Breach of Contract and the Common Law Duty to Perform in Good Faith

Author(s): Steven J. Burton

Source: *Harvard Law Review*, Dec., 1980, Vol. 94, No. 2 (Dec., 1980), pp. 369-404

Published by: The Harvard Law Review Association

Stable URL: https://www.jstor.org/stable/1340584

BREACH OF CONTRACT AND THE COMMON LAW DUTY TO PERFORM IN GOOD FAITH

*Steven J. Burton**

The contractual expectation interest traditionally is conceived in terms of a promisee's expectation of receiving the promised benefit of the contract. In this Article, Professor Burton argues that the expectation interest also encompasses the expected costs to the promisor, which consist of opportunities forgone at the time of contract formation. This cost perspective makes it possible to articulate an operational standard of good faith performance, which is now an implied covenant in every contract in most American common law jurisdictions. The duty to perform in good faith applies when one party exercises discretion in performance and thereby controls the other party's anticipated benefit. The discretion-exercising party performs in good faith when it exercises discretion for any purpose within the reasonable contemplation of the parties, and in bad faith when discretion is used to recapture forgone opportunities.

A MAJORITY of American jurisdictions,[1] the *Restatement (Second) of Contracts*,[2] and the Uniform Commercial Code (U.C.C.)[3] now recognize the duty to perform a contract in good faith as a general principle of contract law. The conduct of virtually any party to any contract accordingly may be vulnerable to claims of breach stemming from this obligation.[4] Yet neither courts nor commentators have articulated an operational standard that distinguishes good faith performance from bad faith performance.[5] The good faith performance doctrine consequently appears as a license for the ex-

---

* Associate Professor of Law, University of Iowa. B.A., University of California at Los Angeles, 1970; J.D., University of Southern California, 1973.

The author wishes to express his gratitude to the many colleagues who read and commented on earlier drafts. Special thanks go to Professors Clifford Calhoun, Robert Hillman, and Alan Widiss and to Dr. Serena Stier. Thomas S. Kiriakos and James Stinehart assisted in the research.

[1] Cases indicating jurisdictions that explicitly recognize a general obligation of good faith performance in every contract at common law are set out in the Appendix, p. 404 *infra*.

[2] RESTATEMENT (SECOND) OF CONTRACTS § 231 (Tent. Draft No. 5, 1970).

[3] U.C.C. § 1-203. All citations are to the UNIFORM COMMERCIAL CODE 1978 OFFICIAL TEXT WITH COMMENTS (1978).

[4] This Article concentrates on claims of bad faith giving rise to a breach of contract rather than on claims of bad faith asserted against a party who concedes the breach but claims to have substantially performed. In the latter case, good faith performance is one of several factors bearing upon substantial performance. *See* note 35 *infra*.

[5] *See generally* Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963); Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968). Professor Summers does not

ercise of judicial or juror intuition,[6] and presumably results in unpredictable and inconsistent applications.[7] Repeated common law adjudication,[8] however, has enriched the concept of good faith performance so that an operational standard now can be articulated and evaluated.

---

purport to identify the criteria that judges use or ought to use in deciding whether particular conduct is in bad faith. Instead, he asserts that

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

Id. at 201. Professor Summers identifies six categories of bad faith in contract performance: evasion of the spirit of the deal, lack of diligence and slacking off, willfully rendering 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. *Id.* at 232–43. He identifies similar categories relating to contract formation and enforcement. *Id.* at 220–32, 243–52. No effort is made to develop a unifying theory that explains what these categories have in common. Indeed, the assertion is made that one cannot or should not do so. *Id.* at 204–07.

On the treatment of good faith performance in the civil law, see J. DAWSON, ORACLES OF THE LAW 461–79 (1968); Powell, *Good Faith in Contracts*, 9 CURRENT LEGAL PROB. 16 (1956). On the treatment of similar matters in the Commonwealth, see Burrows, *Contractual Co-Operation and the Implied Term*, 31 MOD. L. REV. 390 (1968). On the problems of good faith at the bargaining and formation stages of the contracting process, see Kessler & Fine, Culpa in Contrahendo, *Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964). *See also* Hillman, *Policing Contract Modifications Under the U.C.C.: Good Faith and the Doctrine of Economic Duress*, 64 IOWA L. REV. 849 (1979). On the problem of good faith at the enforcement stage, see Summers, *supra*, at 248–52. *See also* Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 813 (1958). On good faith in other contexts, see note 17 *infra*.

[6] The question of a contract party's good faith performance generally is one of fact. *See, e.g.*, Dorsey Bros. v. Anderson, 264 Md. 446, 450–51, 287 A.2d 270, 273 (1972); Pernet v. Peabody Eng'r Corp., 20 A.D.2d 781, 782, 248 N.Y.S.2d 132, 135 (1964) (per curiam); Atomic Fuel Extraction Corp. v. Estate of Slick, 386 S.W.2d 180 (Tex. Civ. App. 1964).

[7] *See* Schultze v. Chevron Oil Co., 579 F.2d 776, 779 (3d Cir. 1978); Wolf v. Illustrated World Encyclopedia, Inc., 41 A.D.2d 191, 192–93, 341 N.Y.S.2d 419, 421 (1973); Eisenberg, *Good Faith Under the Uniform Commercial Code — A New Look at an Old Problem*, 54 MARQ. L. REV. 1 (1971); Hillman, *supra* note 5, at 856–76; Summers, *supra* note 5. *See also* R. UNGER, LAW IN MODERN SOCIETY 210 (1976); Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1713–24 (1976).

[8] This Article does not present a theory of the duty to perform a contract in good faith under the Uniform Commercial Code. The U.C.C. does not reflect a consistent theory of good faith on its face. *See generally* Farnsworth, *supra* note 5, at 673–74 ("future vitality of the Code's obligation of good faith performance depends largely upon the post operative care it receives from the courts"); Hillman, *supra* note 5 (contract modification under U.C.C. § 2-209); Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of our New Commercial Law*, 11 VILL. L. REV. 213, 244–53 (1966); Summers, *supra* note 5, at 215 ("Code's definitions

The good faith performance doctrine establishes a standard for contract interpretation[9] and a covenant that is implied in every contract.[10] The good faith question often arises because a contract is an exchange expressed imperfectly and projected into an uncertain future.[11] Contract parties rely on the good faith of their exchange partners because detailed planning may be ineffectual or inadvisable.[12] Therefore, express contract terms alone are insufficient to determine a party's good faith in performance.

Even so, the courts employ the good faith performance doctrine to effectuate the intentions of parties, or to protect their reasonable expectations.[13] Standards expressed in these terms, however, are of little aid in applying the doctrine. They direct the inquiry away from duties imposed upon the parties irrespective of their assent.[14] But they direct attention to the

---

[of good faith] restrictively distort the doctrine of good faith"); Note, *Good Faith Under the Uniform Commercial Code*, 23 U. PITT. L. REV. 754 (1962).

Several important good faith provisions of the Code, however, have been interpreted consistently with the common law counterpart. *See generally* Feld v. Henry S. Levy & Sons, 37 N.Y.2d 466, 470, 335 N.E.2d 320, 322, 373 N.Y.S.2d 102, 105 (1975); Weistart, *Requirements and Output Contracts: Quantity Variations Under the UCC*, 1973 DUKE L.J. 599, 600 (U.C.C. § 2-306(1) good faith limitation and common law treatment of good faith in output and requirements contracts indistinguishable.) This Article therefore relies upon cases decided under the U.C.C. only in those areas where the U.C.C.'s compatibility with the common law is clear. The theory presented here in turn should provide a perspective and policy framework that makes full analysis of the U.C.C.'s good faith performance provisions more manageable.

[9] *See* Ryder Truck Rental, Inc. v. Central Packing Co., 341 F.2d 321, 323–24 (10th Cir. 1965); Milstein v. Security Pac. Nat'l Bank, 27 Cal. App. 3d 482, 486–87, 103 Cal. Rptr. 16, 18–19 (1972); Martindell v. Lake Shore Nat'l Bank, 15 Ill. 2d 272, 283–84, 154 N.E.2d 683, 690–91 (1958); Veatch v. Black, 363 Mo. 190, 199, 250 S.W.2d 501, 507 (1952); Association Group Life, Inc. v. Catholic War Veterans of the United States, 61 N.J. 150, 153–54, 293 A.2d 382, 384 (1972) (per curiam); Hilleary v. Skookum Root Hair-Grower Co., 4 Misc. 127, 129–30, 23 N.Y.S. 1016, 1017–18 (C.P. 1893).

[10] *See* Appendix, p. 404 *infra*.

[11] *See generally* Farnsworth, *Disputes Over Omission in Contracts*, 68 COLUM. L. REV. 860 (1968); Macneil, *The Many Futures of Contract*, 47 S. CAL. L. REV. 691 (1974).

[12] *See, e.g.*, Llewellyn, *What Price Contract? — An Essay in Perspective*, 40 YALE L.J. 704, 727 (1931); Macneil, *supra* note 11; Weistart, *supra* note 8, at 618–22. *See also* Kessler & Stern, *Competition, Contract, and Vertical Integration*, 69 YALE L.J. 1 (1959); Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297 (1978).

[13] *E.g.*, Sessions, Inc. v. Morton, 491 F.2d 854, 857 (9th Cir. 1974); Ryder Truck Rental, Inc. v. Central Packing Co., 341 F.2d 321, 323–24 (10th Cir. 1965); Perkins v. Standard Oil Co., 235 Or. 7, 15–17, 383 P.2d 107, 111–12 (1963) (en banc).

[14] The good faith performance doctrine should be distinguished sharply from the doctrine of unconscionability, which governs the formation of a contract. *See, e.g.*, U.C.C. § 2-302; RESTATEMENT (SECOND) OF CONTRACTS § 234 (Tent. Draft No. 5, 1970). Unconscionability gives courts latitude to refuse to enforce all or part of an

amorphous totality of the factual circumstances at the time of formation, and fail to distinguish relevant from irrelevant facts within that realm. The analysis would be advanced further by an operational standard that respects the autonomy of contract parties and calls the relevant facts to the foreground of the totality of the circumstances.

This requires a better understanding of the contractual expectation interest. Traditionally, the expectation interest is viewed as comprising the property, services, or money to be received by the promisee. This Article suggests that it also encompasses the expected cost of performance to the promisor.[15] This expected cost consists of alternative opportunities forgone upon entering a particular contract.[16]

The cost perspective is essential to a proper understanding of the good faith performance doctrine,[17] even though it is not necessary when clear express promises are breached. Good faith

---

agreement that is not a product of meaningful choice by both parties or is so one sided in its terms as to favor one party unreasonably. *E.g.*, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965); U.C.C. § 2-302(1). Unconscionability thus is a limitation on freedom of contract that allows the courts to police the bargaining relationship and to override the manifested intention of the parties in the interests of justice. *See generally* Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1969); Leff, *Unconscionability and the Code — The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967); *see also* p. 383 *infra*.

The good faith performance obligation, in contrast, typically is implied in contracts involving arm's-length transactions, often between sophisticated businesspersons. *See* pp. 380–84 *infra*. Although the parties are not free to disclaim the obligation to perform in good faith as such, Industrial & Gen. Trust, Ltd. v. Tod, 180 N.Y. 215, 225–26, 73 N.E. 7, 9–10 (1905), they are free to determine by agreement what good faith will permit or require of them. *See, e.g.*, VTR, Inc. v. Goodyear Tire & Rubber Co., 303 F. Supp. 773 (S.D.N.Y. 1969); Milstein v. Security Pac. Nat'l Bank, 27 Cal. App. 3d 482, 486, 103 Cal. Rptr. 16, 18 (1972); Zapatha v. Dairy Mart, Inc., 1980 Mass. Adv. Sh. 1837, 408 N.E.2d 1370 (1980).

[15] *See* pp. 374–78 *infra*.

[16] *See* pp. 387–89 *infra*.

[17] The analysis will be confined to good faith in the context of contract performance. The words "good faith" appear in a wide variety of other contexts. Failure to keep different contexts analytically distinct can result in much confusion. Good faith performance thus should not be equated with requirements of "good faith" at the formation or enforcement stages of the contracting process, where "good faith" serves different purposes. *See* sources cited note 5 *supra*.

Good faith performance also should not be equated with "good faith" (1) as an absence of fraud, *e.g.*, Guardino Tank Processing Corp. v. Olsson, 89 N.Y.S.2d 691 (Sup. Ct. 1949) (claim of promissory fraud rejected while breach of contract by failing to perform in good faith sustained); (2) as a fiduciary duty, because the doctrine obviously could not mean that every contract requires "something stricter than the morals of the marketplace," Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, C.J.); *see* Broad v. Rockwell Int'l Corp., 614 F.2d 418, 430–31 (5th Cir. 1980); New v. New, 148 Cal. App. 2d 372, 306 P.2d 987 (1957); note 109 *infra*; or (3) in various statutory contexts, *see, e.g.*, Farnsworth, *supra* note 5, at 670–71 (confusion of good faith performance with the good faith of a holder or limits the exercise of discretion in performance conferred on one party by the contract. When a discretion-exercising party may determine aspects of the contract, such as quantity, price, or time, it controls the other's anticipated benefits. Such a party may deprive the other of these anticipated benefits for a legitimate (or good faith) reason. The same act will be a breach of the contract if undertaken for an illegitimate (or bad faith) reason.[18] Therefore, the traditional focus on the benefits due the promisee is inadequate.

