 2-209(2), 2-201(2).

portant are certain other provisions which parties cannot vary by agreement.¹⁵² Most significant of all is section 2-302:¹⁵³

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Case law under this section is scant. What little there is suggests that "unconscionable" at least means "excessively expensive,"¹⁵⁴ that an "add-on" clause in a secured consumer sale may be unconscionable,¹⁵⁵ that under some circumstances a franchise contract clause dispensing with advance notice of termination may be invalid,¹⁵⁶ and that a waiver-of-defense clause in a contract for the sale of consumer goods is, at least in some states, unenforceable.¹⁵⁷

B. Bad Faith in Performance

Contract case law recognizes distinguishable types of bad faith in performance, including evasion of the spirit of the deal, lack of diligence

¹⁵² One scholar has remarked that the "core task" of commercial law is "to determine the relatively few rules which are not subject to change by agreement, the rules which are designed to stake out the necessary minimum area of protection for parties whose bargaining power is inferior . . ." Schlesinger, 1955 N.Y. LAW REVISION COMM'N REP. 101. Among relevant Code provisions which cannot be varied by agreement are, "the obligations of good faith, diligence, reasonableness and care prescribed by this Act" (§ 1-102(3)), the provision which extends the seller's warranties to the buyer's family and guests (§ 2-318), and certain provisions of article 9 applicable to secured sales of goods (§ 9-501(3)).

¹⁵³ For an exhaustive study of this section, see Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967).

¹⁵⁴ *American Home Improvement, Inc. v. MacIver*, 105 N.H. 435, 201 A.2d 886 (1964); *Frostifresh Corp. v. Reynoso*, 3 UCC Calaghan Rep. 1058 (N.Y. Sup. Ct. 1966).

¹⁵⁵ *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

¹⁵⁶ *Sinkoff Beverage Co. v. J. Schlitz Brewing Co.*, 51 Misc. 2d 446, 273 N.Y.S.2d 364 (1966).

¹⁵⁷ *Unico v. Owen*, 50 N.J. 101, 232 A.2d 405 (1967).

and slacking off, willful rendering of only substantial performance, abuse of a power to specify terms, abuse of a power to determine compliance, and interference with or failure to cooperate in the other party's performance. Thus in addition to the more familiar sources of standards of performance—for example, the contract language itself, case law on how contract gaps are to be filled, and custom and usage—judges turn to specific concepts of good faith in deciding whether a party has or has not performed his agreement. Admittedly, judges frequently introduce these concepts as implied terms in contracts, and not as duties of good faith.¹⁵⁸ But it is almost always better to recognize something for what it is rather than to fictionalize it. And surely, how a doctrine is conceptualized can affect the outcome of cases. For example, it seems likely that a judge who thinks in terms of implied provisions will be less willing to enforce duties of good faith than the judge who thinks explicitly in terms of such duties; one who views himself as "implying terms" is more likely to think he is remaking a contract to some extent—something which judges are reluctant to do.¹⁵⁹ It seems, too, that a judge may be unduly hampered by the parol evidence rule if he considers himself to be implying terms instead of enforcing duties of good faith.¹⁶⁰

Under the Code, performance of a sales agreement is similarly meas-

¹⁵⁸ One writer has even suggested that the sole significance of good faith is "in implying terms in the agreement." Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 670 (1963). It must be admitted that courts do not always mean the same thing when they speak of implying terms. No one has put this better than Glanville Williams:

Judges are accustomed to read into documents and transactions many terms that are not logically implied in them. As an academic matter non-logical implication may be classified into three kinds: (i) of terms that the parties (the plural shall throughout include the singular) probably had in mind but did not trouble to express; (ii) of terms that the parties, whether or not they actually had them in mind, would probably have expressed if the question had been brought to their attention; and (iii) of terms that the parties, whether or not they had them in mind or would have expressed them if they had foreseen the difficulty, are implied by the Court because of the Court's view of fairness or policy or in consequence of rules of law. Of these three kinds of non-logical implications (i) is an effort to arrive at actual intention; (ii) is an effort to arrive at hypothetical or conditional intention—the intention that the parties would have had if they had foreseen the difficulty; (iii) is not concerned with the intention of the parties except to the extent that the term implied by the Court may be excluded by an expression of positive intention to the contrary.

Williams, *Language and the Law—IV*, 61 L.Q. REV. 384, 401 (1945).

¹⁵⁹ See *Parev Prods. Co. v. I. Rokeach & Sons*, 124 F.2d 147, 149 (2d Cir. 1941).

¹⁶⁰ See generally Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161 (1965).

ured against standards from varied sources. These sources include the language of the agreement itself, as well as specific Code provisions which may be used to fill gaps left by the contract language—for example, section 2-314, on warranties of merchantability; section 2-309, on “absence of specified time provisions”; section 1-103, on supplemental general principles, like the principle recognizing “constructive conditions of co-operation”;¹⁶¹ section 1-205, on course of dealing and usage of trade; section 2-208, on course of performance and practical construction; and section 1-203, imposing a general obligation of good faith in the performance of sales contracts. It will be recalled that section 1-201(19) defines good faith for the purposes of section 1-203 as “honesty in fact in the conduct or transaction concerned.” Whether this definition “enfeebles” section 1-203¹⁶² will largely depend on the willingness of courts to invoke the prefatory language of section 1-201(19): “unless the context otherwise requires.” If courts are unwilling to invoke this language, Code requirements of good faith will be restricted significantly, for the more expansive special definition of good faith in article 2 apparently applies only to the thirteen sections of the article which use the phrase.¹⁶³

Evasion of the Spirit of the Deal

Some judges recognize that to evade the spirit of a deal is to act in bad faith and thus is to commit a breach, even though the evasive conduct is within the letter of the agreement or the agreement is silent on the matter. Any form of bad faith may be contrary to the spirit of a transaction, but this section is addressed only to forms of bad faith that are also essentially evasive. A few illustrations will show what is meant. Courts will not permit a buyer under a requirements contract to “pretend not to have a requirement to avoid his obligation”;¹⁶⁴ nor can he suddenly expand requirements to take advantage of the seller.¹⁶⁵ Evasive action of this nature conflicts with good faith. Further examples may

¹⁶¹Patterson, *Constructive Conditions in Contracts*, 42 COLUM. L. REV. 903 (1942).

¹⁶²Farnsworth, *supra* note 158, at 674.

¹⁶³See the discussion at 212-13 *supra*.

¹⁶⁴Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp., 130 F.2d 471, 473, (3d Cir. 1942); *see* Western Oil & Fuel Co. v. Kemp, 245 F.2d 633 (8th Cir. 1957).

¹⁶⁵Cullinan v. Standard Light & Power Co., 65 S.W. 689, 690 (Tex. Civ. App. 1901). *See also* Loudonback Fertilizer Co. v. Tennessee Phosphate Co., 121 F. 298 (6th Cir. 1903).

be helpful. Suppose a seller develops and builds a market for product X and then sells his rights to manufacture and market it; the buyer of these rights is to pay royalties according to a rate based on the sales he makes. Later, the buyer develops product Y, which competes with X. Can the buyer keep X under his control until the market for Y has been built up and then safely forget X? The answer is "no," for the buyer would be evading the spirit of the deal and therefore would be acting in bad faith.¹⁶⁶ Or suppose a lessor rents premises to a lessee who agrees to pay a 2,000 dollar minimum rental plus a fixed percentage of receipts, in excess of this minimum, from sales and services "in the course of the aforesaid business on said premises." Subsequently, the lessee finds another location at a lower rental and moves enough of his business there to avoid payment of anything beyond the minimum rental. The lessee here may also be evading the spirit of the deal.¹⁶⁷

Under the Uniform Commercial Code, some courts are likely to say there is a general principle of law that the spirit of a deal is, within limits, just as much a part of that deal as its letter and is always enforceable via section 1-103 on supplemental general principles. What is the likely bearing of section 1-203, the general good faith provision? Courts may try to use this provision despite the restrictive "honesty" definition of good faith, for evasion will often involve a state of mind sufficiently close to dishonesty to justify calling it that. Specific article 2 sections will also have bearing—for example, section 2-306, which imposes obligations of good faith on parties to requirements contracts. It will be recalled that whenever the words "good faith" appear in an article 2 section, they require, by virtue of section 2-103(1)(b), much more than honesty in fact.

Lack of Diligence and Slacking Off

In a variety of contract cases courts have stated that good faith excludes lack of diligence and slacking off, even when that conduct does not violate the letter of the agreement. To cite an example of lack of diligence, a vendor who contracts to convey realty is guilty of bad

¹⁶⁶ This example is discussed in *Parev Prods. Co. v. I. Rokeach & Sons*, 124 F.2d 147, 150 (2d Cir. 1941); *accord*, *Mechanical Ice Tray Corp. v. General Motors Corp.*, 144 F.2d 720 (2d Cir. 1944); cases cited in 3 A. CORBIN, CONTRACTS § 570, at 372 n.94 (1960).