Bad faith performance occurs precisely when discretion is used to recapture opportunities forgone upon contracting — when the discretion-exercising party refuses to pay the expected cost of performance.[19] Good faith performance, in turn, occurs when a party's discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation — to capture opportunities that were preserved upon entering the contract, interpreted objectively.[20] The good faith performance doctrine therefore directs attention to the opportunities forgone by a discretion-exercising party at formation, and to that party's reasons for exercising discretion during performance.

Part I of this Article explores the concept of contract breach from a cost perspective, and proposes a general description of the breach of an express promise. Part II presents a theory of the good faith performance doctrine derived from the cases and the general description in Part I. Part III is a survey of cases that illustrates the theory's capacity to distinguish cases holding that a party performed in good faith from cases holding that a party performed in bad faith.

I. Contract Breach Behavior: A Cost Perspective

This Part explores the concept of contract breach in the context of a simple breach of an express contract. Bad faith performance should be a breach of contract only if in important respects it is like a breach of contract by failing to perform

purchaser for value under the U.C.C.); Summers, *supra* note 5, at 208–12 (same). On good faith in insurance contracts, see J. McCarthy, Punitive Damages in Bad Faith Cases (2d ed. 1978); Keeton, *Liability Insurance and Responsibility for Settlement*, 67 Harv. L. Rev. 1136 (1954); note 109 *infra*.

If the words "good faith" have a general meaning in all or many of these various contexts, it probably is along the lines of an absence of intention to harm a legally protected pecuniary interest. Such a statement is the reverse side of the doctrine of prima facie tort. Much more specific analysis is needed to render such an abstract statement useful.

[18] *See* pp. 379–85 *infra*.

[19] On noneconomic motives, see note 80 *infra*.

[20] *See* pp. 385–87 *infra*.

as expressly promised.[21] The simple breach case serves well as a vehicle to develop the basic concept through which to analyze the more difficult problem of good faith performance — the concept of recapturing forgone opportunities.

A. The Concept of Contract Breach

The concept of a breach of contract is troublesome. The *Restatement (Second) of Contracts*, for example, says that a breach of contract is nonperformance of a legal duty when due under a contract.[22] The drafters' inability to provide a less tautological concept is perhaps a function of the fact that contract rules must operate in a wide diversity of factual situations. This requires that a concept of general contract law be articulated in the abstract, and precludes the development of a mechanical rule. A general concept of contract breach can be made operational, however, if based on a primarily descriptive general model that allows legal consequences to be attached to facts common to many situations. But no complete model has been constructed. Traditional descriptions, which focus on the promised benefit to be received by the promisee, are plainly inadequate when a promise is implied. A better general description of all contract breach behavior can be constructed from an economic analysis of the traditional view of simple express promises.

A simple express promise has been analyzed traditionally as a commitment to transfer goods, services, or money in the future, on which the promisee is justified in relying from the time of formation until performance is rendered.[23] The en-

---

[21] In fact, the remedies awarded in bad faith performance cases are the same as those awarded for "any garden variety breach of contract." Liberty Mut. Ins. Co. v. Altfillisch Constr. Co., 70 Cal. App. 3d 789, 797, 139 Cal. Rptr. 91, 95 (1977). Expectation damages are the preferred remedy. *See, e.g.*, Dasenbrock v. Interstate Restaurant Corp., 7 Ill. App. 3d 295, 287 N.E.2d 151 (1972); Fortune v. National Cash Register Co., 373 Mass. 96, 364 N.E.2d 1251 (1977); Pernet v. Peabody Eng'r Corp., 20 A.D.2d 781, 248 N.Y.S.2d 132 (1964); Western Natural Gas Co. v. Cities Serv. Gas Co., 507 P.2d 1236 (Okla.), *appeal dismissed and cert. denied*, 409 U.S. 1052 (1972). *See also* Baldwin v. Kubetz, 148 Cal. App. 2d 937, 307 P.2d 1005 (1957) (party's duty to perform discharged); Isbell v. Anderson Carriage Co., 170 Mich. 203, 136 N.W. 457 (1912) (reliance damages); Wigand v. Bachmann-Bechtel Brewing Co., 222 N.Y. 272, 118 N.E. 618 (1918) (same); Western Hills, Or., Ltd., v. Pfau, 265 Or. 137, 508 P.2d 201 (1973) (en banc) (specific performance); Miller v. Othello Packers, Inc., 67 Wash. 2d 842, 410 P.2d 33 (1966) (per curiam) (*quantum valebat*); Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145 (1970); Vernon, *Expectancy Damages for Breach of Contract: A Primer and Critique*, 1976 WASH. U.L.Q. 179 (1976).

[22] RESTATEMENT (SECOND) OF CONTRACTS § 260 (Tent. Draft No. 8, 1973).

[23] *See* RESTATEMENT (SECOND) OF CONTRACTS § 2 (Tent. Draft No. 1, 1964); RESTATEMENT OF CONTRACTS § 2 (1932).

forcement of promises thus tends "to eliminate the distinction between present and future (promised) goods,"[24] and to give the promisee's expectation of receiving future benefits the character of present property.[25] The security of contractual transactions[26] and the reliability of promises[27] are enhanced by the requirement that a party in breach compensate the promisee for the disappointed expectation.

This classic perspective should be supplemented by focusing attention on the cost side of the coin.[28] If it is true that every present transfer of property, services, or money is costly, it is also true that enforcing promises to transfer such benefits in the future tends to eliminate the distinction between present and future (promised) costs.

The economic cost of any action — including the act of contracting, the act of performing, and the act of breaching a contract — should be viewed descriptively as the value of the next best opportunity necessarily forgone by taking that action.[29] Almost every action entails many forgone opportunities because resources, such as goods, services, money, or reputation, are scarce.[30] In a present exchange, two independent costs — the costs of entering the exchange and the costs of performing — are incurred together. But when an exchange is projected into the future by contract, the economic costs of contracting are incurred separately from the costs of performing later.[31]

For example, if a person contracts to have a swimming pool built that will cost $3,000, the commitment to have the pool built may itself cost only $500, in that a change of mind immediately thereafter will result in an actual loss of only $500. The remaining $2,500 of the costs will be incurred as

[24] Fuller & Perdue, *The Reliance Interest in Contract Damages* (pt. 1), 46 YALE L.J. 52, 59 (1936).

[25] *Id.*

[26] *See* Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 808–13 (1941). For discussions on related functions of contract law, see Llewellyn, *supra* note 12, at 721–25; Macaulay, *Justice Traynor and the Law of Contracts*, 13 STAN. L. REV. 812, 813–16 (1961); Patterson, *An Apology for Consideration*, 58 COLUM. L. REV. 929, 945 (1958).

[27] *See generally* Fuller & Perdue, *supra* note 24; Goetz & Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980).

[28] The contracts literature has ignored almost completely the fact that every contract involves a cost to the promisor that may differ from the value to the promisee. This fact was noted in Gardner, *An Inquiry Into the Principles of the Law of Contracts*, 46 HARV. L. REV. 1, 8 (1932), though Professor Gardner did not elaborate on its meaning or implication. *See also* Goetz & Scott, *supra* note 27.

[29] P. SAMUELSON, ECONOMICS 474–75 (10th ed. 1976); Alchian, *Cost*, in 3 INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES 404 (D. Sills ed. 1968).

[30] Alchian, *supra* note 29, at 404.

[31] *Id.* at 407.

work progresses and payments are made.[32] The posited $500 cost of contracting includes transaction expenditures to gather information concerning alternative opportunities and to negotiate and draft the contract, as well as any deposit.[33] Significantly, the owner's economic cost of *contracting* does not include the value of primary forgone alternative uses to which resources *committed* to the swimming pool contract no longer can be committed honestly[34] — a swimming pool by a different designer, a tennis court, or a new car. These are economic costs not of contracting but of performing the contract in the future.

This wholly economic description of contracting costs maintains the distinction between present and future (promised) costs. But for familiar normative reasons — to enhance the reliability of promises — the expectation principle requires that enforceable promises for an exchange in the future be given present effect. This means that the legal analyst should include the expected cost of performing with the cost of entering the contract. The legal cost of contracting to build a swimming pool for $3,000 consequently is $3,000.

B. Contract Breach Behavior: Express Contracts

A simple breach of an express contract[35] consists of an attempt by one party to recapture opportunities forgone upon

---

[32] *Id.*

[33] The costs of entering the contract also include the risk of breaching the contract later — the costs of breach discounted by the probability that the party later will want to breach. The costs of breach, in turn, include the resulting loss of reputation and good will, as well as any money to be paid in settlement of a contract dispute or as contract damages, attorneys' fees, and other litigation expenses. *See generally* R. POSNER, ECONOMIC ANALYSIS OF LAW § 4.1 (2d ed. 1977); Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); Priest, *Breach and Remedy for the Tender of Nonconforming Goods Under the Uniform Commercial Code: An Economic Approach*, 91 HARV. L. REV. 960 (1978).

[34] A party who enters a contract without a present intention to perform is liable for promissory fraud.

[35] The analysis in the text assumes deliberate behavior because the common law cases generally do not suggest that a negligent or inadvertent action is a breach of contract by failing to perform in good faith. Few cases involving claims of bad faith performance state facts from which negligence can be inferred. Where negligence appears, as in Concrete Specialties v. H.C. Smith Constr. Co., 423 F.2d 670 (10th Cir. 1970); Miller v. Othello Packers, Inc., 67 Wash. 2d. 842, 410 P.2d 33 (1966) (per curiam), it is so blatant as to suggest gross negligence or intentional behavior. *But see* Amoco Oil Co. v. Capitol Indem. Corp., 95 Wis. 2d 530, 542–44, 291 N.W.2d 883, 890–91 (Ct. App. 1980) (negligent materials supplier held not to have performed in good faith); p. 398 & note 126 *infra*.

In cases where a party in breach claims to have substantially performed, bad faith as a factor bearing on the substantiality of the performance is treated by the courts contracting. By hypothesis, a party enters a contract when it believes that no greater benefit can be derived by expending elsewhere the resources required for the contract performance.[36] Events between the time of formation and the time of performance may prove this belief to have been erroneous.[37] Before its own performance is rendered, a party with a losing contract may seek to recapture forgone opportunities to the extent possible. This can be accomplished *only* by redirecting the resources committed to the promised performance and therefore by failing to perform the promise.

A buyer of corn, for example, may fail to perform a contract for future delivery for a large number of reasons. If the market price falls, the buyer will wish to recapture the opportunity of buying on the spot market or on a changed futures market. If the buyer gets a hot tip on the potato market, it may wish to redirect purchase money earmarked for the corn contract to enable it to purchase more potato contracts. If investor confidence in the commodities market slips, the buyer may wish to move its business into stocks or real estate or may wish to go out of business. These and other uses for the resources committed to the initial corn contract may be opportunities necessarily forgone when entering the corn contract.

An express promise therefore should be viewed as entailing representations as to the future, both regarding the resources to be received by the promisee and simultaneously regarding opportunities forgone by the promisor, even though the iden-

---

as intentional or willful behavior. RESTATEMENT (SECOND) OF CONTRACTS § 266 & Comment f (Tent. Draft No. 8, 1973); *see, e.g.*, Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 129 N.E. 889 (1921).

In contrast, discussions of the obligation to perform a contract in good faith under the U.C.C. often do center on the question whether the standard is subjective or objective. "Good faith" generally is defined as "honesty in fact in the conduct or transaction concerned" — a subjective standard. U.C.C. § 1-201(19). For transactions within article 2, however, "good faith" in the case of a merchant is defined as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." U.C.C. § 2-103(1)(b). The latter definition approximates an objective negligence standard. *But see* 1956 ALI RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE 21 (1957) (reference to "fair dealing" added to "eliminate the possibility that the definition might be read as imposing on merchants a general standard of due care"). *See generally* Farnsworth, *supra* note 5; Summers, *supra* note 5, at 208–14. However, the question of subjective and objective standards does not seem to bother the courts in cases governed by the U.C.C. and almost never is mentioned expressly in the common law cases.

[36] This assumes that the person has a present intention to perform. *See* note 35 *supra*.

[37] Any subsequent decline in the value of the contract or any rise in the value of a foregone opportunity may result in a losing contract.

tity of opportunities forgone in any case is problematic.[38] Consequently, one can describe a simple breach of an express contract as a failure to do that which one promised to do or doing that which one promised not to do, and independently as a recapture of opportunities forgone upon entering the contract. The effect is identical in the simple case. The concept of recapturing forgone opportunities, however, is more general and can be employed also to embrace at least the implied covenant of good faith.[39]

II. A THEORY OF THE GOOD FAITH PERFORMANCE DOCTRINE

A breach of contract by failing to perform in good faith is both like and unlike a breach of contract by failing to perform a simple express promise. From the cost perspective, it is similar analytically in that the key fact establishing a breach is a party's recapture of opportunities forgone upon entering the contract. It is different in that an observer cannot know whether a party acted to recapture forgone opportunities by determining that the other party did not receive the property, services, or money to be transferred under the contract. This Part introduces the concept of discretion in contract performance as a means of examining the specific problem governed by the good faith performance doctrine. The theory developed here is that a party fails to perform in good faith when it uses such discretion to recapture forgone opportunities.[40]

---

[38] *See* pp. 389–90 *infra*. A premise of this Article is that the identification of a proper question advances the analysis even if the answer to that question remains elusive in some cases.

[39] This study does not cover some other generally implied promises that might be explained from this cost perspective. One is the implied promise to cooperate with the other party, or not to prevent or hinder the other party's performance. 3 A. CORBIN, CORBIN ON CONTRACTS §§ 570–571 (1960); Patterson, *Constructive Conditions in Contracts*, 42 COLUM. L. REV. 903 (1942). The problem, there, often is to draw a line between noncooperation that is a breach of contract and noncooperation that evidences a merely difficult contract partner who insists on its rights to the letter. Such a line might be drawn on the basis of whether the party is acting to recapture forgone opportunities. A few cases do in fact treat the implied promise of cooperation as an aspect of good faith performance. *See, e.g.*, Burgess Constr. Co. v. M. Morrin & Son Co., 526 F.2d 108 (10th Cir. 1975), *cert. denied*, 429 U.S. 866 (1976); Concrete Specialties v. H.C. Smith Constr. Co., 423 F.2d 670 (10th Cir. 1970); Ligon v. Parr, 471 S.W.2d 1 (Ky. 1971); Odem Realty Co. v. Dyer, 242 Ky. 58, 45 S.W.2d 838 (1932); Carter v. Sherburne Corp., 132 Vt. 88, 315 A.2d 870 (1974). The doctrine of anticipatory breach similarly might be analyzed in these terms. *See* New York Life Ins. Co. v. Viglas, 297 U.S. 672 (1936) (Cardozo, J.); Peter Kiewit Sons' Co. v. Summit Constr. Co., 422 F.2d 242, 257 (8th Cir. 1969); RESTATEMENT (SECOND) OF CONTRACTS § 275, Comment a (Tent. Draft No. 8, 1973).

[40] For a sample of opinions explicitly assimilating good faith to an implied obligation not to abuse discretion in performance, see Boone v. Kerr-McGee Oil Indus.,

A. The Problem: Legitimate and Illegitimate Uses of Discretion in Contract Performance

The standard doctrinal formulation of the good faith performance duty was first[41] articulated in 1933 by the New York Court of Appeals in *Kirke La Shelle Co. v. Paul Armstrong Co.*:[42]

> In every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits

217 F.2d 63, 65 (10th Cir. 1954); Loudenback Fertilizer Co. v. Tennessee Phosphate Co., 121 F. 298, 303 (6th Cir. 1903); California Lettuce Growers, Inc. v. Union Sugar Co., 45 Cal. 2d 474, 484, 289 P.2d 785, 791 (1955); Milstein v. Security Pac. Nat'l Bank, 27 Cal. App. 3d 482, 486–87, 103 Cal. Rptr. 16, 18–19 (1972); Oliphant v. Woodburg Coal & Mining Co., 63 Iowa 332, 19 N.W. 212 (1884); Heckard v. Park, 164 Kan. 216, 222, 188 P.2d 926, 930 (1948).

[41] Some of the earliest cases to imply a general obligation of good faith performance were Ratzlaff v. Trainor-Desmond Co., 41 Cal. App. 586, 183 P. 269 (1919); People *ex rel.* Wells & Newton Co. v. Craig, 232 N.Y. 125, 133 N.E. 419 (1921); Wigand v. Bachmann-Bechtel Brewing Co., 222 N.Y. 272, 118 N.E. 618 (1918); Simon v. Etgen, 213 N.Y. 589, 107 N.E. 1066 (1915); Brassil v. Maryland Cas. Co., 210 N.Y. 235, 104 N.E. 622 (1914); Industrial & Gen. Trust, Ltd. v. Tod, 180 N.Y. 215, 225, 73 N.E. 7, 9 (1905); Genet v. President of Del. & Hudson Canal Co., 136 N.Y. 593, 611, 32 N.E. 1078, 1082 (1893); Hilleary v. Skookum Root Hair-Grower Co., 4 Misc. 127, 23 N.Y.S. 1016 (C.P. 1893). Earlier cases implied an obligation of good faith in the context of contracts containing conditions of satisfaction. *See* Baltimore & O. Ry. v. Brydon, 65 Md. 198, 3 A. 306, *aff'd on rehearing*, 65 Md. 611, 9 A. 126 (1886); Doll v. Noble, 116 N.Y. 230, 22 N.E. 406 (1889); Singerly v. Thayer, 108 Pa. 291, 2 A. 230 (1885).

[42] 263 N.Y. 79, 188 N.E. 163 (1933). Pursuant to a settlement of a prior suit, the plaintiff obtained a contract right to one-half the gross receipts from future stage productions of a play, and a right to approve all contracts, sales, licenses, and other arrangements affecting the stage production of the play, except "motion picture" rights. Without obtaining such approval, the defendant sold the "talkie" movie rights. Kirke La Shelle brought an action for one-half of the net amount received from the sale. The New York Court of Appeals upheld the plaintiff's claim because a "talkie" movie — not invented at the time of contracting — was not within the contemplation of the parties when they excepted "motion pictures" and would impair the market for the stage play and therefore the plaintiff's income from the contract. The express promise giving the plaintiff a right of approval thus was broken. The primary problem was finding a remedy. The court looked to the law of fiduciaries in awarding the plaintiff one-half of the proceeds from the sale of movie rights.

The court also found an implied covenant of good faith and fair dealing as an alternate basis for liability and the remedy, although probably improperly. Since the court found a breach of an express promise and a fiduciary relationship, its use of the good faith performance concept was unnecessary. *See* Manners v. Morosco, 252 U.S. 317, 327 (1920) (implied negative covenant not to use ungranted rights to the detriment of the other party). There is some question whether the case was correctly decided on its facts. *See* L.C. Page & Co. v. Fox Film Corp., 83 F.2d 196, 199 (2d Cir. 1936) (words "motion picture" in pre-"talkie" contract held to include "talkies"). *See also* Bartsch v. Metro-Goldwyn-Mayer, Inc., 391 F.2d 150 (2d Cir.), *cert. denied*, 393 U.S. 826 (1968).

> of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.[43]

Because it adopts the traditional focus on the benefit to be received by the promisee and fails to focus on the problem of discretion in performance, however, this early effort to articulate the good faith principle conceals more than it reveals.

1. Discretion in Performance. — Discretion in performance arises in two ways. The parties may find it to their mutual advantage at formation to defer decision on a particular term and to confer decisionmaking authority as to that term on one of them. Discretion also may arise, with similar effect, from a lack of clarity or from an omission in the express contract.[44] In either case, the dependent party must rely on the good faith of the party in control. Only in such cases do the courts raise explicitly the implied covenant of good faith and fair dealing, or interpret a contract in light of good faith performance.[45] This will be illustrated by examining cases involving discretion as to quantity, price, time, and conditional aspects of a contract.

Deferred decisions as to quantity take the form of requirements and output contracts, in which specific agreement typically is reached on all terms except the quantity of goods bought or sold. A buyer under a requirements contract and a seller under an output contract have effective control of the quantity exchanged because they can manipulate their apparent requirements or output by modifying their methods of

---

[43] 263 N.Y. at 87, 188 N.E. at 167. The phrases "good faith" and "fair dealing" within the meaning of this covenant appear not to have independent legal significance. A plain meaning interpretation might ascribe a subjective meaning to "good faith" and an objective meaning to "fair dealing," but there is no basis in the cases for such an approach. *See* Moore v. Home Ins. Co., 601 F.2d 1072, 1074 (9th Cir. 1979). On subjective and objective standards of good faith performance, see note 35 *supra*; note 126 *infra*.

[44] It is the potential for a lack of clarity and completeness that necessitates the implication of the good faith covenant in every contract. Contracting parties typically will presuppose a measure of cooperation from each other. Express language accordingly will fail to set forth all of the specific undertakings of the parties. *See, e.g.*, Concrete Specialties v. H.C. Smith Constr. Co., 423 F.2d 670 (10th Cir. 1970). Residual discretion may not be controllable by contract language, as where a franchisor controls the good will of a franchise. *See, e.g.*, Photovest Corp. v. Fotomat Corp., 606 F.2d 704 (7th Cir. 1979). Moreover, unforeseen events may create discretion in performance that the parties did not and could not anticipate. *See, e.g.*, Bartsch v. Metro-Goldwyn-Mayer, Inc., 391 F.2d 150 (2d Cir.) (invention of television renders ambiguous defendant's right, pursuant to a 1935 assignment, to "exhibit" a movie film), *cert. denied*, 393 U.S. 826 (1968).

[45] The analysis in this Article is based on a survey of over 400 cases in which courts explicitly refer to good faith in performance.

marketing[46] or production.[47] At the time of formation, the dependent party could have insisted on fixed quantity terms in the contract or required agreement on detailed provisions governing the other party's method of doing business. The flexibility and simplicity of a requirements or output contract, however, often compensate for the risk of such manipulations.[48] Both at common law and under the U.C.C., a buyer's requirements or a seller's output means such actual quantities as occur in good faith.[49]

Deferred decisions as to price may take two forms. In most jurisdictions at common law, agreement as to price is an essential term and must be set or be ascertainable for a contract to be formed.[50] There is, however, some authority at common law for enforcing a contract in which the price is to be set by an appraisal by one party. In that case, the price must be set in good faith.[51] In addition, the price term more

---

[46] *See, e.g.*, Loudenback Fertilizer Co. v. Tennessee Phosphate Co., 121 F. 298 (6th Cir. 1903); Chalmers & Williams v. Walter Bledsoe & Co., 218 Ill. App. 363 (1920); Orange & Rockland Utils., Inc., v. Amerada Hess Corp., 59 A.D.2d 110, 397 N.Y.S.2d 814 (1977).

[47] *See, e.g.*, Feld v. Henry S. Levy & Sons, 37 N.Y.2d 466, 335 N.E.2d 320, 373 N.Y.S.2d 102 (1975). In some cases, a party in control changed the form of legal ownership of its business and claimed that it was free of its obligations because the business no longer was a party to the contract. Such a ploy was successful prior to the development of the good faith performance doctrine. *See* Drake v. Vorse, 52 Iowa 417, 3 N.W. 465 (1879). Good faith may preclude such action today. *See* Western Oil & Fuel Co. v. Kemp, 245 F.2d 633 (8th Cir. 1957); RESTATEMENT (SECOND) OF CONTRACTS § 231, Illustration 1 (Tent. Draft No. 5, 1970). On the effect of good faith when parties go out of business altogether, compare Neofotistos v. Harvard Brewing Co., 341 Mass. 684, 171 N.E.2d 865 (1961) (sale of business not seen as a bad faith elimination of output), with Wigand v. Bachmann-Bechtel Brewing Co., 222 N.Y. 272, 118 N.E. 618 (1918) (sale of business seen as a bad faith elimination of output).

[48] *See generally* Weistart, *supra* note 8. On good faith in relation to freedom of contract ideology, see pp. 392–94 *infra*.

[49] U.C.C. § 2-306(1); Weistart, *supra* note 8; sources cited notes 46–47 *supra*.

[50] *See* 1 A. CORBIN, *supra* note 39, § 97.

[51] Price v. Speilman Motor Sales Co., 261 A.D. 626, 26 N.Y.S.2d 836 (1941) (automobile dealer's reappraisal of trade-in at time of delivery must be in good faith and not arbitrary). In an almost identical case decided in the same jurisdiction following enactment of the U.C.C., the court relied on the Code to reach the same result, without citing *Price*. Umlas v. Acey Automobile, Inc., 62 Misc. 2d 819, 310 N.Y.S.2d 147 (Civ. Ct. N.Y. 1970). *See also* Krauss v. Kruechler, 300 Mass. 346, 15 N.E.2d 207 (1938) (upholding closed corporation's appraisal of stock to be purchased by the corporation upon shareholder's death); RESTATEMENT (SECOND) OF CONTRACTS § 231, Illustration 7 (Tent. Draft No. 5, 1970).