¹⁶⁷ Cf. *Food Fair Stores, Inc. v. Blumberg*, 234 Md. 521, 534-35, 200 A.2d 166, 174 (1964); *Dickey v. Philadelphia Minit-Man Corp.*, 377 Pa. 549, 105 A.2d 580 (1954).

faith if he acquiesces in a cloud on his title, such as a lien¹⁶⁸ or an adverse tenancy,¹⁶⁹ and does not strive to clear it so he can convey a good title. In some jurisdictions he also is subject to special damages. In one case an agreement between a power district and a contractor provided that the deal was not to become "effective" until the contractor had procured certain policies of insurance. After the contractor had failed not only to procure the insurance, but also to perform the agreement, the district sued the contractor's performance bond surety. Although the surety was successful in his defense that the contractor in good faith failed to get the insurance and thus was never obligated to perform the agreement, the court added that the contractor would have become obligated had he acted in bad faith by acquiescing in an obstacle within his power to remove.¹⁷⁰ In the course of contractual relations, occasions may arise when one party knows he should notify the other of some event that has occurred or of some intended action, even though the contract, by its terms, does not so require. A party who fails, for want of diligence, to give such notice or to give timely notice is guilty of bad faith and may be liable as for breach. For example, it has been held that good faith requires a party who intends to exercise a right to cancel to give reasonable notice of his intent.¹⁷¹

There are some "generalizable" insurance cases on slacking off in bad faith. In one case an insurer exercised a contract right to take over exclusive control of the defense of a claim against the insured. The contract did not explicitly require the insurer to appeal adverse judgments, and it refused to appeal an adverse judgment which went beyond the policy limits. The insured then prosecuted the appeal, obtained a reversal and successfully sued the insurer for the expenses of the appeal. The court stressed that

there is a contractual obligation of universal force which underlies all written agreements. It is the obligation of good faith in carrying out what is written. The defendant's failure to observe this requirement of the contract in suit is the thing upon which its liability may safely

¹⁶⁸ *Kramer v. Mobley*, 309 Ky. 143, 147, 216 S.W.2d 930, 934 (1949) (dictum).

¹⁶⁹ See *Sitlington v. Fulton*, 281 F.2d 552 (10th Cir. 1960) (dictum).

¹⁷⁰ *Omaha Public Power Dist. v. Employers' Fire Ins. Co.*, 327 F.2d 912 (8th Cir. 1964).

¹⁷¹ *Sylvan Crest Sand & Gravel Co. v. United States*, 150 F.2d 642, 644 (2d Cir. 1945).

be predicated. Its failure to continue the defense of these cases was in effect a breach of its contract.¹⁷²

Turning to the Uniform Commercial Code, some jurisdictions may have general principles which, via section 1-103, proscribe lack of diligence and slacking off in the performance of sales contracts. But it seems clear that the section 1-203 general requirement of good faith is not, given the "honesty" definition of the phrase, a useful weapon here. Unless it knowingly misleads, conduct of this kind is not dishonest, however bad it may otherwise be. Of course, whenever the words "good faith" expressly appear in an article 2 provision, they impose, in the case of a merchant, requirements of reasonableness.¹⁷³ Some of these provisions can operate to rule out lack of diligence or slacking off in a particular context. Section 2-306(2) on exclusive dealing contracts should be singled out, for it requires both buyer and seller not just to use ordinary efforts, but to use best efforts. Also, numerous provisions of article 2 expressly require one party to notify the other of certain facts or of certain intended acts.¹⁷⁴

Willfully Rendering Only "Substantial" Performance

In some branches of contract law, a plaintiff who fails to perform in full is, nevertheless, entitled to recover on the contract if he has "substantially performed."¹⁷⁵ Recovery generally is for less than the full contract price since the plaintiff has not performed fully. This principle of "substantial performance" is most commonly applied in the field of construction contracts. Courts often say that for a contractor to qualify as one who has substantially performed, he must, among other things, establish that his noncompliance was not in bad faith. According to some cases, this means that he must show that his omissions or deviations were "the result of mistake or inadvertence, and were not intentional."¹⁷⁶ Otherwise, the contractor will be remitted to *quantum meruit* recovery—the reasonable value of the benefit he has conferred.

¹⁷² *Brassil v. Maryland Cas. Co.*, 210 N.Y. 235, 241, 104 N.E. 622, 624 (1914). An analogous form of slacking off occurs in the collective bargaining context when a union adopts a "slow down" or "work to rule" stance.

¹⁷³ UCC § 2-103(1)(b).

¹⁷⁴ UCC §§ 2-201(2), 2-206(2), 2-207(2)(c), 2-309(3), 2-311, 2-327, 2-503, 2-504, 2-508, 2-602, 2-607(3)(a), 2-615(c), 2-705(3)(a), 2-706(3), 2-717; see UCC § 1-205(6).

¹⁷⁵ A. CORBIN, *CONTRACTS* ch. 36 (1960).

¹⁷⁶ *Odegard v. Investors Oil, Inc.*, 118 N.W.2d 362, 375 (N.D. 1962).

For years the doctrine of substantial performance was not, at least in theory, recognized in the law of sales.¹⁷⁷ If the seller did not perform strictly, the buyer could reject the goods with impunity, even though the noncompliance was trivial.¹⁷⁸ The Uniform Commercial Code, however, allows the substantially performing seller to recover on the contract in some types of cases, despite his trivial breach. But in such cases "[t]he buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract."¹⁷⁹ An interesting question arises. Now that the Code recognizes the doctrine of substantial performance in some contexts, will judges draw on construction contract cases to impose, via section 1-103, a requirement that the otherwise substantially performing seller act in good faith? And if judges choose not to do this, will they invoke section 1-203, the general good faith provision? Willful breaches do go to state of mind and in some cases may be dishonest and, therefore, not in good faith. The effect of a finding of bad faith in this context would, if parallel to the usual result in general contract law, be to remit the seller to *quantum valebat* recovery—the reasonable value of the goods delivered.

But it is not clear that article 2 provisions leave any leeway for a good faith requirement. When the buyer accepts substantially conforming goods, he becomes liable "on the contract" under section 2-607, and the Code specifically contemplates that buyers may "accept" goods "in spite of their non-conformity."¹⁸⁰ This may indicate that *quantum valebat* is not to be the alternative in such cases even when the seller has acted in bad faith.¹⁸¹ When a buyer rejects nonconforming goods wrongfully (because the Code tolerates the nonconformity), the Code's remedial scheme appears to allow the seller to recover "on the contract," whether or not his deviation was in bad faith. Still, since an essential function of the Code's general obligation of good faith is to modify rights and duties arising under a contract or under rules of law, a buyer may be able to convince a court that *quantum valebat* is the appropriate remedy for sellers who do not substantially perform in good faith.

¹⁷⁷ 48 COLUM. L. REV. 161 (1948).

¹⁷⁸ See generally Honnold, *Buyer's Right of Rejection*, 97 U. PA. L. REV. 457 (1949).

¹⁷⁹ UCC § 2-717.

¹⁸⁰ UCC § 2-607(2).

¹⁸¹ See UCC § 2-703.

Abuse of a Power to Specify Contract Terms

A power to specify terms may be held jointly, as where parties to a contract agree to agree later on a given term, or severally, as where one party has the power to specify a term. Contract cases condemn the abuse of these powers as a form of bad faith in performance, even when the objectionable conduct is within the letter of the contract or when the contract says nothing at all about how the powers are to be exercised. For example, a farmer and a railroad agreed to agree at a later time on the location of a crossing that the railroad would maintain for the farmer. The parties failed to agree, and the farmer successfully sued the railroad for damages. On appeal, the court inquired into the good faith of the railroad and decided that its failure to agree "was not capricious or arbitrary." Presumably, however, the railroad would have been liable for damages if it had acted in bad faith.¹⁸²

When only one party has the power to specify one or more terms of a deal, the opportunity—and the temptation—to take advantage of the other is likely to be greater. It should not be surprising, therefore, that courts require such a power to be exercised in good faith. Relevant cases deal with varied matters—for example, time of performance, price and quantity. In a New York case *A* offered to sell property and give *B* part of the proceeds if *B* would give *A* a release from any claims he might have against *A*. *B* agreed and gave *A* the release. Their contract did not specify when *A* should sell, and eight years went by without the sale of the property. The plaintiff, an assignee of *B*, sued *A*'s executors, who responded that the contract did not obligate *A* to sell before he "felt disposed to do so." The court disagreed:

Every contract implies good faith and fair dealing between the parties to it When the contract between these parties is read in the light of this implication, it is obvious that the defendants assumed the obligation to sell within such reasonable time as the circumstances would permit.¹⁸³

Similarly, good faith prohibits a party from setting unreasonably high (or low) prices under an "open price" provision,¹⁸⁴ and in a require-

¹⁸² *Chesapeake & O. Ry. v. Herringer*, 158 Ky. 267, 164 S.W. 948 (1914).

¹⁸³ *Simon v. Etgen*, 213 N.Y. 589, 595, 107 N.E. 1066, 1067-68 (1915).

¹⁸⁴ *Pillois v. Billingsley*, 179 F.2d 205, 207 (2d Cir. 1950); *California Lettuce Growers, Inc. v. Union Sugar Co.*, 45 Cal. 2d 474, 484, 289 P.2d 785, 791 (1955).

ments contract good faith requires the buyer not to demand unreasonable quantities.¹⁸⁵

Under the Uniform Commercial Code, section 1-103 on supplemental general principles is available to remedy abuse of discretionary contract powers when warranted by extra-Code law. Section 1-203 is less likely to be useful, for however culpable an open abuse of discretionary power may be, many judges are not likely to think it dishonest. Article 2 contains relevant specific provisions, including sections 2-311(1), 2-305(2) and 2-306(1). The first of these is of prime significance:

An agreement for sale which is otherwise sufficiently definite (subsection (3) of Section 2-204) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

It will be recalled that when good faith is used expressly in an article 2 section, it means, in the case of a merchant, "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."¹⁸⁶ Since the majority of contracts granting discretionary power to one party are between merchants, the foregoing requirement of good faith will find a wide scope for application here.

Abuse of a Power to Determine Compliance

Under the terms of a contract one party may, in effect, have power to determine whether the other party's performance complies. Thus a party may agree to perform not only in accordance with the contract plan, specification or description, but also to the "satisfaction" of the other party or a third party. Arrangements of this kind occur in a variety of contractual settings—for example, in contracts involving employment, lease, building, construction, land sale and sale of goods. Many courts say a party cannot arbitrarily and capriciously refuse to be satisfied, for this conflicts with good faith. Thus a buyer who declares that he is dissatisfied with a heating and hot water system, but is unable to say why, acts capriciously and in bad faith.¹⁸⁷ Similarly a

¹⁸⁵ See discussion and cases cited in Havighurst & Berman, *Requirement and Output Contracts*, 27 ILL. L. REV. 1, 13 (1932).

¹⁸⁶ UCC § 2-103(1) (b).

¹⁸⁷ *O'Hare v. McGee*, 116 Pa. Super. 318, 323, 176 A. 525, 526 (1935).

buyer of a piano acts in bad faith when his reasons for dissatisfaction have nothing to do with the piano.¹⁸⁸

It should not be surprising that contract cases require a party to act in good faith in determining his own satisfaction, for a satisfaction clause, by its nature, affords him an unusual opportunity to take advantage of the other party.¹⁸⁹ The law under the Code will surely be the same. The wealth of pre-Code cases requiring good faith in satisfaction cases generally, and in sales of goods cases in particular,¹⁹⁰ can be introduced into the Code as a general principle of law via section 1-103. Moreover, section 1-203 will rule out all cases of feigned, and therefore dishonest, dissatisfaction.

Interfering with or Failing to Cooperate in the Other Party's Performance

It is one thing not to perform the consideration moving to the other party, and another to interfere with or fail to cooperate in his performance. Contract cases rule out the latter as well as the former, and often in the name of good faith. Indeed, deliberate interference with the other's performance is one of the most flagrant forms of bad faith. In one type of fact pattern, a seller of a product hires a broker to market it and, just as the broker is about to close the deal, steps in and closes it himself, thereby cutting out the broker. By the express language of the agreement the broker will have no rights if he has agreed that he is to receive a fee only for sales actually made. However, judges have held that a seller who intervenes in this way acts in bad faith and incurs liability for damages. Thus in a New York case the court stressed:

The law reads good faith into every contract. Reasonableness is the rule for construing contracts and determining their implications. To hold that one may employ another at an agreed compensation to do a specific thing, and yet may with impunity deliberately prevent the other from doing that thing, is so plainly violative of good faith and reasonableness as to preclude extending the rule in ordinary brokerage cases to such a case as this.¹⁹¹

¹⁸⁸ *Sears, Roebuck & Co. v. Kitchens*, 31 Ga. App. 574, 121 S.E. 583 (1924).

¹⁸⁹ As with harems and eunuchs, where temptations are great, measures must correspond.

¹⁹⁰ Annot., 86 A.L.R.2d 200 (1962).

¹⁹¹ *Carns v. Bassick*, 187 App. Div. 280, 284, 175 N.Y.S. 670, 673 (1st Dep't 1919).

In another New York case a vendor did not own land he contracted to convey, expecting to buy it at a foreclosure sale. The court refused to allow the buyer to get away with outbidding the seller at the foreclosure sale, stating that "[i]n the case of every contract there is an implied undertaking on the part of each party that he will not intentionally and purposely do anything to prevent the other party from carrying out the agreement on his part."¹⁹²

Turning to cases which have required affirmative cooperation, the plaintiff in *Kehm Corp. v. United States*¹⁹³ agreed to manufacture practice bombs for the United States, which was to supply tail assemblies. The contract did not say when the assemblies were to be delivered. Unreasonable delays by the United States caused the plaintiff damages for which the court allowed recovery, holding that a party must "not only not hinder his promisor's performance, he must do whatever is necessary to enable him to perform."¹⁹⁴ Similarly, if an insured unsuccessfully attempts to comply with policy requirements as to notice and proof of loss, "[g]ood faith on the part of the insurer requires that it point out the details in which a notice or proof of loss is insufficient under the contract and give the insured an opportunity to correct these defects. Good faith does not permit an insurer to be silent and evasive under such circumstances."¹⁹⁵

In contract law courts recognize a general principle of law imposing "constructive" terms of cooperation.¹⁹⁶ Judges, therefore, can invoke Code Section 1-103 to rule out the foregoing forms of bad faith. But the section 1-203 general requirement of good faith again seems of little utility, given its "honesty" definition; however blameworthy openly hindering or refusing to cooperate may be, it is not, as such, dishonest. On the other hand, when lack of cooperation is the issue, it is unlikely that a court will have to rely on either section 1-103 or 1-203 since section 2-311 provides that

where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies

¹⁹² *Patterson v. Meyerhofer*, 204 N.Y. 96, 100, 97 N.E. 472, 473 (1912).

¹⁹³ 93 F. Supp. 620 (Ct. Cl. 1950).

¹⁹⁴ *Id.* at 623.

¹⁹⁵ *Johnson v. Scottish Union Ins. Co.*, 160 Tenn. 152, 156, 22 S.W.2d 362, 363 (1929). Compare UCC § 2-508.

¹⁹⁶ See *Patterson*, *supra* note 161.

- (a) is excused for any resulting delay in his own performance; and
- (b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure . . . to cooperate as a breach by failure to deliver or accept the goods.

C. Bad Faith In Raising and Resolving Contract Disputes

Parties to a contract may engage in disputes over a variety of issues, including the meaning of contract language, compliance with applicable law and the existence of relevant facts. It may be a conservative guess that for each contract dispute resolved by an appellate court, a hundred others are settled before trial. Much can turn on a contract dispute, and thus a party may be tempted to act in bad faith, as by conjuring up a dispute, adopting an overreaching interpretation or taking advantage of the other party in order to get a favorable settlement. Case law rules out these and cognate forms of bad faith. Similarly, the Code includes provisions which can be brought to bear against such conduct.

Conjuring up a Dispute

A party acts in bad faith when, in an attempt to stall or bluff, he pretends to dispute, not really believing in his position. And a party who disputes capriciously is deemed to have acted in bad faith. A bad faith disputant may not even try to put up appearances—he may not try to base his position on anything. For example, in an early case a logger's employer refused to pay him wages plainly due then and there. The logger capitulated and agreed to take a lesser sum, the balance to be paid later. Shortly thereafter the logger sued for the balance, claiming that since there was no good faith dispute between the parties as to their rights, the employer gave no consideration for the agreement to delay payment. The court agreed, stating that the employer

did not claim that the contract was different from what plaintiff asserted it to have been, or that by law the wages were not payable He simply asserted . . . that he would not pay all the money because it was not "the law of the company," or . . . because they "didn't settle that way," without giving any reason. A person cannot create a dispute sufficient as a consideration for a compromise by a mere refusal to pay an undisputed claim.¹⁹⁷

¹⁹⁷ DeMars v. Musser-Sauntry Land, Logging & Mfg Co., 37 Minn. 418, 419, 35 N.W. 1, 2 (1887); accord, Berger v. Lane, 190 Cal. 443, 450-51, 213 P. 45, 49 (1923).

More commonly, a party who conjures up a dispute tries to put up appearances—he tries to base his position on something. In some cases he will rely on contract language. But unless his position is “founded on some reasonably tenable or plausible ground,”¹⁹⁸ any settlement he induces is not likely to stand up.

Many cases in which courts appear to require good faith in raising a dispute involve the validity of an accord and satisfaction. But this is not always the issue. For example, where an insurance company ceases disability payments, incorrectly claiming that the insured is no longer disabled, several courts have held the insurer liable only for the back payments and not for the value of all likely future payments as well.¹⁹⁹ A few courts have conditioned this limitation of liability on the good faith of the insurer in raising the dispute.²⁰⁰ Presumably the insurer who disputes in bad faith is liable for something more—perhaps the whole value of the policy.

A party who conjures up a dispute will not fare well under the Code. Section 1-203 might even be invoked against him. For example, if he takes a position without really believing in it, but rather for some ulterior purpose, his action is deceptive, and therefore dishonest. There is one hitch in this. Section 1-203 applies only to bad faith in the performance or enforcement of contracts, and some judges may think that raising a dispute concerns neither performance nor enforcement. But, if he wishes, a judge can relate almost any dispute to performance or enforcement. No specific provisions of article 2 deal with the bad faith disputant, as such, but extra-Code law can be brought to bear via section 1-103.

Adopting Overreaching or “Weaseling” Interpretations and Constructions of Contract Language

Though not conjuring up a dispute, a party may take a position that is plainly a form of overreaching. In *Sylvan Crest Sand & Gravel Co. v. United States*²⁰¹ the United States adopted an overreaching construction of a contract which provided that the gravel company would

¹⁹⁸ *State v. Mass. Bonding & Ins. Co.*, 40 Del. 274, 9 A.2d 77 (1939); *accord*, *Hogue v. National Automotive Parts Ass’n*, 87 F. Supp. 816, 821 (E.D. Mich. 1949); *Modern Dust Bag Co. v. Commercial Trust Co.*, 34 Del. Ch. 354, 104 A.2d 378 (1954); 6 A. CORBIN, CONTRACTS § 1287 (1962).

¹⁹⁹ Annot., 99 A.L.R. 1171 (1935).

²⁰⁰ See, e.g., *New York Life Ins. Co. v. Viglas*, 297 U.S. 672, 676 (1936).