There also is some authority for enforcing an agreement to agree on price, in which case the parties must negotiate the price in good faith. Coleman Eng'r Co. v. North Am. Aviation, Inc., 65 Cal. 2d 396, 420 P.2d 713, 55 Cal. Rptr. 1 (1966). *See also* U.C.C. § 2-305(1); Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673 (1969).

commonly may be left open to vary with sales,[52] production,[53] or other factors[54] through a formula in the contract for determining the price when payment is due.[55] Good faith performance is required when one party controls the factors that determine the price.[56]

Deferred decisions as to the time of performance may allow one party to determine when it shall perform, when the other party shall perform, or when the contract shall terminate. Often such decisions must be made in good faith.[57] A final decision as to the binding effect of a contract promise on one

---

[52] *E.g.*, Malloy v. Coldwater Seafood Corp., 338 Mass. 554, 156 N.E.2d 61 (1959) (broker working on a commission).

[53] *E.g.*, California Lettuce Growers v. Union Sugar Co., 45 Cal. 2d 474, 289 P.2d 785 (1955) (price to be measured by quantity of useful product after processing by buyer); Miller v. Othello Packers, Inc., 67 Wash. 2d 842, 410 P.2d 33 (1966) (same).

[54] *See, e.g.*, Ryder Truck Rental, Inc. v. Central Packing Co., 341 F.2d 321 (10th Cir. 1965) (rental price based on use of trucks).

[55] Because the price is ascertainable, no jurisdiction holds that such floating terms prevent the formation of a contract. 1 A. CORBIN, *supra* note 39, § 98.

[56] Where the price is measured as a percentage of gross receipts, good faith may preclude the party in control of sales from manipulating its bookkeeping, Hempstead Theatre Corp. v. Metropolitan Playhouses, Inc., 16 Misc. 2d 781, 183 N.Y.S.2d 972 (Sup. Ct.), *aff'd*, 7 A.D.2d 625, 179 N.Y.S.2d 306 (1958), *rev'd on other grounds*, 6 N.Y.2d 311, 160 N.E.2d 604, 189 N.Y.S.2d 837 (1959), or from marketing competing products that reduce sales of the contract product. Mechanical Ice Tray Corp. v. General Motors Corp., 144 F.2d 720 (2d Cir. 1944), *cert. denied*, 324 U.S. 844 (1945); Parev Prods. Co. v. I. Rokeach & Sons, 124 F.2d 147 (2d Cir. 1941).

The same good faith requirement is imposed when one party controls the use of property while the other has a right to a portion of the property's earnings stream. *See, e.g.*, Ryder Truck Rental, Inc. v. Central Packing Co., 341 F.2d 321 (10th Cir.) (rental price based on extent of use), *cert. denied*, 382 U.S. 827 (1965); Baldwin v. Kubetz, 148 Cal. App. 2d 937, 943, 307 P.2d 1005, 1009 (1957) (exclusive rights to minerals in return for promised royalties); Brawley v. Crosby Research Foundation, 73 Cal. App. 2d 103, 166 P.2d 392 (1946) (intellectual property rights given in return for royalties); Goldberg 168-05 Corp. v. Levy, 170 Misc. 292, 9 N.Y.S.2d 304 (Sup. Ct. 1938), *modified and aff'd*, 256 A.D. 1086, 11 N.Y.S.2d 315 (1939) (possession of commercial real estate under a percentage lease). *See also* Broad v. Rockwell Int'l Corp., 614 F.2d 418, 429–30 (5th Cir.), *rehearing granted*, 618 F.2d 396 (5th Cir. 1980); Van Gemert v. Boeing Co., 553 F.2d 812 (2d Cir. 1977); Uproar Co. v. National Broadcasting Co., 81 F.2d 373 (1st Cir.), *cert. denied*, 298 U.S. 670 (1936); Matzen v. Horwitz, 102 Cal. App. 2d 884, 228 P.2d 841 (1951).

[57] *See, e.g.*, Sylvan Crest Sand & Gravel Co. v. United States, 150 F.2d 642 (2d Cir. 1945) (party may call for delivery of goods without agreed limitations as to time); McKinney v. National Dairy Council, 491 F. Supp. 1108 (D. Mass. 1980) (discretion to terminate an employment contract at will); Dorsey Bros. v. Anderson, 264 Md. 446, 287 A.2d 270 (1972) (agreement to harvest crop with discretion to decide when crop is ripe); Simon v. Etgen, 213 N.Y. 589, 107 N.E. 1066 (1915) (agreement to pay debt by selling a real estate property with discretion to decide when to sell); Richard Bruce & Co. v. J. Simpson & Co., 40 Misc. 2d 501, 243 N.Y.S.2d 503 (Sup. Ct. 1963) (promise to market securities with discretion to terminate if market unfavorable). *See also* pp. 399–401 *infra*.

party similarly may be deferred when the contract is subject to a condition. When that condition is within one party's effective control, that party must act in good faith.[58] For example, a party whose performance is conditioned on governmental approval of its plans[59] or on other related contracts[60] may be required to act in good faith to secure the fulfillment of the condition. Similarly, a party benefiting from a condition of satisfaction[61] must act at least in good faith in claiming that it is dissatisfied with the proffered performance.[62]

The good faith performance doctrine thus may be used to protect a "weaker" party from a "stronger" party.[63] Unlike the unconscionability doctrine, however, weakness and strength in this context do not refer to the substantive fairness of the bargain or to the relative bargaining power of the parties.[64] Good faith performance cases typically involve arm's-length transactions, often between sophisticated business persons. The relative strength of the party exercising discretion typically arises from an agreement of the parties to confer

---

[58] Barnes v. Atlantic & Pac. Life Ins. Co. of America, 295 Ala. 149, 156, 325 So. 2d 143, 150 (1975) (citing J. MURRAY, MURRAY ON CONTRACTS § 187, at 365 (1974)); *see* Pernet v. Peabody Eng'r Co., 20 A.D.2d 781, 248 N.Y.S.2d 132 (1964) (per curiam). *See also* pp. 392–94 *infra*.

[59] *See, e.g.*, Vanadium Corp. of America v. Fidelity & Deposit Co., 159 F.2d 105 (2d Cir. 1947); Crooks v. Chapman Co., 124 Ga. App. 718, 185 S.E.2d 787 (1971); Dasenbrock v. Interstate Restaurant Corp., 7 Ill. App. 3d 295, 287 N.E.2d 151 (1972); Brenner v. Schreck, 17 Misc. 2d 945, 192 N.Y.S.2d 461 (App. Term. 1959).

[60] *See, e.g.*, Fry v. George Elkins Co., 162 Cal. App. 2d 256, 327 P.2d 905 (1958); Kerrigan v. City of Boston, 361 Mass. 24, 278 N.E.2d 387 (1972); Lane v. Elwood Estates, Inc., 31 A.D.2d 949, 298 N.Y.S.2d 751 (1969), *aff'd*, 28 N.Y.2d 620, 268 N.E.2d 805, 320 N.Y.S.2d 79 (1971); Ide Farm & Stable, Inc. v. Cardi, 110 R.I. 735, 297 A.2d 643 (1972); Frangesch v. Kamp, 262 Wis. 446, 55 N.W.2d 372 (1952).

[61] Different standards normally apply to conditions of satisfaction and conditions of personal satisfaction. When the performance relates to matters of mechanical fitness, utility, and the like, dissatisfaction must be such that a reasonable person would not be satisfied in similar circumstances. Performance relating to matters of personal taste and fancy, however, may be "unreasonably" rejected so long as the dissatisfaction is asserted in good faith. *See, e.g.*, Mattei v. Hopper, 51 Cal. 2d 119, 330 P.2d 625 (1958) (en banc); Western Hills, Or., Ltd. v. Pfau, 265 Or. 137, 508 P.2d 201 (1973) (en banc); 3A A. CORBIN, *supra* note 39, §§ 644–648; Annot., 86 A.L.R.2d 202 (1962). *But see* Childres, *Conditions in the Law of Contracts*, 45 N.Y.U. L. REV. 33, 42–44 (1970) (distinction not neatly observed in practice).

[62] *E.g.*, Neumiller Farms, Inc. v. Cornett, 368 So. 2d 272 (Ala. 1979); Devoine Co. v. International Co., 151 Md. 690, 136 A. 37 (1927); Fechteler v. Whittemore, 205 Mass. 6, 91 N.E. 155 (1910); Maas v. Scoboda, 188 Neb. 189, 195 N.W.2d 491 (1972); Kree Inst. of Electrolysis, Inc. v. Fageros, 478 S.W.2d 569 (Tex. Civ. App. 1972).

[63] *See* Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 858 (1964).

[64] *See* note 14 *supra* and sources cited therein.

control of a contract term on that party. The dependent party then is left to the good faith of the party in control.

2. Distinguishing Legitimate and Illegitimate Uses of Discretion. — The problem of good faith in contract performance can be clarified in terms of a party's reasons for exercising discretion. The *Kirke La Shelle* formulation of the implied covenant of good faith and fair dealing is misleading. It suggests on its face that there are but two issues: whether one party received the fruits of the contract and, if not, whether the other party caused the harm.[65] That the dependent party does not receive anticipated benefits, however, is not dispositive. A party with discretion may withhold all benefits for good reasons. The cases therefore carry the inquiry further and establish that the state of mind of the discretion-exercising party is of central importance. The courts, mindful that good faith should not be used as a vehicle for judicial fiat, defer to a party who acts with no improper purpose.[66]

Consider, for example, a set of cases involving actions by lessees under commercial percentage leases in which the implied covenant of good faith and fair dealing was applied. The leases provided for rentals to be paid primarily as a percentage of the gross receipts of the lessee's business on the premises. In each case, the lessee altered its business in a way that reduced sales from the leased premises and therefore the amount owed as rent: by moving a lucrative part of the business to other premises leased from the same lessor on a flat rental basis;[67] by opening competing stores in the same neighborhood;[68] or by diverting customers to another store.[69]

---

[65] *See* pp. 379–80 & note 43 *supra*. The implied covenant is not invariably explained in terms of denying a party the fruits of the contract. In California, this formulation sometimes is supplemented by the statement: "This covenant not only imposes upon each contracting party the duty to refrain from doing anything which would render performance of the contract impossible by any act of his own, but also the duty to do everything that the contract presupposes that he will do to accomplish its purpose." Steinmeyer v. Warner Consol. Corp., 42 Cal. App. 3d 515, 519, 116 Cal. Rptr. 57, 60 (1974) (quoting Harm v. Frasher, 181 Cal. App. 2d 405, 417, 5 Cal. Rptr. 367, 374 (1960)). But the emphasis here seems to be only that acts of omission and commission equally may run afoul of the implied covenant, and the additional language has no discernible effect on the results in particular cases. *See also* Boone v. Kerr-McGee Oil Indus., 217 F.2d 63 (10th Cir. 1954), *quoted at* note 75 *infra*.

[66] *See, e.g.*, E.J. Albrecht Co. v. New Amsterdam Cas. Co., 164 F.2d 389 (7th Cir. 1947); Dorsey Bros. v. Anderson, 264 Md. 446, 287 A.2d 270 (1972); Tillett v. Deering, Milliken & Co., 88 N.Y.S.2d 148 (Sup. Ct. 1948).

[67] Mutual Life Ins. Co. v. Tailored Woman, Inc., 309 N.Y. 248, 128 N.E.2d 401 (1955).

[68] Food Fair Stores, Inc. v. Blumberg, 234 Md. 521, 200 A.2d 166 (1964). *See also* Stop & Shop, Inc. v. Ganem, 347 Mass. 697, 200 N.E.2d 248 (1964).

[69] Goldberg 168-05 Corp. v. Levy, 170 Misc. 292, 9 N.Y.S.2d 304 (Sup. Ct. 1938), *modified and aff'd*, 256 A.D. 1086, 11 N.Y.S.2d 315 (1939).

The lessor lost in two of the three cases, even though the lessee in each instance reduced the actual rent received by the lessor under the contract formula. Where the lessee opened competing stores in the same neighborhood, the court observed simply that large chains usually kept adding to the number of their stores.[70] When the lessee moved a lucrative part of its business to other premises in the same building, where a flat rental applied, the court held that the lessee was free to decide on which floor to locate that part of its business, absent fraud, trickery, or express terms to the contrary.[71] However, where the lessee diverted business for the "sole purpose"[72] of bringing gross receipts down at the leased premises, a "direct violation"[73] of the covenant was established.

The fact that a discretion-exercising party causes the dependent party to lose some or all of its anticipated benefit from the contract thus is insufficient to establish a breach of contract by failing to perform in good faith. The *Kirke La Shelle* dictum, although still widely employed, fails to reflect the subsequent common law experience. The cases suggest that the purpose of the discretion-exercising party is a key factor.[74]

B. Breach of Contract by Failing to Perform in Good Faith

1. Good Faith: The Reasonable Contemplation of the Parties. — The results in the percentage lease cases, as in most good faith performance cases, have intuitive appeal. A few courts have sought to articulate this intuition in terms of the reasonable contemplation of the parties.[75] The good faith performance doctrine may be said to permit the exercise of discretion for any purpose — including ordinary business purposes[76] — reasonably within the contemplation of the

---

[70] Food Fair Stores, Inc. v. Blumberg, 234 Md. 521, 535, 200 A.2d 166, 174 (1964).

[71] Mutual Life Ins. Co. v. Tailored Woman, Inc., 309 N.Y. 248, 128 N.E.2d 401 (1955).

[72] Goldberg 168-05 Corp. v. Levy, 170 Misc. 292, 294, 9 N.Y.S.2d 304, 306 (Sup. Ct. 1938), *modified and aff'd*, 256 A.D. 1086, 11 N.Y.S.2d 315 (1939).

[73] *Id.*

[74] *See* Goodman v. Mutual Broadcasting Sys., Inc., 16 Misc. 2d 858, 185 N.Y.S.2d 152 (Sup. Ct. 1959), *aff'd*, 10 A.D.2d 632, 196 N.Y.S.2d 313 (1960); Dickey v. Philadelphia Minit-Man Corp., 377 Pa. 549, 105 A.2d 580 (1954).

[75] As one court stated,

> Where discretion is lodged in one of two parties to a contract or a transaction, such discretion must . . . be exercised in good faith. That simply means that what is done must be done honestly to effectuate the object and purpose the parties had in mind in providing for the exercise of . . . power.

Boone v. Kerr-McGee Oil Indus., 217 F.2d 63, 65 (10th Cir. 1954).

[76] *See* Burgess Constr. Co. v. M. Morrin & Son Co., 526 F.2d 108 (10th Cir. 1975); Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corp., 130 F.2d 471 (3d Cir. 1942); Martindell v. Lake Shore Nat'l Bank, 15 Ill. 2d 272, 286, 154

parties.[77] A contract thus would be breached by a failure to perform in good faith if a party uses its discretion for a reason outside the contemplated range — a reason beyond the risks assumed by the party claiming a breach.[78]

The contemplation standard of good faith performance is helpful because it distinguishes in principle the duty to perform in good faith from duties imposed on the parties either for reasons of public policy or to avoid unjust enrichment. Moreover, it suggests two specific questions for determining good faith: (1) what was the discretion-exercising party's purpose in acting; and (2) was that purpose within the reasonable contemplation of the parties?[79] The first is an inquiry into subjective intent, as suggested above. The second, in contrast, is an objective inquiry that assumes a normal or ordinary course of events that the parties expect or should expect at the time of contract formation, and with reference to which they implicitly contract, absent express terms to the contrary.

N.E.2d 683, 690–91 (1958); Food Fair Stores, Inc. v. Blumberg, 234 Md. 521, 200 A.2d 166 (1964); Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publishing Co., 30 N.Y.2d 34, 281 N.E.2d 153, 330 N.Y.S.2d 329, *cert. denied*, 409 U.S. 875 (1972), *discussed at* pp. 398–99 *infra*.

[77] New York Cent. Iron Works Co. v. United States Radiator Co., 174 N.Y. 331, 335, 66 N.E. 967, 968 (1903); *see* Milstein v. Security Pac. Nat'l Bank, 27 Cal. App. 3d 482, 486–87, 103 Cal. Rptr. 16, 18–19 (1972); Pierce v. MacNeal Memorial Hosp. Ass'n, 46 Ill. App. 3d 42, 51, 360 N.E.2d 551, 558 (1977); Comini v. Union Oil Co., 277 Or. 753, 756–57, 562 P.2d 175, 176–77 (1977).

[78] *See* pp. 387–92 *infra*; *cf.* Bergum v. Weber, 136 Cal. App. 2d 389, 288 P.2d 623 (1955) (direct solicitation of former customers of a partnership after sale of partnership's good will is bad faith); Devoine Co. v. International Co., 151 Md. 690, 136 A. 37 (1927) (rejection of goods under a condition of satisfaction in order to buy more cheaply elsewhere); Commonwealth Dep't of Property & Supplies v. Berger, 11 Pa. Commw. Ct. 332, 312 A.2d 100 (1973) (defendant decided he wanted to get out of the contract); Beckett v. Kornegay, 150 Va. 636, 143 S.E. 296 (1928) (party acting in good faith is not acting for speculative reasons).

[79] The percentage lease cases may be explained in this light. Where a lessee opened competing stores in the same neighborhood, the court said there is nothing "unusual" about large retail chains adding to the number of their stores, *see* pp. 384–85 & notes 68, 70 *supra*, and so held that the act was undertaken in good faith. The implication was that the defendant's action was within the ordinary course of business and therefore was reasonably within the contemplation of the parties. When a lessee moved part of its business to a different floor of the building where a flat rental applied, *see* pp. 384–85 & notes 67, 71 *supra*, the rearrangement of the merchant's wares within the rented space was similarly seen as a normal business practice. However, where a lessee diverted customers to other premises for the sole purpose of bringing down gross receipts at the leased premises, *see* pp. 384–85 & notes 69, 72 *supra*, the lessee's reason for acting lay outside the bounds of the contract. The lessor reasonably contemplated that variations in the percentage rent would result from market factors affecting the volume of business at the lessee's location. But it may be inferred reasonably that neither party contemplated at formation that the lessee would interfere with the flow of customers in order to reduce its own sales at the leased premises. *See* HML Corp. v. General Foods Corp., 365 F.2d 77, 81–82 (3d Cir. 1966) (dictum) (analogizing requirements contracts to percentage lease cases).

However, the contemplation standard alone leaves much room for manipulation and fiction. It provides little guidance for determining which of the plausible expectations at formation and which of the plausible motives at performance manifest good faith or bad faith performance. The contemplation standard only directs one to consult the parties' intentions and reasonable expectations — an amorphous totality of the circumstances at the time of formation. In contrast, the cost perspective on contract breach behavior makes it possible to identify with greater particularity the relevant expectations and motives that have been held to constitute bad faith.

2. *Bad Faith: Recapturing Forgone Opportunities.* — Bad faith performance consists of an exercise of discretion in performance to recapture opportunities forgone at formation. The dependent promisee's expectations encompass both the subject matter to be received under a contract, and the expected costs of performance by the other party. A recapture by one party of forgone opportunities necessarily harms the other. A reasonable person accordingly would enter a contract that confers discretion on the other party only on the belief that the discretion will not be used to recapture forgone opportunities.[80]

That businesspersons do in fact take into account opportunities forgone by a discretion-exercising party also is suggested by the doctrinal history of good faith performance. Many of the contracts in which good faith performance is of central importance once would have been unenforceable for indefiniteness or lack of mutuality. This generalization is most accurate with respect to conditions of personal satisfaction,[81] discretionary termination clauses,[82] many open and floating quantity contracts,[83] and open price contracts.[84] The definite-

---

[80] The economic motive to be described is not the only motive that is beyond the reasonable expectations of a dependent party. Some noneconomic motives, such as spite or ill will, are likely to run afoul of the good faith performance doctrine or otherwise to result in liability for breach of contract. *See* Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549 (1974) (bad faith of employer found when employee under at will contract was fired after refusing sexual advances of her boss). *See also* Pstragowski v. Metropolitan Life Ins. Co., 553 F.2d 1 (1st Cir. 1977); Wild v. Rarig, 302 Minn. 419, 234 N.W.2d 775 (1975), *appeal dismissed*, 424 U.S. 902 (1976). Noneconomic factors so rarely are evidenced in the reported cases, however, that the focus of the theory must be on economic motives.

[81] *See, e.g.*, Mattei v. Hopper, 51 Cal. 2d 119, 330 P.2d 625 (1958) (en banc); De Laurentiis v. Cinematográfica de las Américas, S.A., 9 N.Y.2d 503, 174 N.E.2d 736, 215 N.Y.S.2d 60 (1961).

[82] *See, e.g.*, Miami Coca-Cola Bottling Co. v. Orange Crush Co., 296 F. 693 (5th Cir. 1924); Bernstein v. W.B. Mfg. Co., 238 Mass. 589, 131 N.E. 200 (1921).

[83] *See, e.g.*, Oscar Schlegel Mfg. Co. v. Peter Cooper's Glue Factory, 231 N.Y. 459, 132 N.E. 148 (1921). *See also* Wickham & Burton Coal Co. v. Farmers Lumber Co., 189 Iowa 1183, 179 N.W. 417 (1920).

[84] *See* 1 A. CORBIN, *supra* note 39, § 97.

ness and mutuality requirements indicate that contract formation depends on a real commitment by each party. In other words, each party must forgo some future opportunity upon formation and thus restrain its future freedom in some way.[85] The implication of good faith now renders many of these contracts enforceable,[86] suggesting judicial recognition that the parties in fact were forgoing opportunities in many such contracts.

For example, in an early requirements contract case involving a buyer who was a jobber,[87] the court read discretion regarding quantity as allowing the buyer to deal elsewhere in a falling market, and to increase its orders at the contract price in a rising market.[88] The buyer was seen as having made no legal commitment because it did not forgo its freedom to pursue alternative opportunities — such as purchases on the spot market — in the future. Yet the use of output and requirements contracts persisted and expanded, suggesting that contracting parties believed that they were each getting some commitment in fact[89] — including the discretion-exercising party's forgone opportunity to speculate on the price. Even before adoption of the U.C.C., many courts consequently hurdled the mutuality barrier to enforce such contracts by implying a good faith duty.[90]

The deployment of good faith to avoid finding an illusory promise in these cases suggests that opportunities indeed are forgone upon the formation of contracts.[91] Moreover, a quan-

---

[85] *See* Corbin, *The Effect of Options on Consideration*, 34 YALE L.J. 571, 574 (1925).

[86] *See, e.g.*, Jacobs v. Freeman, 104 Cal. App. 3d 177, 163 Cal. Rptr. 680 (1980); Brawley v. Crosby Research Foundation, 73 Cal. App. 2d 103, 166 P.2d 392 (1946); Heckard v. Park, 164 Kan. 216, 188 P.2d 926 (1948); Phelps v. Shawprint, Inc., 328 Mass. 352, 103 N.E.2d 687 (1952); Griswold v. Heat Inc., 108 N.H. 119, 229 A.2d 183 (1967); De Laurentiis v. Cinematográfica de las Américas, S.A., 9 N.Y.2d 503, 174 N.E.2d 736, 215 N.Y.S.2d 60 (1961); H.P. Hood & Sons v. Heins, 124 Vt. 331, 205 A.2d 561 (1964).

[87] Crane v. C. Crane & Co., 105 F. 869 (7th Cir. 1901).

[88] *Id.* at 872.

[89] *See* 1 S. WILLISTON, CONTRACTS §§ 103–104 (S. Williston & G. Thompson ed. 1937); Havighurst & Berman, *Requirement and Output Contracts*, 27 ILL. L. REV. 1, 1 (1932); Llewellyn, *supra* note 12, at 727.

[90] *See, e.g.*, Imperial Ref. Co. v. Kanotex Ref. Co., 29 F.2d 193 (8th Cir. 1928); Weistart, *supra* note 8. Good faith as such was not the only device used to render such contracts enforceable. *See* Hickey v. O'Brien, 123 Mich. 611, 82 N.W. 241 (1900) (requirements contract enforceable if buyer forgoes opportunity to buy elsewhere).

[91] The view that opportunities are forgone upon contract formation also is central to the classic justification of the expectation measure of contract damages. *See* Fuller & Perdue, *supra* note 24, at 57–66. In that context, it is the promisee's forgone opportunities (its costs) that are taken into account in determining the measure of compensation.

tity-controlling party commonly is found to have acted in bad faith when it speculates in rising or falling markets,[92] recapturing specific opportunities that the other party reasonably expected it had forgone. A seller's belief that a buyer in a requirements contract will not use its discretion to recapture the opportunity of taking advantage of changes in market prices therefore appears as part of the seller's legally protected interest. The principles of formation and breach thus are wholly congruent.

Expectations as to specific forgone opportunities may be inferred from the express contract terms in light of the ordinary course of business and customary practice, in accordance with the objective theory of contract interpretation.[93] Even so, such expectations may be difficult to prove. Some uncertainty is inevitable because dispute settlement proceeds with the benefit of hindsight and refers to the parties' intentions or expectations with respect to the future. The necessary abstraction of a general principle of contract law adds further complications.[94] In these respects, the good faith performance doctrine suffers epistemological and semantic limitations along with other contract doctrines. Contract law generally endeavors to overcome these limitations by presuming that the parties expect future events to proceed in a normal course and expect each other to behave, absent express terms, in accordance with customary practices of trade.[95] Some uncertainty is inevitable, though no greater here than elsewhere in contract law.

The question whether a party used its discretion in order to recapture forgone opportunities is one of subjective intent, and is a question of fact for the jury. In a forerunner of the

---

[92] Loudenback Fertilizer Co. v. Tennessee Phosphate Co., 121 F. 298 (6th Cir. 1903), *discussed at* pp. 395–96 *infra*; New York Cent. Iron Works Co. v. United States Radiator Co., 174 N.Y. 331, 66 N.E. 967 (1903); Orange & Rockland Utils., Inc. v. Amerada Hess Corp., 59 A.D.2d 110, 397 N.Y.S.2d 814 (1977) (under the U.C.C.); Asahel Wheeler Co. v. Mendleson, 180 A.D. 9, 167 N.Y.S. 435 (1917); Moore v. American Molasses Co., 106 Misc. 263, 174 N.Y.S. 440 (Sup. Ct. 1919).