²⁰¹ 150 F.2d 642 (2d Cir. 1945).

deliver rock to the United States and that "[c]ancellation by the Procurement Division may be effected at any time." The United States refused to request deliveries within a reasonable time and denied liability, citing this clause. Construing the agreement against the United States, the Second Circuit remarked:

Surely . . . [the agreement] would not have been understood thus: "We accept your offer and bind you to your promise to deliver, but we do not promise either to take the rock or pay the price." The reservation of a power to effect cancellation at any time meant something different from this. We believe that the reasonable interpretation of the document is as follows: "We accept your offer to deliver within a reasonable time, and we promise to take the rock and pay the price unless we give you notice of cancellation within a reasonable time." Only on such an interpretation is the United States justified in expecting the plaintiff to prepare for performance and to remain ready and willing to deliver. Even so, the bidder is taking a great risk and the United States has an advantage. It is not "good faith" for the United States to insist upon more than this.²⁰²

Overreaching also takes the form of trying to do indirectly under a contract's language what obviously could not be done directly under it. For example, a contract which required Chrysler to give its dealer ninety days notice of franchise termination also provided: "All orders are subject to approval and acceptance by Chrysler at its principal place of business." Chrysler argued that this clause allowed it, in effect, to terminate the franchise without notice merely by not delivering cars. The court disagreed:

To construe it as Chrysler now contends would result in making the agreement one terminable at will and thus rendering the 90-day termination clause meaningless. . . . [T]he right of termination must be exercised in good faith.²⁰³

"Weaseling out," another form of bad faith interpretation or construction, is commonly intertwined with the form of bad faith characterized earlier as "evasion of the spirit of the deal"—for example, pretending not to have a requirement, hoping thereby to evade one's true obliga-

²⁰² *Id.* at 644.

²⁰³ *Chrysler Corp. v. Quimby*, 51 Del. 264, 284, 144 A.2d 123, 134 (1958).

tions under a requirements contract. As was seen, judges are not willing to allow such conduct.²⁰⁴

What, if anything, does the Code say about bad faith interpretation or construction? It is obvious from Code Comments that Llewellyn and company considered this species of bad faith a problem.²⁰⁵ However, section 1-203 applies only to bad faith in performance or enforcement, and adopting overreaching or weaseling interpretations or constructions is not necessarily either. Whenever weaseling is accompanied by bad faith in performance, such as evading the spirit of the deal, it seems that section 1-203 could be invoked, for evasiveness is akin to dishonesty. But even if section 1-203 does not apply, it seems likely that courts will almost automatically turn to general principles of contract interpretation and construction—principles which already rule out these forms of bad faith. Few courts are likely even to cite section 1-103 on supplemental general principles as authority.

Taking Advantage of Another to Get a Favorable Readjustment or Settlement of a Dispute

Questionable techniques of negotiation, such as stalling or bluffing, have already been alluded to. In addition, some courts recognize a variety of "weaknesses" of which one party may not take advantage to procure a favorable settlement. It suffices to mention three such weaknesses. First, there are cases where one party has another "over a barrel," so to speak. For example, in *Lingenfelder v. Wainwright Brewing Co.*²⁰⁶ plaintiff's testator was an architect who had drawn plans for and was supervising defendants' construction job. He walked off, thus threatening timely completion of the entire project, but later agreed to come back on condition that the defendants promise to pay him a bonus. The court refused to enforce this promise, for "[t]o permit plaintiff to recover under such circumstances, would be to offer a premium upon bad faith, and invite men to violate their most sacred contracts, that they may profit by their own wrong."²⁰⁷

In another category of cases courts have refused to permit one party to take advantage of the other's relative lack of knowledge of facts or law. For example, an insurer cannot hold an unknowing insured to a

²⁰⁴ See p. 234 *supra*.

²⁰⁵ See, e.g., UCC § 2-313, Comment 4; § 2-314, Comment 4; § 2-504, Comment 2; § 2-612, Comment 3.

²⁰⁶ 103 Mo. 578, 15 S.W. 844 (1891).

²⁰⁷ *Id.* at 593, 15 S.W. at 848.

settlement procured by inducing him to accept and cash a check given "in full payment" when the insurer has failed to explain to the insured that the legal effect of cashing such a check is to give the insurer a valid defense to any subsequent claim by the insured for a larger sum.²⁰⁸

There also is authority for the proposition that a party cannot, in bad faith, take advantage of another's "necessitous circumstances." For example, one Headley sued one Hackley to recover full compensation for cutting, hauling and delivering a quantity of logs, after having earlier accepted a settlement for less. The flavor of the context should be appreciated:

The amount [Headley] claimed was upwards of \$6200, estimating the logs by the Scribner scale. He had an interview with Hackley in the morning, who insisted that the estimate should be according to the Doyle scale, and who also claimed that he had made payments to others amounting to some \$1400 which Headley should allow. Headley did not admit these payments, and denied his liability for them if they had been made. . . . Hackley said to him: "My figures show there is 4260 and odd dollars in round numbers your due, and I will just give you \$4000. I will give you our note for \$4000." To this Headley replied: "I cannot take that; it is not right, and you know it. There is over \$2000 besides that belongs to me, and you know it." Hackley replied: "That is the best I will do with you." Headley said: "I cannot take that, Mr. Hackley," and Hackley replied, "You do the next best thing you are a mind to. You can sue me if you please." Headley then said: "I cannot afford to sue you, because I have got to have the money, and I cannot wait for it. If I fail to get the money to-day, I shall probably be ruined financially, because I have made no other arrangement to get the money only on this particular matter." Finally he took the note and gave the receipt, because at the time he could do nothing better, and in the belief that he would be financially ruined unless he had immediately the money that was offered him, or paper by means of which the money might be obtained.

If this statement is correct, the defendants not only took a most unjust advantage of Headley, but they obtained a receipt which, to the extent it assumed to discharge anything not honestly in dispute between the parties, and known by them to be owing to Headley beyond the sum received, was without consideration and ineffectual.²⁰⁹

²⁰⁸ Kellogg v. Iowa State Traveling Men's Ass'n, 239 Iowa 196, 212-13, 29 N.W.2d 559, 568 (1947).

²⁰⁹ Headley v. Hackley, 45 Mich. 569, 573-74, 8 N.W. 511, 512 (1881).

Ultimately, Headley recovered full compensation because Hackley had, in fact, not acted in good faith.²¹⁰

We saw that in sales transactions one party may try to take advantage of another's weaknesses to strike a bargain, fair or unfair.²¹¹ It is no different with modifications, readjustments, compromises or settlements under pre-existing contractual relations. The Code contains several relevant provisions. Section 2-209(1) provides that "[a]n agreement modifying a contract within this Article needs no consideration to be binding." The Comment states, however, that "modifications made thereunder must meet the test of good faith imposed by this Act."²¹² Section 1-107 provides: "Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party." The Comment to this section states that it "must be read in conjunction with the section imposing an obligation of good faith." These Code sections do not use the words "good faith." Accordingly, some courts are likely to conclude that the "honesty" definition of good faith applies, even in the case of merchants, and that the Code does not rule out forms of openly taking advantage in bad faith. One who openly takes advantage of someone he has over a barrel, someone less well informed or someone whose financial situation is "necessitous" certainly is a scoundrel, but this does not also make him dishonest. In such cases courts may have to fall back on section 1-103 and relevant extra-Code principles of law, or on section 2-302 on unconscionability, discussed earlier.²¹³

D. Bad Faith in Taking Remedial Action

Recognizing that a party may act in bad faith when seeking a remedy, courts specifically rule out various remedial actions, including abuse of the right to adequate assurances of performance, wrongful refusal to accept delivery, willful failure to mitigate damages and abuse of a power to terminate. The Code similarly imposes good faith limitations on remedial action.

Abuse of Right to Adequate Assurances of Future Performance

What can be done to protect a party faced with the prospect that

²¹⁰ 50 Mich. 43, 14 N.W. 693 (1883).

²¹¹ See pp. 230-32 *supra*.

²¹² UCC § 2-209, Comment 2.

²¹³ See pp. 231-32 *supra*.

one with whom he has contracted may not be able to perform because of intervening circumstances? This problem can arise in almost any contractual context.²¹⁴ It should not be surprising, therefore, that legal techniques have been devised to deal with it. Section 2-609 of the Code gives the aggrieved party a right to demand and receive "adequate assurance of performance"; prior to the Code, lawyers wrote this same right into contracts. Any right of this kind may be abused. For example, a buyer who refuses to be satisfied with assurances given and unnecessarily harasses his seller for repeated assurances may really be trying to force an end to relations so that he can buy elsewhere on more favorable terms. Conduct of this kind plainly violates good faith, and cases hold that dissatisfaction with assurances given must be "actual, and based upon reason, and not arbitrary and capricious."²¹⁵

Judges can apply such law under the Code via section 1-103. But section 1-203 is of little help since courts are not likely to say that open harassment is dishonest. However, if the party harassed can show that the harasser has an undisclosed ulterior motive, section 1-203 might apply.

Wrongful Refusal to Accept the Other's Performance

This, too, is a general problem,²¹⁶ for although not all types of wrongful refusals are in bad faith, some are. Suppose that a buyer has rejected goods ostensibly for minor nonconformities of tender or of quality, but in reality for another reason—for example, the price has fallen, and he wishes to buy elsewhere more cheaply. Under the letter of pre-Code law, which required perfect tender, the buyer would be free to do so. But in a few pre-Code cases judges appear to have denied him this right, partly on the ground that he was merely trying to get out of a deal because of a price break and was not motivated by the seller's slightly defective tender.²¹⁷

Under Article 2 of the Code perfect tender is generally required,²¹⁸

²¹⁴ See generally Wardrop, *Prospective Inability in the Law of Contracts*, 20 MINN. L. REV. 380 (1936).

²¹⁵ *James B. Berry's Sons v. Monark Gasoline & Oil Co.*, 32 F.2d 74, 76 (8th Cir. 1929).

²¹⁶ See generally the cases discussed in Honnold, *Buyer's Right of Rejection*, 97 U. PA. L. REV. 457 (1949), and in Eno, *Price Movement and Unstated Objections to the Defective Performance of Sales Contracts*, 44 YALE L.J. 782 (1935).

²¹⁷ See, e.g., *Fielding v. Robertson*, 141 Va. 123, 129, 126 S.E. 231, 233 (1925); Eno, *supra* note 215.