[93] *See, e.g.*, Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975) (under U.C.C.). Moreover, attention to the relationship of the parties may be helpful, if not essential. *See* Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 Nw. U.L. REV. 854 (1978); Macneil, *supra* note 11.

[94] *See* p. 375 *supra*.

[95] *Cf.* Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 242, 129 N.E. 889, 891 (1921) (Cardozo, J.) ("Intention not otherwise revealed may be presumed to hold in contemplation of the reasonable and probable."); Hadley v. Baxendale, 9 Ex. 341, 355, 156 Eng. Rep. 145, 151 (1854) ("[I]f . . . special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract."); RESTATEMENT (SECOND) OF CONTRACTS §§ 246–249 (Tent. Draft No. 6, 1971) (standards of interpretation).

modern franchise termination case,[96] for example, the plaintiff claimed wrongful termination of a contract giving him a five-year exclusive agency for the sale of the defendant's automobiles. The conduct of the agency was to be at all times satisfactory to the defendant, thereby contractually conferring upon the defendant discretion as to the duration of the contract. Three months into the contract, the defendant notified the plaintiff that the agency was being conducted unsatisfactorily and that the contract would be cancelled if satisfaction were not achieved. The defendant withheld further cooperation and then cancelled the contract. The plaintiff sued, claiming that the defendant was not dissatisfied in good faith. The evidence indicated that the defendant had been kept well informed of the plaintiff's activities, had repeatedly expressed approval, and had surreptitiously negotiated with another agency for a more favorable commission in a market that would sustain but one distributor. The court held the evidence sufficient to submit the question of the defendant's good faith to the jury. The defendant could have feigned dissatisfaction to recapture the forgone opportunity of dealing with another agent at a lower commission. The condition of satisfaction preserved this alternative only under contemplated circumstances — misconduct of the agency or the running of the term — and could not be used to redirect resources to exploit a newfound economic advantage.[97]

Like the contemplation approach to good faith performance, then, the forgone opportunities approach has both objective and subjective aspects. The identity of forgone oppor-

---

[96] Isbell v. Anderson Carriage Co., 170 Mich. 304, 136 N.W. 457 (1912). On modern franchise terminations, see generally Gellhorn, *Limitations on Contract Termination Rights — Franchise Cancellations*, 1967 DUKE L.J. 465; Hewitt, *Good Faith or Unconscionability — Franchisee Remedies for Termination*, 29 BUS. LAW. 227 (1973); pp. 399–400 & notes 133–37 *infra*.

[97] Though no opinion has been found that discusses what in particular should happen at a new trial in such a case, the following allocation of burdens of proof and treatment of mixed motives is suggested as a consequence of the theory put forth by this Article.

The plaintiff's counsel of course is well advised to reintroduce the evidence from which a jury could conclude that the defendant acted in bad faith — the evidence suggesting that the defendant's subjective reason for claiming dissatisfaction was to pursue the alternative opportunity to enter a more favorable contract with another agent — and that the alternative opportunity was forgone upon entering the contract, according to the plaintiff's reasonable understanding of the contract. If the plaintiff does so, the burden of proof should shift to the defendant to show a subjective reason for acting that objectively was within the contemplation of the parties, or to attack the credibility of the plaintiff's evidence.

The hard case is when the defendant fails to undermine the credibility of the plaintiff's case but presents credible evidence of a reason for its dissatisfaction that tunities is determined by an objective standard, focusing on the expectations of reasonable persons in the position of the dependent parties. Whether a particular discretion-exercising party acted to recapture forgone opportunities is a question of subjective intent. The two approaches are consistent. If a discretion-exercising party uses its control to recapture a forgone opportunity, it follows that it is not acting for a purpose within the contemplation of the parties. If such a party acts for a reason contemplated by the parties, it is not recapturing a forgone opportunity.[98]

The forgone opportunities approach, however, advances the analysis further than the contemplation approach. It narrows the field of relevant intellectual inquiry by isolating with greater particularity the factors that must be considered in determining good or bad faith performance. The totality of the circumstances contemplated or expected by the parties includes both benefits to the promisee (the traditional focus) and costs to the promisor (forgone opportunities). For the purpose of the good faith performance doctrine, the relevant and distinct set of facts is that subset of the totality of circumstances (1) at formation, bearing on the expected costs to a discretion-exercising promisor; and (2) at performance, bearing on whether the promisor exercised its discretion in performance

---

relates to the plaintiff's conduct of the agency. The totality of the evidence then would be sufficient to sustain a jury finding that the defendant acted from mixed motives. In such a case, the jury should be instructed in part:

> If you find that both the reasons put forward by the plaintiff and the reasons put forward by the defendant played a significant role in the defendant's decision to claim dissatisfaction with the plaintiff's conduct of the agency and therefore to terminate it, then you must find that the defendant acted in good faith.

This reflects the fact that, in a case of truly mixed motives, the defendant would have been justified in terminating the agency whether or not the illegitimate reason were present, and presumably would have done so. *Cf.* Reuther v. Fowler & Williams, Inc., 255 Pa. Super. Ct. 28, 386 A.2d 119 (1978) (employer may discharge employee in violation of public policy if it also has a separate, plausible, and legitimate reason).

It could be argued that the case of mixed motives should result in a finding of good faith only when legitimate and illegitimate reasons each play a *substantial* part in the defendant's decision. *Cf.* Note, *Free Speech and Impermissible Motive in the Dismissal of Public Employees*, 89 YALE L.J. 376 (1979) (reinstatement should be ordered if an illegitimate motive was a substantial cause of a dismissal). But liability in a case of mixed motives creates insuperable problems as to the remedy. The Second Circuit exposed these difficulties in Parev Prods. Co. v. I. Rokeach & Sons, 124 F.2d 147 (2d Cir. 1941), and seemed to backtrack on the question of liability three years later in Mechanical Ice Tray Corp. v. General Motors Corp., 144 F.2d 720 (2d Cir. 1944), *cert. denied*, 324 U.S. 844 (1945). The quixotic holding in *Parev Products* has been ignored by the courts ever since.

[98] With respect to discretion-exercising parties motivated by spite or ill will, see note 80 *supra*.

to recapture a forgone opportunity. That the dependent promisee did not receive benefits under the contract as it had hoped simply is not dispositive.

C. *Justification of the Good Faith Performance Doctrine*

There are two potential justifications of the good faith performance doctrine — legal and economic.[99] In traditional legal terms, it can be argued that the security of contractual transactions is enhanced by the good faith performance doctrine.[100] Because contracting parties do not contract with those they do not trust to some extent, a dependent party will have reason to rely on the good faith of a discretion-exercising party. Such reliance plausibly is based on the simple belief that the party with discretion in performance will keep the contract, and therefore will not use its discretion to recapture forgone opportunities.[101] Requiring a party who recaptures forgone opportunities to compensate the other increases the reliability of flexible contracts and therefore the security of such transactions.

The security argument, however, is incomplete because of the countervailing policy of allowing contracting parties great freedom of action. One could assert in reply that a discretion-exercising party should be left free to act for any reason or no reason at all, limited only by the express terms of the contract. Although this counterargument proves too much, for it would eliminate all implied promises, it does raise a question whether a dependent party should be left to protect itself by securing the necessary express promises. The real question, however, is which party is in a better position to protect itself, and thus to secure the expectations of both parties.[102] The capacity to protect oneself cuts both ways. As the dependent party may secure additional promises, the discretion-exercising party may protect itself by conditioning its duty to perform. Traditional legal analysis supplies no tools for balancing the relative ca-

---

[99] For a classic exposition on the relationship between juristic and economic justifications of contract law, see Fuller & Perdue, *supra* note 24, at 60–66.

[100] *See* sources cited notes 26–27 *supra*.

[101] The out-of-pocket loss sustained by a dependent party may be the same whether the other party exercises discretion in order to pursue alternative opportunities that were reasonably contemplated by the parties or for other reasons. At the time of contract formation, however, the hypothetically rational dependent party agrees to a discretion-conferring contract after calculating the risk of such a loss. The probability of the loss, and therefore the cost, will vary with the number and intensity of incentives facing the discretion-exercising party, and will be higher when a recapture of forgone opportunities is permissible than when it is not.

[102] *See* note 95 *supra*.

pacities of the parties to protect themselves. An economic analysis, however, suggests an appropriate response.

The good faith performance doctrine may be said to enhance economic efficiency by reducing the costs of contracting.[103] The costs of exchange include the costs of gathering information with which to choose one's contract partners, negotiating and drafting contracts, and risk taking with respect to the future. The good faith performance doctrine reduces all three kinds of costs by allowing parties to rely on the law in place of incurring some of these costs.[104]

Many contracting parties investigate the market in part to identify and select those prospective contract partners whose reputations for business integrity reduce the risk of disappointing contract performance. Such information never will be wholly complete or trustworthy. A choice is presented if the law offers a prospect of compensation to a contract party who may incur losses due to the other party's lack of business integrity. Contract parties who wish to reduce uncertainty as to their prospective partners' integrity either may gather more information before contracting or may substitute the legal incentive for honorable behavior — and the prospect of recovering damages — for some such information. The economically rational person presumably would choose the less costly alternative at the margin.

The good faith performance doctrine similarly reduces the costs of negotiating and drafting contracts. After selecting each other as probable contract partners, the parties will choose the amount of detail to include in their express contract. The alternatives to detailed planning are (1) relying on legal rules that supply a set of normal terms that otherwise would be negotiated,[105] or (2) in the absence of such terms, bearing the cost of uncertainty. The good faith performance doctrine provides such a set of legal rules and gives parties who wish to reduce uncertainty the choice of engaging in more detailed planning or substituting good faith at the margin. The good faith performance doctrine thus makes the short contract, one that requires relatively more interpretation and implication, less risky and therefore less costly.

Finally, the good faith performance doctrine induces the parties to minimize the joint costs of the contract by negotiating and drafting clauses that will reduce the prospect of losses should a party after formation wish to redirect re-

[103] *See* sources cited note 33 *supra*.

[104] On the costs of enforcement, see note 108 *infra*.

[105] R. Posner, *supra* note 33, § 4.1, at 69.

sources.[106] Theoretically, the joint costs of the contract will be minimized if liability is placed on the party who can more cheaply cover the contingency by express terms — the party best able to protect itself.[107] By hypothesis, that party will be the discretion-exercising party, who would have far better information concerning its own alternative opportunities, and the probability that a later opportunity will prove more attractive. On the other hand, for the dependent party to protect itself, it must secure a lengthy series of express promises as to those alternative opportunities that the other party may not pursue. This would involve a costly process of eliminating hypothetical contingencies. The joint cost of contracting therefore would be less when a party with discretion is required to protect itself. All it need do is include a condition that preserves particular alternative opportunities under specified circumstances.[108]

III. Illustrations of Good Faith and Bad Faith Performance

The theory of the good faith performance doctrine will be illustrated in this Part by a survey of cases involving floating quantity contracts, open or floating price contracts, open time contracts, and contracts subject to conditions within the control of one party. Such contracts represent the typical arm's-length relationships in which the implied covenant of good faith and fair dealing is invoked.[109]

---

[106] *See id.* at 68.

[107] *Id.*; Coase, *supra* note 33.

[108] Like the legal argument based on the security of transactions idea, however, the economic argument is not conclusive on the ultimate question whether the good faith performance doctrine is a good thing. It is costly for the legal system to present the parties with the less costly alternative of relying on the good faith of their contract partners rather than on more information concerning their partners' reputations or on more detailed contracts. There is no empirical basis at present for concluding that the legal system is more efficient than the market alternatives at enhancing the reliability of contracts at the margin, though such a conclusion seems intuitively sound. Suffice it to say that this uncertainty is common to any economic analyses of the common law that compare the alternative of no doctrine with an existing doctrine.

In addition, like any theoretical justification, this argument is vulnerable to the legal realist's claim that capability problems so impede the legal system's operation in fact that the theory is insufficiently reflective of reality. *See generally* R. Danzig, The Capability Problem in Contract Law (1978); Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 Va. L. Rev. 451 (1974).

[109] Good faith performance also is required in insurance contracts and contracts creating fiduciary duties. These are special cases in which the meaning of good faith

A. Floating Quantity Terms

The common law treatment of output and requirements contracts has been superseded formally by the U.C.C.[110] The Code nonetheless incorporates the common law good faith limit on a quantity-determining party's discretion.[111] The good faith criterion is used to distinguish "situations in which the quantity-determining party was merely pursuing a better bargain elsewhere from those in which a change in needs or output resulted from the exercise of business judgment which the quantity-determining party had reserved for [it]self."[112] Good faith thus distinguishes cases in which a party exercises the discretion allowed it under the contract for normal business reasons from those in which the party uses its discretion to recapture forgone opportunities.

In *Loudenback Fertilizer Co. v. Tennessee Phosphate Co.*,[113] for example, a buyer contracted to take its entire phosphate rock requirements for five years. The buyer manufactured "acid phosphate" with the rock and sold the product as fertilizer. For more than a year during the term, the buyer ordered no rock but purchased acid phosphate from other manufacturers because, the buyer testified, this was more profitable. When the market price of rock rose, the buyer ordered

---

changes complexion, although in a manner broadly consistent with the theory articulated in this Article.