²¹⁸ UCC § 2-601.

though there are exceptions.²¹⁹ In cases not within these exceptions, how will bad faith rejections fare? A court might utilize section 1-103 to bring into play relevant extra-Code law. Beyond this, there is section 1-203, which should prove useful against buyers who pretend to be rejecting because of the admitted nonconformity. Against buyers who openly say they are rejecting because of the price break and cite the perfect tender rule as window dressing, the bearing of section 1-203 is less clear. Some judges may say that such conduct simply is not in bad faith, for it is not dishonest.

It seems paradoxical that section 2-601 on the buyer's right of rejection does not condition rejection on good faith, while section 2-603, imposing a duty on a merchant buyer to take over and care for or dispose of rejected goods under specified circumstances, does incorporate this language. Under the Code text, then, the merchant buyer is expressly held to a higher standard in handling rejected goods than he is in exercising the more fundamental right of rejecting them in the first place.

Willful Failure to Mitigate Damages

Contract law, in numerous contexts, denies a plaintiff recovery for damages attributable to his own failure to take reasonable steps to mitigate losses. In some sale-of-goods cases judges say the plaintiff must mitigate "in good faith." For example, in *Obrecht v. Crawford*²²⁰ the court approved an instruction to the jury that plaintiff-seller could recover the difference between the price the buyer contracted to pay and the resale price to a third party, provided the resale was in good faith, which the court took to mean with "reasonable care, diligence and judgment." Obviously a plaintiff-seller ought not to be allowed to resell at a low price merely to increase damages recoverable from the buyer. This would be bad faith. But even without this motive, a resale would be in bad faith under the *Obrecht* instruction if it was unreasonable. The same kind of problem can arise when a buyer sues a seller for the difference between the price for which the defaulting seller agreed to deliver the goods and the price the buyer had to pay by going into the market and making a substitute purchase. To the extent that such "cover costs" were not incurred in good faith, they would not be recoverable.

²¹⁹ UCC §§ 2-504, 2-508, 2-612.

²²⁰ 175 Md. 385, 394-96, 2 A.2d 1, 6-7 (1938).

The story is much the same under Article 2 of the Code, for specific provisions thereof expressly require good faith. Under section 2-706 an aggrieved seller may resell and charge the buyer at least the difference between the resale price and the contract price, provided the resale "is made in good faith and in a commercially reasonable manner." Likewise, an aggrieved buyer may go into the market and "cover," charging the seller at least the difference between the cost of cover and the contract price, provided the cover purchase is made "in good faith and without unreasonable delay" and is itself a "reasonable purchase."

Abuse of a Power to Terminate

Having begun this survey with bad faith in the initial stages of contracting, it is fitting to end with abuses of powers to terminate contract relations. In many different kinds of contracts, parties insert a clause giving one party an option to terminate, either "at will" or upon conditions. Most litigation appears to involve clauses of the first type. Not infrequently, courts assert that a party must act in good faith to terminate at will.²²¹ However, it must be admitted that the case law, taken as a whole, does not speak with one voice on good faith in the termination context, and some courts have even refused to adopt a good faith limitation.²²² In one context Congress has intervened and enacted a statute which provides that a dealer may recover damages for the failure of

²²¹ J.R. Watkins Co. v. Rich, 254 Mich. 82, 84-85, 235 N.W. 845, 846 (1931); *accord*, Busam Motor Sales v. Ford Motor Co., 203 F.2d 469, 472 (6th Cir. 1953).

²²² See, e.g., Bushwick-Decatur Motors, Inc. v. Ford Motor Co., 116 F.2d 675 (2d Cir. 1940). See generally Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465, 495-505. Gellhorn questions the "effectiveness of a good faith test" and whether "subjective terms should be imported into contracts. . . ." *Id.* at 505. He views good faith here as merely ruling out bad purposes and correctly notes that bad purpose and "harshness" of termination are not necessarily connected. *Id.* at 504. He also asserts that when a contract provides for termination "at will," so far as good faith is concerned, it can be so terminated, for "the parties can hardly be viewed as having intended to insert a good faith limitation." *Id.* at 502-03. Two comments are called for: first, Gellhorn assumes that good faith here is inevitably merely a matter of motives, which is false. Second, the usual explicit "at will" termination clause does not settle the issue. If anything, it gives rise to it. In agreeing to an "at will" termination power, a party presumably agrees merely to the grant of a power, and not also to the grant of a power to abuse that power. And if it should appear that he has been induced to agree to the latter, a case can be made that this should not be given effect. Cf. UCC §§ 1-102(3), 2-302.

an auto manufacturer "to act in good faith . . . in terminating, canceling or not renewing" a franchise.²²³

By invoking Code Section 1-103 courts can bring relevant extra-Code requirements of good faith to bear upon terminations of deals involving the sale of goods. Also, section 2-309(3) provides:

Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

However, this provision only requires advance notice of termination; it does not protect against all forms of bad faith termination. What of section 1-203? That section may not apply at all, for to terminate obviously is neither to perform nor to enforce, and the section applies only to bad faith in the "performance or enforcement" of contracts. This aside, the section 1-201(19) "honesty" definition of good faith does not rule out arbitrary terminations, for however bad arbitrariness may be, it is hardly dishonest. This definition may proscribe terminations for bad motives, but these seem relatively uncommon.

IV. THEORIES AND FORMS OF RELIEF FOR CONTRACTUAL BAD FAITH—SOME MODEST PROPOSALS

Case law and Code law, then, afford relief against many types of contractual bad faith. While tort theories play a part, especially with respect to fraud, and while quasi-contractual theory may be invoked if the defendant's bad faith enriches him at the plaintiff's expense, most relief against contractual bad faith is premised in contract, and it takes a variety of forms. For example, it is familiar that a defendant's bad faith can make him liable to pay damages, as for breach of an "implied term" in an enforceable contract.²²⁴ Or he might be denied an affirmative defense, as where he conjures up a dispute merely to force an accord and satisfaction—a defense which is not available unless the accord is reached in settlement of a genuine dispute.²²⁵ Or he might become subject to some form of specific relief. For example, goods which he

²²³ The Automobile Dealer's Day in Court Act of 1956, 15 U.S.C. § 1222 (1964).

²²⁴ His bad faith might even constitute an independent substantive basis on which he could be liable in damages, as where he abuses the privilege to break off negotiations. See *Hoffman v. Red Owl Stores, Inc.*, 26 Wis. 2d 683, 133 N.W.2d 267 (1965). See also the discussion at 258 *infra*.

²²⁵ 6 A. CORBIN, CONTRACTS § 1287 (1962).

bought on credit in reckless disregard of prospective inability to pay might be reclaimed.²²⁶ Or bad faith might enhance a defendant's liability in damages, as where the court relaxes the plaintiff's duty to give proof of lost profits flowing from the defendant's willful breach.²²⁷

The significance of a finding that a plaintiff lacks good faith might be that he gets no remedy at all. A plaintiff who fails to show he was unaware of a mistake in an offer he "snapped up" would be a case in point.²²⁸ Or the plaintiff's bad faith may arm the defendant with a valid affirmative defense, such as unconscionability.²²⁹ The effect of his lack of good faith might be the denial of a particular substantive theory of contractual relief, as where a builder loses the right to sue for "substantial performance" and is remitted to *quantum meruit* because of his willful departure from contract specifications.²³⁰ Or the effect of a plaintiff's bad faith might be the denial of a particular remedy. For example, the remedy of specific performance is not available to parties with "unclean hands."²³¹

Contract theory, then, accords diverse significance to bad faith. But it does not adequately protect against all forms of contractual bad faith. Several proposals for reform will be offered here, not as final solutions, but as tentative suggestions worthy of further consideration. While these will be cast in the form of proposals for case law reform, they will not be without significance under the Code, especially in view of section 1-103 and several specific sections of relevance.

A. Relief on Contractual Theory

A case can be made that we ought to enhance measures of recovery for some kinds of bad faith breach of contract. For example, there is no reason that recovery for consequential damages must always be limited to what the defendant had reason to foresee at the time of contracting.²³² Nor is it inevitable that punitive damages can never be awarded in contract.²³³

²²⁶ E.g., *California Conserving Co. v. D'Avanzo*, 62 F.2d 528 (2d Cir. 1933).

²²⁷ 5 A. CORBIN, *CONTRACTS* § 1020 (1964); Bauer, *The Degree of Moral Fault as Affecting Defendant's Liability*, 81 U. PA. L. REV. 586, 592 (1933).

²²⁸ See, e.g., *United States v. Jones*, 176 F.2d 278, 287-88 (9th Cir. 1949).

²²⁹ E.g., *American Home Improvement, Inc. v. MacIver*, 105 N.H. 435, 201 A.2d 886 (1964).

²³⁰ *Odegaard v. Investors Oil Inc.*, 118 N.W.2d 362, 375 (N.D. 1962).

²³¹ See *Carmen v. Fox Film Corp.*, 269 F. 928 (2d Cir. 1920).

²³² The rule is invariably so stated. 5 A. CORBIN, *CONTRACTS* § 1007 (1964).

²³³ But this is the general rule. *Id.* § 1077.

Expanded Recovery for Consequential Damages

In a proper case recovery should be allowed for consequential damages flowing from a defendant's bad faith breach even though, at the time of contracting, he had no reason to foresee such damages. The best possible case for this relief would be one in which the following factors are present: (1) the defendant's breach is malicious, (2) the damages ordinarily recoverable for such a breach are, under the circumstances, either not significant or highly difficult to prove, (3) the unforeseeable consequential loss to the plaintiff is significant so that if the ordinary measure of damages were applied, he would not be compensated for his true losses, (4) the award of greater damages is rationally limitable to something short of ruinous, runaway liability and (5) the loss is of such a nature that, had the parties thought of its possibility, they would not have agreed on a clause depriving the plaintiff of a right to recover therefor in the event of breach, and they would not have agreed on additional consideration for the defendant in return for his incurring greater potential liability. This last factor takes account of the rationale most commonly stated for the rule limiting contractual recovery for consequential losses to those which the parties had reason to foresee at the time of contracting—a party ought not to be liable for losses he had no opportunity to contract against.²³⁴ This rationale loses its force in any case in which a party, given the opportunity, would very likely not have contracted against such losses.

Cases can be imagined which satisfy the foregoing criteria. One example will suffice, based as it is on the alleged facts of an actual case.²³⁵ Suppose a free-lance author enters a contract whereby the publisher agrees to publish and promote the sale of a book which the author agrees to write; the publisher further agrees to pay royalties on copies sold. Prior to publication the publisher mails out advertisements announcing the book, but after copies of the book had been printed, the publisher refuses to publish because he has acquired a malicious and spiteful attitude toward the author. As a result, the author not only loses all royalties, whatever they might have been, but also suffers significant loss of reputation as an author—a loss not reasonably foreseeable at the time of contracting. This loss could manifest itself in various ways; for ex-

²³⁴ *Patterson v. Illinois Cent. Ry.*, 123 Ky. 783, 786, 97 S.W. 426, 427 (1906).

²³⁵ *Schisgall v. Fairchild Publications, Inc.*, 137 N.Y.S.2d 312 (Sup. Ct. 1955), 41 CORNELL L.Q. 507 (1956).

ample, his sources of offers for placement of free-lance articles might dry up.

It is assumed that recovery in tort for defamation would not lie since no defamatory statement was made by the publisher.²³⁶ But should not the author be entitled to recover in contract for his loss of reputation—a loss which flowed from the publisher's malicious breach of contract? While general damages in the form of lost royalties would be hard to prove,²³⁷ the consequential loss of reputation is substantial and would be no more difficult of proof and valuation than is the case in many defamation actions in tort.²³⁸ Furthermore, to require the publisher to compensate for this loss is not to impose ruinous, runaway liability for consequential losses either in this case or in similar cases. And it is most unlikely that the parties would have taken this kind of loss into account at the contracting stage, had the possibility occurred to them.

In sum, it is submitted that there are cases where recovery should be allowed in contract for losses flowing from bad faith breaches, even though the losses were not reasonably foreseeable at the time of contracting. There are analogous contractual contexts in which courts have, in effect, modified the measure of recovery, in part because of the bad faith of a party. In some jurisdictions a plaintiff-builder who willfully departs from specifications cannot recover in contract on the theory of substantial performance, but must sue in *quantum meruit*.²³⁹ A party who contracts to sell realty and recklessly disregards his own prospective inability to convey good title is, upon breach, liable in some states for more than the ordinary defaulting vendor.²⁴⁰ And some courts have relaxed the requirement of certainty of proof of lost profits when the defendant willfully breaks his contract.²⁴¹ Given the foregoing analogies, in a proper case it would not be a radical step for a court to grant recovery in contract for losses which flow from a bad faith breach, but which were not reasonably foreseeable at the time of contracting. Of course, a court could grant relief in tort where the applicable measure of recovery unquestionably includes such losses, but since they flow

²³⁶ W. PROSSER, TORTS 754 (3d ed. 1964).

²³⁷ And generally they must be proved with "reasonable certainty." 5 A. CORBIN, CONTRACTS § 1020 (1964).

²³⁸ Defamation cases which pose difficult problems of proof and valuation of damage are not uncommon. *E.g.*, *Elnis v. Crane*, 118 Me. 261, 107 A. 852 (1919); *Craney v. Donovan*, 92 Conn. 236, 102 A. 640 (1917).

²³⁹ Annot., 6 A.L.R. 137 (1920).

²⁴⁰ *E.g.*, *Arentsen v. Moreland*, 122 Wis. 167, 99 N.W. 790 (1904).

²⁴¹ See note 227 *supra*.

from what is plainly a breach of contract, it seems best to premise relief in contract.

Punitive Damages

The general rule is that punitive damages may not be awarded in contract.²⁴² But if the legal system is to allow punitive damages in civil actions at all, it is difficult to see why they should not be granted in contract actions. In tort law a proper case for punitive damages is generally said to be one in which

the defendant's wrongdoing has been intentional and deliberate, and has the character of outrage such as spite or "malice," or a fraudulent or evil motive on the part of the defendant, or such a conscious and deliberate disregard of the interests of others that his conduct may be called wilful or wanton.²⁴³

There is no reason that such conduct cannot manifest itself in contract as well as in tort contexts, and it seems probable that a significant number of contract breaches actually fit the foregoing description. Allowing a punitive award in these cases would further the primary purposes of punitive damages, as stated in tort law—namely, to punish and to deter.²⁴⁴ In fact, the calculating and malicious contract breaker is both more culpable and more deterrable than those tortfeasors who act impulsively or recklessly and end up having to pay punitive damages.²⁴⁵ Furthermore, the institution of contract is no less important to society than many interests which tort law protects, partly via punitive damage awards. The thin end of the wedge may be in view already, for a growing minority of courts now grants punitive damages for some kinds of bad faith breaches.²⁴⁶

B. Noncontractual Theories of Relief

Since contractual bad faith is contractual, it is tempting to assume that any relief therefor must be premised in contract. But the law seems never to have been that wrongs occurring in a contractual setting

²⁴² 5 A. CORBIN, CONTRACTS § 1077 (1964).

²⁴³ W. PROSSER, TORTS 9-10 (3d ed. 1964) (footnotes omitted).

²⁴⁴ *Id.* at 9.

²⁴⁵ E.g., *Booth v. Kirk*, 381 S.W.2d 312 (Tenn. Ct. App. 1963).

²⁴⁶ Simpson, *Punitive Damages for Breach of Contract*, 20 OHIO ST. L.J. 284 (1959); Note, *Exemplary Damages in the Law of Torts*, 70 HARV. L. REV. 517, 531-33 (1957).

must be redressed, if at all, in contract. One who negligently performs a contract may incur liability in tort as well as in contract, and a party who, at the time of contracting, makes a promise without any intent to perform may become liable in tort for deceit.²⁴⁷ A party also may commit the torts of fraudulent concealment and misrepresentation in contractual contexts. It should not, therefore, seem radical or iconoclastic to suggest that a noncontractual theory may be an appropriate basis for relief against some forms of contractual bad faith.²⁴⁸ The contract-minded judge who accepts this suggestion might even be led to allow damages against a defendant whose bad faith does not take the form of breaking an enforceable contract. As the following examples will show, this is no mere academic matter.²⁴⁹

Recovery for Bad Faith at the Negotiation Stage

The victim of bad faith at the negotiation stage cannot recover in contract since a contract has never been formed. Recovery must be premised in tort, in quasi-contract or in some other theory. Two possible "negotiation" torts are negotiating without serious intent to contract and withdrawing a negotiating proposal after foreseeably inducing another to rely on it. As we have seen, authority that squarely recognizes these wrongs as actionable is scant. But it will be recalled that the Court of Claims in *Heyer Products Co. v. United States*²⁵⁰ held that a disappointed low bidder may recover bid preparation expenses if he can show "that bids were not invited in good faith, but as a pretense to conceal the purpose to let the contract to some favored bidder" ²⁵¹ The court, because it had no jurisdiction over tort claims, was forced

²⁴⁷ W. PROSSER, *The Borderland of Tort and Contract*, in *SELECTED TOPICS ON THE LAW OF TORTS* 380, 387-422 (1954).

²⁴⁸ It is not just that tort theory is already in use against contractual bad faith. The use of noncontractual theory in this way is even more widespread than the use of contractual theories. It has been said that the theory of unjust enrichment, in some of its applications, affords redress against losses flowing from contractual bad faith. R. POUND, *INTRODUCTION TO THE PHILOSOPHY OF LAW* 156, 188-89 (1922). As a possible example, see *Matarese v. Moore-McCormack Lines, Inc.*, 158 F.2d 631 (2d Cir. 1946).

²⁴⁹ In what follows, distinctions between theories of liability will be taken more seriously than may seem becoming of a law teacher. My defense is that many lawyers and judges take these distinctions seriously. Cf. Shanker, *Strict Tort Theory of Products Liability and the Uniform Commercial Code: A Commentary on Jurisprudential Eclipses, Pigeonholes and Communication Barriers*, 17 W. RES. L. REV. 5 (1965).

²⁵⁰ 140 F. Supp. 409 (Ct. Cl. 1956).

²⁵¹ *Id.* at 414.

to say that a cause of action for negotiating without serious intent sounds in contract rather than in tort, and in implied contract at that.²⁵² Yet the dissenting opinion,²⁵³ and subsequent cases citing *Heyer*,²⁵⁴ have pointed out that the appropriate theory is tort. Implied contract, as used here, is merely a fiction prompted by the jurisdictional peculiarities of the Court of Claims.

The Wisconsin Supreme Court in *Hoffman v. Red Owl Stores, Inc.*²⁵⁵ required the defendant to compensate for losses the plaintiff reasonably incurred in reliance upon a negotiating proposal which the defendant subsequently withdrew. The court invoked promissory estoppel, but stated that "this is not a breach of contract action"²⁵⁶ and that the withdrawn negotiating proposal did not constitute an offer to contract.²⁵⁷ If a tort is defined as a civil wrong other than breach of contract, the Wisconsin Supreme Court plainly recognized a cause of action in tort, for the court did not invoke promissory estoppel as a "substitute for consideration in a binding contract." That inducing reliance and then walking away may be a tort is not a new idea.²⁵⁸

Some lawyers and judges have presumably failed to see that relief in tort might lie for bad faith in conducting contract negotiations—a factor that helps explain the dearth of case law.²⁵⁹ Therefore, it is all the more important to recognize explicitly "negotiation wrongs" as tortious; otherwise, some victims will continue to bear losses unfairly for lack of contracts on which to base recovery. And these losses are not always confined to "out-of-pocket" expenses; loss of expectancy may occur, too, as where the defendant induces the plaintiff to pass up other lucrative opportunities in order to deal with him.