For example, the insurer empowered by contract to defend claims against its insured is obligated by good faith to take into account the insured's interest when responding to settlement offers. *See* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Communale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958); Keeton, *supra* note 17. The insurer forgoes the opportunity to act *solely* in its own interest.

A fiduciary must act on behalf of the other party. Scott, *The Fiduciary Principle*, 37 CALIF. L. REV. 539, 540 (1949). It thus forgoes the opportunity to act in its own interest at all. Good faith performance of a contract creating a fiduciary duty should be understood in this sense. For examples of such cases, see Brown v. Superior Court, 34 Cal. 2d 559, 212 P.2d 878 (1949) (contract to make joint wills); Davis v. Kahn, 7 Cal. App. 3d 868, 877, 86 Cal. Rptr. 872, 877–78 (1970) (coadventurers); Schmidt v. Waterford Winery, Ltd., 177 Cal. App. 2d 28, 32, 1 Cal. Rptr. 874, 876–77 (1960) (trustee or agent); Wheeler v. Waller, 197 N.W.2d 585, 587 (Iowa 1972) (confidential relationship between real estate brokers).

The analysis in this Article rests on contracts involving arm's-length relationships, in which there is no indication that a discretion-exercising party may not act solely in its own interest, so long as it acts within the scope of the contract. *See, e.g.*, HML Corp. v. General Foods Corp., 365 F.2d 77, 81 (3d Cir. 1966).

[110] *See* U.C.C. § 2-306.

[111] Weistart, *supra* note 8. *See also* Feld v. Henry S. Levy & Sons, 37 N.Y.2d 466, 335 N.E.2d 320, 373 N.Y.S.2d 102 (1975).

[112] Weistart, *supra* note 8, at 647.

[113] 121 F. 298 (6th Cir. 1903).

the maximum contract quantity of rock from the seller. The seller did not deliver. In an action by the buyer, the court refused to interpret the contract as allowing the buyer discretion to change its business practices by substituting purchased acid phosphate for its own make whenever that was temporarily advantageous.[114] The parties had agreed to vary the quantity with changes in the market for the buyer's product, and, by fixing a price, to isolate themselves from changes in the raw materials market. By purchasing acid phosphate from others in substitution for that of its own manufacture, in a falling raw materials market, the buyer exercised its discretion for a speculative purpose not reasonably contemplated by the parties.[115] It materially breached the contract by recapturing the forgone opportunity of acquiring rock from others at less than the contract price.

A contrasting result was reached in *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.*[116] Southwest's predecessor entered into an agreement to supply, for fifteen years, "all 'natural gas as may be needed or required by' the Cement Company 'for fuel, heating, lighting, power purposes and such other purposes as may be necessary, proper or incidental to the operation of' its plant."[117] During the initial years of the contract, the cement company operation consumed from 2.3 to 5.3 million cubic feet of gas daily.[118] Eight years into the term, the company sought to replace its boilers with a system that utilized the waste heat of cement kilns. This operation was to reduce the maximum quantity supplied by the gas company to .4 million cubic feet per day. The gas company sought to enjoin the use of the new boiler system, contending that the contract prevented a change in the buyer's operations that would so drastically reduce its requirements of natural gas. The court held that the alteration in operations was in good faith because the requirements contract did not prevent the buyer from exercising discretion to improve its plant. Noting the duration of the parties' agreement, the court found an implied assumption at formation that existing equipment would require replacement during the life of the contract, probably by a more efficient system.[119] In other words, the parties did not contemplate that the buyer should forgo tech-

[114] *Id.* at 302–03.

[115] *See* Asahel Wheeler Co. v. Mendleson, 180 A.D. 9, 12, 167 N.Y.S. 435, 437 (1917); New York Cent. Ironworkers Co. v. United States Radiator Co., 174 N.Y. 331, 335–36, 66 N.E. 967, 968 (1903) (dictum).

[116] 102 F.2d 630 (10th Cir. 1939).

[117] *Id.* at 631.

[118] *Id.* at 632.

[119] *Id.* at 633.

nological improvements in the normal course of business. The buyer acted in good faith since it did not recapture any forgone opportunity.

B. *Open and Floating Price Terms*

In *Umlas v. Acey Oldsmobile, Inc.*,[120] the buyer of a new car claimed a breach of a contract for future delivery that left the price term open by reserving to the seller a right to reappraise the buyer's trade-in at the time of delivery. The seller lowered the appraisal from $650 to $50 at the time of delivery. The court found that the vehicle in fact was worth from $300–$400, based on the salesperson's testimony and the appraisal of another dealer, and held that the seller acted in bad faith in violation of the U.C.C.[121] If the vehicle had deteriorated between the time of formation and the time of reappraisal the seller could have lowered the appraisal in good faith.[122] The seller's exercise of discretion then would be in the normal course of business and reasonably within the contemplation of the parties. That the seller was dishonest, so that it could recapture forgone opportunities with the savings, is apparent. Such dishonesty is sufficient to establish bad faith.

When one party may not itself set the price, but controls the factors that go into a formula set in the contract for determining the price, any dishonesty by that party similarly suggests that money is being diverted to other opportunities.[123] Less flagrant behavior also may run afoul of good faith.[124] In *Miller v. Othello Packers, Inc.*,[125] the plaintiff contracted to

---

[120] 62 Misc. 2d 819, 310 N.Y.S.2d 147 (Civ. Ct. N.Y. 1970).

[121] On the relationship of the U.C.C. to the common law in this context, see notes 8, 51 *supra*.

[122] Price v. Spielman Motor Sales Co., 261 A.D. 626, 26 N.Y.S.2d 836 (1941).

[123] *Cf.* Hempstead Theatre Corp. v. Metropolitan Playhouses, Inc., 16 Misc. 2d 781, 183 N.Y.S.2d 972 (Sup. Ct. 1958) (theater rental measured by percentage of gross receipts, including concessions, could not be diminished where concessions were sold by a sham corporation controlled by lessee), *aff'd mem.*, 7 A.D.2d 625, 179 N.Y.S.2d 306, *rev'd*, 6 N.Y.2d 311, 160 N.E.2d 604, 189 N.Y.S.2d 837 (1959) (reversed on construction of the express contract indicating defendant's actions were within the contemplation of the parties).

[124] *See* Daitch Crystal Dairies, Inc. v. Neisloss, 8 A.D.2d 965, 190 N.Y.S.2d 737 (1959) (lessor who gave exclusive right to operate a supermarket to plaintiff-lessee on percentage lease may not allow a competing supermarket on adjacent land), *aff'd mem.*, 8 N.Y.2d 723, 167 N.E.2d 643, 201 N.Y.S.2d 101 (1960); Goldberg 168-05 Corp. v. Levy, 170 Misc. 292, 9 N.Y.S.2d 304 (Sup. Ct. 1938), *modified and aff'd*, 256 A.D. 1086, 11 N.Y.S.2d 315 (1939).

[125] 67 Wash. 2d 842, 410 P.2d 33 (1966); *see* Dorsey Bros. v. Anderson, 264 Md. 446, 287 A.2d 270 (1972) (harvester delays until crop is spoiled in order to harvest at other farms).

grow beans in return for a price determined by a formula based on the useful product after harvesting, sampling, and grading by the defendant. The plaintiff, dissatisfied with the resulting price, sued for the reasonable value of the crop, claiming a breach of contract due to the defendant's incompetence and inefficiency in harvesting and processing. The defendant, among other things, left three truckloads of beans in the fields to rot. The court summarily found a breach by failure to perform in good faith. The mismanagement can be seen to reflect a redirection of managerial resources away from the plaintiff's crop and toward other opportunities — a partial recapture of forgone opportunities.[126]

In *Van Valkenburgh v. Hayden Publishing Co.*,[127] a publisher promised the author of two books a royalty on sales and its best efforts to promote the books. Nine years later, the author refused the publisher's request to update the books and to accept a reduced royalty. The publisher thereupon hired a third person to update the books at a lower royalty, concealed that fact from the original author, and sought to sell the updated version to buyers requesting the original. The court found no violation of the implied covenant of good faith and fair dealing, though the diversion of customers to the updated book was held to violate the publisher's express promise to use its best efforts on behalf of the plaintiff. The court said that the publisher, by entering the contract, did not "close off" its right to issue books on the same subject, to negotiate with and to pay authors of such books, and to promote them fully according to the publisher's economic interests, even though

---

[126] The partial (and intentional) recapture of forgone opportunities apparent in *Miller* suggests a case where a party negligently exercises discretion in performance with the effect of recapturing forgone opportunities. Only one common law case has been found in which the court discussed the question of liability for such negligence. *See* Amoco Oil Co. v. Capitol Indem. Corp., 95 Wis. 2d 530, 542–44, 291 N.W.2d 883, 890–91 (Ct. App. 1980); note 35 *supra*. There is no reason in principle why such negligence should not be actionable. *See* Farnsworth, *supra* note 5.

Much confusion would be generated, however, if the good faith performance concept itself were to take on subjective and objective standards in order to reach both intentional and negligent behavior. *See* note 35 *supra*. Such confusion would be avoided by extending the implied covenant of due care, *see* Ryan Stevedoring Co. v. Pan-Atlantic S.S. Corp., 350 U.S. 124, 133–34 (1956), to cover the negligent exercise of discretion in performance. *Cf.* Lechmere Tire & Sales Co. v. Burwick, 360 Mass. 718, 277 N.E.2d 503 (1972) (implying covenants of due care and good faith). Alternatively, the words "fair dealing" in the context of the implied covenant of good faith and fair dealing could be given an independent, objective meaning. *See* note 43 *supra*.

[127] 30 N.Y.2d 34, 281 N.E.2d 142, 330 N.Y.S.2d 329, *cert. denied*, 409 U.S. 875 (1972).

this adversely affected the original author.[128] In other words, the publisher did not recapture a forgone opportunity because it had an ordinary business purpose for marketing the updated books that was within the reasonable contemplation of the parties.

C. *Open Terms as to Time*

Open terms as to time may confer discretion on one party to decide when it shall perform, when the other party shall perform, or when the contract shall terminate. If one party is given discretion to determine when it shall perform, it may not delay matters for so long that it appears to be abandoning the contract. A party acted in bad faith, for example, when it promised to pay a portion of the proceeds of a sale of real estate in return for the release of a claim, the contract was silent as to the time for performance, and the party delayed selling for eight years.[129] That the defendant was recapturing forgone opportunities is plain.

Similarly, in *Sylvan Crest Sand & Gravel Co. v. United States*,[130] a contract for trap rock gave the government the right to set times for delivery or to cancel. The court found that the government was obligated by good faith to request delivery or to give notice of cancellation within a reasonable time. By doing neither, the government could be seen as attempting to give the contract the effect of an option of unlimited duration. Such an option was, however, a forgone opportunity under the contract as it would be interpreted by a reasonable businessperson.[131]

The exercise of discretionary termination rights is more problematic because it is not settled whether the good faith limitation applies.[132] When a contract includes an express right of termination without cause, the express term usually prevails over the implied covenant of good faith[133] because the party wishing to terminate has done all that could be expected to preserve all of its alternative opportunities. Even when the contract omits a termination provision, the traditional understanding is that such contracts are terminable at will. This may conflict with the more recently recognized good

---

[128] *Id.* at 45, 281 N.E.2d at 144, 330 N.Y.S.2d at 333.

[129] Simon v. Etgen, 213 N.Y. 589, 107 N.E. 1066 (1915).

[130] 150 F.2d 642 (2d Cir. 1945).

[131] *Id.* at 644.

[132] Good faith is required when a right of termination is conditioned on an event within the control of one party. *See* pp. 401–02 *infra*.

[133] *See* note 14 *supra*.

faith implication. The issue arises frequently in franchise termination cases.[134] Although franchises claiming a bad faith termination often have been unsuccessful, whether the court applied a good faith limitation[135] or not,[136] they occasionally have succeeded.[137]

In a few cases involving employment contracts that once would have been terminable at will,[138] the courts similarly have held that an employer breached the contract by terminating in bad faith.[139] These courts have construed good faith performance as suggested in this Article. In *Fortune v. National Cash Register Co.*,[140] for example, the plaintiff was a salesperson for the defendant and was paid in large part by commission. Soon after he obtained a $5 million order, but before all formalities were completed, he was discharged without being paid the full commission. The court held that the employer's decision to end the contract, even though expressly terminable at will, must be made in good faith. The plaintiff therefore was entitled to a jury determination as to the defendant's motives. The defendant could be acting to recapture forgone opportunities if it acted to avoid paying the commission. According to the practice respecting salespersons operating on commission, such a reason probably would be beyond the reasonable contemplation of the parties when contracting.[141] In another case, by contrast, a dismissed employee

[134] *See generally* Gellhorn, *supra* note 96; Hewitt, *supra* note 96. *See also* Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 136 Cal. Rptr. 404 (1977) (termination of insurance contract); note 138 *infra* (termination of employment contracts).