²⁵² *Id.* at 413.

²⁵³ *Id.* at 414 (Laramore, J., dissenting).

²⁵⁴ *Edelman v. FHA*, 251 F. Supp. 715, 719 n.7 (E.D.N.Y. 1966).

²⁵⁵ 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

²⁵⁶ *Id.* at 701; 133 N.W.2d at 276.

²⁵⁷ *Id.* at 697-98; 133 N.W.2d at 274-75.

²⁵⁸ See Snyder, *Promissory Estoppel as Tort*, 35 IOWA L. REV. 28 (1949). The precise characterization of the wrong as a tort or something else is not, of course, as important as the recognition that a breach of contract should not be necessary for relief.

²⁵⁹ There are, of course, other factors. One, which goes to the assumed "nature" of contract, should be noted here. A judge who thinks of contract theory as the only possible basis for relief may, in some cases, be disinclined to grant recovery for the further reason that he thinks contract liability must inevitably be "all or nothing" in character—liability for full expectancy damages, or no liability at all. Such a judge will turn away a plaintiff seeking merely reliance damages if expectancy damages would not also be appropriate. This "all or nothing" approach is perceptively criticized in Fuller & Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 373 (1937).

Recovery Against a Party Who Backs Out of an Imperfectly Formed Deal

The parties may enter a deal without realizing that it is legally unenforceable; for example, the agreement may be too indefinite, or it may not comply with the statute of frauds.²⁶⁰ Later, when one party discovers he has an "out," he may take it, bad faith or no. At this stage it will not be uncommon that the aggrieved party will have partly performed or in some way relied to his detriment. He is allowed to recover in quasi-contract for the value of any unjust enrichment of the other party, but this measure is inadequate whenever his reliance expenditures and other reliance losses exceed the amount by which the defendant is enriched. It must be admitted that some courts have allowed plaintiffs to recover this excess, and in quasi-contract at that.²⁶¹ But this distorts theory.²⁶² In a proper case, recovery should be allowed in tort for that part of the loss which is not properly compensable in quasi-contract. This approach openly premises recovery on appropriate theory and makes it more likely that meritorious plaintiffs will prevail. However, it would be inconsistent with the rules denying enforceability to imperfectly formed deals if such a plaintiff were allowed to recover for loss of expected profits.²⁶³ The losses appropriately compensable in tort would be only those measurable in terms of the "unjust impoverishment" of the plaintiff at the defendant's instance.²⁶⁴

²⁶⁰ Of course, there are many other reasons why such a deal might turn out to be unenforceable.

²⁶¹ See Note, *Quasi-Contractual Recovery for Part Performance of a Contract*, 44 HARV. L. REV. 623, 626 (1931).

²⁶² The true concept underlying the decisions seems to be not one of restitution based on quasi-contractual principles, but rather one of indemnification sounding in tort: the plaintiff has made expenditures foreseen by the defendant, in reasonable reliance on the defendant's promise, which is unperformed because of the latter's fault; the plaintiff recovers such portion of that expenditure as is necessary to make him whole.
Id. at 627 (footnotes omitted).

²⁶³ Not that such consistency is all that important. Some of these rules may themselves be questionable in policy, such as the statute of frauds.

²⁶⁴ This is in contrast to unjust enrichment at the plaintiff's expense. The phrase "unjust impoverishment" was suggested to me by my colleague, Professor Alfred P. Rubin, who, along with another colleague, Professor Herbert W. Titus, kindly commented on an earlier draft of this section of the Article. A noteworthy case openly and squarely granting relief for "unjust impoverishment" as such, rather than via an extension of the unjust enrichment theory, is *Kearns v. Andree*, 107 Conn. 181, 139 A. 695 (1928).

Affirmative Recovery Where Contract Theory Accords Only Defensive Significance to Bad Faith

The only significance contract theory gives to some forms of bad faith is defensive in nature. For example, a party who in bad faith conjures up a dispute to induce an accord and satisfaction merely loses this defense upon being discovered; he does not become affirmatively liable in contract for any losses he causes.²⁶⁵ Similarly, a party who overbears another and talks him into an unconscionable deal merely loses the right to enforce the agreement; he does not become affirmatively liable in contract for any losses he causes.²⁶⁶ And yet it is clear that losses can occur which are traceable to such misconduct. A debtor who arbitrarily and capriciously refuses to pay a necessitous creditor in full, seeking thereby to induce him to settle for less, might cause the creditor financial ruin. As one creditor testified in an actual case: "If I fail to get the money to-day, I shall probably be ruined financially" ²⁶⁷ Similarly, a car dealer's repossession of a car, sold to a buyer pursuant to unconscionable price and credit terms which the buyer could not meet, might deprive the buyer of self-transportation and thereby cause him to lose his job. The relief afforded by contract theory in cases of the foregoing nature seems inadequate. In the first example the debtor is denied the defense of accord and satisfaction and remains liable merely for the amount of the debt plus interest; in the other the buyer acquires a defense of unconscionability which he may set up against the dealer should he try to recover any amount remaining unpaid on the price of the car. Contract theory might be modified to allow the creditor recovery for consequential losses specifically traceable to his debtor's bad faith since the debtor is in breach for failure to pay in the first place. But the debtor's bad faith consists of his capricious refusal to pay in order to force a favorable settlement. This misconduct, rather than mere nonpayment, constitutes the distinctive wrong. In the unconscionability case, contract theory cannot be modified to allow the buyer affirmative relief, for the seller is not in breach of his contract. Accordingly, the tort alternative offers itself as all the more worthy of consideration.²⁶⁸

²⁶⁵ No cases have been discovered in which the defendant has been held liable for such losses.

²⁶⁶ No cases have been discovered in which the defendant has been held liable for such losses. UCC § 2-302 specifies that an unconscionable contract is not enforceable. It neither grants nor denies other relief.

²⁶⁷ *Hackley v. Headley*, 45 Mich. 569, 574, 8 N.W. 511, 512 (1881).

²⁶⁸ Some judges may feel the need for a "doctrinal bridge" from unenforceability

Some Objections

Several proposals to expand relief for contractual bad faith have been outlined. It is appropriate to close this section by considering two general objections to such expansion. First, it might be said that the elements of "negotiation" torts, "backing out" torts, "unconscionability" torts and the like cannot be defined with sufficient precision.²⁶⁹ But is this really true? The mental element in torts of this nature could, in each case, be defined in terms of an intent to do the acts constituting the wrong. If it is thought desirable to restrict liability during an initial period of experimentation, the mental element could be tightened up even further to require the intent not only to do the acts constituting the wrong, but also to do wrong as such—for example, the intent to string another along and drop him after inducing reliance, or the intent to impose a particular unconscionable bargain. Additional elements of these torts might consist of (1) doing the relevant acts, (2) causing damage thereby and (3) having no justification or excuse. Elements of this nature are no less definite than those analogous intentional wrongs which have long been actionable as torts. For example, the elements of the tort of "inducing breach of contract" consist of (1) intentionally (2) causing another (3) to break his contract (4) without justification or excuse.

A second general objection to more expansive liability for contractual bad faith is that there are counter-considerations which, it might be said, ought to carry the day. For example, it is arguable that the recog-

to affirmative recovery in damages: "Just as a whole field of law may be influenced by the accidental *presence* of a particular case at particular stage of its development, so a whole field of law may be influenced by the accidental *absence* of a decision which might serve as a sort of *doctrinal bridge* between existing rules and needed new law." Fuller, *American Legal Realism*, 82 U. PA. L. REV. 429, 441 (1934). The case of *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) can serve as a doctrinal bridge from recognition of unconscionability as a valid defense, to its use offensively to recover damages. In *Williams* the court decided that an "add-on" clause giving a seller a security interest not only in the goods then being sold on credit, but also in all goods previously sold to the buyer and for which he had not paid in full, could, in some circumstances, be unconscionable. When so, the seller could not then lawfully repossess the previously sold goods thus freed from the clause, and would be affirmatively liable in conversion to pay damages for thus seeking to enforce the unconscionable clause. In the *Williams* case, the buyer was resisting replevin, but she might just as well have been suing in conversion, had the facts been slightly different.

²⁶⁹ Another, more general, way to put this kind of objection is to say that since good faith is a phrase some judges use loosely and impressionistically, it should not figure significantly in our law.

nition of "negotiation" torts would conflict with the social policy favoring freedom to negotiate, and that some parties might decline to negotiate at all for fear that they would incur liability in tort. But while it is true that counter-considerations are at work, the crucial question is whether they outweigh the social interests to be protected—ensuring just compensation and maintaining appropriate standards of behavior in the contractual process. It is this kind of question which courts should face up to.²⁷⁰

V. CONCLUSION

Q. You have used the phrase "good faith" throughout, but you still have not said what it means. What does it mean?

S. You and others persist in asking that question, which, as I have contended, misconceives good faith. Good faith, as judges generally use the term in matters contractual, is best understood as an "excluder"—a phrase with no general meaning or meanings of its own. Instead, it functions to rule out many different forms of bad faith. It is hard to get this point across to persons used to thinking that every word must have one or more general meanings of its own—must be either univocal or ambiguous.²⁷¹

Q. You speak as if your conclusions were based on judges' uses of the phrase. Were the cases you cited all ones in which judges actually used these words?

S. No, but ninety per cent of them were.

Q. Is it your view that whether conduct is in bad faith must turn on something substantive rather than on what it is called?

S. Of course.²⁷²

²⁷⁰ Certainly it should not be said, as it was in *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675, 677 (2d Cir. 1940), that obligations of good faith are properly imposed only by legislators. For criticism of this view, see Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 467, 503-04 (1967). See generally Peck, *The Role of the Courts and Legislatures in the Reform of Tort Law*, 48 MINN. L. REV. 265 (1963).

²⁷¹ See pp. 199-209 *supra*. The excluder analysis is admittedly one developed by philosophers. But there is no a priori reason why it should not have application to problems of legal analysis.

²⁷² Cf. Kessler & Fine, *Culpa In Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 408 (1964) ("[t]he absence of good faith language is by no means conclusive") (nor is the *presence* of good faith language).

Q. Can you say what that is?

S. It is possible to say something general, but I doubt if it will satisfy you. In most cases the party acting in bad faith frustrates the justified expectations of another. As I have tried to show, the ways in which he may do this are numerous and radically diverse.²⁷³ Moreover, whether an aggrieved party's expectations are justified must inevitably vary with attendant circumstances. For these reasons it is not fruitful to try to generalize further. It is easy enough to formulate examples of bad faith and work from them.²⁷⁴ Besides, any general definition of good faith, if not vacuous, is sure to be unduly restrictive, especially if cast in statutory form.²⁷⁵

Q. I still can't pin you down. Aren't you, in Sartre-like fashion, really saying that good faith permeates all? At least, you put no limits on it. Doesn't this very promiscuity of good faith make it useless as a distinctive legal test?

S. I have not said good faith permeates all of contract law. Many rules of contract are not merely matters of good faith, and some have little, if anything, to do with good faith.²⁷⁶ It is true that the general enforceability of promises, as such, can be derived from the basic principle that men should act in good faith towards others with whom they deal.²⁷⁷ It is also true that good faith is pervasively relevant in contracting contexts, from the negotiation stage through to discharge.

Q. You welcome uncertainty in the law. Shouldn't the parties, especially in matters contractual, be able to tell where they stand? You won't let me have a definition of good faith, and you tell me good faith is "pervasively relevant." If courts adopt your theory, how am I supposed to be able to tell in advance when some judge will say I am acting in bad faith?

S. You say: "If courts adopt my theory." It is not my theory; it is a judicial and legislative theory. As for your certainty point, I think its

²⁷³ See Part III *supra*.

²⁷⁴ One of the important insights of Professor Fuller is that the bad can often be more usefully discussed than the good. Fuller, Book Review, 9 U. CHI. L. REV. 759, 760 (1942).

²⁷⁵ See pp. 206-07 *supra*.

²⁷⁶ The examples range from relatively narrow rules, for example, "acceptance by post of an offer by post is effective on dispatch," to broad principles, for example, "the parties are generally free to make what contracts they wish."

²⁷⁷ See R. POUND, AN INTRODUCTION TO THE PHILOSOPHY OF LAW 188 (1922).

merit meager. You seem to wish for more certainty than the nature of the case admits.²⁷⁸ This apart, we already have, in regard to some problems, more uncertainty than I believe we would have if courts attacked such problems directly in terms of good faith rather than indirectly in terms of irrelevant contract rules. This seems true, for example, of the law on taking unfair advantage. Some courts have bent and twisted contract doctrines to reach just results;²⁷⁹ other courts have refused to do this and have denied relief.²⁸⁰ One can't be at all sure when to expect a court to take one line or the other.

Furthermore, once we accumulate a body of holdings on what forms of conduct are in bad faith, we should then have the certainty you want, at least as to those forms of conduct, shouldn't we?

Q. Yes, but even then the omniscient presence of good faith would always be with us for new situations. My friends teaching criminal law wouldn't stand for this sort of thing. They honor the maxim, *nulla poena sine lege*, and they insist on clarity and certainty in advance. To them, your doctrine would be "void for vagueness."

S. Good faith is not vague in its applications. Indeed, what good faith requires can only be defined usefully in the context of particulars. As I have tried to show, good faith takes on definite (and variant) meanings by way of contrast with definite (and variant) forms of bad faith.²⁸¹ Moreover, your criminal law analogy is inapposite; the purposes and functions of criminal law and contract law are not the same.

Q. Maybe the criminal analogy isn't apt, but you still haven't convinced me that a requirement of good faith can really qualify as true law. It is far from a rule.

S. You reveal your prejudice in favor of rules: "If something can be formulated as a definite, detailed rule, then it can qualify as law, but if it is merely a general maxim, policy or principle, then it cannot qualify as law at all. Only rules can be laws." This is a common view.²⁸² But

²⁷⁸ Aristotle stressed that we should not seek more certainty than the subject matter allows—always sobering counsel. *THE BASIC WORKS OF ARISTOTLE* 936 (McKeon ed. 1941).

²⁷⁹ See, e.g., pp. 257-58 *supra*.

²⁸⁰ E.g., *O'Callaghan v. Waller & Beckwith Realty Co.*, 15 Ill. 2d 436, 155 N.E.2d 545 (1958).

²⁸¹ See pp. 202-04 *supra*.

²⁸² For discussion of this view, see Dworkin, *The Case for Law—A Critique*, 1 VALPARAISO U. L. REV. 215, 216-17 (1967).

it is not in accord with relevant reality. In fact, a moment ago even you cited to me *nulla poena sine lege*, which surely is no more than a maxim. And what of our law of negligence? Aren't its formulations rather vague? And what of the principle of unjust enrichment? Of Section 90 of the Restatement? Of the "prima-facie tort" doctrine? Of the whole of equity, with its vague maxims, policies and principles? In point of fact, our law recognizes many kinds of non-rules as law.²⁸³ Why not similarly recognize the principle requiring contractual good faith? Furthermore, if we are to have doctrines which, among other things, perform safety valve functions, then isn't it inevitable that they will take rather general form? Of course, in their specific applications they will generate rules.²⁸⁴

Q. You argue with conviction. Aren't you at bottom just a moralist trying to foist your ideas of good faith off on others?

S. So moralism concerns you, too. The ABA committee which induced the Code's sponsors to delete the expansive definition of good faith from Section 1-201(19) of the Code was plainly fearful of moralism.²⁸⁵ Several comments must be made. First, I have tried to make it clear that legal good faith, in the case law, is not identical with moral good faith, though it must be admitted that the two overlap.²⁸⁶ Second, insofar as legal good faith incorporates morals, which require a party to act in ways he ought to act anyway, I see nothing to object to. It may be true that many men, in their commercial dealings, do not think consciously in terms of right and wrong, but rather in terms of profit and loss and possibly of the standards of dealing that prevail in their businesses, however high or low. But to the extent this is so, it seems irrelevant. At the least, a judge should always be willing to intervene to enforce minimal standards of just dealing as well as the spirit of any consummated

²⁸³ On maxims, policies and principles as law, see Dworkin, *Judicial Discretion*, 60 J. OF PHILOSOPHY 624 (1963). See also the important recent study, P. STEIN, *REGULAE JURIS—FROM JURISTIC RULES TO LEGAL MAXIMS* (1966).

²⁸⁴ "[T]he general requirement tends to be systematized into a series of rules." P. DEVLIN, *THE ENFORCEMENT OF MORALS* 46 (1965).

²⁸⁵ [I]t is of interest that this provision and certain others in the same vein have produced quite a violent reaction on the part of some businessmen and business lawyers. They say: "Why should the Code draftsmen tell us to be good? Businessmen, or at least most of them, carry on business ethically and did so long before the Code was ever conceived. The Code should not try to prescribe morals."

Malcolm, *The Proposed Commercial Code*, 6 BUS. LAW. 113, 127 (1951).

²⁸⁶ See pp. 204-06 *supra*.

deal. It is possible that a judge might, in the name of good faith, impose on a contracting party merely his own personal ideals of upright behavior. But this is a risk worth running. And it is not much of a risk, for good faith is more a minimal standard than a high ideal anyway.²⁸⁷ Also, a party can appeal.

Q. If you are right in all this, then why haven't lawyers and judges made more of good faith than they have?

S. Any answer would, of course, have to be speculative. It should be noted first, though, that the influence of good faith is greater than your question implies. One reason people don't see its full reach is that it is sometimes clothed in other doctrinal garb. But to get on with my answer, no one has satisfactorily conceptualized good faith for the law's purpose. Flummoxed by the question, "What does good faith itself mean?" people may have decided that good faith is useless as a legal requirement. There has not been much study of cases to see how judges actually use the phrase. You have already mentioned other factors which presumably have impeded acceptance of good faith in our contract law—misplaced concern about uncertainty, prejudice favoring narrow, definite and detailed rules, and fear of judicial moralism. Anti-paternalism, the ideology of free contract, and regard for "arms-length" bargaining have no doubt played a part, too.²⁸⁸ It has even been said that courts are not free to require good faith; only the legislature can.²⁸⁹ Despite all this, we now have a considerable body of law. If all the cases cited here were on the books of a single state, that state would have a rather fully developed doctrine of good faith.²⁹⁰ But it is true

²⁸⁷ Cf. H. HART, *THE CONCEPT OF LAW* 176-80 (1961).

²⁸⁸ If the Court were to interfere otherwise than as a referee to prevent fouls, or if it were to tender help to the party who appeared to be getting the worst of it, worse still if it engaged itself as an active promoter of fair dealing, sooner or later it would be telling both parties that it knew what was good for them better than they did themselves. That is an attitude that always has been and still is repugnant to lawyers

P. DEVLIN, *THE ENFORCEMENT OF MORALS* 47 (1965). "The traditional notion that parties when negotiating for a contract should look out for their own protection is still exercising a powerful pull" Kessler & Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 419 (1964). "[M]andatory rules, not subject to agreement by the parties, are not ordinarily favored in our law" Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 678 (1963).

²⁸⁹ *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675, 677 (2d Cir. 1940).

²⁹⁰ New York appears to have the most fully developed doctrine of good faith.

that in most states the law of contractual good faith seems relatively undeveloped. Maybe the Code will serve as a stimulus, especially if it is amended as suggested.²⁹¹

²⁹¹ See note 73 *supra*.