[135] *E.g.*, Tele-Controls, Inc. v. Ford Indus., 388 F.2d 48 (7th Cir. 1967); 33 Flavors of Greater Delaware Valley, Inc. v. Bresler's 33 Flavors, Inc., 475 F. Supp. 217 (D. Del. 1979).

[136] *See, e.g.*, Niagara Mohawk Power Corp. v. Graver Tank & Mfg. Co., 470 F. Supp. 1308 (N.D.N.Y. 1979); Division of Triple T Serv., Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 304 N.Y.S.2d 191 (Sup. Ct. 1969), *aff'd*, 34 A.D.2d 618, 311 N.Y.S.2d 961 (1970). *See also* A & M Fix-It, Inc. v. Schwinn Bicycle Co., 494 F. Supp. 175 (D. Utah 1980) (dealership contract).

[137] *See* Baker v. Ratzlaff, 1 Kan. App. 2d 285, 564 P.2d 153 (1977) (applying the U.C.C.); Atlantic Richfield Co. v. Razumic, 480 Pa. 366, 390 A.2d 736 (1978).

[138] On employment contracts that are terminable at will, see Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404 (1967); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816 (1980); Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335 (1974); Annot., 62 A.L.R.3d 271 (1975).

[139] *See, e.g.*, McKinney v. National Dairy Council, 491 F. Supp. 1108, 1117–22 (D. Mass. 1980); Malloy v. Coldwater Seafood Corp., 338 Mass. 554, 156 N.E.2d 61 (1959); Monge v. Beebe Rubber Co., 114 N.H. 130, 316 A.2d 549 (1974). *But see* Mason v. Farmers Ins. Cos., 281 N.W.2d 344 (Minn. 1979).

[140] 373 Mass. 96, 364 N.E.2d 1251 (1977).

[141] *See* Colwell Co. v. Hubert, 248 Cal. App. 2d 567, 56 Cal. Rptr. 753 (1967);

brought an action to recover his pension. The claim was rejected because the plaintiff failed to substantiate that the termination was a bad faith effort by the employer to avoid its conditional duty to pay pension benefits. Moreover, the defendant had sound business reasons for the dismissal.[142]

At least in employment contracts at common law, then, the good faith performance doctrine sometimes is applied to limit express or implied discretionary rights of termination. When so applied, it distinguishes the employer's use of discretion for a purpose beyond the reasonable contemplation of the parties from the use of discretion for normal business reasons. In cases involving express termination clauses, however, the range of alternative opportunities that are preserved by the contract is unusually large, and particularly egregious conduct by the employer probably is necessary to breach the contract.

D. Conditions Within the Control of One Party

A condition of satisfaction may confer discretion upon one party to determine whether the other party's performance is acceptable. If the party in control honestly is dissatisfied with the quality of the proferred performance, it may reject such performance and freely pursue alternative opportunities. The condition of satisfaction preserves precisely such a course.[143] But if that party feigns dissatisfaction for other reasons, such as a falling market price, the discretion obviously is being exercised for a purpose not contemplated by the parties. A jury reasonably may infer that the party was recapturing a forgone opportunity.[144]

A contract also may be conditioned on the conclusion of another related contract by the party in control. Consider a contract for demolition work to be done by the defendant if it can obtain certain insurance policies. The condition presumably is designed to protect the defendant from normal business difficulties that might prevent it from obtaining insurance. So if the defendant makes every reasonable effort to obtain the policies but cannot do so because of financial difficulty arising from an injury to one of its employees on another job, its duty

---

Eline Realty Co. v. Foeman, 252 S.W.2d 15 (Ky. 1952); Association Group Life, Inc. v. Catholic War Veterans of the United States, 61 N.J. 150, 293 A.2d 382 (1972) (per curiam); Perkins v. Standard Oil Co., 235 Or. 7, 383 P.2d 107 (1963) (en banc).

[142] Stevenson v. ITT Harper, Inc., 51 Ill. App. 3d 568, 366 N.E.2d 561 (1977).

[143] *See* pp. 389–90 *supra*.

[144] *See* Neumiller Farms, Inc. v. Cornett, 368 So. 2d 272 (Ala. 1979); Devoine Co. v. International Co., 151 Md. 690, 136 A. 37 (1927); Maas v. Scoboda, 188 Neb. 189, 195 N.W.2d 491 (1972).

to perform will be discharged.[145] A breach may be established, however, if the defendant deliberately fails to obtain the insurance.[146] The latter behavior may be characterized as an attempt to use the condition as a pretext to recapture forgone opportunities.

Similarly, in *Ide Farm & Stable, Inc. v. Cardi*,[147] a contract for the sale of land was conditioned on the buyer's obtaining financing. The buyer, claiming an inability to obtain financing, did not go through with the deal. The seller sued the buyer for breach of contract by failing to perform in good faith. The evidence indicated that the buyer had gone to four banks, but was unsuccessful because of a tight money market. The court rejected the claim that the efforts to secure financing were a sham. The reason for the buyer's failure was indeed the very one that induces the typical financing condition in land sale contracts. The buyer's discretion thus was exercised in good faith in light of the purpose that parties normally have in mind in so conditioning a promise to buy land.

A different result was reached in *Fry v. George Elkins Co.*,[148] where a sale of a residential home was conditioned on the buyer securing financing at a specified rate. The buyer was informed at the time of formation that such financing could not be obtained from a bank, but he applied only to banks and only after obviously dragging his heels. The buyer refused to close and sought recovery of his deposit on the ground that required financing had not been secured. The court held that the factfinder could find that the buyer had not acted in good faith. The evidence indicated that the buyer had changed his mind and had decided to move to Hawaii,[149] a postformation decision that would be outside the normal reasons for so conditioning a promise to buy a house. The factfinder therefore could conclude that the buyer sought to recapture an opportunity forgone upon entering the contract.

---

[145] Omaha Pub. Power Dist. v. Employers' Fire Ins. Co., 327 F.2d 912 (8th Cir. 1964). The case is the basis for RESTATEMENT (SECOND) OF CONTRACTS § 231, Illustration 4 (Tent. Draft No. 5, 1970).

[146] Omaha Pub. Power Dist. v. Employers' Fire Ins. Co., 327 F.2d 912, 916 (8th Cir. 1964) (dictum). *See also* Dasenbrock v. Interstate Restaurant Corp., 7 Ill. App. 3d 295, 287 N.E.2d 151 (1972) (lessee was liable for rent when lease was conditioned on lessee obtaining government licenses and lessee did nothing to obtain them).

[147] 110 R.I. 735, 297 A.2d 643 (1972).

[148] 162 Cal. App. 2d 256, 327 P.2d 905 (1958).

[149] *Id.* at 259, 327 P.2d at 906–07.

IV. Conclusion

The theory of contract breach by failing to perform in good faith has been derived from a cost perspective on the contractual expectation interest. Cases holding one party's exercise of discretion in performance to constitute a breach of contract and those holding such conduct to be legitimate can be distinguished with reference to facts tending to show that the discretion-exercising party is or is not using discretion to recapture opportunities forgone upon entering the contract. Discretion in performance may be exercised legitimately for the purposes reasonably contemplated by the parties, including ordinary business reasons. It cannot be exercised for the purpose of recapturing forgone opportunities, for such conduct harms the expectation interest of the dependent party.

The good faith performance doctrine, like contract law generally, functions to support the market. It advances the time at which alternative opportunities are deemed to be forgone to the time of formation, when they otherwise would be forgone upon the expenditure of resources in performance of the contract. A promisee thus may rely not only on the express terms of a contract, but also on the customary implications of the express terms as to opportunities forgone in the commercial setting. The law puts the burden of careful contract planning on the discretion-exercising promisor who wishes to depart from the norm, because such a promisor is in the best position to secure the expectations of both parties. The cost perspective on the contractual expectation interest thus renders the common law good faith performance doctrine reckonable.

APPENDIX

The following cases indicate jurisdictions that explicitly recognize a general obligation of good faith performance in every contract at common law: Commerce Int'l Co. v. United States, 338 F.2d 81, 85 (Ct. Cl. 1964); World's Exposition Shows v. Benevolent Protective Order of Elks, No. 148, 237 Ala. 329, 331, 186 So. 721, 723 (1939); Guin v. Ha, 591 P.2d 1281, 1291 (Alaska 1979); Beaugureau v. Beaugureau, 11 Ariz. App. 234, 236, 463 P.2d 540, 542 (1970); Nelson v. Abraham, 29 Cal. 2d 745, 750–51, 177 P.2d 931, 934 (1947); Blish v. Thompson Automatic Arms Corp., 30 Del. Ch. 538, 569, 64 A.2d 581, 597 (Sup. Ct. 1948); Crooks v. Chapman Co., 124 Ga. App. 718, 719, 185 S.E.2d 787, 789 (1971); Martindell v. Lake Shore Nat'l Bank, 15 Ill. 2d 272, 286, 154 N.E.2d 683, 690–91 (1958); Midwest Management Corp. v. Stephens, 291 N.W.2d 896, 913 (Iowa 1980); Odem Realty Co. v. Dyer, 242 Ky. 58, 61, 45 S.W.2d 838, 840 (1932); Food Fair Stores, Inc. v. Blumberg, 234 Md. 521, 534, 200 A.2d 166, 174 (1964); Kerrigan v. City of Boston, 361 Mass. 24, 33, 278 N.E.2d 387, 393 (1972); Burkhardt v. City Nat'l Bank, 57 Mich. App. 649, 652, 226 N.W.2d 678, 680 (1975); Faust & Forden, Inc. v. Greenbaum, 421 S.W.2d 809, 813 (Mo. 1967); U.V. Indus., Inc. v. Danielson, 602 P.2d 571, 581 (Mont. 1979); Griswold v. Heat, Inc., 108 N.H. 119, 124, 229 A.2d 183, 187 (1967); Palisades Properties, Inc. v. Brunetti, 44 N.J. 117, 130, 207 A.2d 522, 531 (1965); Kirke La Shelle Co. v. Paul Armstrong Co., 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933); Weyerhaeuser Co. v. Godwin Bldg. Supply Co., 40 N.C. App. 743, 746, 253 S.E.2d 625, 627–28 (1979); Miles v. N.J. Motors, Inc., 44 Ohio App. 2d 351, 356, 338 N.E.2d 784, 787–88 (1975); Western Natural Gas Co. v. Cities Serv. Gas Co., 507 P.2d 1236, 1241 (Okla.), *appeal dismissed and cert. denied*, 409 U.S. 1052 (1972); Perkins v. Standard Oil Co., 235 Or. 7, 16–18, 383 P.2d 107, 112 (1963) (en banc); Ide Farm & Stable, Inc. v. Cardi, 110 R.I. 735, 739, 297 A.2d 643, 645 (1972); Commercial Credit Corp. v. Nelson Motors, Inc., 247 S.C. 360, 366–67, 147 S.E.2d 481, 484 (1966); Zion's Properties, Inc. v. Holt, 538 P.2d 1319, 1321 (Utah 1975); H.P. Hood & Sons v. Heins, 124 Vt. 331, 338, 205 A.2d 561, 566 (1964); Miller v. Othello Packers, Inc., 67 Wash. 2d 842, 844, 410 P.2d 33, 34 (1966) (per curiam); Chayka v. Santini, 47 Wis. 2d 102, 108, 176 N.W.2d 561, 564 (1970).

See also Howard P. Foley Co. v. J.L. Williams & Co., 622 F.2d 402, 406–07 (8th Cir. 1980) (applying Arkansas law); Rees v. Bank Bldg. & Equip. Corp. of America, 332 F.2d 548, 551–52 (7th Cir.) (applying Missouri law), *cert. denied*, 379 U.S. 932 (1964); National Safe Corp. v. Benedict & Myrick, Inc., 371 So. 2d 792, 795 (La. 1979) (applying LA. CIV. CODE ANN. art. 1901 (West 1977)).

Good faith performance also may be required in specific contexts in any jurisdiction. *See, e.g.*, Wild v. Rarig, 302 Minn. 419, 441–42, 234 N.W.2d 775, 790 (1975), *cert. denied*, 424 U.S. 902 (1976); Singerly v. Thayer, 108 Pa. 291, 298, 2 A. 230, 233 (1885); Atomic Fuel Extraction Corp. v. Estate of Slick, 386 S.W.2d 180, 185 (Tex. Ct. App. 1964); Carpenter & Co. v. Virginia-Carolina Chem. Co., 98 Va. 177, 183, 35 S.E. 358, 360 (1900). Only one case has been found that conceivably could be construed as a rejection of a general obligation of good faith performance. *See* Shoemaker v. Mountain States Tel. & Tel. Co., 38 Colo. App. 321, 325, 559 P.2d 721, 724 (1976). *But see* Eastern Tunneling Corp. v. Southgate Sanitation Dist., 487 F. Supp. 109, 113 (D. Colo. 1980) (applying Colorado law).